

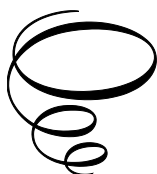
The Compliance of Foreign-Owned Banks with the European Union's Rule of Law in the Western Balkans

The Compliance of Foreign-Owned Banks with the European Union's Rule of Law in the Western Balkans

By

Vesna Lukovic

**Cambridge
Scholars
Publishing**



The Compliance of Foreign-Owned Banks with the European Union's
Rule of Law in the Western Balkans

By Vesna Lukovic

This book first published 2023

Cambridge Scholars Publishing

Lady Stephenson Library, Newcastle upon Tyne, NE6 2PA, UK

British Library Cataloguing in Publication Data

A catalogue record for this book is available from the British Library

Copyright © 2023 by Vesna Lukovic

All rights for this book reserved. No part of this book may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior permission of the copyright owner.

ISBN (10): 1-5275-9473-4

ISBN (13): 978-1-5275-9473-9

CONTENTS

Foreword	vii
Chapter 1	1
Introduction	
1.1 The Problem.....	3
1.2 Methodology and Research Questions.....	5
Chapter 2	7
Bank's Procedure to Approve a Loan	
Chapter 3	10
Background of the Problem	
Chapter 4	18
Legislation and Case Law by Countries	
4.1. Serbia.....	18
4.1.1. Legal Framework	20
4.1.2. Case Law and SCC Court.....	27
4.1.3. EU Legislation and EU Case Law Cited by Authorities in Serbia.....	38
4.2. Bosnia and Herzegovina	46
4.2.1. Legal Framework	48
4.2.2 Case Law.....	53
4.3. Montenegro.....	57
4.3.1. Legal Framework	58
4.3.2 Case Law.....	59
Chapter 5	62
Role of Consumer and Banking Associations and National Banks	
5.1. Associations, Attorneys and Others for the Protection of Consumers	62
5.2. Banking Associations.....	66
5.3. National Banks.....	70

Chapter 6	72
Legal Certainty	
6.1. Serbia	74
6.2. Bosnia and Herzegovina	80
6.3. Montenegro	83
Chapter 7	85
A View from Consumer	
7.1. Examples.....	85
7.2. Are Consumers Provided with all Information?.....	87
7.3 . What Can Consumers Infer About all This?	89
Chapter 8	92
Legality, Transparency and Fairness	
8.1. Questions About Behaviour of Banks.....	92
8.2. Questions About Courts, Fairness and Transparency	96
Chapter 9	102
Conclusion	

FOREWORD

This book addresses questions about the application of the rule of law and the protection of consumers of financial services in a local Western Balkan context. How do national laws include the European Union's fundamental values of consumer protection, and more importantly, how are these laws actually applied in the Western Balkans? An important point is that the majority of banks in the Western Balkans are foreign-owned and originating in the European Union. Permissibility and legality of certain charges and other elements of banking practices have been called into question by more than a hundred thousand lawsuits in Serbia, Montenegro and Bosnia and Herzegovina. Application of the law contrary to the purpose of a certain legal norm and any attempt to change the rights of consumers of financial services is not only a violation of the rule of law, but it impacts on the legal security as well. This book provides a deeper insight into the "power" of banks in the Western Balkans by taking economic and social context into account. It is an important contribution to the ongoing debates on these questions.

CHAPTER 1

INTRODUCTION

In the aftermath of the 2008 financial crisis, the financial industry in Europe struggled with low or even negative interest rates enforced by central banks to fight the crisis.¹ In line with theories on banking² there are challenges for banks to generate revenues if the credit environment is sluggish, and if there is over-banking or if their business models are not optimal.³ More than a decade after the crisis in the period of ultra-low interest rates, banks were trying to make their income more independent from interest rates, trying to strengthen their fee income.⁴ As a consequence, questions of lawfulness of various fees in loan contracts, charged in addition to interest rates, have produced a growing number of disputes in Europe⁵ and in the Western Balkans as well.

¹ European Central Bank. 2011. Central banking after the financial crisis. <https://www.ecb.europa.eu/press/key/date/2011/html/sp110221.en.html> [Accessed 15 March 2022].

² Dewatripont et al. 2010. *Balancing the Banks: Global lessons from the financial crisis*. Princeton: Princeton University Press.

³ Krash S. and Villamil A.P. 1992. *A Theory of Optimal Bank Size*. Oxford Economic Papers . Vol. 44(4):725-749. Oxford University Press.

⁴ Haubrich J.G and Young T. 2019. Trends in the Noninterest Income of Banks. <https://www.clevelandfed.org/publications/economic-commentary/2019/ec-201914-trends-in-the-noninterest-income-of-banks> [Accessed 5 February 2022].

⁵ See judgements of the Court of Justice of the European Union on Consumer Protection-2021. Case law C-609/19 from 10 June 2021.

<https://curia.europa.eu/juris/document/document.jsf?jsessionid=BE9864033F3963E4788798561C26B41E?text=&docid=242571&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=13105272> [Accessed 15 September 2022].

Commercial banks perform many tasks but primarily they are an intermediary.⁶ Banks take deposits from those with money and lend them to those who need money. Depositors and borrowers can be individuals, firms or national and local governments.⁷ Besides pocketing the difference between the interest they pay on deposits and the interest they collect from borrowers, banks also make money from fees for various customer services, including from loan servicing.

