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Review Paper

COVERED BONDS: NEW OPPORTUNITY FOR RECOVERY OF SERBIAN CAPITAL MARKET

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Vladimir Mirković[1], Jelena Lukić[2]

[1]Economists Association of Belgrade, Serbia
[2]Modern Business School, Belgrade, Serbia

Abstract. *At the beginning of the XXI century, Serbia entered into transition process toward open market economy. One of the segments which should be developed in accordance with market economy principles was financial markets, more precisely capital market. Recovery of the Belgrade Stock Exchange and increasing trend in the first half of the XXI century gave optimism in prospective development of the Serbian capital market. Unfortunately, Serbian capital market did not make expected progress. In this paper, the situation on the Belgrade Stock Exchange is analyzed, trading with equity and debt instruments, emphasizing deficiencies which caused insufficient level of development of the Serbian capital market. As many opportunities for growth have been missed and capital markets are at the stagnant level for years, there are new, sophisticated products which could give an impulse to further development of financial markets. An example of such products is covered bonds, type of debt instruments with widespread use in the European Union. In this paper the main characteristics of those products are elaborated with experiences in other countries that could be very useful for Serbia.*

Key words: *covered bonds, debt instruments, capital markets, initial public offerings, credit rating agencies*

JEL Classification: G21, G24, G31

INTRODUCTION

Overall level of capital markets is one of the most significant pillars for the development of each country, especially of countries that are focused on open market economy principles. The role of capital markets in the global economic and financial system is indisputable (Erić,

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Corresponding author: Vladimir Mirković
Društvo ekonomista Beograda, Beograd, Serbia
E-mail: vladimir.mirkovic79@gmail.com

2013). According to "Global Competitiveness Report 2016-2017" published by World Economic Forum, Serbia is ranked 90th out of 138 countries (Schwab, 2016). Observing the financial market development pillar, the positioning of Serbia is even worse. Namely, Serbia is ranked 110th out of 138 countries, with the average score of 3.4 (scores are distributed between 1 and 7). Within the financial development pillar, Serbia has the best rank in the segment of access to loans (73th place, with the average score of 3.8) and only in two more segments is Serbia positioned higher than 100th place (i.e. 99th place in the segment of soundness of banks with the average score of 4.3 and 68th place in the segment of legal rights measured by appropriate index, with the average index of 5 – whilst the index is set between 0 as the worst and 10 as the best). The above mentioned describes that Serbia is not among countries with well-developed financial markets, indicating that there is a lot of space for improvement in the future.

In Serbia there is an absence of initial public offering (hereinafter: IPOs) although the Belgrade Stock Exchange (abbreviation: BSE) was restored in the last decade of the XX century. Even some neighboring countries realized IPOs successfully (e.g. the government of the Republic of Croatia conducted IPO of their Telekom in 2007 through the sale of 32.5% of shares on stock exchange, while 25% of shares were offered by preferred price to citizens) leaving Serbia at the bottom of the list when we are considering the capital market development. Compared to Croatia's experience in IPOs, in 2006 we had the acquisition of Telekom Srpska, where Telekom Srbija was the leading company in financing. The final decision in that process was not IPO of Telekom Srpska, funding was already realized through commercial loans. After several years, the possibility of Telekom's IPO emerged again, but the budget deficit problems and the absence of political will in the process led to another missed chance.

IPOs could bring a lot of positive changes such as the introduction of new financial instruments on capital markets. Observing the financial markets of developed countries, Serbian financial market could be assessed as less developed. It is characterized by the absence of institutional investors and the existence of fewer financial instruments, i.e. tighter options among several investment alternatives. The transition period in Serbia has lasted for too long, so inevitable changes were not realized as it is necessary bearing in mind the basic principles of open market economy. Furthermore, investment banking is not developed in Serbia, while commercial banks are focused on traditional banking, where the vast majority of assets are loans (about 60% of the total assets) disbursed to corporate and retail customers. The mentioned structure implies that commercial banking is more attractive and more developed than investment banking in Serbia. Insufficient level of development in terms of financial instruments available on the Serbian capital market and unawareness of potential investors regarding investment opportunities combined influenced the poor deployment of the capital market.

