



SECURING PERFORMANCE AND PAYMENT BY BANKS

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Table of Contents

Chapter I: Introduction.....	1
Chapter II: International scene	5
1. USA.....	5
1.1. Legal environment	5
1.2. UCC Art.9-building blocks	6
1.2.1. The unitary and comprehensive concept of the security interests.....	6
1.2.2. The system of priorities	6
1.2.3. The floating lien concept	8
1.2.4. The filing system.....	8
1.2.5. The enforcement system.....	9
1.2.5.1. Creditor's right of repossession	10
1.2.5.2. Creditor's rights of disposition and strict foreclosure	10
1.2.5.3. Debtor's right of redemption	11
2. ENGLAND	12
2.1. Banking legal environment	12
2.2. Publicity of security rights	12
2.3. Enforcement of security rights	12
2.4. Types of available securities.....	13
2.4.1. Fixed Charges.....	14
2.4.2. Floating Charges	14
2.4.3. The Relevance of the Distinction.....	16
2.5. Practical problems with the concept on example of Book Debts.....	16
2.6. Further steps	17
3. GERMANY	18
3.1. Legal environment	18
3.2. Publicity of security devices	19
3.3. Enforcement of security rights	19
3.4. Types of security devices.....	20
3.4.1. Land Charge ("Grundschuld")	20
3.4.2. German Security Transfer ("Sicherungsübereignung")	22
3.4.3. Fiduciary security assignment ("Sicherungsabtretung").....	23

Chapter III: SERBIA	24
1. Introduction.....	24
2. <i>In personam</i> security devices.....	26
2.1. Suretyship.....	26
2.1.1. Practical difficulties.....	27
2.2. Bank guarantee	27
2.3. Bill of exchange.....	28
2.3.1. Practical implications	29
3. <i>In Rem</i> Security Devices.....	30
3.1. Security interests on Immovables	30
3.1.1. Mortgage (<i>Hipoteka</i>).....	30
3.1.1.1. Subject of a mortgage.....	31
3.1.1.2. Mortgage on object under construction.....	32
3.1.1.3. Scope of the mortgage	34
3.1.1.4. Types and creation of mortgage.....	34
3.1.1.5. Exception from accessoriness principle	35
3.1.1.6. Mortgage contract	36
3.1.1.7. Enforcement	37
3.1.1.7.1. Extrajudicial enforcement.....	39
3.1.1.7.2. The right of sale	40
3.1.1.8. Central mortgage register	40
3.2. Security interest on movables	41
3.2.1. Possessory pledge.....	41
3.2.2. Non-possessionary pledge.....	42
3.2.2.1. The unitary and comprehensive concept of security interests (?).....	43
3.2.2.2. Filing	45
3.2.2.2.1. Content of filing.....	46
3.2.2.2.2. Exemptions from filing in the Pledge Registry	46
3.2.3. Priorities	47
3.2.3.1. Concept of proceeds	48
3.2.3.2. The priority of judicial, statutory and right of pledge by the State.....	48
3.2.4. Floating lien?	48
3.2.5. Enforcement	49

3.2.5.1. Creditor's right of repossession	49
3.2.5.2. Creditor's rights - Disposition and strict foreclosure.....	51
3.2.5.3. Debtor's rights	52
3.3. Assignment of receivables	53
3.4. Investment Property.....	54
4. Other Credit Enhancement Methods	56
4.1. Negative pledge covenants	56
4.2. Subordination.....	56
4.3. Right of set-off	57
5. Importance of the other areas of law	57
5.1. Importance of bankruptcy proceedings	57
5.1.1. Reorganization and rights of secured creditor.....	59
5.1.2. Voidable preferences	60
5.2. Consumer protection.....	60
Chapter IV: CONCLUSION.....	62
Bibliography	66

Table of Abbreviations

BGB	<i>Bürgerliches Gesetzbuch</i> (German Civil Code)
<i>e.g.</i>	<i>exempli gratia</i> (for example)
<i>i.e.</i>	<i>id est</i> (that is)
UCC	Uniform Commercial Code

ABSTRACT

This short thesis focuses on manner in which Serbian banks secure their claims when granting credit. Since state of a legal system when placed in international setting, first chapter elaborates on leading security devices of banking systems in USA, England and Germany, since solutions known to these systems served as a basis for introducing changes to the Serbian system. Chapter on Serbia elaborates on types of collateral required by banks in their General Terms and Conditions, as well as novel possibilities of extra-judicial enforcement of claims introduced by new set of laws. At the end of the chapter, complementary fields of bankruptcy and consumer protection will be tackled in order to paint a full picture on the state of Serbian secured transactions law. Finally, the thesis tries to evaluate state of current affairs in banking practice and suggest possible ways of development.

Chapter I: Introduction

Importance of the banking systems in promoting or facilitating economic development is well elaborated by economists. Review of the essential functions of the banking system reveals that these include its acting as an intermediary between savers and borrowers and capability of increasing or decreasing a stock of money by supplying it to the customers. Perhaps the most important function is an inherent one. By playing a significant role in the process of credit supply, banks appear as real guides of entrepreneurial talent and economy as a whole. This last function proves to be of the greatest importance to the developing countries. In order for banks to “set the country on the road to continuing growth”¹ they need to act as agents eager to attract funds and allocate them to the entrepreneurs and investments, rather than to just make use of their monopolistic position and distribute loans to the unproductive projects².

For banks to make credit more accessible and minimize the risk for non-payment it is of a great importance to use a reliable instrument of security. Having been recognized as crucial in the transition to free market economies, creating a well functioning security system has become one of the major tasks for developing countries. Serbia is amongst the countries that have recognized true potentials in reforming its collateral law and it is going through an intensive transition period in order to comply with the requirements set by the European Union.

¹ “*Banking and economic development some lessons of history*”, edited by Rondo Cameron (New York Oxford University press, London 1972) at 8

² See id. at 8.

This thesis will provide an insight into what types of collateral Serbian banks usually use, present their advantages and disadvantages and provide some future paths of development and examples of the types of collateral that might be used. It will evaluate whether Serbian banks utilize every type of asset that can be used as collateral so that they can respond to the needs of a growing market.

During this evaluation, analytical approach to the legal reforms in Serbian security system will be applied. It is easily concluded that the legal reform is anything but an easy process of drafting borrowed concepts from the foreign systems. By now the practice proved the crude implants of foreign law to be inefficient in domestic setting. In order for law to fit the needs of a particular legal system, it has to be tailor-made by its legal experts and to reflect local tradition and culture. This was the system adopted by Serbian legislators who paid due respect to domestic legal institutes while adapting ways of improving the legislation suggested by EBRD.

The new law incorporates features that were unthinkable before. Enforcement can, if agreed by the parties, take place outside the judicial process, making it quicker and cheaper. Lenders can accept a wider variety of assets as security, and pledges are recorded in an online database. When borrowers default, lenders are allowed to seize the assets straightaway to avoid losing them.

Features of the Serbian legislation will be examined according to their use by banks. When elaborating on types of collateral utilized by banks, focus will be on assets required by banks' General Terms and Conditions when approving retail and business credits. Thus, this thesis will not include possibilities of crediting on the account of retention of title and other

types of title financing, which represent security interest in some jurisdictions.³ It can be concluded that banks secure their claims in very much the same way, regardless of type of debtor. Even though regulatory framework is set, especially with the enactment of Law on Pledge of Movable Assets in the Pledge Registry, for a modern secured transactions law, Serbian banks still heavily rely on “hard assets”, such as immovable’s, pledge on equipment, deposits and bank guarantees.

State of Serbian collateral law will be examined in comparison with national legislation on this issue in England, USA and Germany. Since confines of this thesis do not allow for an overall elaboration on whole security spectrum granted by these laws, text will focus on leading security devices of each secured transactions system. The comparative approach with these countries is chosen precisely because they have established mechanisms for securing credit that seem appealing to other countries as well. Most of the novel features brought into Serbian collateral law was actually inspired by solutions existent in the above stated counties. In attempt to provide overall picture of tendencies within secured transactions law and role of banks in the above stated systems, with a special emphasis on Serbian banks and legislation, structure of thesis will be as follows:

First chapter will make a short overview of the situation on the international scene. Thus, within the chapter, under the title of the US law, attention will be paid to features of Art. 9 of Uniform Commercial Code since it are considered to be a piece of legislation which enabled utilization of all types of movables as collateral and enhanced the overall business activity. Its unique features served as a role model for drafters of the EBRD Model Law on

³ E.g. According to UCC Art.9 conditional sales confer security interest. See Tajti ,Tibor *Comparative Secured Transactions Law* (Akademiai Kiado, Budapest,Hungary,2002)at 93

Secured Transactions⁴ which largely influenced regulation of this field in CEE countries as well as in Serbia. England, as another common law country, even though did not make an influence on Serbian legislators, is chosen since its most powerful security device in form of floating charge is very interesting to Serbian theoreticians and practitioners. Discussion on German law security devices is included because it helps understanding of a logic of civil law systems and proves that well – developed economy can be built on peculiar legal institutes that are however, completely suitable to the needs of country in question.

Second chapter is devoted to types of collateral in use by Serbian banks. Special emphasis will be made on changes introduced by Mortgage Act⁵ and Law on Pledge of Movable Assets in the Pledge Registry⁶ which really brought difference within the field. At the end of the chapter, surrounding areas of consumer protection and protection of secured creditor in bankruptcy will be tackled.

Conclusion will evaluate achievements in the field and identify areas that may be improved in the future.

⁴ See available at <http://www.ebrd.com/pubs/legal/secured.pdf> (last visited March,22,2010)

⁵ Published in "Official Gazette" No.115/05

⁶ Published in "Official Gazette" No 57/2003 and 61/2005

Chapter II: International scene

1. USA

1.1. Legal environment

United States have definitely one of the most developed markets in the world. Its financial structure can be described as a market-oriented one, as opposed to German bank centered orientation. According to Dalgic market orientation can be said to express a marketing perception that put customer in the center of all firms' activities⁷. Market structure with a varied scheme of creditors coupled with an ever-rising credit demand actually helps boosting small businesses. Even though banks are not the only investors in the economy, their position is backed up by a unique legislation on personal property securities which help them utilize every conceivable kind of movable assets. This policy choice of legislator is still having a very strong impact on the overall economic development in US because it enables crediting small enterprises whose highest value can be obtained from their future business activities.

Even though security spectrum known to US banks is very broad and includes all types of securities, such as mortgage, possessory and non-possessory pledge over movables, all sorts of personal securities, such as guarantees and standby letters of credit as well as other credit enhancement methods⁸, such as subordination, covenants, comfort letters and right of set-off, UCC Art. 9, devoted to regulation of security interests over personal property and fixtures is something which really made US law of secured transactions stand out and lead the way. This is the reason why features of UCC Art.9 are going to be described in more

⁷ Dalgic, Tefik, *Dissemination of market orientation in Europe: A conceptual and historical evaluation*, (International Marketing Review, MCB UP Ltd, Vol.15, 1998) 45-60

⁸ Largely in use in practice, as opposed to civil law systems, including Serbia.

detail, according to its building blocks⁹. Among other things, more room is going to be given to this Code because its unique and comprehensive system of security interests made a large impact on makers of EBRD Model Law which largely influenced modeling regulation on secured transaction in CEE region as well as in Serbia.

1.2. UCC Art.9-building blocks

1.2.1. The unitary and comprehensive concept of the security interests

When thinking about main features of UCC Art.9, one cannot proceed without first pointing out to its unique philosophy that enabled creation of the whole system. Its drafters were practical enough to look beyond the form of secured transaction and look at the actual function of particular security device. This kind of philosophy enabled putting together all types of security interest in movables and fixtures, including sale under retention of title and receivables financing and embracing them under the same concept of security interest which led to a simplification of creating a security right over collateral. Art.9 does not distinguish between various kinds of security and there are all subject to the same rules of creation of security interests and filing. The best example of a complete departure from the pre-code, formalist approach to the matter is inclusion of the same rules on perfection and priority rules even for receivables financing, thus making them equivalent with other security devices¹⁰. Furthermore, since this system is not based on *numerous clauses* concept, way for introducing new types of security devices that will entertain needs of modern financing is open.

1.2.2. The system of priorities

Article 9 has a priority system which allows for special priority rules in addition to a general first-to-file rule. These priority rules are in reliance with the philosophy of the US

⁹ Enumerated in Tajti at 141

¹⁰ However, rules of enforcement are different and apply to receivables only.

secured transactions law which is to enhance credit life as much as possible. The consequence of such policy is that two or more creditors may claim an interest in the same collateral and additional purchasers of the collateral may appear also as having conflicting interests. In this case, the security interests rank accordingly to priority received at the time of perfection or filing. In case of conflict between unperfected security interests, the first to attach has priority.¹¹ However, it is just a general rule; in reality priority system is very complex and depends on the type of the collateral, special priority rules etc. Most important priority rules include protection of buyer in the ordinary course of business, the super-priority of purchase-money security interest (hereinafter: PMSI) and priority of bank's security interests in deposit accounts.