Questions of fairness and justification of approval and management fees charged by banks in loan contracts have appeared as an issue in the EU⁸ and in the Western Balkans as well. Still, the number of judgements by the Court of Justice of the European Union (hereinafter: CJEU) following questions for preliminary ruling from national courts on consumer protection and unfair terms in consumer contracts has been small compared to thousands of lawsuits in the Western Balkans. Consumer protection is held high in the CJEU⁹ and even though the final assessment of a particular case law is left to national courts in the EU, banks have to meet the requirements of consumer protection law as claims by consumers may be expected many years after the conclusion of loan agreements.

The administrative and institutional capability to effectively apply the law might be even more important than legal convergence. However, evidence and case law show that implementation of national legislation with respect to consumers of financial services in the Western Balkans has produced multiple legal and other issues. An important part of an explanation why that is so lies in the fact that judicial systems in the Western Balkans have some common weaknesses. According to the Organization for Economic Cooperation and Development (OECD), the highest authorities in the Western Balkans, which should ensure the independence of the judiciary,

⁶ IMF. International Monetary Fund. 2022. Banks. At the heart of the matter. <https://www.imf.org/en/Publications/fandd/issues/Series/Back-to-Basics/Banks>. [Accessed 2 October 2022].

⁷ Ibid

⁸ See for example CJEU case law, case C-621/17 of 3 October 2019.

⁹ See judgement of the CJEU case C-609/19 from 10th June 2021.

are exposed to external pressures.¹⁰ This then affects the way in which judges and prosecutors are recruited, impacting on the quality of judiciary reviews.

1.1 The problem

This study is about an extraordinary case not observed to such an extent anywhere in the world of modern banking. It is about the region that is almost at the centre of the European Union, a region that aims to join the European Union. It is about hundreds of thousands of lawsuits against banks. Banks are more likely to be defendants than plaintiffs in banking litigation in the Western Balkans. Financial systems in the region have been dominated by foreign-owned banks from the European Union in the last two decades. However, loan contracts between banks and their customers have become the source of many lawsuits in most of the states that emerged from the dissolution of the former Yugoslavia.

Candidates or potential candidates of the Western Balkans have signed Stabilization and Association Agreements¹¹ and should have started working towards harmonizing domestic legislation with the EU's *acquis*. That process includes, among other things, providing the highest possible protection of consumers. European Commission's reports on the progress of Western Balkans in the accession process have largely found that the legal framework in the area of consumer credit needed to be further aligned with the EU *acquis*.¹² It has been hoped that the Western Balkans' convergence to the EU's rule of law, however slow, is not just a promise on paper. Still, the convergence of the national law towards the EU *acquis*

¹⁰ OECD. Organization for Economic Cooperation and Development. Multi-dimensional Review of the Western Balkans: Assessing Opportunities and Constraints. 2022. <https://www.oecd-ilibrary.org/cites/cfa8ee8f-en/index.html?itemId=/content/component/cfa8ee8f-en>

¹¹ European Commission. 2022. European Neighbourhood Policy and Enlargement Negotiations. Stabilisation and Association Agreement. https://neighbourhood-enlargement.ec.europa.eu/enlargement-policy/glossary/stabilisation-and-association-agreement_en. [Accessed 21 December 2021].

¹² See for example European Commission. Serbia Report 2022. https://neighbourhood-enlargement.ec.europa.eu/serbia-report-2022_en [Accessed 28 December 2021].

might not be enough to evaluate a country as a market economy being able to withstand competitive pressures of the EU's internal market.

The focus of this research is on the individual users of banks' services in selected countries of the Western Balkans. The study is not focused on a detailed analysis of all laws and regulations in the Western Balkans with respect to legal convergence to the EU *acquis*. There are annual reports from the European Commission that evaluate legal convergence in the Western Balkans. This study is also not about financial stability, supervision or oversight of banks in the Western Balkans and does not focus on whether the banking sector is well capitalized and liquid or not. Further, the focus of this research is also not about exploring the reasons why the diversification of the financial sector remains low and why foreign, mainly EU banks, continue to dominate Western Balkans' financial sectors. Reports and assessments from many authorities have focused on banks with respect to access to finance,¹³ financial stability,¹⁴ strengthening financial supervision,¹⁵ social infrastructure in the Western Balkans,¹⁶ alignment of national legislation with the EU's *acquis*¹⁷ and other relevant viewpoints.¹⁸

¹³ European Central Bank. 2017. Occasional Paper Series. Access to finance in the Western Balkans. <https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op197.en.pdf>. [Accessed 18 October 2022].

¹⁴ European Central Bank. Occasional Paper Series. Financial stability assessment for EU candidate countries and potential candidates. 2016. <https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op233~ae2d552448.en.pdf>. [Accessed 12 September 2022].

¹⁵ European Central Bank. 2009. Strengthening macro and micro-prudential supervision in EU candidates and potential candidates. <https://www.ecb.europa.eu/pub/pdf/other/strengtheningsupervision201003en.pdf>. [Accessed 5 October 2022].

¹⁶ Council of Europe Development Bank. 2021. Social Infrastructure in the Western Balkans. Increasing the region's economic resilience, enhancing human capital and counteracting the effects of brain drain. https://coebank.org/media/documents/Social_Infrastructure_in_the_Western_Balkans.pdf [Accessed 21 September 2022].

¹⁷ European Union. External Action. EEAS. The EU and the Western Balkans: towards a common future. 2022. https://www.eeas.europa.eu/eeas/eu-and-western-balkans-towards-common-future_en. [Accessed 28 August 2022].

¹⁸ IMF. International Monetary Fund. 2017. JVI. 3. Banking Challenges in the Western Balkans: Prospects and Challenges.