1. Review of Capital Markets Development in Serbia

Analyzing the available opportunities for investment on BSE, it is important to take insight into BSE's listings (see Fig. 1), such as:

1. Prime listing – contains only the major companies in Serbia, whose shares are actively traded. There are four shares listed on Prime Listing: Aerodrom Nikola Tesla (ticker:

AERO), Energoprojekt holding (ticker: ENHL), NIS (ticker: NIIS) and Sojaprotein (ticker: SJPT). Also, on Prime Listing are listed bonds issued by two different issuers: Republic of Serbia (74 bonds in total) and EBRD (1 bond with ticker EBRD01, included on BSE since December 13, 2016).

2. Standard listing – contains shares of three companies: Jedinstvo Sevojno (ticker: JESV), Komercijalna banka (ticker: KMBN) and Metalac (ticker: MTLC).
3. SMart listing – include only shares and deposit receipts on shares, with additional terms such as: minimum equity amount of issuer no less than 1 million EUR and minimum free-float of shares set at 25% of total outstanding shares (Belgrade Stock Exchange, 2016).
4. Open market – consisting of shares of 28 companies.
5. Multilateral trading platform (MTP) – the largest number of listed securities is on MTP segment, but those securities are not liquid. The total amount of listed shares is 642 (the number of issuers is 630), while there are also issued municipal bonds – namely two of them: Grad Šabac (ticker: SABC01) and Opština Stara Pazova (ticker: STPZ01).

Fig. 1 Market organization of BSE
Source: Adapted from Belgrade Stock Exchange (2017)

It is evident that the domestic capital market did not succeed in developing itself in compliance with the rules of open market economy. Several reasons could explain the described deficiency, but the most common factor is the absence of political will to make the transition on the market economy principles. The legislative framework was not detached from political will, while due to the same reason potential impulse impersonated in public companies listing on BSE was rare. It further ruined all necessary assumptions for the development of a modern stock exchange and slowed the transition process. Nevertheless, the recovery process of BSE started with simultaneous development of 2 types of instruments: debt and equity financial instruments.

Debt financial instruments were the first financial instruments of high-quality listed on BSE. These were the so-called "old savings bonds" that originated due to the fact that Serbian government recognized the debt of state-owned banks regarding savings in foreign currency and for that purpose government issued bonds with maturity dates at each year as the end of May till 2016 (see Table 1). The notional value of issued bonds was 4.2 billion EUR and trading with this kind of debt instrument was planned to be very

attractive (Miladinovski, 2012). In that sense, those bonds were excluded from tax burden, whilst they could be used before final maturity date under national amount for several purposes such as: the purchase of company's shares in the privatization process, the purchase of commercial and residential real estates, tax payments etc. Old savings bonds have a great role in Serbia as an instrument which brings back the confidence in the financial system and especially banks (see Fig. 2 and Fig. 3).

Table 1 Volume of converted savings deposits into bonds and OTC trading by series

Description	ISIN	Ticker	Volume of conversion (EUR)	OTC trading (EUR)
Bonds RS - Series A 2002	RSMFRSD60544	ARS2002	111.497.645	85
Bonds RS - Series A 2003	RSMFRSD38805	ARS2003	186.740.761	20.993.227
Bonds RS - Series A 2004	RSMFRSD62078	ARS2004	202.953.790	64.915.906
Bonds RS - Series A 2005	RSMFRSD64033	ARS2005	235.726.271	111.950.667
Bonds RS - Series A 2006	RSMFRSD40710	ARS2006	223.426.994	126.107.585
Bonds RS - Series A 2007	RSMFRSD60130	ARS2007	219.128.818	236.635.102
Bonds RS - Series A 2008	RSMFRSD60916	ARS2008	220.665.329	284.166.493
Bonds RS - Series A 2009	RSMFRSD31842	ARS2009	226.933.716	395.557.068
Bonds RS - Series A 2010	RSMFRSD14186	ARS2010	237.065.229	426.764.602
Bonds RS - Series A 2011	RSMFRSD18757	ARS2011	250.814.038	430.060.067
Bonds RS - Series A 2012	RSMFRSD93024	ARS2012	267.212.214	501.457.246
Bonds RS - Series A 2013	RSMFRSD68018	ARS2013	287.331.015	636.627.469
Bonds RS - Series A 2014	RSMFRSD73810	ARS2014	310.896.705	672.987.063
Bonds RS - Series A 2015	RSMFRSD79726	ARS2015	334.311.938	778.643.898
Bonds RS - Series A 2016	RSMFRSD70279	ARS2016	349.472.127	1.098.350.081
		Total:	3.664.176.590	5.785.216.559