As in most of the systems, protection of *bona fide* purchasers in the ordinary course of business is also embraced by the UCC, for a simple reason of facilitating free flow of goods. This is especially important in an inventory financing arrangement.¹²

Priority of the PMSI is connected with the recognition of the after-acquired property interest¹³. Reason for introducing such a priority right is seen in the fact that subsequent financing contributes to the assets of the debtor as well as creditor who own the rights in the after-acquired property¹⁴. Only requirements for enjoying this priority right is that it is perfected either before debtor acquires possession over collateral or within 20 days.

A bank's priority right in deposit account maintained by it supersedes any other security interest in that account, with the sole exception of perfection by control¹⁵.

¹¹ Attachment describes the point at which property becomes subject to a security interest. The agreement must be in writing, unless the collateral is in the possession of the secured party.

¹² See UCC s. 9-307

¹³ See Gilmore, *Grant Security Interests in Personal Property* (Little, Brown and Company, Boston 1965) at 743, Chapter 28

¹⁴ See Tajti at 167

¹⁵ A secured party may obtain control over a deposit account through one of three mechanisms described in U.C.C. 9-104: (1) in case the secured party is the bank in which the deposit account is maintained; (2) if the secured party is authorized by the debtor and the bank to dispose of the funds in the account without further consent by the debtor; or, (3) if the secured party has become a customer with respect to the deposit account

1.2.3. The floating lien concept

Even though US floating lien is only a concept as opposed to English floating charge, which is construed as security device, it serves the same end of enabling long-term financing. By covering after-acquired property, proceeds and future advances, floating lien substantially simplifies granting new credit lines to the debtor. Perfection of floating lien is not different from perfection of other security devices- it is done by filing a financial statement which only has to contain “reasonable identification of collateral”¹⁶. Priority rights to a floating lien are subject to basic “first in time rule” and subject only to a super –priority right of PMSI. Code also allows debtor to continue doing his business and protects the floating lienholder by providing that his security interest will continue in collateral regardless of its disposition by debtor, except if disposition was authorized by secured parties or disposition was provided for in the security agreement¹⁷.

1.2.4. The filing system

“Ostensible ownership”¹⁸ problem is handled by UCC by recognition of perfection methods as a main public notice mechanism. Filing is seen as a central perfection method which allows creditors to make easy searches on encumbrances on assets accepted as collateral¹⁹. When filing a financial statement, creditor has to only include names of the

(e.g. has been added as signatory to the account). Control can be said to serve the same end as possession in case of tangible personal property.

¹⁶ See UCC s.9-100

¹⁷ See Tajti at 179

¹⁸ Generally the ostensible ownership dilemma occurs where non-possessory security interests are involved. The debtor retains possession or control of the personal property subject to the security interest, but the secured party has *in rem* rights (the security interest) in the property. In some situations, possession or control, while not necessarily good evidence of ownership, may be the best evidence available. A third party, unaware of the security interest which doesn't have the facilities to discover it is forced to rely on appearances, thus the ostensible ownership dilemma. The ostensible ownership dilemma is important in the secured transactions context because it can result in **multiple competing security interests** in one piece of property. Solutions offered for the problem differ in various systems, e.g. in US: focus is on public notice whenever a security interest exists while in Germany focus in the BGB is on numerous clauses of proprietary rights.

¹⁹ Other than filing, UCC recognizes other means of perfection a security interest such as perfection by possession, by control and automatic perfection in case of consumer goods, but filing is seen as the main avenue of perfection.

parties and reasonable identification of collateral by type. This kind of filing is known as “notice filing” and it is said to reduce costs of filing which certainly suits business needs²⁰. Once made, filing is effective for five years, but a continuation statement can be lodged six months before expiration²¹. Searches in the register can be conducted under the name of debtor. Exempted from filing are consumer goods²², certain assignments of accounts²³ and beneficial interests in decedent’s estate²⁴.

1.2.5. The enforcement system

Efficiency of enforcement system of US secured transaction is a feature that cannot be solely attributable to Article 9²⁵. Even though a unique set of rules of self-help enforcement plays a central role, it can be said that the actual option given to secured creditor is a feature that makes the whole enforcement system successful²⁶. This option enables him to choose the best way of satisfaction of his claims and turn to courts in case the self-help alternative does not work. Therefore, enforcement system is created as a four-pronged system which consists of efficient bailiff system, efficient general execution system, self-help and efficient provisional measures²⁷.

Since, present attempts of reforming systems of secured transaction regulations in transition countries, including Serbia, guided by EBRD Model Law share the fascination with UCC self-help method of enforcement, it is going to be described in more detail below.

²⁰ Opposite to that is “transaction filing”, type of filing introduced by Serbian Registries. In case of “transaction filing” the whole underlying document is enclosed along the financial statement with the filing body.

²¹ See s.9-522 RV UCC

²² The reason for this exception is seen in requirements of economic efficiency. Security interest in consumer goods is perfected at the time of its creation. The only security interest still left to be filed is in automobiles. See Gilmore at 534-535

²³ See UCC s.9-302 (e) (f) (g). This exemption is made for casual and isolated assignments. Other than that, general filing requirement applies also to assignments. See Tajti at 157

²⁴ See s.9-309 RV UCC

²⁵ See Tajti at 182

²⁶ Ibid.

²⁷ Ibid.

However, one must bear in mind that it is not the one institute that make a system efficient, by the overall structure surrounding it.

1.2.5.1. Creditor's right of repossession

Creditor's right of repossession is certainly seen as one of the major advantages given to secured creditors under Art.9. It can be effectuated in two ways: by private repossession and by action. When making use of granted right of private repossession, creditors have to bear in mind the "without a breach of peace"²⁸ standard which prevent this vehicle to be seen as a creditor biased.

1.2.5.2. Creditor's rights of disposition and strict foreclosure

Strict foreclosure is a legal proceeding aimed at terminating debtor's right in collateral by conferring title to a creditor, without first conducting a sale²⁹. This type of foreclosure certainly gives creditor short and efficient manner of enforcing a security interest in collateral. However, this institute is not immune from problems that may arise in case the value of collateral is higher than the amount of the loan. Being concerned with rights of the debtor-borrower, who is prone to bringing rash decision when in need of money, legislator imposed two limitations to the right of strict foreclosure. First one is a "60% rule" which is mostly applicable to consumer finance. This rule insists upon mandatory disposition of collateral in which debtor built up equity by paying out 60% of a purchase price. Any surplus from this sale should be ultimately returned to debtor³⁰. The second limitation is provided by

²⁸ A clear definition of "breach of the peace" is not found in any state statute, much less in the UCC. In summary, it can be said that in case the collateral recovery agent (repo man) is faced with potential violence or physical confrontation, he must retreat without the collateral. In case he does not, he might face serious sanctions which might go as far as awarding punitive damages in favour of debtor.

²⁹ See Black's Law Dictionary (8th ed. 2004)

³⁰ See Tajti at 190

the “proposal and objection” model, which is in principle available against all the creditors that did not follow the detailed set of steps when making use of this advantage³¹.

In case the remedy of strict foreclosure is not viable for any reason, creditor may dispose of collateral. If creditor decides to proceed with private sale, it has to be conducted in a commercially reasonable manner³².

1.2.5.3. Debtor’s right of redemption

In case the debtor pays out the whole amount of debt due, increased by amount of certain expenses, he might be able to redeem the pledged collateral. This right of debtor is also valid against certain purchasers (except for buyers for value in the ordinary course of business) in case disposition was conducted improperly³³. Other than that debtor is also protected by possibility of judicial review of creditor’s action or protection by provisions of criminal law in cases of fraud. When the possibility of punitive damages and constitutional protection in case of summary remedies³⁴ is added, it can be said that secured transactions system established by UCC addressed properly interests of debtor.

³¹ Ibid.

³² Examples from court practice consider sale of agricultural equipment during winter to be commercially unreasonable (*First Interstate Credit Alliance, Inc. v. Clark* 11 UCC Rep. Serv.2d 1012 (S.D.N.Y.1990))

³³ See UCC 9-504 (4)

³⁴ See decisions in *Fuentes v. Shevin* 407 U.S. 67,92 S. Ct. 1983,32 L. Ed. 2d 556, *re’l g denied*; 409 U.S. 902 ,93 S. Ct. 177,34 L. Ed. 2d 165 (1972); *Mitschell v. W.T.Grant Co.* 416 U.S. 600,94 S.Ct. 1895,40 L.Ed. 2d 406 (1974)

2. ENGLAND

2.1. Banking legal environment

England does not have Art.9 – like unified and comprehensive type of security interest. Rather, it can be seen as a compartmentalized and incoherent system.³⁵ It can be said that the US approach is functional whereas the English approach is pragmatic³⁶. Regulation on secured transaction is scattered around various legal sources-statutes, judicial decisions and scholarly writings. Accordingly, different rules apply to various kinds of security devices, since more attention is given to the name of security than its function.

2.2. Publicity of security rights

Registration even though provides publicity for security rights is not seen as central method of it. Thus, notice on security interests can be given in three ways depending on the kind of security device - by taking actual or constructive possession, by registration and by giving notice to the debtor in case of choses in action. Even so, one cannot deny that England is mostly registration based system. However, existence of more than eleven³⁷ registers for different types of security devices is often been criticized. This approach is said not to facilitate efficiency of obtaining information and is recommended to be changed on the Article-9 basis.

2.3. Enforcement of security rights

Creditors in England, as in US, can utilize right of self-help to enforce their security interest. Differences that might be noticed in this system are due to the distinction between equitable and legal securities. Therefore, rights of repossession of equitable mortgagee or

³⁵ Diamond, A.L. *A Review of Security Interests in Property*, Department of Trade and Industry (1989)

³⁶ Gerard McCormack, *Secured Credit under English and American Law*, Series: Cambridge Studies in Corporate Law (No. 3), University of Manchester Published June 2004

³⁷ See Tajti, 246

chargee can only be used if provided for in the debenture³⁸. Even though right of sale and foreclosure exist in the system, foreclosure is not often used because it requires a court order which can take a lot to be issued.

A method of self-help that is peculiar for England is appointment of a receiver, who can be given large powers by debenture deed, such as a power to run a business of a debtor or dispose of his business on a going concern basis³⁹.

Creditors in England are also provided with very powerful ex parte measures such as *Mareva* injunction or *Anton Pillar* order⁴⁰ which are designed to circumscribe debtor's efforts of moving all the assets out of creditor's reach. Coupled with efficient means of self-help, these measures provide for efficient protection of creditor and clearly emanate legislator's efforts to protect rights of credit suppliers.

2.4. Types of available securities

English law on secured transactions is full of differences that exist between various kinds of securities. Main differences recognized by the system are⁴¹:

1. distinction between legal and equitable securities,
2. possessory and non-possessory security interests,
3. consensual and non-consensual.

Distinction between legal and equitable securities is a peculiar feature of the English law on security interests. This distinction stems from historical distinction between courts in common law and courts in equity. Equitable securities are very easily created, for example, mere agreement to create a legal mortgage gives rise to an immediate equitable mortgage. On

³⁸ See Tajti 248

³⁹ S.44 (1) Insolvency Act 1986

⁴⁰ *Mareva* injunction is seen as one of the most powerful devices the creditor can have; it freezes the assets of debtor pending further order or final resolution by the court. It can be obtained in a form of a worldwide injunction. *Anton Pillar* order is made to help gathering evidence and help discovery in general.

⁴¹ *Ibid.* at 39

the contrary, creating legal security interests require registering it. However, equitable mortgage is easily defeatable by the existing legal mortgage, at the same property.

Non-possessory securities include equitable liens, mortgages and charges while pledge and the common law lien are possessory securities.

Security interests created by contract between parties are deemed to be contractual, such as pledge, charge and mortgage whereas liens that arise by operation of law are non-consensual securities.

Even though English law recognizes broad range of security devices largely utilized by banks, the most distinguishing security right is that of the floating charge. Since floating charge is the most discussed security device and it seems to be of interest even to countries which barely began to regulate their secured transaction regulations, it is going to be described in more detail below along with fixed charge with which it has multiple crossing points.

2.4.1. Fixed Charges

Fixed charge is created over an identifiable asset, although it need not be in existence at the time the charge was created. The main characteristic of a fixed charge is that the company that has assets encumbered by a fixed charge is not at freedom to deal with them without the agreement of the chargee (usually a bank). Fixed charges are suitable for encumbering permanent capital structure of a company, like land, plant or machinery. The creditor will endeavor to have a fixed charge since it confers to him a stronger bargaining position.

2.4.2. Floating Charges

A company may have assets that are not suitable for granting a fixed charge. The reason behind it is a the fluctuating nature of the asset (for example, raw materials or stock in

trade) or impracticability to require permission of the debenture holder every time chargor needs to deal with charged assets. It is designed to cover broadest range of assets such as land, all kinds of movable property, intellectual property, *etc.* Floating charge enables debtor to use charged assets in the ordinary course of business, generating the profit to repay the loan which is a benefit desired by any creditor.

The company can continue to deal with the assets upon the event that is named in debenture crystallization event. Crystallizing event that is usually specified is a default in the repayment of principal or interest. However, parties may agree upon any event allowed by law such as the winding up of a company, the appointment of a receiver or cessation of a company's business. When a floating charge crystallizes it turns into equitable fixed charge. Upon crystallization the company loses the right to deal with the assets in the normal course of business.