However, so far none of these reports and papers have focused on the actual application of the rule of law in regard to consumers of financial services in the Western Balkans. This study aims to contribute some answers in this respect. The chosen countries for this research were Montenegro, Serbia, and Bosnia and Herzegovina, all three with similar issues, similar national legislation and similar history with respect to consumer protection and loan contracts. The study devotes a significantly larger amount of space to Serbia, not because it has the largest number of inhabitants and the largest number of banks' customers, but because the problem there has been the most severe and controversial.

1.2 Methodology and Research Questions

The methodology is based on the collected qualitative and quantitative data that included national central banks, national banking associations, statistical offices, national consumer associations and other public and private resources.

The analysis of this study has been based on the following:

- i.) analysis of relevant legislation at the Western Balkans and EU level,
- ii.) review and analysis of case law at the Western Balkans and EU level,
- iii.) review of existing institutional reports, academic studies and other sources,
- iv.) in-depth case studies of three countries (Serbia, Bosnia and Herzegovina and Montenegro),
- v.) review of banks' financial reports with respect to income from fees,
- vi.) review of social and economic context of the problem.

The key questions in this research are:

- i.) did banks have the right to charge processing and approval fees in addition to interest rate in loan contracts?
- ii.) if yes, how were they allowed to charge those fees, according to the national legislation?
- iii.) how transparent, fair and ethical was that from a consumer point of view?
- iv.) how does that affect the well-being of a consumer?
- v.) what can be inferred about legal certainty?

The focus is on banks's transparency, procedures, legality of those charges and the ethical/moral ambiguity of the whole process from a consumer point of view. The problem of approval and management fees in loan contracts was just one of the allegations against banks, as they have been also taken to court for a number of other, largely fairness and transparency-related issues (e.g., repayment installments based on a bank's calculation of variable interest rate and similar), which are not the focus of this research.

The answers to key questions in this study evolve around certain clauses of loan contracts and banks' practices that might be more opaque in the Western Balkans compared to practices in their EU home countries which are allegedly regulatory, supervisory and otherwise strict in regard to the protection of consumers of financial services.

CHAPTER 2

BANK'S PROCEDURE TO APPROVE A LOAN

In order to better explain the problem about approval and similar charges in loan contracts, it is necessary to look at the whole process of approving a loan by a bank. The process typically starts with a customer's visit to the bank and meeting a personal banker. The COVID-19 pandemic has – due to physical restrictions – pushed the world to move online and, as a consequence, banks started providing online applications for credit and other services¹⁹ which has led some banks to arrange the possibility of applying and approving a loan credit online (e.g., Procredit Bank, Serbia)²⁰ and getting a loan extremely fast.²¹ Still, a loan discussion and signing a loan contract is mostly done in person, especially in those countries where people are not digitally savvy and prefer to clarify potential questions with banks' employees in person.

The process of approving a loan is standardized as typically, regardless of the type of a loan, it involves the following steps:

- i.) loan application,
- ii.) discussion with the bank about the conditions of a loan,
- iii.) providing necessary documentation to the bank,

¹⁹ European Parliament. 2021. Did the pandemic lead to structural changes in the banking sector?

[https://www.europarl.europa.eu/RegData/etudes/IDAN/2021/689460/IPOL_IDA\(2021\)689460_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/IDAN/2021/689460/IPOL_IDA(2021)689460_EN.pdf). [Accessed 22 August 2022].

²⁰ Procredit Bank. 2022. Investment loans for private individuals. Online loans up to 600.000 RSD, without having to visit the bank.

<https://www.procreditbank.rs/en/private-individuals/loans/investment-loans-private-individuals>. [Accessed 25 November 2022].

²¹ NLB Banka. Montenegro. 2022. NLB Super brzi kredit. Do Novca za samo 1 sat, online, putem racunara, mobilnog telefona i Viber-a.

<https://www.nlb.me/me/stanovnistvo/proizvodi/nlb-super-brzi-kredit>. [Accessed 26 November 2022].

- iv.) verification by the bank,
- iv.) signing necessary documents and
- v.) loan disbursement.

Providing credit to customers is one of the key functions of commercial banks in the modern world²² as this function is embedded in banks' basic mission. Banks employ staff to work in credit and related departments whose main tasks are about checking, verifying and approving all types of loans.

The first step for a bank after it receives a loan application from a customer is to inquire about customer's needs and find out if a customer fulfills the basic conditions to get a loan in line with the criteria set by the bank. A bank has to check if an applicant is eligible to get a loan or not by analyzing data such as age of a customer, their employment status, their "quality" of employment etc. Regardless of whether loan applications are done online or in person, customers have to provide some data so that a bank receives sufficient information to evaluate credit worthiness and get an idea about the probability of having the loan repaid. In doing that, a bank must take into account its own rules and all national regulations in that respect.

After an informative discussion between a customer and a personal banker at the bank, the next step for a bank is to find out about the purpose of the loan, its amount and the repayment timeframe. Then a bank may provide a customer with an offer that must include key information about the interest rate and monthly repayment obligations. If this offer of informative nature is acceptable for the customer, they must gather the documentation depending on the type and purpose of a loan. For instance, an application for a short-term cash credit compared to a long-term mortgage credit requires different additional documentation that the customer must provide to the bank.

²² IMF. International Monetary Fund. 2022. Banks. At the heart of the matter. <https://www.imf.org/en/Publications/fandd/issues/Series/Back-to-Basics/Banks>. [Accessed 2 October 2022].