Source: Authors based on data from Central Securities Depositary and Clearing House

Fig. 2 Conversion of saving deposits into bonds from August 2002 till July 2017
Source: Central Securities Depositary and Clearing House

Fig. 3 OTC trading from August 2002 till July 2017
Source: Central Securities Depositary and Clearing House

With the emergence of the global financial crises, in 2009 the government of the Republic of Serbia issued government Treasury bills and bonds. Unfortunately, the strategy for debt market development did not give any tangible results, so those securities were not traded frequently and based on market principles (already through direct contract with a known counterparty), while securities of municipalities and cities were not affirmed yet. A similar epilogue was noticed for corporate bonds, due to the fact that with the crisis emerging there was issue of short-term debt securities of over-indebted companies with relatively high, unsustainable interest rates. Government securities are financial instruments denominated in domestic or in foreign currency, issued by the government or competent ministry and registered in electronic form in the Central Securities Depositary and Clearing House - CSD (RS, Ministarstvo finansija, Uprava za javni dug, 2013). Short-term government securities are those with maturity up to one year, while long-term securities have maturity longer than one year. Domestic and foreign legal and physical entities could buy long-term government securities via authorized market participants (such as: banks and brokerages), whilst solely domestic legal and physical entities could buy short-term government securities. The rating of bonds is based on the financial stability of the issuer and it is a crucial indicator of bond's riskiness. "Credit rating is a forward-looking opinion about credit risk and an assessment of the ability and willingness of an issuer to meet its financial obligations in full and on time" (National bank of Serbia, 2017). The major rating agencies in the financial market are: Standard & Poor's (S&P), Moody's Investors Service (Moody's) and

Table 2 Investment grades per 3 major credit rating agencies

Moody's	S&P	Fitch
Aaa	AA	AA
Aa1	AA+	AA+
Aa2	AA	AA
Aa3	AA-	AA-
A1	A+	A+
A2	A	A
A3	A-	A-
Baa1	BBB+	BBB+
Baa2	BBB	BBB
Baa3	BBB-	BBB-
Ba1	BB+	BB+
Ba2	BB	BB
Ba3	BB-	BB-
B1	B+	B+
B2	B	B
B3	B-	B-

Source: QuadCapital Advisors (2017)

Fitch Ratings (Fitch) (see Table 2). Credit rating agencies usually express ratings as letter grades (A, B, C, D) where “AAA” is assigned as the best and “D” as the worst.

Rating agencies also provide outlooks that indicate the potential direction of rating in the future, which could be: positive, negative, stable and developing. Positive outlook means that a rating may be raised. Negative outlook means that a rating may be lowered and stable means that it is not likely to change. Furthermore, credit ratings of a certain country affect the credit ratings of other issuers headquartered in the same country. Table 3 presents the most recent credit rating development for the Republic of Serbia.

Table 3 Sovereign credit rating - Republic of Serbia

	Standard and Poor’s	Fitch Ratings	Moody’s Investors Service
Rating	BB- / positive outlook	BB- / stable outlook	Ba3 / stable outlook
Date	16 June 2017	16 June 2017	17 March 2017
Activity	Rating affirmed	Rating affirmed	Rating upgraded

Source: National bank of Serbia

Table 4 and Table 5 present the most recent trends in government securities taking into account the type of holder and currency in which securities are denominated in the period between the end of December 2015 and the end of June 2017. The balance of government securities denominated in EUR has an increasing trend in the observed period, with residents as the dominant type of holder (ranging between 94% and 98%). Also, considering the total amount of government securities denominated in EUR, the largest portion of holdings belongs to banks operating in Serbia (ranging between 61% and 69%). Considering only the population of residents (which includes the banks in Serbia), then the share of banks in government securities denominated in EUR is between 62% and 73%. If we separate the whole banking sector in Serbia per ownership structure, the results are as follows:

- foreign banks have a share between 49% and 51%;
- state-owned banks have a portion ranging from 43% to 47%; and
- private banks have a minority share which ranges from 4% to 6% at maximum.