Once the crystallization occurs, priority question between fixed and floating charge is set by "first in time" rule according to the time of registration of the charge. However, registration is not seen as exclusive means of providing notice of existence of the floating charge. That is why some further acts has to be performed, such as an appointment of receiver and filing his appointment as required by s. 405(1) of the Companies Act 1985 or taking possession .

The essential difference between a fixed and a floating charge is existence of proprietary interest of a fixed charge in the assets so that until the loan remains unpaid, only chargee can give permission to release the assets.⁴² By contrast, under a floating charge, the chargee's interest is an interest in a circulating assets and unless and until the chargee intervenes (upon crystallization) company and not the bank, decides how to run its business.

⁴² James Hanlon, *Spectrum Plus And Book Debts: The Final Chapter?*, Web Journal of Current Legal Issues (2006), 1 WEB JCLI, available at <http://webjcli.ncl.ac.uk/2006/issue1/hanlon1.html> (visited March, 25, 2010)

For dealing with the asset in the ordinary course of its business chargor does not have to obtain the consent of the creditor.

2.4.3. The Relevance of the Distinction

A most important reason for distinguishing between a fixed and floating charge is that, generally, a fixed charge will have a priority right over a floating charge. This is particularly important in the case of insolvency of a company, where preferential debts run ahead of the floating charge but not of the fixed charge.

Another disadvantage of a floating charge is that it may be invalid if granted within a specified period before starting of any insolvency proceedings⁴³. In some cases this period is twelve months prior to the onset of the chargor's insolvency but in cases involving "connected persons" that period is extended to two years.

Perhaps the crucial disadvantage of a floating charge is that the fluctuating value of the assets does not confine a certainty of the satisfaction of creditor's claims. The amount available for satisfaction of debts is seen only once the charge crystallizes.

2.5. Practical problems with the concept on example of Book Debts

Book debts, uncollected debt owed to a company and realized proceeds of such a debt are often the largest asset owned by a company. Actually, some companies (e.g. those in service industries) may have only book debts as available collateral.

At first sight, book debt seems to be appropriate as a subject of a floating charge since it is an asset that fluctuates all the time. However, it is the general priority position of a floating charge that makes it less attractive for a creditor to take such a security. Therefore creditors will try to draft such a debenture that would grant them a right of a fixed charge over book debt. Nevertheless, even though debenture bears a label of a fixed charge, a court may

⁴³ s.245 Insolvency Act 1986

conclude that in fact, the parties have in fact created a floating charge⁴⁴. In deciding the matter most decisive factor is degree of control on the disposal of the book debt prior to collection. Thus, if the control is interpreted to be sufficient (meaning that the company was only permitted to receive payment of book debts and could not assign, factor, discount, sell, charge or otherwise deal with them) the charge is deemed to be fixed. Once the collected book debts are paid into a bank account, a company could not be granted unrestricted access to that account. In case the company was able to draw on its account as it wished, charge should be characterized as a floating charge.

2.6. Further steps

The big drawback of this approach to the book debt is lack of legal certainty. Courts gave little guidance on how much control should be utilized by banks in order for debenture to create a fixed charge. Lack of predictability in the area called for “desirability of legislation in the area”⁴⁵. Recommendations for legislating this field have already been made by the Law Commission for England and Wales⁴⁶. New system will treat all the charges over book debts as floating charges.

⁴⁴ See *Re Yorkshire Woolcombers* [1903] 2 Ch 284, *Siebe Gorman and Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd’s Rep 142, *New Bullas Trading* [1994] 1 BCLC 449, *Spectrum Plus* [2005] UKHL 41

⁴⁵ See *Are Charges Over Book Debts Fixed or Floating? The English Court of Appeal’s Decision in Spectrum*, THE WORLD BANK GLOBAL INSOLVENCY LAW DATABASE (Clifford Chance L.L.P., London, Eng.)

⁴⁶ See Lauren Pogue, *The Spectrum Plus Case: Fixed or Floating Charges over Book Debts in England?* at 438 available at <http://studentorgs.law.unc.edu/documents.ncbank.volume9.laurenpogue.pdf>

3. GERMANY

3.1. Legal environment

Germany is one of the world's most advanced economies. However, its financial system is based on building blocks quite different from the one UCC is based on. Thus, Germany can be described as concentrative bank oriented financial system, rather than dependant on the stock-market. Having been the major players on the market, banks are naturally very closely tied to businesses that are limited in their borrowing options. This long-term relationship between banks and companies have a number of advantages for bank, such as timely access to information and possibility of monitoring affairs of the firm.

Nevertheless, legal regulation and underlying philosophy of the German law of secured transactions are not as business-friendly as its US counterparts. Courts were concerned about supposedly unfair advantage of banks and created priority rules that generally disadvantage banks⁴⁷. Spectrum of possible collateral utilized by banks is closed by typically civil concept of *numerus clauses* rights. The only statutory security device is still the possessory pledge which is highly unsuitable to entertain needs of modern business financing. Being unable to create security devices that would give the creditor *in rem* rights, parties, using the consensual freedom, created number of security devices latter supported by judiciary. Therefore, along with the established statutory security devices such as suretyship, security provided by negotiable instruments, mortgage, pledge of movables and rights, new contractual types of security devices, known as "*kautelarische Sicherheiten*" began to be largely utilized. Having been the genuine product of German secured transaction law highly influential to number of other civil law systems, including Serbia⁴⁸, more attention will be

⁴⁷ Haussmann, Jens, *The Value of Public – Notice filing Under Uniform Commercial Code Art.9: A Comparison with the German Legal System of Securities in Personal Property*, 25 GA.J.INT'L&COMP. L.427 (1996) at 474

⁴⁸ Serbian Draft Code on Ownership and Other Property Rights is about to introduce fiduciary transfer and land charge as new types of securities

given to land charge, security transfers (“*Sicherungsübereignung*”) and fiduciary security assignment (“*Sicherungsabtretung*”).

3.2. Publicity of security devices

The peculiarity of German legal system can be best seen in the way it copes with “the false wealth problem” inherent to the non-possessory securities. It embraced registration hostile system that is relying on the closed list of *in rem* rights in property enumerated in codes to give publicity to rights in pledged collateral. In this way, creditor’s can obtain information on previous encumbrances on collateral only from debtors, which negatively affects credit decisions⁴⁹. This problem was not seen as a major drawback to the rights of creditor since personal property was not a strength on which the assets were borrowed to the debtor. Even though times has changed and German banks start to utilize personal property as collateral there is no reform plans that envisage shift to the registration based system⁵⁰. However, problems which this kind of approach already caused to the German financiers will perhaps cause changes in the future⁵¹.

3.3. Enforcement of security rights

The only way of enforcing security rights in Germany still goes through the courts. Yet, one of the features of the efficient credit economy is precisely a possibility of prompt realization of pledged collateral. Since self-help, which is seen as most effective means for achieving this goal, is not in use in Germany, pre-trial measures are observed as good substitute. Thus, most widely used pre-trial measures in Germany are those named “*Arrest*” and “*einstweilige Verfügung*”. While “*Arrest*” is a prejudgment order securing enforcement of monetary claims of the applicant, “*einstweilige Verfügung*” secures all types of non-monetary

⁴⁹ Tajti at 290

⁵⁰ See Id. at 291

⁵¹ See *Hongkong and Shanghai Banking Corp, Ltd. V. HEH USA Corporation* 805 F. Supp. 133 (W.D.N.Y. 1992). Here, valid security right over collateral acquired in Germany was not accepted by US courts since it was in contradiction to the filing philosophy of UCC.

claims⁵². Conditions for granting these measures are similar as in other systems, therefore applicant has to furnish evidence of existence of a right and urgency, proving that his right is going to be in jeopardy if the measure is not granted. As opposed to not so predictive duration of court proceedings, duration of issuing pre-trial measures is very strict – one month from the day of application⁵³. Yet, this kind of court based enforcement system complemented with efficient pre-trial measures seem function quite good in Germany.

3.4. Types of security devices

3.4.1. Land Charge (“*Grundschild*”)

Along with Hypothek, which is an accessory security device dependant on underlying transaction, Land charge is more flexible and therefore better suitable for long-term financing⁵⁴. Land charge differs from Hypothek in that:

- 1) It is not accessory;
- 2) Creditor having right of land charge has priority rights in enforcement proceedings as well as in bankruptcy;
- 3) Beneficiary of the land charge can be owner of the real estate as well any security holder.

Land charge is created upon entry into the land registry. Until registration, beneficiaries have no security right over property. Application for the registration of land charge is made by notary, who needs to be given power of attorney from the registered owner of the property in order to register the land charge⁵⁵.

⁵² See Tajti at.286

⁵³ Section 929 para. 2 of the ZPO

⁵⁴ See Strohmann, Chapter on Germany, in MOOJEN & TRUIDEN, *Bank Security and Other Credit Enhancement Methods: A Practical Guide on Security Devices Available to Banks in Thirty Countries Throughout the World* (Kluwer Law International, The Hague, 1999) *supra* note 23, at 162

⁵⁵ David Cox, Jeremy Trinder, Ekkehard Moeser and Endrik Lettau, *Security over real estate: Germany compared to England and Wales*, Corporate Real Estate 2006/2007 at.22

Land charge gives right to beneficiary to keep the registered amount from proceeds of sale of the property. Beneficiary does not have a right to a deficiency judgment towards the owner of the immovable, because right to a land charge does not allow for that. Owner of the immovable can pay the registered amount to the beneficiary of the land charge and stop its sale.

Since registration process takes considerable amount of time in Germany, the bank can agree to drawdown a loan against a notarial confirmation that the land charge shall have priority right after registration⁵⁶. On the grant of a land charge, bank can make a request to the notary for issuance of “immediately enforceable copy” which will enable bank to enforce its right immediately, without going through court proceedings to obtain a legal title from the owner of the property.

A land charge shall specify a maximum amount of loan payable to the lien holder, which will enable bank to extend the amount of credit without having to obtain a new legal charge as a security⁵⁷. In case additional amount of credit granted exceeds amount registered, land charge will also be increased and registered. A beneficiary of all subordinated registered rights has to agree to the increase of the land charge, since they can be adversely affected by it.

Land charges can be certified and uncertified. Certified land charges are utilized more because its transfer is effected more easily, by way of assignation. It is not necessary to register such an assignment. Assignation of existing certified land charge is less costly than creation of a new charge and therefore more appealing to banks.

⁵⁶ See Ibid.

⁵⁷ Ibid.

3.4.2. German Security Transfer (“*Sicherungsübereignung*”)

Security transfer is essentially the transfer of the ownership over the collateral to the transferee in trust, for a limited period of time and for the purpose of security (constructive possession). Security transfers always involve a type of fiduciary ownership. Accordingly, even though a transferee acquires the full ownership on the transferred rights, it is just temporary and only for security purposes⁵⁸. The security giver retains actual possession. The ownership of the trustee is never a full ownership because his rights are restricted by the purpose of the security. This security is based on a simple agreement, which need not be in a particular form. This agreement would be normally valid only between parties. Consequences of this are especially visible in the bankruptcy setting where the secured party is treated as a mere pledgee entitled to only separate satisfaction.

Security transfer is not regulated, but rather based on customary law. Also, it is founded on BGB principles such as *constitutum possessorum* and the rules of trust law⁵⁹.

Three basic forms of the security transfer are simple, extended, expanded.

Expanded security transfer means that security given to the bank secures not only the debt originally made but also any other debts burdening the original debtor on other grounds⁶⁰. In this way, one collateral secures several credits.

Extended security transfer means that the bank's security interest automatically attaches to goods that are result of processing of the initially encumbered collateral⁶¹. Then the bank authorizes the debtor through a selling clause to transfer the goods in his own name to purchasers and to collect the price from them in his own name. However, advanced assignment of all such proceeds is required.

⁵⁸ See Serick, Rolf *Securities in Movables in German Law: An Outline* (Kluwer Law and Taxation Publishers, Deventer 1990), supra note 19, at 23 and HAUSMANN, supra note 241, at 459

⁵⁹ See Serick supra note 19, at 32

⁶⁰ See Tajti at 279

⁶¹ Ibid.

Extended and expanded devices are equally non-registrable and are therefore essentially secret transactions.

When used in combination, these clauses will have the effect of the English floating charge and enable the bank to encumber all the present and future assets of a debtor.

3.4.3. Fiduciary security assignment (“*Sicherungsabtretung*”)

Creation of fiduciary security assignment came as a response to provisions of BGB on security assignments, which require a notification of the account debtor in order for it to be valid⁶². This requirement was overcome by introduction of fiduciary security assignment which provided that a contract between assignor and assignee alone is enough to enforce such a security interest⁶³. This also enabled pledging future rights as collateral.

Fiduciary nature of this assignment restricts the rights of an assignee since they are limited in time and serve for the security purposes only.

Even though through practice many kinds of assignment were developed⁶⁴, bulk assignment (“*Globalzession*”) is most commonly utilized by banks, because it can encompass all the present and future claims. In case a bulk assignment competes with a latter advance assignment to a supplier extending his reserved ownership, latter interest deserves priority right.