The next step for the bank is the analysis of credit worthiness. A personal banker applies all necessary information as an input in a bank's computer software/program to calculate the credit worthiness of a customer. The final assessment lies with a responsible credit analyst who makes an evaluation about the riskiness of approving the loan application and whether to approve, conditionally approve or reject the application.

Banks' profitability of lending to individuals might be higher relative to lending to businesses while the dynamics of interest income vs income from fees and commissions may vary across the countries of Western Balkans.²³ Banks generate income from interest rates they charge for lending money to individuals, companies and others. The other type of income is operational income that covers fees and commissions banks charge for providing loans and other services to banks' customers. These fees are classified under "operational" income of banks²⁴ in banks' financial statements.

²³ As per annual reports on the banking sectors' success statements (e.g., Banking Agency for BiH).

²⁴ Banking Agency for BiH. 2022. Information on the banking system entities of the Federation of Bosnia and Herzegovina as of 30 June 2022. <https://www.fba.ba/eng/information-on-the-banking-system-entities-of-the-federation-of-bosnia-and-herzegovina-as-of-30062022-2> [Accessed 6 November 2022].

CHAPTER 3

BACKGROUND OF THE PROBLEM

As early as in 1968, certain authors established²⁵ that lenders had tried to justify their finance charges but only produced a variety and inconsistency in the language used for loan contracts. There is a difference between interest and other charges because economic and legal definitions of interest are narrower than what is included in “finance charge”. However, while lenders may regard finance charges as including various costs and fees (in addition to the “pure” interest charge), the borrower’s standpoint is “that all finance charges are identically part of the effective cost to him of borrowing, and can therefore appropriately be represented by a single interest rate.”²⁶

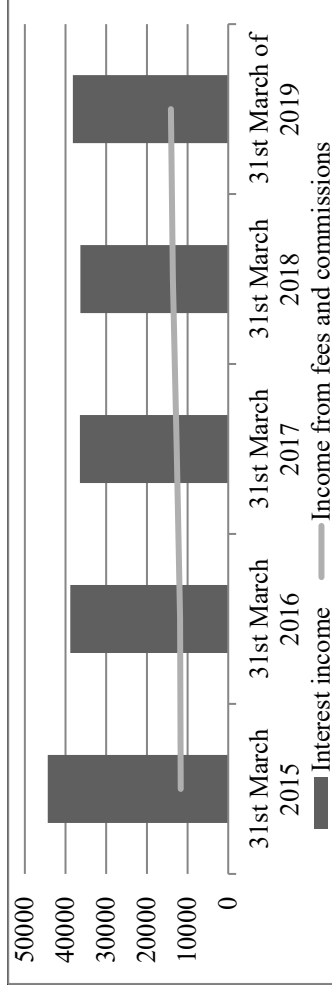
The size and structure of the financial sector varies across the Western Balkan countries, however, in all these countries, as already mentioned, the financial sector is primarily bank-based and foreign-owned.²⁷ The majority of foreign owned banks from the EU as of October 2022 are from Austria, Italy, Hungary and Slovenia. The importance of banking income from fees (such as approval and management/disbursement fees) is not negligible (Fig. 1, Fig. 2 and Fig. 3) as the share of income from fees has consistently increased (Fig. 4) in Western Balkans. Incomes and fees have been labeled slightly differently across countries.

²⁵ Thomas A.L. 1968. Estimating the Effective Interest Rate. *The Accounting Review*. Vol.43(3):589-591. American Accounting Association.
<https://www.jstor.org/stable/244084> [Accessed 8 July 2022].

²⁶ *Ibid*, p. 589.

²⁷ EC-WB. European Commission-World Bank. 2007. Financial sector Restructuring and Regional Integration in the Western Balkans.
<https://documents1.worldbank.org/curated/en/760431468275694776/pdf/42007optmzd0SE1ial0Markets01PUBLIC1.pdf>
[Accessed 15 November 2021].

Fig. 1: Banking sector: Income from interest vs income from fees in Serbia (in million RSD)²⁸



Data source: National Bank of Serbia, 2022²⁹

²⁸ The last available report on the National Bank of Serbia's website as of 30th October 2022 was a quarterly report for 2019.

²⁹ Narodna banka Srbije. 2022. Finansijske institucije. Banke. Izveštaji i analize. <https://nbs.rs/sr/finansijske-institucije/banke/izvestaji-i-analize/> [Accessed 30 November 2022].

In the last twenty years, banks in the Western Balkans have charged their customers with fees for approving, processing and/or managing loans. All three countries have had a similar problem of interpretation about the permissibility of approval and similar fees. The question of permissibility of this practice is first and foremost a legal question, but the consequences of this question have important economic and other implications. In Serbia, this problem has exploded compared to Montenegro or Bosnia and Herzegovina. Litigation proceedings increased considerably between 2018 and 2021, and although it is not officially known how many lawsuits have been filed and what the overall amount to be returned by banks is, there has been at least a hundred thousand lawsuits in Serbia according to the Supreme Court of Cassation (hereinafter: SCC Court) opinion in 2021.³⁰ Others believe that up to two hundred and fifty (250) thousand lawsuits³¹ have been filed, a very high number for such a small country. It is not possible to initiate a consumer collective redress in the courts in Serbia. A collective claim in the courts in Serbia was abolished following the 2013 decision of the Constitutional Court³² leading to collective redress in an administrative procedure³³ making a significant turn away from the practice of European countries.