Table 4 Government securities by type of holder (residents/non-residents) in Serbia

Periods	31.12.2015				31.12.2016				30.6.2017			
Type of holder	EUR	%	RSD	%	EUR	%	RSD	%	EUR	%	RSD	%
Non-residents	156,947,722	6%	261,502,340,000	39%	95,880,000	3%	202,698,910,000	39%	57,329,872	2%	186,076,740,000	29%
Residents	2,682,187,706	94%	407,435,810,000	61%	2,980,519,727	97%	453,544,740,000	61%	3,220,518,725	98%	455,523,300,000	71%
Total	**2,839,135,428**	**100%**	**668,938,150,000**	**100%**	**3,076,399,727**	**100%**	**656,243,650,000**	**100%**	**3,277,848,597**	**100%**	**641,600,040,000**	**100%**

Source: Central Securities Depositary and Clearing House Database (2017)

Table 5 Ownership structure of government securities holders in Serbian banking sector

Periods	31.12.2015		31.12.2016		30.6.2017	
Ownership structure	EUR	RSD	EUR	RSD	EUR	RSD
Foreign banks	972,749,000	257,532,970,000	987,832,000	251,825,910,000	980,399,000	252,449,660,000
State-owned banks	913,440,000	81,130,590,000	817,702,000	86,709,370,000	920,629,000	71,780,590,000
Private banks	76,874,000	26,093,000,000	113,977,000	27,100,000,000	111,256,000	31,550,600,000
Total	**1,963,063,000**	**364,756,560,000**	**1,919,511,000**	**365,635,280,000**	**2,012,284,000**	**355,780,850,000**

Source: Central Securities Depositary and Clearing House (2017)

On the other hand, the balance of government securities denominated in domestic currency (RSD) has a decreasing trend, again with residents as the dominant type of shareholders ranging

from 61% to 71%. By segregating the total amount of government securities denominated in RSD per banks which operate in Serbia, we concluded that banks are recognized as holders in 55% (minimum) or 56% (maximum) cases. Within the category of residents separately observed, the portion of banks in government securities denominated in RSD is between 78% (as minimum at the end of June 2017) and 90% (as maximum at the end of December 2015). Classifying all banks according to their ownership structure, the movements regarding balance of government securities are as follows: foreign banks have a portion ranging from 69% to 71%; state-owned banks have a share ranging from 20% to 24%; while private banks have the smallest share ranging from 7% to 9% as the maximum.

As the debt market (especially the bond market) in Serbia was not developed as it could be, in same way sharing the destiny of the overall capital market, the crucial question which arises is: What could be the potential impulse for debt market development in the prospective period and how could it be realized? Bearing in mind that the absence of IPOs and relatively small number of high-quality shares on BSE diminish the potential of equity market in Serbia, it is reasonable to initiate the question of debt market upgrade especially when all series of old savings bonds have already matured. Short-term and long-term bonds have some kind of important role, but the expected scope of development in this area was not reached. All above mentioned indicated that the revival of the debt market could be found in some new impulse, new product that is already known and established in the developed market economies. Such product are covered (or guaranteed) bonds which occupy the central part of this paper.

2. Covered Bonds as a New Product

Covered bonds are the type of corporate bonds with fixed return (slightly higher than the return of government bonds), where credit risk stays recorded into bank's balance sheet (the so-called "on-balance securitization"). The main characteristic of this bond is twofold collateralization for investors. Namely, the investor in covered bonds has collateral in the equity of issuer (financial institution or bank) on one side, or in priority right over cash flow derived from loan that was the basis for issuance of covered bond (in case of issuer bankruptcy). The investor in covered bonds is exposed to credit risk of the issuer. Although, observed historically, those bonds have existed for more than two and a half centuries, finally in the XXI century covered bonds became an irreplaceable and fast-growing segment of capital markets. Covered bonds were developed very intensively at the end of the XVIII and the beginning of the XIX century in Prussia, Denmark, Poland and France.