⁶² See s.1280 BGB

⁶³ See §398 BGB

⁶⁴ For example, accessory assignment (“*Anchlusszession*”) which is an advanced assignment used to assign a right in the price of goods as well as covering assignment (“*Mantelzession*”) which is assignment of future debts once they arise See Serick *supra* note 19, at 90-91

Chapter III: SERBIA

1. Introduction

Banking system in Serbia has experienced dramatic changes within last few years⁶⁵. The collapse of previous regime in the end of 90's imposed a heavy burden on banks. This was caused by large amounts of bad loans resulting in major losses, low liquidity and distrust of depositors. In order to cope with this heritage, Central Bank decided to consolidate the banking sector and close weakest banks. This approach proved to be successful. The banking sector is growing again and depositor's confidence is returning. According to the large number of international players involved in the Serbian banking sector, banking market in Serbia looks very promising today.

When deciding on granting credit, the most important information banks will try to obtain is on credit standing of a client. In case client is a natural person, banks will examine amount of his monthly wage. In case the client is a company, his financial reports will be the basis for deciding on granting credit. Information on solvency and indebtedness of clients became more available with the introduction of Credit Bureau which is a central, national data base that provides credit rating details on individuals and businesses. An authorized person from the bank, with a written consent of a client, can obtain report from Credit Bureau.

In view of efficient risk management, along with the acceptable business plan and positive evaluation of the credit capacity, banks usually require various security instruments that will provide additional guarantee of the repayment abilities of the client. Type of collateral depends on duration of credit, application of credit, as well as on the solvency of the client. By comparing various bank credit terms and conditions, one can conclude that most often used types of collateral by Serbian banks are following:

⁶⁵ Serbia Banking market 2006 - CEE banking series, available at http://www.researchandmarkets.com/reports/316374/serbia_banking_market_2006_cee_banking_series.htm (last visited March,23,2010)

Personal securities:

- 1) Suretyships granted by natural or legal person are highly utilized.
- 2) Bank guarantees granted by domestic or foreign banks;
- 3) Bills of exchange as well as the promissory notes;

Real securities:

- 1) Mortgage ,
- 2) Pledge over every kind of movable asset ,
- 3) Assignment of receivables,
- 4) assignment of rights deriving from the insurance policy based on insurance given for the object of the pledge or mortgage,
- 5) assignment of rights deriving from debtor's life insurance policy,
- 6) Cash deposit,
- 7) contractual authorizations for debiting a bank account,
- 8) Administrative ban.⁶⁶

Quasi-securities:

- 1) Negative pledge covenants,
- 2) Subordination ,
- 3) Set-off.

It can be concluded that Serbian banks rely on same security devices notwithstanding the type of debtor. For long-term credits, banks tend to use what they consider to be more solid types of collateral, such as mortgage, pledge on equipment, cash deposits, bank

⁶⁶ Administrative ban is a banks form filled and certified by the authorized person in the company where the client is employed. This form is used when evaluating credit standing of the debtor since it consists of data on employment and wage of the client. At the same time, administrative ban provide means of securing credit since , in case the client stops making payments to bank, employer is obliged to pay a certain amount of wage (usually 30%) into the banking account for the purposes of repaying the credit amount.

guarantees, etc. In case of short-term loans, where further steps in development of enterprise are more likely to be foreseen, banks accept so-called soft collateral such as bills of exchange and suretyships of natural and legal persons. These types of security devices will be discussed in proportion of their importance. Since Serbian law is experiencing some transitory changes, special focus will be on new regulation on Serbian mortgage and pledge law.

2. *In personam* security devices

2.1. Suretyship

Suretyship is often used as collateral in Serbian banking practice both for retail and business crediting. This kind of *in personam* security right is regulated by Law on Obligations⁶⁷. It does not differ from the other jurisdiction in that it is accessory to the principal contract concluded between the principal debtor and a creditor. A suretyship contract is concluded between creditor and surety in writing. Subject of suretyship agreement can be any valid claim regardless its content, even future and conditional claims.

Surety can be any person that has legal capacity to enter this obligation which means that both legal and natural persons can be used as sureties. Having a company as a surety for a credit of another company was widely used practice.

Surety's obligation is seen in repaying the sum owed by the debtor in case he does not satisfy his debt upon default. Creditor may request payment of the debt from the surety before principal debtor defaults if it is clear that the debtor is insolvent. Once the surety discharges the indebtedness, he is subrogated to the creditor's rights towards the debtor.

In case surety undertook a solidary obligation towards a creditor, the creditor does not have first to try to collect a debt from the principal debtor but may turn to the surety immediately upon debtor's default.

⁶⁷ Published in "Official Gazette" No.29/78, 39/85, 45/89, 57/89, 31/93

2.1.1. Practical difficulties

Even though widely used by banks, suretyship is not immune to various problems. First of all, problems might arise when collecting the amount due from the surety if the consent for disposal of the property is not given by his spouse or other adult members of his household. The other problem can be seen in numerous objections available to the debtor which include both objections available to the principal debtor as well as surety's own objections, *e.g.* right of set off, nullity of the suretyship etc.⁶⁸

2.2. Bank guarantee

Bank guarantee represents a written statement by which the bank undertakes obligation towards the beneficiary to pay a certain amount in compliance with its provisions in case the debtor fails to meet his obligation. It is regulated by the Law on Obligations which prescribes written form for its validity.

Bank guarantee establishes legal relationship between at least three persons-creditors and debtors form the principal contract, bank and drawer (debtor from the principal obligation) and bank and beneficiary (creditor from the principal obligation). More than one bank can be included in this type of transaction which further complicates relationship between parties to the guarantee.

Bank guarantee is a security device which is used very often in business transactions. Its main advantage is seen in its prompt and efficient enforcement. It provides for a greater degree of security than suretyship because bank as an institution is a guarant for debtor's obligation.

⁶⁸ See Art. 100 Law on Obligations

2.3. Bill of exchange⁶⁹

Bill of exchange is regulated by Bill of Exchange Act⁷⁰. Rules contained in the Law are based on the Genevan Convention Providing a Uniform Law For Bills of Exchange and Promissory Notes and regulations in force in other countries with whom Serbia performs commercial transactions.

In practice, the most common are two types of bills of exchange-promissory note and bill of exchange.

From the simplified point of view, promissory note⁷¹ is a certain variant of a credit paper. In substance it is a promise of a drawer to pay to a creditor (payee) certain financial sum. As a rule, a promissory note therefore contains characteristic expression “I will pay”. Basically, it has only two participants – drawer and creditor (payee). The drawer of a promissory note is a direct debtor obliged by his sign to pay upon default. Owner of an enterprise can sign a promissory note acting in capacity of natural person.

Opposed to that, the bill of exchange is distinguished from the note above by the fact that, in its basic form, it requires higher number of participants. Beside drawer and payee, another participant-drawee is included. Substance of a bill of exchange is in payment order of a drawer to a drawee to pay a certain financial sum to a payee. As a rule, a bill of exchange therefore contains characteristic expression “Pay to”.

Most often utilized by banks are blank promissory notes with a “no *protest*” clause.⁷² Along with the note banks require client to sign the authorization allowing banks to fill in the

⁶⁹ Term will be used as generic term encompassing both promissory note and bill of exchange.

⁷⁰ Published in the “Official Gazette FNRJ”, No. 104/46 and 16/58, “Official Gazette SFRJ”, No. 16/65, 54/70 and 57/89 and “Official Gazette SRJ” br. 46/96

⁷¹ Promissory note in systems based on Genevan conventions differs significantly from the common-law one. The common law promissory note contains very extensive details of principal transaction and in order to execute payment according to the note creditor has to prove that he fulfilled his obligation from the underlying transaction. Opposed to that, in the “Genevan” type promissory note its abstract nature is seen as its basic feature and main advantage.

⁷² “*Protest*” represents a document issued by court confirming that measures pointed at satisfaction of debt have been done as well as whether they led to the satisfaction of debt or not.

amount of debt due along with additional costs. Once the debtor pays out the amount of debt, bank returns the promissory note to him.

The reason why bill of exchange seems so appealing to the banks is a possibility of simplified and prompt enforcement.⁷³ When enforcing his claim, creditor is freed from proving the actual basis of debt which significantly shortens the time needed for debt collection. If the debtor does not comply with his obligation within the deadline contained in the bill of exchange, creditor has a right to proceed with enforced collection of claims.

Enforced collection of debt is directed towards all the accounts of the debtor based on creditor's authorization. The priorities are determined according to time the bill of exchange is delivered to the bank by the creditor. If there is not enough assets on the accounts of the debtor in the bank named in the bill of exchange as a place where payment should be executed, the banks sends data to the National Bank of Serbia in order to block all the debtor's accounts in all the banks.

Once the debtor's account is blocked, the enforcement of claims based on bill of exchange is done according to the time of the acceptance of the executive orders. Thus, enforcement of claims is not stopped even if the debtor's account is blocked. The bill of exchange has third priority rank and comes after payment of taxes and other public debts as well as after debts based on court orders.

2.3.1. Practical implications

Even though conceived as means of prompt satisfaction of debt, in practice there is a growing number of bills of exchange that cannot be enforced. Nowadays, bill of exchange is seen as collateral that cannot provide much security to the creditor and it is often used in combination with other types of collateral. Problems with this type of security are visible in

⁷³ In these kinds of proceedings, debtor's right of objection and appeal is very limited and the deadlines for bringing them up are shortened (8 days, as opposed to the general 15 days rule).

case there are not enough assets on the blocked accounts which can lead to enforcement proceedings lasting two years or more.

For that reason a National Bank of Serbia proposed amendment to the Law on Payment transactions⁷⁴. Amendment will introduce a public register of promissory notes and authorizations which will enable companies to have an insight into how many promissory notes their partners have already issued. If this proposal would be accepted, the enforced collection of claims would be executed once a day, proportionate to the amount of debt owed to the creditor and not according to the priority of the order, as the case is now. The possibility of payment of the wages and other income when the account is blocked will be cancelled. The enforced collection will be directed towards the account where the debtor has the most of assets and it will proceed respectively according to the amount of assets. Also, if the account owners do not inform the bank on their statutory and other changes, it will impose prohibition of the free disposal of the assets from their accounts and, in case this information is not provided within three month time, these accounts will be cancelled.

3. In Rem Security Devices

3.1. Security interests on Immovables

3.1.1. Mortgage (*Hipoteka*)

New legislation regulating this security introduces a lot of novelties into the field and make mortgage on immovables even more appealing to the banks. Serbian Mortgage Act⁷⁵ defines mortgage as a lien on real estate, which empowers creditor to satisfy his claim from the value of the immovable before non-secured and junior mortgage creditors, regardless of

⁷⁴ Published in Official Gazette No 43/2004,62/2006

⁷⁵ Published in the "Official Gazette RS", No. 115/05 of 27 December 2005. One *caveat* has to be added regarding the English term mortgage used here. Here, the mortgage doesn't mean a transfer of ownership of the asset by way of security upon condition that it will be re-transferred once the debt is paid. Mortgage used in this sense means solely a "lien" on the real property, a *jus in re aliena*.

the actual possession of immovable.⁷⁶ This means that the mortgage is *in rem* security right which gives the creditor a priority in satisfaction and a right of pursuit. It is an accessory security dependant on the existence of the debt it secures.

3.1.1.1. Subject of a mortgage

The way in which the subject of the mortgage is defined is influenced by issues lying beyond the field of mortgage law. One of them is certainly the socialist legacy which is visible in many substitutes of ownership rights in movables, such as various kinds of rights of disposition, right of use, right of priority construction, etc. The other reason is lack of unitary regulation on immovables. Construction land is still state owned but buildings are considered to be part of private property. Illegal building is also a problematic zone. There is a vast number of buildings that are either built without any permit or still missing a usage permit and therefore cannot be registered. Besides attempts to legalize this building, state has strong incentive to activate the inherent credit value in them.

Art.3 of the Mortgage Act enumerates immovable that can be used as a collateral. Thus the mortgage can be created upon:

- 1) an immovable property (title to land, building and the like);
- 2) a part of a real estate property, in accordance with the decision on partition;⁷⁷
- 3) a portion in a common immovable property;
- 4) a separate part of a building in tenure, and/or some other right containing the right of disposal (a dwelling, business premises, garage, parking space, etc.)⁷⁸;

⁷⁶See Art .2 of the Mortgage Act

⁷⁷ This provision introduces a rule which is opposite to the one suitable for the systems based on public land registers. According to traditional rule, a part of a real estate property can only become subject of a mortgage once the partition is done in the land register which is a consequence of the concept of unity of mortgage and the fact that it is created by filing in the register. In this way a non practical solution is created, because it is not possible to register a mortgage on a part of a real estate until an official partition is completed.

⁷⁸ A mortgage on the ideal portion in a common immovable property can be established without approval of the rest of co-owners except if the mortgage is created on the ideal portion of the object under construction when the consent of all the co-owners is needed.

- 5) a right to land authorizing the free legal disposition, including in particular the right of construction, right of priority construction or disposition in government and/or social ownership;
- 6) a building under construction, as well as a separate part of a building under construction (a dwelling, business premises, garage, etc.), irrespective of whether completed or not, provided that a valid building permit has been issued in conformity with the law governing the building construction.

The subject of the mortgage can also be a non- registered immovable in case it complies with certain conditions imposed by banks and National Corporation for Securing Housing Loans⁷⁹ which insures loans secured on the strength of this security and in that way enhances chances to obtain bank credit.