Lawsuits against banks have exposed a chaotic approach to the application of the rule of law in financial services in some Western Balkan countries, most notably in Serbia. Many contradictory judgements, “supplemented” legal opinions of the same Court, ultimatums from banks, calls by attorneys, banks’ and consumers’ associations have all raised the question

³⁰ SCC Court’s opinion. Supreme Cassation Court. 2021. Pravni stav o dozvoljenosti ugovaranja troskova kredita.

<https://www.vk.sud.rs/sites/default/files/attachments/dopuna%20pravnog%20stava%20o%20dozvoljenosti%20ugovaranja%20troškova%20kredita.pdf> [Accessed 20 August 2022].

³¹ Udruzenje banaka: Pred Vrhovnim sudom nekoliko hiljada postupaka revizije. 10.feb.2022. <https://nova.rs/vesti/biznis/udruzenje-banaka-pred-vrhovnim-sudom-nekoliko-hiljada-postupaka-revizije/> [Accessed 15 October 2022].

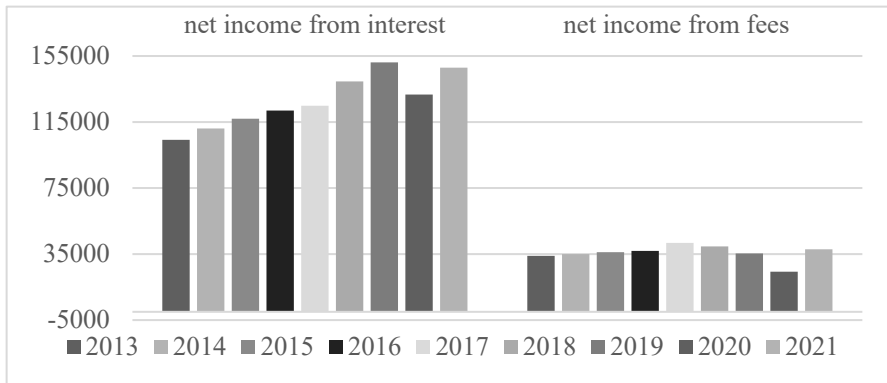
³² Official Gazette of Republic of Serbia no. 72/11, 49/13 – US, 74/13 – US, 55/14, 87/18 and 18/20

³³ Karanikić Mirić, M. 2014.Consumer Collective Redress in Serbian Law.

<https://www.prf.unze.ba/Docs/Anali/AnaliBr14god7/3.pdf>. [Accessed 15 October 2022].

of legal certainty and whether all is well with respect to various fees that have been charged to consumers by their banks. The question is if banks' practices were in line with the national legislation and whether the overall context of their business practices were "serious" about the standards of protection for consumers of financial services.

Fig. 2: Net income from interest vs net income from fees in Montenegro (in 000 euro)

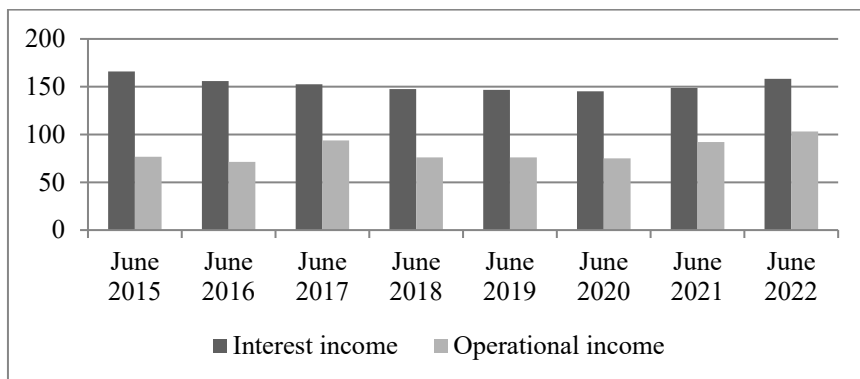


Data source: National Bank of Montenegro, 2022³⁴

One of the most important elements is to understand the effective interest rate by all parties and authorities involved. Since national legislation in all three countries stipulated that all costs related to the loan contract should be included in the effective interest rate, a logical conclusion is that there shouldn't be any additional costs and fees that had to be paid separately and additionally to the borrowing interest rate stated in a loan contract.

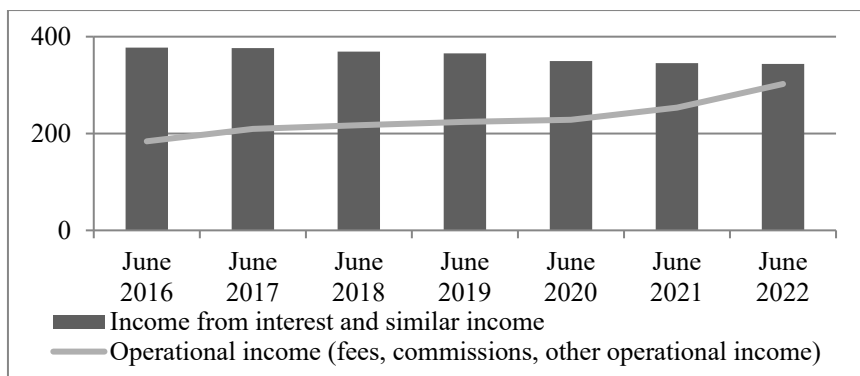
³⁴ Central Bank of Montenegro. 2022. Financial Stability Report 2021. <https://www.cbmg.me/en/publications/regular-publications/financial-stability-report> [Accessed 15 September 2022].