The turning point in the development of covered bonds is related to 1995 and issuing of German benchmark Jumbo Pfandbriefe bonds primarily aimed at providing liquidity for the public sector and response to investor's needs (Jonathan, 2006). The Pfandbriefe Act is a legal act, which serves to satisfy the demand of investors for a secure investment. Pfandbriefe provides issuers with a very cheap and reliable source of funding. This in turn enables the issuers to supply the credit market with loans on a continuous basis at prices that take their bearings from the capital market (Verband Deutscher Pfandbriefbanken, 2011). After the introduction of euro as the unique currency and general fall of interest rates, banks were motivated to revitalize the covered bond system for the purpose of competitive capital market creation. Rapid growth of covered bonds market within the European Union

(hereinafter: EU) was confirmed through development over recent years - average growth rate of 7.5% since 2007. In 2015, outstanding volume of covered bonds was on extraordinary level of 2.5 trillion EUR with 314 active issuers and 434 programs in 30 countries in and outside the EU (European Banking Authority, 2016). Simultaneously, most of the countries are working on improvement and harmonization of legislation in the segment of covered bonds.

In the absence of a unique definition of the "covered bonds" term, there are 4 preconditions which securities must fulfill in order to be considered as covered bonds. Those preconditions are (European Central Bank, 2008):

1) the issuer should be the credit institution which is the subject of supervision and regulation by competent authorities;
2) investors in covered bonds should have privileged position in comparison with other creditors in the case of issuer's bankruptcy;
3) the issuer of covered bonds is obliged to continuously maintain sufficient coverage in the pool of collaterals for fulfilling obligations toward investors at each point of time; and
4) the obligations of issuers are monitored by a qualified public body or other independent body.

The above mentioned preconditions (which are simultaneously characteristics) of covered bonds should be regulated by "special" or general legislative acts. In most countries, the covered bond system is regulated by "a lex specialis", while in the minority of cases this area is the subject of regulation by general legislative framework. In that sense, covered bonds could be divided into: regulated and structured covered bonds. Regulated covered bonds are those whose main attributes are regulated by "a lex specialis" or certain secondary legislative acts. Structured covered bonds imitate regulated covered bonds by their attributes, but they are not regulated by "a lex specialis", but by general laws on contracts and financial activities. Covered bonds could be compatible or not compatible with the EU Directives. In other words, it does not mean that all regulated covered bonds are at the same time compatible with the EU Directives due to the fact that regulation itself is not the only and sufficient requirement for compatibility evaluation. Adjustment to the Basel standards and requirements by banks put upon demand detailed analysis and treatment of covered bonds. It is necessary to include covered bonds into numerator of LCR ratio (as a part of highly liquid assets) respecting differences in interpretation of conditions given by the Basel Committee and the European Banking Authority on one side and the European Commission on the other.

According to interpretation of the European Commission, covered bonds have extraordinary liquid performances and certain covered bonds could be qualified into the segment of liquid assets of the first level for LCR ratio if they fulfill the following provisions: credit rating at 1 given by an external credit rating agency; minimum issue volume of 500 million EUR and full coverage of bonds pool with additional coverage over the full amount for minimum 2%. If listed conditions are satisfied then a haircut at the amount of 7% of the market value will be applied to those covered bonds. Other covered bonds which have: credit rating 2 given by an external credit rating agency (or assigned risk weighted factor of 20% in case that the rating is not available); minimum issue volume of 250 million EUR and full coverage of bonds pool with additional coverage over the full amount for minimum 7%; will be treated as liquid assets of the second level. A haircut factor set at 15% of the market value of covered bonds will be implemented on those assets (Bank for international settlements, 2013).

3. Covered Bonds Market in the EU and Other Countries

The development of the covered bonds market within the EU is owed to the EU Directives to a great extent and the main directives that arrange covered bonds market are:

- Directive 2009/65/EC on undertakings for collective investment in transferable securities (abbreviation: UCITS) which define concentration limit in terms of investment possibility in a certain security, with constraint that individual limit of 5% could be increased to 25% in case of investments in covered bonds (Directive 2009/65/EC of the European Parliament and of the Council (2009);
- 2006/48/EC and 2006/49/EC (that together represent CRD Directive – *Directive on Capital requirements*) for the purpose of prescribing rules about calculation of credit risk capital requirements for investments in covered bonds (Directive 2013/36/EU of the European Parliament and of the Council, 2013).