Solutions included in the Act regarding the subject of the mortgage are completely in accordance with the principle of specialty of a mortgage as an *in rem* right. However, the Act introduced a number of novelties. The most important novelty includes the possibility of mortgaging an object under construction as well as a part of a real estate property under construction regardless of the fact that it is not yet built as long as the valid building permit is issued.

3.1.1.2. Mortgage on object under construction

The need for this solution is emphasized by the fact that the Serbian law did not recognize the principle *superficies solo cedit*⁸⁰ in the areas with the construction land. Up till the enactment of the Constitution of the Republic of Serbia⁸¹ the construction land in cities could only be in governmental or social ownership. The re-establishment of the unity of

⁷⁹ Available at <http://www.nkosk.co.rs/code/navigate.asp?Id=5> (last visited, march,23,2010)

⁸⁰ The principle can be described as "everything what is built on the land (buildings) belong to the owner of the land"

⁸¹ "Official Gazette RS" No. 98/2006

immovable infringed during the socialist times by the nationalization of the building land cannot be achieved. Since the owners had a right to build and own buildings and there parts (*i.d.* flats) they were entitled to a right of permanent use of land. Since enactment of the Law on Planning and Construction⁸² the unfledged governmental land can be leased for the purposes of building (which is the equivalent of the right of building).

However without rights in the land, investors did not have anything to mortgage till the building was not completed and registered. The pressure of the international organizations, which did not completely understand reasons for inability to pledge an object under construction, was directed towards on the one hand allowing investors to obtain credits for the building and on the other hand enabling buyers to get credit by encumbering the flat they are buying. This idea was backed up by a commercial logic but the legal obstacles were clearly not considered much.

In case of the object under construction, mortgage is created by filing the appropriate notice on the land registry regarding the object which is being built. Once the construction is over, a mortgage over that object is filled *ex officio*. Until this conversion, the mortgage on the object under construction is created by transferring a valid building permit. The issuer of the building permit is obliged to cancel the old and issue a new permit for the transferee of the permit⁸³. Even though this solution has enabled encumbering objects under construction, it brought a major inconsistency into the Serbian legal system. It made a public subjective right (the building permit) which is issued in the administrative proceedings transferrable, while it is well established that negotiability is a characteristic of a subjective legal rights. Therefore, this kind of solution should be regarded as only temporary.

⁸² Published in "Official Gazette " No. 47/2003-1 and 34/2006-3

⁸³ See Art.39 Mortgage Act

3.1.1.3. Scope of the mortgage

Mortgage is construed to cover all the component parts of the immovable, products (if the opposite is not contracted for), accessories, as long as provided in the contract, and all the latter improvements and enhancements in the value of collateral.

Each and every claim can be secured by means of mortgage -monetary, non-monetary, in domestic or foreign currency. The mortgage can be furnished for a future and conditional claim which can be seen as an exception from the principle of the accessoriness of a mortgage. However, it can be noticed that in that case the Act does not include provision regarding filing of a maximum amount of claim which can be seen as a serious draw-back of the Act since it could provide for larger use of this type of collateral in bank loans. Even so, provisions on filing the maximum amount of the claim exist in other acts⁸⁴ so its implementation in practice is possible.

3.1.1.4. Types and creation of mortgage

According to legal basis, the Act recognizes:

1. contractual mortgage, which is created by contract or a settlement before court;
2. unilateral mortgage, that is created by the statement of the mortgagor;
3. statutory mortgage;
4. judicial mortgage created by a court's decision.

In practice, banks use most often first two types. In each case, the mortgage is created upon filing in register. Filing may be described as “transaction filing” because filing of the document underlying transaction is also required.⁸⁵

⁸⁴ See Law on land registers of the Kingdom of Yugoslavia 1930. and Law on State Survey and Cadastre 2009.

⁸⁵ See Tajti at 146

3.1.1.5. Exception from accessoriness principle

Provisions on creating a new mortgage, inspired by the solutions in ABGB from 1916, are at odds with traditional principle of accessoriness of mortgage. Mortgage Act includes three novel institutes which have in common possibility of preserving a rank of the registered mortgage even in case the debt is satisfied.⁸⁶ This solution may prove as useful in the banking practice because having a first ranking mortgage is seen as the most powerful security device.

The legal significance of establishing the mortgage rank lies in eliminating collision between the rightful holders of real rights regarding the same property when all these rights cannot be fully put into effect.

The rank of mortgages on the same property is determined according to the moment of filing an application for registration.

The approach embraced by the Serbian legislator is sliding scale principle⁸⁷. When a debt is repaid to the creditor who is secured by a mortgage of the first preferential mortgage rank, the next in line creditor is rightful claimant of the next preferential rank. This solution prevents the owner of a mortgaged realty to redeem the mortgaged property before claims of all the mortgage creditors are satisfied.

The other solutions offered in various legal systems recognize the fixed rank principle which enables the creditor to keep the rank and transfer it to a new creditor. After a claim of the mortgage creditor earlier in rank is satisfied, his place is not taken by the mortgage creditor of the next in rank. Instead, the owner of a mortgaged property acquires the proprietary mortgage which is at his free disposal⁸⁸.

⁸⁶ These possibilities include transfer of priority rank of the mortgage to a new creditor within 3 years after satisfaction of debt, making pre-entry of a mortgage in register to preserve the rank and making notice of keeping priority rank in the register along with the request to erase an old mortgage

⁸⁷ See Lazic, Miroslav *Mortgage reforms in Serbian legislation*, European LawyerJournal, 2/2007 at 72

⁸⁸ Ibid. The proprietary mortgage is a mortgage of the debtor on his own property (*hypotheca in re propria*)

Proprietary mortgage enables a future creditor to “book” the rank in the Land Registry which is a tempting option. For the transformation of mortgage into proprietary mortgage and the other way round the approval of creditors subsequent in rank is not needed because they remain in the same situation in the economic terms. Thus, the fixed rank makes multiple pledge of the same property easier.

Even though the Serbian Mortgage Act does not provide for the proprietary mortgage, various options for retaining a rank exist. For example, within the period of three years after the claim is satisfied the mortgagor can transfer the mortgage to a new or to a prior creditor in order to secure a new claim. The new mortgage is same in rank and secures the same total debt sum as the previous one. In case the claim exceeds the claim secured by the previous mortgage, the consent of all the latter mortgage creditors is needed. This solution improves the position of the mortgage creditor and cures the deficiencies of the sliding rank solution.

3.1.1.6. Mortgage contract

The mortgage contract may be separated or form a part of another contract. The form is written with the verification of signatures and it can be concluded by owner or another authorized person⁸⁹.

When granting credit, banks insist on including following provisions in the mortgage contract that would enable them to benefit from the extra-judicial sale of the mortgaged property as provided for in the Act:

- 1) a clear statement by which the owner of the property authorize a creditor to satisfy his claim out of the price received from the sale of the property in the course of extrajudicial proceedings, without a need to initial court proceedings.
- He also promise to transfer immovable into buyer’s possession within 15 days

⁸⁹ See Art. 10 Mortgage Act

after the conclusion of the sales contract ,except if the mortgage is registered on the a portion in a common property,

- 2) a clear statement made by the owner that he is aware of all the consequences of not paying a debt due and therefore he agrees to the possibility of out-of –court enforcement of claims without the right to litigation,
- 3) a clear statement that the owner agrees that the creditor can approach and enter the premises for justified reasons and that he will cooperate with the creditor during the course of the sale,
- 4) a clear statement of the third party in possession of the mortgaged property, that he is aware of the consequences of this contract and that he consents to them.

If the mortgage contract does not contain all the provisions enumerated above, the enforced collection of claims is run according to the provisions of Law on Execution proceedings.

Contracting for a possibility of transferring a title to the creditor once in case debtor is not capable of fulfilling his obligation on the principal contract is void. This would be possible only if agreed upon by the creditor and debtor after default. Provisions seen as void include also the prohibition of out-of –court sale that contradicts provisions of the Act, the prohibition to the mortgagee to use immovable or its products and the prohibition on transferring and latter constitution of a new mortgage.

3.1.1.7. Enforcement

Mortgage creditors can enforce their claims according to the Law on Execution proceedings in the court or in extra-judicial sale according to Mortgage Act. The biggest change the Act brings is precisely a possibility of out-of-court enforcement of claims which

frees creditor from the obligation to endorse various kinds of documents that prove ownership rights of the debtor on the mortgaged property. Interestingly, these provisions were inspired by the solutions found in Ukrainian law which transferred them from the US⁹⁰. Also, more credit is given to the priority rights of the mortgage creditor in this Act than in the Law on Execution proceedings. His claims are ranked immediately behind the costs of the sale which are evidenced by a document that is sent to all the involved parties.⁹¹ Mortgage giving rights to a non-judicial enforcement is filed in the register by the name of “executive extrajudicial mortgage” which gives it a special publicity.

A condition necessary for being able to benefit from the out-of-court settlement of claims is the mortgage contract containing all the necessary elements envisaged by the Art 15 of the Mortgage Act or the mortgagor’s statement which contains the same elements as a mortgage contract. This contract is an equivalent of executive statement and are enough grounds for starting an extrajudicial settlement proceeding.

Since this solution gives a major advantage to the creditors, the Act provides for the possibility of making a separate contract between mortgagor and mortgage that provides for the possibility of out-of-court enforcement of claims even for the mortgages established before the enactment of this Act.⁹² This contract can be concluded upon debtor’s default and it is concluded between mortgagee and the owner of the mortgaged realty. The debtor himself, if not the owner of the mortgaged property, is not a party to this contract although he should be notified of its existence without delay.

⁹⁰ See Zivkovic, Milos, *Novo hipotekarno pravo u Republici Srbiji (New mortgage law in Republic of Serbia)*, available at <http://www.ius.bg.ac.yu/prof/Materijali/xivmil/NovoHipotekarnoPravoClanak.pdf> (last visited March,23,2010)

⁹¹ According to the Law on Execution proceedings priority rules are ranked as follows:

1. costs of enforcement proceedings
2. claims based on the right of legal support when proved with the executive document and if applied for at latest on the session held prior to sale

The mortgaged creditors’ claims are third in the rank which means that their rights are not valued highly.

⁹² See Art.27 Mortgage Act

3.1.1.7.1. Extrajudicial enforcement

The enforcement proceedings start by sending **first notice** to both the owner of the mortgaged property and the debtor (if they are different persons). The precondition of initiating the whole proceedings is having the executive extrajudicial mortgage filed in the official registries of immovable⁹³. This notice should include data on mortgage contract and encumbered property, debtor's right of redemption, deadline for payment of debt, a warning that if the payment is not effectuated the sale of the mortgaged property will be conducted, the name and data of the person which the debtor can contact for more information and the other data considered necessary by the creditor. The period of 30 days since the first notice is received is given for a debtor to cure his default.

If the payment is not effected yet, the **second notice** is addressed to the same persons as the first one. It includes the notice that the whole debt became due, the amount of the debt and information of the manner in which the sale will be conducted.⁹⁴ Simultaneously, the creditor files with the register a request for the record of sale of the mortgaged property which will be effectuated by the register in 7 days time. After filing this record, the register will issue a decree to the creditor, debtor and the owner. This decree⁹⁵ specifically authorizes the creditor (upon its validity but not before 30 days after this decree is issued) to sell the encumbered property in his own name⁹⁶ as well as the prohibition on disposal by the debtor.

⁹³ "Mortgage is not to be registered in the Central mortgage register but it should represent a central register of all mortgages registered in registers. Mortgage is registered in the authorized real estate register – that being the land book or real estate cadastre" taken from the http://www.rgz.gov.rs/template1.asp?PageName=ceh_opsti (last visited March ,8,2010)

⁹⁴ See Art.30 Mortgage Act

⁹⁵ This decree can be appealed within 15 days by the creditor, debtor and the owner of the encumbered property. The appeal is filed with the Republic Geodetic Authority. The decision based on appeal must be issued in 15 days from the day the appeal is submitted and it is final.

⁹⁶ It seems unclear how the buyer will register his property in the land registers since he did not contract with the registered predecessor. This solution works in the common law countries since they do not have cadastre based registers

The debtor and owner of the mortgaged property can ask for a meeting⁹⁷ with the creditor or his representative who are obliged to receive him in their premises during the working hours. If the parties do not reach an agreement on a manner in which the debt should be settled, creditor can proceed with a sale.

3.1.1.7.2. The right of sale

In case the debt is not paid 30 days upon validity of decree, the property can be sold by way of auction or outright sale. The creditor is free to choose the manner in which the sale will be effected. If the manner he chooses turns out to be ineffective, he may proceed with the alternative way. The sale can be conducted by creditor himself or a professional. In case there is any overhead left from the sale, creditor is required to return it to the debtor. In case the sales price does not suffice to repay the entire obligation due, a creditor is entitled to a deficiency judgment. However, Act provides for reduction of the debt due if the sales price is less than 75% of the estimated value by the difference between the amount of price paid and 75% of the value of the mortgaged property.