Fig. 3: Interest income and operational income in Republic of Srpska (in million Convertible Mark (hereinafter: KM))



Data source: Agency for Banking, Republic of Srpska, 2022³⁵

Fig. 4: Income from interest and operational income in Federation of BiH (in million KM)



Data source: Agency for Banking, Federation BiH, 2022³⁶

³⁵ Agencija za Bankarstvo Republike Srpske. 2022. Izvjestaji o stanju u bankarskom sistemu Republike Srpske. <https://www.Abrs.ba/sr/izvjestaji/c3> [Accessed 20 October 2022].

³⁶ Banking Agency for BiH. 2022. Information on the banking system entities of the Federation of Bosnia and Herzegovina as of 30.09.2021.

The question is whether banks charged their customers twice for the same service of approving and administering the loan, once via an effective interest rate (i.e. a borrowing interest rate in a loan contract); and secondly, via a separate additional payment first at the time of signing and approving the loan as the approval fee, and then later, on a yearly basis, as a loan disbursement (administration) fee. Even though the position of the National Bank of Serbia in 2021, for instance, was that an effective interest rate was just an informative rate,³⁷ that had to be presented to a consumer before signing a contract, and that banks didn't charge approval and similar fees twice³⁸ (although it is not clear how the National Bank of Serbia would know that without reviewing each loan application and loan contract), the legitimate expectation and a logical understanding of a consumer would be that an interest rate in the contract adequately corresponded to an effective interest rate advertised (that included all costs and fees of a loan) and that it was interest (as per interest rate stated in the loan contract) that was all that a consumer had to pay in terms of approval and disbursement costs and fees. According to the legislation at the time, a customer could have legitimate expectations that all costs related to a loan were included in one interest rate (effective interest rate) and that via that interest rate a customer would gradually repay interest in monthly installments together with the principal over the timeframe of the loan contract. Hence, a customer's legitimate expectations from a common sense's point of view would likely not see any other costs and fees that could be, in addition to interest payment in monthly annuity, additionally and separately charged by a bank as one-time payment or even annual payments.

<https://www.fba.ba/eng/publications-the-banking-system-entities-of-the-federation-of-bosnia-and-herzegovina-as-of-30092021> [Accessed 15 November 2022].

³⁷ Narodna banka Srbije. 2021. Stav Narodne banke Srbije o dopunjenim stavovima VKS.

<https://www.pravniportal.com/stav-narodne-banke-srbije-o-dopunjenim-stavovima-vks/> [Accessed 15 November 2022].

³⁸ Narodna banka Srbije. 2021. Narodna banka Srbije poziva na doslednu i zdravorazumsku primenu Dopune pravnog stava Vrhovnog Kasacionog suda.

<https://www.nbs.rs/sr/scripts/showcontent/index.html?id=17429> [Accessed 15 November 2022].

There is no doubt that the main provisions in the relevant legislation in Serbia, Montenegro, and Bosnia and Herzegovina were drafted in a clear and comprehensible manner with respect to all costs and fees pertaining to the loan contract between a bank and its customer. Since banks didn't only impose a borrowing interest rate on consumers, but also charged extra, one-time-to-be-paid additional costs as well, it is not surprising that consumers, lawyers and judges were inclined to understand that practice as illegal.

Moreover, it is not clear if the conditions of loan contracts in a pre-contract phase were presented to the consumers in such a way that it was clear to them what the effective interest was, how that corresponded to the interest rate in their contract, what they were paying for with the monthly interest and if there were any other charges that were not included in that borrowing interest rate, but had to be paid separately.

The most important omission is that courts didn't check whether loan approval fees and other fees were actually calculated in the effective interest rate and/or whether they were also charged separately, in addition to the effective interest rate. Courts in Serbia did not examine the actual banks' approach in calculating what a consumer had to pay. Since courts largely did not try to find out what exactly was charged to consumers in order to clearly establish what was lawful and what was not lawful, their judgements only produced more lawsuits. According to some legal practitioners,³⁹ the National Bank of Serbia in 2018 sent a letter to the presidents of the executive boards of all banks in Serbia in relation to the costs and fees that banks charge to their customers. The letter stated⁴⁰ that banks should align their policies and internal acts with the national legislation so that they ensure that loan contracts were in line with the rule of law. This letter implies that the National Bank of Serbia knew that banks were not acting in line with the rule of law since "the Governor in this letter said that the approval fee calculated as percentage of a loan does not correspond to true costs of these banks' services, because they (i.e.

³⁹ Ignjatić I. and Ilić D. 2018. Pitanje naplate troškova obrade kredita. *Iustitia.Casopis udruženja sudijskih i tuzilackih pomoćnika Srbije*. <https://www.ust.rs/img/Broj12.pdf> [Accessed 12 January 2022].

⁴⁰ *Ibid.*

services) are all equal regardless of the amount of credit, while banks' charge to a customer is not."⁴¹

In July 2021, when three members of SNS party (Serbian Progressive Party, originally Srpska Napredna Stranka) submitted an initiative to the Parliament of Serbia for "authentic interpretation" of relevant regulations⁴² with an aim to assist banks so that they don't have to prove neither the structure nor the size of approval fee and similar fees, the president of the Chamber of Commerce of Serbia, Marko Čadež, stated that with these authentic interpretations there should be an end to "the robbery of economy" by irresponsible attorneys.⁴³ He asked "how to otherwise call more than 200,000 lawsuits filed by attorneys in the name of manipulated customers? How otherwise to call a situation when a customer sues a bank for return of approval fee in the amount of approximately 20 eur when the customer gets back those 20 eur while an attorney – on average – gets 42-times more! How, if not "robbery" to call attorneys' resale of cases while the customers don't know about that?"⁴⁴

⁴¹ Ibid, p. 20.