In the structure of covered bonds issuers within the EU countries there are:

- Universal credit institutions – with diversified business operations;
- Specialized credit institutions – focused on just one type of lending (for example: mortgage lending);
- Credit institutions that realize issuance via their entities founded just for those special business needs (the so-called "special purpose vehicle" or SPV).

The European bank for reconstruction (hereinafter: EBRD) is also very active on the covered bonds market development taking into account all potential benefits from a prospective growth of this market. EBRD made some analysis regarding current phase of covered bonds development in some Central and Eastern Europe countries, such as: Poland, Slovakia, Turkey, Croatia, Romania and Lithuania.

For a long time Poland did not succeed in the covered bonds development, although satisfactory preconditions existed. The main reason for failure was obsoleted legislative framework and structured model of covered bonds, where solely mortgage banks were authorized for issuance of covered bonds. In order to overcome these deficiencies, the creation of new legal and regulatory framework in Poland was defined, which should enforce the issuance of covered bonds and usage of more favorable market conditions. In July 2015, the amendments on legal acts for covered bonds were adopted in Poland which were put into force starting from January 1, 2016. Covered bonds in Poland are in compliance with the main provisions of the UCITS Directive as well as Credit Risk Regulation (CRR). At the end of June 2017, EBRD invested 12 million EUR in local currency (zloty)-denominated covered bond issue by PKO Bank Hipoteczny S.A. (abbreviation: PKO BH). It was fixed rate covered bond issuance of PKO BH, backed by Polish-Zloty-denominated residential mortgage loans and with a provisional rating of Aa3 assigned by Moody's credit rating agency. PKO BH is one of three mortgage banks operating in Poland (subsidiary of PKO Bank Polski, the largest commercial bank in Poland) and specializes in zloty-denominated residential mortgages (Reiserer, 2017a).

In Croatia, covered bonds are not clearly defined and regulated by the law, although there are obvious expectations from market participants to be involved in the process of issuance or/and investing in covered bonds. Those expectations motivated the Government of the Republic of Croatia to bring the Law on covered bonds which will overcome deficiencies of the local market and establish a minimum of standards with clearly defined eligibility criteria that are already known and regulated through CRR (Moraru, Kubas & Istuk, 2016).

At the beginning of 2017, as a result of partnership relations between EBRD and Ministry of Finance, EBRD rolled out 200 million EUR framework for mortgage covered bonds in Slovakia with the aim of strengthening the development of the local capital market. In the first project under the program, the EBRD invested 49 million EUR in a series of 7-year mortgage covered bonds issued by the Všeobecná úverová banka (VUB), the second largest universal bank in the Slovak Republic by total assets. The notional amount of the issuance was 250 million, the largest so far on the Slovak market (Reiserer, 2017b).

Starting in 2010, action for the issuance of covered bonds were undertaken in Romania. The law on covered bonds issuing came into force in March 2016. The issuances of bonds guaranteed with real estate claims contribute to the expansion of the maturity of liabilities, therefore allowing banks to have an adequate balance in their portfolios of assets with longer maturities. Romania is in an atypical situation, being among the few EU states still not benefiting from such issuances, although the balance of mortgage loans of over 11.2 billion EUR is enough to start issuing covered bonds, this value being higher than the values found in the portfolios of the states in the region where such operations have already started (Romanian Association of Banks, 2017).

Undoubtedly, similar activities are necessary in Serbia in order to create incentives and favorable circumstances for the revival of the debt market. It means that legal acts, incorporated in the EU countries and some neighboring countries (such as: Croatia), should define provisions which will cover the covered bonds regulation and should be put into force in the manner that creates prerequisites for primary issuance and active trading on secondary market with those bonds. For the realization of the above mentioned, a cost-benefit analysis should be made regarding inclusion of covered bonds on market, having in mind all specifics of the domestic financial sector and missed opportunities in the past to lift the financial market onto a higher level of development. The legislative framework should be created carefully in order to cover all important provisions, especially the provision related to investor's protection. Protection of investors in covered bonds is one of the key advantages, so the legislation should provide it in two contexts:

1) Maintenance of payment dynamic and tenor of bonds in compliance with initially contracted terms; and
2) Investors should keep their priority position in relation to other (uninsured) creditors of bank.