3.1.1.8. Central mortgage register

The Act introduces a central mortgage register as a central electronic database. It is maintained by the Republic Geodetic Authority which does not guarantee correctness and completeness of the data registered. In practice this means that the creditor will still have to check legal status of immovable by checking the land registers which appear not to be kind of solution envisaged by legislators. Nevertheless, possibility of accessing the register on free of charge basis and attempt to regulate the filed in a centralized manner are features whose overall impact on the business climate in Serbia cannot be denied.

⁹⁷ This right is criticized for not being of much help bearing in mind state of affairs and mentality in Serbia. The creditor is not obliged to negotiate in good faith nor to reach an agreement (*See Zivkovic*)

3.2. Security interest on movables

3.2.1. Possessory pledge

One of the oldest security devices over personal property, namely possessory pledge, is regulated by the Law on Obligations. The object of a pledge can be every movable thing, generic thing when individualized, even money under certain conditions as well as future and conditional obligation. Right of pledge can arise out of contractual agreement, court's decision or statute. For its creation, law does not ask for any particular form. The security interest in pledged collateral is perfected by possession.

The collateral used for securing the debt existent between pledgor and pledgee may be used for securing other obligations that arise between these parties prior to the debtor's default upon primary obligation. Multiple pledging of the same collateral is possible and in that case the pledge is perfected once the pledgor gives notice of the conclusion of the contract with another creditor to the person that already has possession of collateral. The rank of the pledge is then determined according to the time of perfection. Different rules apply in the commercial contracts where the priority right belongs to the last perfected pledge.

The pledgee may enforce his claim only by bringing an action in the court. The provision that provides for transferring the ownership of the pledged collateral to the pledgee once the default occurs is void. But if the collateral has determinate price, this provision can be contracted for or collateral can be sold at that price.

When approving credit on the security of possessory pledge, banks take a security warehouse receipt as evidence that the pledged goods are placed in the warehouse agreed upon. Even though still used by Serbian banks, costs of pledging make possessory pledge less attractive and practical to the needs of modern business. That is the reason why Serbian law

also paid a great attention to regulating a non-possessory pledge in the Law on Pledge of Movable Assets in the Pledge Registry⁹⁸.

The evolution from possessory to non-possessory pledge went through wide use of judicial right of pledge which is based on a contractual arrangement and has a force of a court settlement. Here, a possession over an object in question was left to the debtor. However, in practice this solution proved not to give enough publicity to the creditor's right of pledge thus it was easy for debtor to dispose of it in favour of a buyer in the ordinary course of business who would acquire ownership free of any charge. By making judicial right of pledge subject to filing in the Register, third parties cannot plead that they were not aware of the legal status of the object they are buying.

3.2.2. Non-possessory pledge

By introducing a central register for non-possessory pledge over movables it can be said that Serbian law introduced chattel mortgage⁹⁹ into its system. The reform in Serbian legislation was inspired by EBRD Model Law on Secured Transactions based on the idea of a single security right (“*charge*”) in respect of all types of movables. Since even EBRD's solutions was inspired by the famous UCC Art. 9, a Law on Pledge of Movable Assets in the Pledge Registry will be described according to five building blocks of this Act¹⁰⁰. Author of these lines believes that this approach is justified since Law, as well as UCC, regulates security interests in movables¹⁰¹ and has a potential of being a leading player in regulating Serbian field of “secured transactions”.

Purpose of identifying these building blocks was seen in bringing UCC Art.9 closer to non-Americans. The author believes that the opposite is also possible.

⁹⁸ Published in “Official Gazette ” No 57/2003 and 61/2005

⁹⁹ Existence of a chattel mortgage presupposes registration. See Tajti, Tibor, *Comparative Secured Transactions Law* (Akademia Kiado, Budapest, Hungary 2002) at 88

¹⁰⁰ See Tajti at 141

¹⁰¹ Although, UCC regulates security interests in fixtures, as well.

While proceeding along the above stated blocks, it will be explained whether these features can be found in Serbian Law on Pledge of Movable Assets in the Pledge Registry and in which form.

3.2.2.1. The unitary and comprehensive concept of security interests (?)

The UCC solutions are mostly praised for its ability to respond to the needs of modern finance and courage to put “content before the form” in addressing regulated issues. When regulating creditor’s right in collateral, Article 9 uses a term “security interest” notwithstanding the form of the underlying agreement. The unitary nature of Art.9 can be seen in its determination to do away with the inherited scheme of differentiating between various types of security devices and apply to all transactions intended to create security interest in personal property and fixtures.

Serbian rules on various security devices are, however, scattered around legal acts. Law on Pledge of Movables in the Pledge Registry was an attempt to set a comprehensive scheme for a broad spectrum of security devices, which include any individually specified asset, movable asset categorized by kind, a body of movable assets such as specific warehouse or store, the inventory used for conducting commercial activities, pledge of claims, share of a movable asset or of a body of movable asset in common ownership, pledge on assets or rights that the pledge will acquire in future. In case of securing future or conditional claims, the maximum amount of the main claim which is being secured shall be filed in the register¹⁰². Having information on possible indebtedness of a debtor is certainly beneficial to the creditors who will accordingly consider extending credit lines towards debtor. This solution is also in line with solution found comparatively, e.g. both England and US recognize contracting for “future advance clause” which excludes the need for contracting for new credit agreement every time the new amount of credit is approved.

¹⁰² See Art.7 Law on Pledge on Movable Assets in the Pledge Registry

Even though Law provides for a large number of possibilities, most widely in use in practice is pledge over vehicles, equipment and machines.

The Law on Pledge provides that the right of pledge over described collateral can be based on:

- 1) agreement in writing (contractual right of pledge),
- 2) enforcement proceedings – by agreement before the court, forced execution of an executive or authentic document, or by pronouncing a provisional measure (judicial right of pledge)
- 3) tax procedure before commencement of forced collection, or during forced collection of tax arrears (statutory right of pledge).

Even though spectrum of security devices covered by the Law is wide, it however, did not achieve the same degree of unity as the UCC Art.9. It explicitly excludes pledge over securities and does not apply to leasing contracts, as a form of title financing.

Nevertheless, for the types of security actually covered, Law on Pledge of Movable Assets in the Pledge Registry provided for unified, rationalized and simplified system of filing. The central place for filing is The Register of Pledges on Movable Property and Rights which is kept by the Business Registers Agency, established by the Law on the Business Registers Agency¹⁰³. The Register of Pledges is a single electronic database containing data on pledges, amendments to and changes of data pertaining to the registered pledges, data on the commencement of settlement proceedings, entries on any disputes (on filing a lawsuit for the strike off of the pledge from the Register of Pledges, as well as proceedings concerning the subject matter of the pledge or the relationship of the parties in this legal transaction)¹⁰⁴. Introduction of Register enables a consistent application of “first in time, first in right” rule

¹⁰³ Published in “Official Gazette of the Republic of Serbia”, no. 55/04

¹⁰⁴ Register available at <http://www.apr.gov.rs>

because priority rights are determined according to the time of filing. The database of the Register of Pledges can be searched using three basic search strings, which are:

1. Parties to a pledge (pledger or pledgee)
2. Object of the pledge
3. Submission number in the Register of Pledges (ZL.no.).

By introducing such a central evidence of pledges, Serbian legislator greatly influenced the overall credit and commercial environment. By making registered data available to the public at large, free of any charges information on debtor's credit capacity and available collateral is made easily accessible.

3.2.2.2. Filing

Filing is seen as a central method of providing publicity to the non-possessory pledge. Even though Serbian legislation was traditionally widely influenced by civil law systems, The German solution peculiar for its lack of public notice system and reliance on numerous clauses of real rights was not embraced.

The pledge over movables according to Serbian Law on Pledge of Movable Assets in the Pledge Registry is created upon filing. By filing his security interest in the Serbian Business Registers Agency creditor secures his priority rights towards junior secured creditors, non-secured creditors, the acquirer of the encumbered property and the bankruptcy trustee. Filing in the authorized register also provides solution for "ostensible ownership" problem inherent to the non-possessory security interests and gives prospective creditors a better insight into debtor's affairs. Bank's searching of publicly available register is seen as a part of due diligence process in verifying credit capacity of the debtor.

The request for filing may originate from creditor or the pledgor, but it is more viable that the creditor will request filing. The period in which created security interest must be filed

is not determined by law and is left to the contractual arrangement of the parties. The time until a proper filing is effective is not limited¹⁰⁵.

3.2.2.2.1. Content of filing

The content of filing represents more than just a mere technical issue because it has to provide for “balancing of interests”¹⁰⁶. Thus, systems that support so called “transaction filing” (*i.e.* filing accompanied by lodging the content of underlying legal transaction with the register) are more concerned with the protection of third parties, while “notice filing” systems merely point out at the transaction that serves as a basis for filing and by that reduces costs of filing and disburden the maintenance of registers¹⁰⁷.

Even though the Law on Pledge of Movable Assets in the Pledge Registry does not include provisions regarding the content of filing, in practice it has to include all the data that should be available in the Register of the Serbian Business Registers Agency which encompass all the information about parties and nature of transaction underlying the security interest which filing is requested. By adopting this approach, legislator missed the opportunity to include clear notice filing as a modern solution with clear advantages, namely possibility of registering other types of security interests as retention of title, pledges on future receivables and inventory.¹⁰⁸

3.2.2.2.2. Exemptions from filing in the Pledge Registry

According to Law on Pledge of Movable Assets in the Pledge Registry pledge on all the movable assets or rights has to be registered in the Pledge Register. The exemptions from this rule are made for¹⁰⁹:

¹⁰⁵ While the UCC provides for 5 years cut-off period, with possibility of extension of 6 months before expiration See Tajti at 151

¹⁰⁶ Ibid. at 148

¹⁰⁷ Ibid.

¹⁰⁸ Ibid at 80

- 1) ships and aircrafts,
- 2) pledge of securities for which a registry has been instituted in accordance with special regulations in which the rights of third persons are registered¹¹⁰,
- 3) intellectual property rights which are registered in the Registry of the institution competent for intellectual property¹¹¹.

Even though special registries are established for pledge over these kinds of securities there is no danger that this pledge will not be recognized by the systems based on public notice mechanism.

3.2.3. Priorities

According to the Law on Pledge of Movable Assets in the Pledge Registry, the general priority rule is based on the “first in time first in right” principle, according to the time of lodging the application for registration in the Registry.

In case of multiple pledging of the same object two cases should be differentiated:

- 1) In case object of the pledge is encumbered in favor of multiple creditors, priorities are settled according to the time of filing application for registration in the Registry;
- 2) In case that one object is subject to both possessory and registered pledge, a possessory pledge has priority if the underlying contract is concluded in writing and verified in court.¹¹²

¹¹⁰ The pledge over securities is registered in the Central registry on the owner's security account.

¹¹¹ Place of registration is Intellectual Property Office.

¹¹² Even though this rule is introduced in order to better protect creditors, this rule poses unnecessary burden to the creditor from possessory pledge because even without a notarial contractual form, he has perfected his rights in collateral. Since the potential for priority related problem is recognized, proposals for including mandatory registration for the possessory pledge and statutory pledge based on the commercial contracts in the The Law on Pledge of Movable Assets in the Pledge Registry are already made.

3.2.3.1. Concept of proceeds

Concept of proceeds embraced by Art.9 is important as one of the means for extending credit. The ways proceeds are understood in law have a big impact on the overall position of creditor. Thus, his security position is weaker if his security interest is limited only to the initial collateral. Serbian law allows for extension of security right over produced goods in case the right of pledge is constituted over raw materials. It does not extend to proceeds of proceeds as allowed by UCC. In case pledged collateral is sold in the ordinary course of business, buyer for value without notice takes the collateral free of every interest and secured creditor has right to purchase price received by debtor.

3.2.3.2. The priority of judicial, statutory and right of pledge by the State

Judicial¹¹³ and statutory right of pledge¹¹⁴ have priority over right of pledge filed in the register notwithstanding time of its creation. However, when regulating statutory right of pledge by the State, Law on Pledge on Movable Assets in Art. 34 determine priority rights for claims for taxes and other duties according to the time of registration in the Pledge Registry.

3.2.4. Floating lien?

Even though not an independent security device such as English floating charge, the floating lien concept offers a great support to the creditors. The Article 9 floating lien is seen as a great help when granting a credit over constantly shifting collateral such as receivables and inventory.¹¹⁵

¹¹³ The charge based on a courts decision is created upon making a record of inventory and its priority rights in relation to the other types of registered pledge are counted from that moment.

¹¹⁴ Statutory right of pledge of a carrier, commission agent, forwarding agent and warehouse operator arising from forwarding or transportation of pledged assets shall have priority over right of pledge registered in the Pledge Registry. Statutory right of pledge of a worker for claims of remuneration, reimbursement for materials used and other claims in connection with his work, arising from a service contract in accordance with the law governing obligations, shall have priority over rights of pledge registered in the Pledge Registry. In these cases statutory right of pledge is based on mandatory rules and this solution facilitate functioning of market because there is no need for concluding special contracts that would govern costs of each transaction.

¹¹⁵ See *supra* Chapter I:USA Floating lien

When it comes to long term financing, Serbian legislator does not provide for this option. Even though law introduced possibility of registering pledge over future assets or rights, the right of pledge arises when the pledgor acquires ownership over the assets¹¹⁶.