⁴² The Law on Banks (Official Gazette of Republic of Serbia no. 107/05, 91/10 and 14/15), The Law on the Protection of Financial Service Consumers (Official Gazette of Republic of Serbia no.36/11 and 139/14) and Law on Obligations (Official Gazette of SFRY no. 29/78, amendments in 39/85, 45/89, 57/89; Official Gazette of FRY no. 31/93 and final amendments Official Gazette of Republic of Serbia no. 18/20.

⁴³ Telegraf BIZNIS. 200.000 tužbi pokrenuli su građani Srbije protiv banaka: Da li je ovo rešenje koje će staviti tačku? 2021. <https://biznis.telegraf.rs/info-biz/3359388-200000-tuzbi-pokrenuli-su-gradjani-srbije-protiv-banaka-da-li-je-resenje-koje-ce-staviti-tacku> [Accessed 1 January 2022].

⁴⁴ Ibid.

CHAPTER 4

LEGISLATION AND CASE LAW BY COUNTRIES

4.1 Serbia

Serbia had about 7.2 million inhabitants (without Kosovo) as of October 2022.⁴⁵ This number is cited in order to get an idea about the number of customers of the financial system. The structure of the financial system in Serbia is primarily bank-based and foreign-owned.⁴⁶ Foreign banks have allegedly been the key to introducing modern banking practices, as well as access to credit in Serbia, according to some international reports.⁴⁷ Serbia recorded the greatest change with respect to the number of banks compared to the other two countries. In 2010, there were 33 banks, but by 2020 their number was reduced to 26 banks. That figure further fell to 24 as of the end of June 2021 to drop to 22 banks as of October 2022.⁴⁸ There are many reasons for this consolidation in the banking sector. They range from competition issues, to profitability questions, digitalization and other reasons.

As of September 2022, there are the following banks in Serbia:

1. Addiko Bank a.d. Beograd
2. Agroindustrijsko Komercijalna banka AIK Banka a.d. Beograd

⁴⁵ The Government of Serbia. 2022. Basic info. Get to know Serbia. <https://www.srbija.gov.rs/tekst/en/130127/basic-info.php> [Accessed 1 April 2022].

⁴⁶ European Banking Authority. 2020. ANNEX – Republic of Serbia. https://www.eba.europa.eu/sites/default/documents/files/document_library/News%20and%20Press/Press%20Room/Press%20Releases/2020/EBA%20acknowledges%20Commission's%20decision%20on%20equivalence%20for%20Serbia%20and%20South%20Korea/Annex%20Serbia.pdf [Accessed 12 September 2022].

⁴⁷ Barisitz S. and Gardo S. 2008. Financial Sector Development in Serbia: Closing Ranks with Peer. <https://ideas.repec.org/a/onb/oenbfi/y2008i2b4.html>. [Accessed 15 August 2022].

⁴⁸ Narodna Banka Srbije. 2022. Spisak banaka. <https://nbs.rs/sr/finansijske-institucije/banke/spisak-banaka/> [Accessed 12 May 2022].

3. Alta Banka a.d. Beograd
4. API Bank a.d. Beograd
5. Banca Intesa a.d. Beograd (Novi Beograd)
6. Banka Postanska Stedionica a.d. Beograd
7. Bank of China Srbija a.d. Beograd (Novi Beograd)
8. Expobank a.d. Beograd
9. ERSTE Bank a.d. Novi Sad
10. Eurobank Direktna a.d. Beograd
11. Halkbank a.d. Beograd
12. NLB Komercijalna Banka a.d. Beograd
13. Mirabank a.d. Beograd (Novi Beograd)
14. Mobi Banka a.d. Beograd (Novi Beograd)
15. Nasa AIK Banka a.d. Beograd
16. 3 BANKA a.d. Novi Sad
17. OTP Banka Srbija a.d. Novi Sad
18. Procredit Bank a.d. Beograd (Novi Beograd)
19. Raiffeisen banka a.d. Beograd
20. RBA Banka a.d. Novi Sad
21. Srpska Banka a.d. Beograd
22. Unicredit Bank Srbija a.d. Beograd

Banks' business models in Serbia are built around traditional banking, as interest-related income remains the most important source of revenue generation.⁴⁹ The trend of consolidation of the banking system via mergers and acquisitions in Serbia that started after 2000,⁵⁰ became more evident after 2009 and the onset of the global financial crisis. However, despite consolidation via mergers and acquisitions leading to the reduction of banks to 22 by the end of 2022, the ownership structure of the banks has not changed considerably over the years. Following the sale of state-owned Komercijalna Banka to Nova Ljubljanska Banka (NLB) from

⁴⁹ European Central Bank. 2017. Occasional Paper Series. Access to finance in the Western Balkans. <https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op197.en.pdf>. [Accessed 11 October 2022].

⁵⁰ Barisitz S. and Gardo S. 2008. Financial Sector Development in Serbia: Closing Ranks with Peers. <https://ideas.repec.org/a/onb/oenbf/y2008i2b4.html>. [Accessed 15 August 2022].