Analyzing data in and outside the EU, there were significant changes in investors' base and their preferences. Central banks as investors increased their share by almost 4 times from 8.9% in 2009 to 30.09% in 2015. Oppositely, asset managers, insurance companies and pension funds implemented exit strategy from the market: lowering their share from 50.6% in 2009 to 31.9% in 2015, focusing on other investment alternatives with similar yields (see Fig. 4). Banks had a stable share in the observed years, meaning that their demand for covered bonds is highly motivated by LCR (liquidity coverage ratio) requirements and eligibility criteria for LCR according to the Basel III standards (Mirković, 2015).

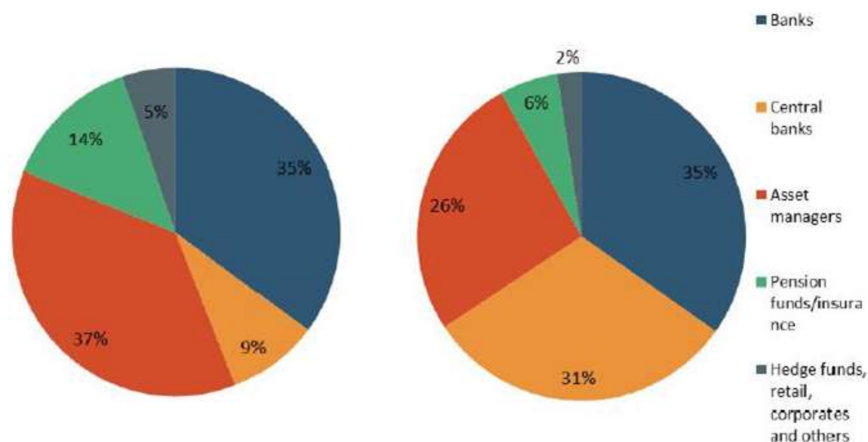

Fig. 4 Allocation of euro benchmark covered bonds by investor type (2009 & 2015)
Source: European Banking Authority (2016). EBA report on covered bonds, recommendations on harmonisation of covered bond frameworks in the EU

More cautious investors usually have on their mind the main shortcomings that are linked with covered bonds as institute of debt market. The main risks of investing in covered bonds are (Božović, 2016):

1) Credit risk – in case when issuers cannot make their contractual payments partially or fully (when bankruptcy proceedings emerge);
2) Interest rate risk – inherent for all types of banking products with a fixed interest rate. The changes of interest rates on the market have a reverse impact on the price of bonds: with an increase of interest rates on the market, the price of bonds declines and vice versa;
3) Reinvestment risk – correlated with interest rate risk which occurs at long-term coupon bonds. The increase of interest rates diminishes the value of bonds bought with initial investment;
4) Recall risk – inherent to bonds with the recall option;
5) Inflation risk – as a probability that an unexpected inflation change will occur. In that moment, all investors lose interest revenue, while if the inflation rate exceeds the coupon rate, all investors have capital losses.

Banks are focused on the issuance of covered bonds in order to provide liquidity sources, so it is very likely that banks will decide to issue covered bonds when they have a low rate of return and a high loan-to-deposit ratio. After the issuance of covered bonds, the rate of return is growing while loan-to-deposit ratio is declining. Covered bonds could have an extraordinary positive impact on the financial markets development, because they are bearing alternative, consistent, sustainable, relatively cheap and available source of funding. Investments in covered bonds represent an alternative instrument, but are simultaneously characterized by great quality and stability, which is very important especially in the situation of instability on the financial market. In order to make incentives for further development of the covered bonds market, it is necessary to achieve consensus among banks in terms of their interest to show up as investors in those securities and after that to become active players in trading activities.