Bearing legal opportunities in mind and applying contractual freedom when describing collateral in the pledge agreement, various opportunities are opened for creditors. However, when examining possibilities given worldwide for long-term financing (the most important being floating charge in English law) it can be said that Serbian creditors are deprived of such a mighty and overwhelming security device. Serbian law in that respect stays along the lines of specialty of pledge. Even though there is no possibility of pledging enterprise as a “going concern” or assets in general, banks are finding their way to constitute pledge over as many assets as possible in when granting credit. For example, they are already using pledge on goods in a certain warehouse, inventory, claims, securities and economic component of intellectual property rights.

3.2.5. Enforcement

3.2.5.1. Creditor's right of repossession

If the creditor decides to proceed with enforced collection of his claim he is obliged to inform the debtor (and pledgor if it is not the same person) of his intention by registered mail¹¹⁷. The enforcement proceedings are initiated when that notice is actually delivered. Since in practice debtors usually avoid to accept delivery of such a notice, banks already made suggestion that this notice should be deemed delivered three days after it is sent by

¹¹⁶ See art.13 Law on Pledge on Movables

¹¹⁷ See art.36 Law on Pledge on Movables

post¹¹⁸. The creditor is required to register notice of initiation of enforcement in the Pledge Registry¹¹⁹.

Once the notice of intention to proceed with the enforced collection of claim is delivered, the creditor is authorized to take object of the pledge into his possession. However, he is not entitled to repossess object on his own¹²⁰. In order to prevent possible objections by the creditor that the object of a pledge is taken against his will, the debtor will attempt to obtain consent in writing. If, however, debtor does not voluntarily fulfill his obligation of transferring possession of the object of pledge, creditor is entitled to file petition with the court to order seizure of the pledged asset from the pledgor or the person in possession thereof and its transfer to his possession. Along with the petition, a certified excerpt from the Pledge Registry and the pledge agreement shall be enclosed. The excerpt from the Pledge Registry is equal to an executive document.¹²¹ The court is obliged to issue a decision with respect to the petition within three days from the date of filing the petition.

Administrator¹²² nominated by court shall be in charge of the object of the pledge until the moment of settlement of the current claim. In case the object of the pledge is a machine, the possession over these types of collateral can be established by taking away one of its key parts.¹²³

¹¹⁸ Suggestion made by Erste bank, available at

<http://www.ria.merr.gov.rs/uploads/media/3.%20Namirenje%20iz%20zaloge%20na%20pokretnim%20stvarima%20i%20pravima.pdf> (visited on March,12,2010)

¹¹⁹ See Art.37 Law on Pledge on Movable Assets

¹²⁰ "from among all the constituent elements of self-help undoubtedly repossession is the one the least acceptable to civil laws" See Tajti 187

¹²¹ See Art.41 Law on Pledge on Movable Assets

¹²² Similar institute exist in English law-receiver. However, Serbian administrator does not have such a wide powers, for example right of taking over the management of the company since it does not recognize a charge over enterprise as a "going concern". Yet, this right can be contracted for even in Serbia.

¹²³ UCC also provides for "repossession" of collateral by leaving it in debtor's possession by rendering equipment unusable or disposing of collateral at debtor's premises. This must be done in a "commercially reasonable manner" See Tajti at 189

The debtor can file a complaint against the order for seizure of the object of pledge within three days from the date of receiving the order. However, this complaint shall not delay execution.

3.2.5.2. Creditor's rights - Disposition and strict foreclosure

Creditor can dispose of collateral according to provisions of Law on Pledge of Movable Assets in the Pledge Registry by means of judicial and extra-judicial sale.

Judicial sale is based on a court's decision. Even though inclusion of courts assures better protection of debtor's rights, involvement of state institutions makes the enforcement proceedings more lengthy and costly. For that reason, the Law on Pledge of Movable Assets in the Pledge Registry¹²⁴, introduced opportunity of an extra-judicial sale of the object of the pledge upon expiry of 30 days from the registration of initiation of enforcement proceedings in the Registry. Parties can agree on shorter term than this.

If the pledgor has a capacity of a commercial entity¹²⁵, the pledge agreement may stipulate that the pledge is entitled to sell the object of a pledge at an extra-judicial sale if his claim is not settled upon default. If the object of pledge has a market or stock exchange price, the pledge agreement may stipulate that the pledgee is entitled to sell it at that price or to retain it at that price. However, if the object of pledge does not have a market or exchange price, the pledge may sell it as a reasonable and prudent person would, with due consideration to the interests of the debtor and pledgor, when these are different persons.

It appears that "a reasonable and prudent person" manner of sale is not adequately chosen. By lowering a standard of care to "a reasonable and prudent person", conduct of professionals such as banks is judged according to a standard lower than usually applicable when regulating their affairs. Similarly, the provision of due consideration to the interests of

¹²⁴ See art.44 Law on Pledge on Movable Assets

¹²⁵ An enterprise, company owner of a small business and other natural person engaged in a commercial activity as an occupation shall have the capacity of a commercial entity. See art. 27 Law on Pledge of Movable Assets in the Pledge Registry

the debtor and pledgor might be criticized for being contradictory since it is clearly opposite to the nature of pledge¹²⁶.

Opposed to this, in case the pledgor is a natural person entering into the pledge agreement outside the course of business, extra-judicial sale by public auction may be agreed upon after his default. Also, only upon default may the parties' contract for transferring the object of pledge to the creditor or his retaining or selling the collateral at a predetermined price.

Strict foreclosure, even though comparatively seen as the most efficient way of debt satisfaction, is adopted by Serbian legislator only for commercial entities, while natural persons are allowed to contract for it only upon default. The Law starts from the assumption that commercial entities are capable of assessing consequences and risks of their own transactions. Opposite to that, natural persons are only capable for contracting for this right upon default because it is supposed that by that time they are better aware of their debt payment capacities. Legislator feels the need to shield them from the lack of experience and mindless entering into these kinds of unfavorable contractual provisions. From the comparative perspective it appears that Serbian legislator overprotects the debtor. This solution can be justified in the light of previous state of Serbian "secured transactions" regulation which was mostly debtor oriented.

3.2.5.3. Debtor's rights

Protecting rights of debtor is important in order to achieve balance between parties in contest of enforcement proceedings.

First of all his rights are protected by the possibility to settle the amount of debt and redeem collateral prior to selling the object of pledge. This right is also available to the pledgor. Debtor /pledgor has also a right to bring up an action in court along with the

¹²⁶ UCC also provides for selling collateral in a commercially "reasonable manner", See Tajti at 192

evidence that the pledgee's claim or right of pledge is non-existent, that the debt is mature or has been settled¹²⁷. This action can be filed within 30 days from the date of registration of initiation of enforcement proceedings in the Pledge Registry, but it does not delay execution.

The law also protects debtor through the general rule of right of compensation for damage caused by the sale of the pledged object. Pledgee and the person entrusted with the sale are jointly liable to the debtor/pledgor.

3.3. Assignment of receivables ¹²⁸

Pledge over rights and claims over debtor are another security option recognized by the Law on Pledge of Movable Assets in the Pledge Registry. It is effected by means of assignment of rights and claims to the creditor. Security right over receivables is filed in the Pledge Registry. At the moment, the pledge over receivables is regulated by Law on Obligations¹²⁹ but provisions on this type of security are also set by the Draft Code on Ownership and Other Property Rights. In each case, acquiring this security right requires notification of the account debtor in writing.¹³⁰ Assignor should transfer to assignee a document including right that is being assigned. As long as the debtor is not notified of assignation of right to the new creditor, he is entitled to settle his debt by making payments to the assignor. Until default, payment is received by assignor and upon that by assignee.

This type of regulation is often for civil law systems. Even though Serbian law does not relinquish creditor from the obligation of notification of the account debtor in the way it is done in the UCC Art. 9 based on *Benedict v. Ratner* rule, at least an effective means of providing public notice of the pledged collateral is introduced by requirement of filing the

¹²⁸ Assignment is the only way in which the security interest over claims can be taken in Serbian Law. Opposed to that, US law regard both sale and security assignment of receivables as a means of receivables financing and subject it to the same filing requirements.

¹²⁹ See Art. 49 Law on Obligations

¹³⁰ See Art. 989 Law on Obligations

pledge in question in the Pledge Registry, along with other security interest in tangible collateral.

However, the Draft Code on Ownership and Other Property Rights adds the provision that attempts to do away with the debtor notification requirement at least in case of the pledge agreement concluded in the ordinary course of business by stating that the right of pledge is acquired upon conclusion of the pledge agreement, unless otherwise agreed.¹³¹

3.4. Investment Property

According to UCC Art 9., investment property comprises security, certificated and uncertificated, security entitlements, securities accounts, commodity contracts and commodity accounts¹³². This type of security is peculiar because it requires specific market financial structure in order to be utilized. The market has to include sophisticated network of intermediaries and a market base for trading these types of securities. Precisely for that reason, trading with these types of securities is more accustomed in the market-based economies, such as US.

However, steps are being made in order to make a perfect base for utilizing this type of collateral in Serbian economy. In achieving this task, banks willingness and potential to develop investment banking is considered as crucial.

When naming securities that can serve as collateral banks usually enumerate shares of stock corporation or shares which are traded at the stock exchange. These are seen as a very liquid type of collateral. Pledge on state bonds is also acceptable

¹³¹ See Art.532 (3) of Draft Code on Ownership and Other Property Rights

¹³² See s. 9-102(a) (14)&(15). Certificated security exists when a right in certain number of shares is represented by a certificate and registered in the books maintained by the company. If the certificates are not issued by a company but investors claims are registered directly in its stockholders books, the investor has a right of uncertificated security. If securities of the investor are not represented by a document and not registered on the company's books, but held through a chain of intermediaries, the interest in securities is named "securities entitlement".

Right of pledge over securities is regulated by the Law on Obligations¹³³. According to its provisions, right of pledge over certificated securities is acquired by means of transfer¹³⁴. Transfer for securities on demand is effectuated by means of endorsement in which it is stated that the certificate is given as an object of a pledge. The assignee is obliged to take necessary precautions to preserve the security interest in this type of collateral.

Law on Obligations includes special provisions on credit agreement having securities as collateral. This agreement has to be in writing. It also has to describe the pledged securities, state the name and the seat of the company whose securities are pledged or in case of natural person his residence, amount and conditions of the approved credit arrangement as well as amount and value of the pledged securities.

Law on Pledge on Movables specifically excludes this type of pledge from its scope. Therefore, rights over this special type of securities are filed in the Central Registry of Securities based on authorization of the rightful owner.

By registering rights to securities the balance of such securities is blocked in the pledge account and they may be transferred only in accordance with legal regulations until expiry of the obligation according to the principal contract. Trading with securities while they are object of the pledge is not possible.¹³⁵ If the debtor does not return the debt upon default, bank may sell the pledged collateral.

¹³³ See Art. 990 Law on Obligations

¹³⁴ Opposed to that the main method of perfection adopted by UCC Art. 9 are by control. In case of certificated securities control is obtained through delivery of the security certificate, whereas in case of securities held through intermediaries, control is acquired once the securities are transferred into creditor's account or when intermediary agrees to act on secured creditor's instructions in relation to the certificates in question.

¹³⁵ Therefore, it is not possible to conclude a credit contract with a bank by pledging right in a share portfolio which would enable a bank to, in his name, authorize broker to effectuate transfer from proprietary account to the pledge account while retaining discretionary right of registering a pledge.

Opinion available at http://www.sec.gov.rs/index.php?option=com_content&task=view&id=898&Itemid=71 (visited March,12,2010)

4. Other Credit Enhancement Methods

Instruments that might fall within this group are used along with other security devices in order to give more strength to creditor's rights. In Serbian banking practice they are used only occasionally.

4.1. Negative pledge covenants

Negative pledge covenants represent contractual provisions whose aim is seen in restricting debtor from granting security interest in favour of other creditors because in that way he might endanger rights of the lender. An example of these covenants can be seen in obligation of a debtor to maintain the status of assets on stocks in case the credit is issued on the security of stock list. Debtor's obligation is checked by periodical reports made to the creditor. Since, in case this contractual provision is breached the debtor has only rights to damages, creditor will prefer to register a ban on right of disposition of collateral in the Pledge Register because in this way he can give his claim *erga omnes* validity.

4.2. Subordination

Even though a right of subordination is not mentioned by statutes, it is possible to draft such a clause that would make bank's right junior to other creditors by means of contractual freedom. For example, even though Bankruptcy Act is explicit in stating that obtaining credit is only possible on account of unencumbered assets, it is clear that bankruptcy administrator is able to constitute mortgage or pledge on otherwise encumbered assets but only if creditor consents to junior ranking of his security right.¹³⁶

¹³⁶ This possibility is explicitly provided for in the US Bankruptcy Code §364(c) (3).

4.3. Right of set-off

According to the Law on Payment Operations¹³⁷ possibility of mutual claim satisfaction by set-off is restricted to commercial entities and monetary obligations. Right of set-off can be effected notwithstanding the fact that account of a debtor is blocked (as opposed to right of assignation). Right of set-off eliminates accessory rights (*e.g.* suretyship), except for accrued interest rate. Bank's right to set-off towards the debtor acquires priority rank only if confirmed in the course of court's proceedings

5. Importance of the other areas of law

In order to adequately regulate interests of secured creditors, legislator has to pay special attention to the interests of secured creditors in bankruptcy as well as the consumer protection. Therefore, any reform in the field of secured transactions has to take reasonable account of the state of surrounding areas.¹³⁸ Since confines of this work does not allow for extensive elaboration on these issues, progressive changes in these fields will be only taken note of.