Slovenia at the end of 2020, foreign-owned banks continued to dominate the financial system, holding around six sevenths of banking system assets.⁵¹ That sale was part of the strategy for banks with state ownership agreed with the International Monetary Fund (IMF). Komercijalna Banka was the third largest bank by assets and the largest remaining state-owned bank in Serbia. The privatization of Komercijalna Banka was completed by a transfer of 395 million euros by Nova Ljubljanska Banka to the Serbian budget in December 2020.⁵²

4.1.1 Legal Framework

In 2008, Serbia implemented the Law on confirming the Stabilization and Association Agreement between the countries of the European Union and Serbia. This law in Article 78 stipulates the harmonization of national legislation in regard to consumer protection and to actively implement the policy on consumer protection so as to reach the level of the European Union in that respect.⁵³

The Law on the protection of consumers⁵⁴ in Serbia has certain provisions in line with the Directive 93/13/EEC⁵⁵ that obligates the country to provide suitable and effective means in order to stop unfair clauses in consumer contracts. The guidance on the interpretation and application of this directive⁵⁶ provides a structured presentation of the key terms and argumentation of the Court of Justice of the European Union so that the

⁵¹ European Commission. Serbia Report 2022.

https://neighbourhood-enlargement.ec.europa.eu/serbia-report-2022_en [Accessed 15 November 2022].

⁵² Ibid.

⁵³ Zakon o potvrđivanju Sporazuma o stabilizaciji i pridruživanju između Evropskih zajednica i njihovih država članica sa jedne i Republike Srbije sa druge strane, Sluzbeni glasnik Republike Srbije, Međunarodni ugovori, br. 83/2008.

⁵⁴ Zakon o zaštiti potrošača, Sluzbeni glasnik Republike Srbije br. 62/14, 6/16, 44/18.

⁵⁵ Council Directive 93/13/EEC of 5 April 1993 on Unfair Terms in Consumer Contracts, Official Journal L 95 from 21.4.1993.

⁵⁶ Guidance on the Interpretation and Application of Council Directive 93/13/EEC on unfair terms in consumer contracts. Official Journal of the European Union C 323/4 from 27.9.2019.

EU countries and candidate countries can see key interpretations in this respect.

Courts in Serbia have had various attitudes with respect to permissibility to allow banks to charge their customers approval and processing fees when concluding a loan contract. Some courts decided such clauses to be null and void, others that they were not against the law. The *Law on Obligations* that sets the basic rules on all contracts does not explicitly mention any other cost except an interest rate.⁵⁷ Article 1065 of the Law on Obligations states that interest rate is the only “price” of a loan. The concept of a loan is reflected in Section XXXV of the Law on Obligations that states:

*“The loan contract obliges the lender to make available to the borrower a sum of money in the agreed amount for a limited or unlimited period, for a certain purpose or without a defined purpose, while the borrower is obliged to pay agreed interest owed and, at the due date, to repay the loan made available as per agreed in the contract.”*⁵⁸

The law mentions interest as the only price of the loan, but that does not exclude a possibility that a bank defines an interest rate in any percentage it wants, as long as a customer accepts that interest rate. A logical interpretation of the interest rate that a borrower agrees to, with respect to the Article 1065, is that this interest rate is equivalent to an effective interest rate (that includes all costs and fees in regard to the loan) as the only and true price of a loan.

Another important piece of legislation, the *Law on Banks*⁵⁹ does not prescribe the content of the loan contract. However, according to Article 43 of this law, banks have the right to charge certain costs when concluding a credit contract with a customer. Further, Article 43 of this law stipulates that the National Bank of Serbia can define the method of

⁵⁷ Law on Obligations. Official Gazette of SFRY no. 29/78, amendments in 39/85, 45/89, 57/89; Official Gazette of FRY no. 31/93 and final amendments Official Gazette of Republic of Serbia no. 18/20.

⁵⁸ Ibid.

⁵⁹ Law on Banks. Official Gazette of the Republic of Serbia no. 107/05, 91/10 and 14/15.

calculation and publication of costs, interest rates and fees for banks' services with respect to credit services. This is done via specific decrees and decisions. On the 30th June, 2006, the *Decree about the Unique Method of Calculation and Announcement of the Effective Interest Rate on Deposits and Credit*⁶⁰ was published by the National Bank of Serbia. According to this decree, the calculation of an effective interest rate must include i) nominal interest; ii) sum of fees and costs that a bank charges to a customer at the time of approval of a loan and iii) sum of fees and costs that are known (on the day of the calculation of credit) and are charged to a customer during the time frame of a loan contract. All this information has to be clearly stated in an offer for credit so that a consumer is never misled with respect to any condition or obligation of the offer. A bank must, in its premises and in other ways of public advertising, in a clear and visible way, state an effective interest rate, nominal interest rate and a foreign currency or other possible revaluation criteria that is used to index the credit, if the latter is applicable. An effective interest rate must be stated in percentage terms with two decimal numbers and is valid as of the day of the calculation of the credit. When signing a loan contract, a bank must provide a client with a copy of the plan of repayment as well as an overview of all the elements of the repayment of the credit. The overview must contain all data that are included in the *calculation* of the effective interest rate, as well as all data that are not included in the effective interest rate. Data that are included in the calculation of the effective interest rate are the amount of loan, the repayment timeframe, a nominal interest rate, the sum of interest that has to be paid during the time frame of the loan repayment, the sum of all costs and fees that a consumer has to pay during the timeframe of the contract and the amount of repayment installments.

In 2009, the *Decree on Methods and Procedures of Banks when Implementing General Terms and Conditions in Relation to their Clients, Private*

⁶⁰ Decree about the Unique Method of Calculation and Announcement of the Effective Interest Rate on Deposits and Credit. Official Gazette of the Republic of Serbia no. 57/06.