The models of covered bonds which are already implemented in the EU countries could serve as a solid ground and a lesson on which to raise the prospective growth of the covered bonds market in Serbia. A different view states that it is not realistic to expect that the emergence of covered bonds as a new debt instrument would change rapidly the relations in the structure of market participants on the Serbian financial market. Similarly, due to the fact that the Serbian financial system is bankocentric (with banks as the major players covering more than 90% of the whole financial market) banks are solely "responsible" for the future development of this debt instrument. Banks as issuers are very interested in covered bonds. The interests of banks in covered bonds are additionally supported by the significance which covered bonds have for LCR ratio calculation which is a part of the Basel III regulation. The above mentioned could be realized only if adequate legislation exists to establish precise roles and responsibilities of all market participants and in final instance create assumptions for foreign direct investor's entrance on the covered bond market (Radević & Lekpek, 2014). Having in mind the sensitivity of this matter and insufficient domestic practice, it is necessary to create special legislation which will cover the subject of covered bonds (lex specialis) as it has already been done in several countries with greater experience in handling and treatment of covered bonds on the debt securities market.

CONCLUSION

Some neighboring countries successfully conducted IPOs and in that way enriched the existing offer on their capital markets. At the same time due to a wide variety of instruments on capital markets, those countries became very attractive for foreign investors. Unfortunately, that was not the case in Serbia. It is specially indicated that several years after the Law on the Right to Free Shares to citizens of Serbia entered into force, there was the absence of IPOs, but also the absence of launch of new debt securities issued by the government, other territory units and municipalities. The period of positive economic conjuncture, manifested into growing trend on BSE during the first half of the first decade of this century, was not fruitful for stock exchange development in terms of inclusion of large institutional investors. One of the reasons for that is, to a great extent, the delay in the process of passing the Law on investment funds in Serbia. The consequence of the delay in the legislative context were delayed activities of investment funds so they have only had an active role in Serbia since a declining trend on BSE was obvious in 2008.

The negative effect of delay in introducing the Law on investment funds is impersonated in inadequate development of financial market products, especially in the absence of sophisticated products. BSE was not recovered in full manner until today, simultaneously recording very modest daily turnovers in comparison with the potential that was expressed at the beginning of the XXI century. In more detail, the turnover on BSE is mostly defined by shares trading (trading of equity instruments) and it seems that additional effort is necessary in order to create a stimulating debt financial market. Bearing in mind the above mentioned, the issuing of covered bonds as a new, sophisticated product could be a great step towards a more efficient and effective debt market. Generally, it is very difficult to expect that the emergence of covered bonds would change dramatically the whole outlook of the Serbian financial market, but it could certainly enrich the offer and indicate the potential positive

movements in the prospective period. In case that the option of covered bonds introduction and implementation in Serbia prevails, then the crucial point would be to acquaint investors with the main advantages and disadvantages of covered bonds. In that way, it would be possible to create a stimulating ambience for further development of the capital market and increasing credibility of foreign direct investors into the Serbian financial system.

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POKRIVENE OBVEZNICE: NOVA ŠANSA ZA OPORAVAK TRŽIŠTA KAPITALA U SRBIJI

Početkom XXI veka Srbija je otpočela proces tranzicije ka otvorenoj tržišnoj ekonomiji. Jedan od segmenata koji je trebalo razviti u skladu sa principima tržišne ekonomije jesu finansijska tržišta, tačnije tržište kapitala. Oporavak Beogradske berze i rastući trend u prvoj polovini XXI veka su dali optimizam po pitanju budućeg razvoja srpskog tržišta kapitala. Nažalost, tržište kapitala u Srbiji nije napravilo očekivani napredak. U radu je sprovedena analiza stanja na Beogradskoj berzi, trgovanja vlasničkim i dužničkim instrumentima, uz identifikovanje nedostataka koji su doveli do nedovoljnog nivoa razvijenosti srpskog tržišta kapitala. Kako su mnoge šanse za rast propuštene i tržište kapitala stagnira nekoliko godina unazad, u radu je istaknuto da postoje novi, sofisticirani proizvodi koji mogu dati impuls daljem razvoj finansijskih tržišta. Primer takvih proizvoda su pokrivene obveznice, vrsta dužničkih instrumenata koji se široko primenjuju u Evropskoj Uniji. U radu se iznose osnovne karakteristike ovog proizvoda zajedno sa iskustvima drugih zemalja koja mogu biti vrlo korisna za Srbiju.

Ključne reči: *pokrivene obveznice, dužnički instrumenti, tržište kapitala, inicijalne javne ponude, kreditne rejting agencije*