5.1. Importance of bankruptcy proceedings

Efficient bankruptcy proceedings are essential part of market economy. It enables payment to the creditors, rehabilitation of the company and prompt inclusion of the blocked assets into the market. Bankruptcy proceedings are deemed to be prompt by default. The reason behind this is the fact that assets in company's possession lose their value by each day. Efficient realization proceedings on collateral are also vital since their value is used to pay out employees as well as creditors. Carefully regulated bankruptcy proceedings are beneficial for everyone- creditors, employees and economy as a whole.

¹³⁷ Published in "Official Gazette SRJ" No. 3/2002

¹³⁸ See Tajti at 200

However, in Serbia, bankruptcy proceedings are still seen as a final resort, which is quite different from the American approach which regards the bankruptcy as a desirable social policy. This kind of approach, which is still rooted in practice of Serbian economic mentality, is a product of a socialist heritage which did not recognize failure of the state owned enterprises. The repercussions of this system are visible in the manner in which losses are socialized and covered by the whole society through subsidies and other forms of budgetary financing. The other misconception is related to a formed opinion that bankruptcy proceedings are initiated in order to protect insolvent debtors through the court. In developed market economies the purpose of bankruptcy proceedings is seen as completely opposite; as a means to protect creditors from running the debtor's enterprise at their own expense.

All being said, for a country that is trying to introduce a complete and coherent scheme of secured transactions it is crucial to think about interest of secured creditors in bankruptcy setting because strength of their rights is best shown there. This is especially true in case of *in rem* securities which are designed to survive bankruptcy. Banks which created security interest in debtor's assets prior to bankruptcy continue to have position of secured creditors and their rights will be discussed in that context below.

According to Serbian Bankruptcy Act¹³⁹ there are two types of insolvency proceedings: **bankruptcy** and **reorganization**.

Bankruptcy proceedings in any case do not infringe rights of secured creditors (whose claims are filed in the registers and in force at the time of opening the bankruptcy proceedings). Secured creditor has a right of satisfaction only in course of sale of assets that are object of their rights. Secured creditor has to file his request for satisfaction with all the other creditors. His request has to include description of collateral as well as the amount of debt due along with the calculated interest. In case the price obtained at the sale does not

¹³⁹ Published in "Official Gazette" No. 104/09

satisfy his claim in total, creditor is entitled to a deficiency judgment. Secured creditor also has a right to renounce his status and participate in bankruptcy proceedings as unsecured creditors.

According to Act, bankruptcy estate can be sold at a public auction, by public collection of offers or through a direct sale.¹⁴⁰ Secured creditors do not participate with others in the division of proceeds from the sale. Their claims are satisfied from the proceeds of sale immediately after expenses. If there are any proceeds left after the claims of secured creditors are satisfied, they are added to a bankruptcy estate and divided among other creditors in accordance with the rank given to them by the Act.¹⁴¹

5.1.1. Reorganization and rights of secured creditor

Concept of reorganization embodies the idea of giving debtor the opportunity to consolidate his affairs and continue with his business. This approach actually enables better exploitation of assets of the bankrupt. Bankruptcy estate is certainly worth more as a whole than when sold separated. Furthermore, know-how and good will of the bankrupt, which often worth more than the assets themselves, are in this way better preserved.

However, interests of non-secured and secured creditors are quite adversary in the bankruptcy setting. While non-secured creditors are pro reorganization oriented because it gives them the opportunity to be paid out in higher percentage, secured creditors are more willing to sell debtor's assets and satisfy their claims from their purchase price. Thus, for

¹⁴⁰ The direct sale can be conducted only with prior approval of the creditor's committee. See art.132 Bankruptcy Act

¹⁴¹ According to Bankruptcy Act, claims in the bankruptcy proceedings are satisfied in the following order¹⁴¹:

1. Costs of bankruptcy proceedings
2. Unpaid net salaries of employees of the bankruptcy debtor in the amount of yearly minimum wage for the year before starting the bankruptcy proceedings, as well as unpaid contributions for pension and disability insurance for two years before starting the bankruptcy proceedings;
3. All public income claims which became due in the last three months before starting the bankruptcy proceedings, except contributions for pension and disability insurance of the employees;
4. Claims of other bankruptcy creditors

secured creditors to accept reorganization, reorganization plan has to adequately address their interests.

Creditors that have at least 30% of secured claims can suggest reorganization plan¹⁴². According to newly enacted Bankruptcy Act, bankrupt himself can submit proposal of his reorganization plan to the creditors.¹⁴³ Status of secured creditors is regulated according to the plan and is being discussed between debtor and creditor. If debtor uses pledged collateral during the reorganization, creditor is entitled to adequate reimbursement.

5.1.2. Voidable preferences

Rights of secured creditor obtained 60 days prior to initiating of bankruptcy proceedings are deemed to be voidable preferences¹⁴⁴. Based on order of bankruptcy judge, registers containing evidence of these rights will erase such preferences.

5.2. Consumer protection

When proceeding with the reform of secured transactions law, legislator has to address protection of consumers. Since banks base a gross proportion of their business on granting consumer credits, it is fair that rights of consumers as weaker parties are adequately addressed by existing laws. Serbia, being in the process of accession to European Union, is obliged to accept and apply certain standards into its legal framework. Draft Law on Consumer Protection¹⁴⁵ is one of the vehicles for achieving this goal.

When preparing this Law, 15 key EU Directives were transposed to it¹⁴⁶. However, due regard was given to consistency of the new act with the Law on Obligations, which

¹⁴² See Art.161 Bankruptcy Act

¹⁴³ See Art. 158 Bankruptcy Act

¹⁴⁴ Transfer of property by insolvent to secure antecedent debts.

¹⁴⁵ The draft law can be viewed at the website of Ministry of Trade and Services *available at* (www.mtu.gov.rs)

¹⁴⁶ Including Distance Selling Directive 97/7/EC, Electronic Commerce Directive 2000/31/ EC, Consumer Credit Directive 2008/48/EC, etc

contains general rules for regulating the field. Also, when deciding to include consumer related issues in the separate act, French and Italian models are used as a guideline.

Draft provisions on consumer credit are focused on obligation on informing the client prior to entering the credit contract, content of the credit contract and default of the client. If a credit agreement does not contain all the provisions required by Law, client can request annulment of a contract within one year from conclusion. In case he does not choose to do so, client may ask for application of interest rate provided for by statute or National bank of Serbia. Client loses these rights in case he starts using amount of credit given by bank.¹⁴⁷ In case bank refuses to grant credit to a client, it is required to inform client on reasons causing such a refusal within two weeks.¹⁴⁸

Draft also includes possibility of extrajudicial proceedings for settling consumer-related cases, as well as the possibility of collective charges against the trader, which will increase efficiency of otherwise overburdened system.

¹⁴⁷ See art.139 Draft Law on Consumer Protection

¹⁴⁸ See art .135 (5) Draft Law on Consumer Protection

Chapter IV: CONCLUSION

With the enactment of new regulation on security devices, Serbia certainly made huge progressive steps towards creation of truly modern secured transactions law. Intention of legislator was to establish a broad range of security devices on which credit may be given. When introducing novel solutions into the field, Serbian legislator looked up at some of the most developed markets. However, as mentioned in introduction, transplanting legal institutes into the field will not produce desirable results, unless policy choices and overwhelming institutional structure of the system is not looked upon.

Since Serbian banks still feel most comfortable when granting credit on a security of a mortgage, it was essential to bring novelties into this field that would correspond to the needs of increasing credit demand. Advantages caused by the Mortgage Act are numerous. One of them, introduced as a reflection of the situation in the field, is possibility of pledging an immovable under construction which greatly improved credit capacity of citizens. This solution enables those who at the moment when the credit is asked for do not own immovable available for mortgage to obtain a credit secured by the object being built by the means of credit. Introduction of the Centralized evidence provides available and precise information on all the mortgages which additionally improves legal security and reliance of the investors. However, the biggest change in the field is brought by introduction of extra-judicial manner of enforcement of mortgage, which is inconsistent with a traditionally rooted principle of officiality (*i.e.* enforcement of claims *via* court proceedings). Even though this solution was inspired by the US one, there is a feeling that Serbian law made a sharp turn towards a very

creditor-friendly oriented piece of legislation after decades of placing debtor protection in the focus.¹⁴⁹

Even though changes made into the field of mortgages are certainly beneficial for boosting the overall economic activity of the country, accessoriness of the mortgage does not make it a very flexible institute capable of answering challenges Serbian market will face in the future, especially after accession to European Union. Deficiencies of mortgage as a security device are already recognized in other jurisdictions. Development of financial markets, as well as the primary and secondary mortgage market is conditioned upon adoption of non-accessory security devices, such as land charge or fiduciary transfers of property whose value can be contained in securities that can be transferred independently. In legal systems that recognize non-accessory security devices, they have taken priority over accessory ones, because they allow for use of greater number of financial techniques, especially possibility of refinancing a debt and securitization.¹⁵⁰

One of the aims of EU is creating a competitive system of international crediting and consolidating the costs of a credit. An obstacle to these attempts is the fact that most of the European countries recognize only accessory security devices on movables. This situation does not allow banks to enlarge offer based on non-accessory security devices. Therefore, until introducing eurohypothec¹⁵¹, introduction of non-security devices into national legislations would prove as beneficial.

Advantages of introducing alternate ways of pledging immovables are already recognized by Serbian legislator. Draft Code on Property and other Real Rights contains provision on real charge and fiduciary transfer of ownership inspired by German solutions.

¹⁴⁹ See Zivkovic at 19

¹⁵⁰ In Germany "*Grundschuld*" is used in 90% of the cases.

¹⁵¹ Guidelines are already set in the "Basic guidelines for a Eurohypothec" available at http://www.ehipoteka.pl/corporate_site/content/download/646/2521/file/zeszyt_21.pdf (last visited March, 25, 2010)

Even though in Germany these security rights are not registered, Serbian legislator introduced filing for these security rights as well, since filing is adopted as a way of coping with the problem of false wealth. Although In Germany these institutes were developed through practice and they is not statutorily regulated, Serbian legislator decided to introduce them through a code. This solution will certainly provide more certainty to future investors. In the end, German institutes, known for their peculiarities, proved as beneficial only in their own legal surrounding and will not “feel at home” anywhere else.

Wider use of immovable as collateral, even though beneficial, cannot respond to the needs of modern financing since it is based on the strength of utilizing movables as security. Since differences between collateral laws in European countries are great and there is little chance of unification¹⁵², the work on harmonization in the field is guided by EBRD Model Law, which made an impact over Serbian collateral law as well. By introducing Law on Pledge of Movable Assets in the Pledge Registry a wide array of opportunities is given for banks. Introduction of centralized register is proved to be especially beneficial in the process of examining credit standing of a debtor. Still, Law excludes pledge over securities and retains notification of the account debtor in case of assignment of receivables, which in combination with the restricted concept of proceeds limits possibilities for granting credit to businesses.

A brief overview of banks General Terms and Conditions show that credits for citizenry and businesses are granted on almost the same terms. In both cases, most often banks secure themselves on the basis of mortgage, promissory notes and suretyships. Thus, possibilities for a long term financing of businesses are very scarce. Serbian law stayed true to the principle of specialty of pledge and did not include anything that would resemble English floating charge. Event though drafting clauses that would create security rights over as many

¹⁵² Prof .Drobnig in UNCITRAL Report of the Secretary- General: Study on security interest (A/CN.9/131)1977

securities as possible is enabled by the principle of contractual freedom, it seems that banks are more likely to take security over existing collateral and disregard future income of an enterprise as a possible security. Until introducing security that would enable for larger opportunities of financing businesses in this manner, perhaps quasi securities, especially covenants, can be used to bridge the gap.

However, the prospects for further changes in the future look bright. Introduction of Credit Bureau that contains data on clients indebtedness provide for certain way of obtaining information of client's credit standing. Credit standing of the client should be the most influential condition when granting credit because banks expect that installments are regularly paid out when due. That is only guaranteed by sufficient and stable amount of income. Having credit secured only on the basis of the client's standing is approach already being adopted for retail crediting. Banks should bear in mind that, no matter how strong, collateral should serve only as a backup option.

Prospective legislative changes are meant to cover all the related fields of secured transactions law. Along with Bankruptcy Law and Law on Consumer Protection, acts regulating securitization, new laws on enforcement proceedings, etc. which aims to completely and coherently regulate the field. However, they will not make improvements in the field if their possibilities are not popularized among the major players and if they are not consistent with the policy choices behind. If not adequately understood at all stages of implementation including courts, changes will remain dead letter on the paper. Hopefully, pressure of competition with foreign markets along with increased number of players on the financial market will make use of already existent possibilities for securing credits as well as introduce new ones. Still, an emphasis should be made on adequate protection of rights granted to creditors as well as to financial discipline of debtors.

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