BDK Advokati

Capital Markets

Serbia: Further steps in harmonization of Capital Markets Act with the Market Abuse Regulation plus some unwarranted confusion regarding certain definitions

JANUARY 2017

The Serbian Capital Markets Act enters 2017 with the new provisions on market abuse, bringing it closer to the Regulation (EU) No 596/2014 (Market Abuse Regulation or MAR). The amendments took effect on 6 January 2017.

In addition, the definition of financial instruments has been, in our view, unnecessarily extended to include separate definitions of "commodity derivatives" and "credit default swaps". **Commodity derivatives**, now forming part of a broader definition of **financial instruments**, are defined as "derivative financial instruments pertaining to a commodity, which have to be settled physically or, exceptionally in cash, if traded on a regulated market or MTP [multilateral trading platform]", while **commodity** is defined as "any generic goods able to be delivered, including metal and its ore and alloy, agricultural products and energy".

This new definition of "commodity derivatives" is confusing. The Capital Markets Act already contains a broad definition of "financial instruments", which encompasses, *inter alia*:

- "options, futures, swaps, forward rate agreements and any other derivative financial instruments relating to commodities which have to be settled in cash, or may be settled in cash at the option of one contractual party for the reasons which are not related to non-performance or termination of the agreement" (Article 2, paragraph 1, 1 (5)); and
- "options, futures, swaps and any other derivative financial instruments relating to commodities which can be settled physically, provided they are traded at a regulated market of MTP" (Article 2, paragraph 1, 1 (6)).

One would have thus thought that commodity derivatives, whether OTC-traded or exchange-traded, are already considered financial instruments. The amendment, however, appears to provide a new and exhaustive definition of commodity derivatives, limited to exchange-traded instruments. It is to be hoped that this new narrow definition of commodity derivatives will be used only with reference to the market abuse provisions and some other provisions of the Capital Markets Act which explicitly refer to the term, while, for other purposes, the broader definition of financial instruments will be understood to cover OTC-traded commodity derivatives. This is important because the Foreign Exchange Act allows cross-border payments and netting under certain financial derivatives only, including those for hedging the risk of commodity prices. However, it defines financial derivatives by referring to the definition of financial instruments in the Capital Markets Act. Accordingly, if OTC commodity derivatives were not understood as financial instruments, cross-border payments and netting under those transactions would become questionable. Also, special close-out netting provisions under the Insolvency Act apply to financial contracts only. The definition of "financial contracts" under the Insolvency Act refers to financial derivatives, but the Insolvency Act does not define financial derivatives. As mentioned, the Foreign Exchange Act does define financial derivatives, by reverting to the definition of financial instruments in the Capital Markets Act. Accordingly, a terminating party under a framework agreement covering, inter alia, commodity derivatives would be able to benefit from the close-out netting provisions of the Insolvency Act only if the commodity derivatives are understood as financial derivatives or, more broadly speaking, as financial instruments.

New definition of **credit default swap**, as part of the notion of financial instruments, instructs that this is a credit derivative under which the party offering credit protection undertakes towards the beneficiary of credit protection to cover its losses in the event of debtor's default or another credit event foreseen in the contract, in exchange for a fee. The new definition is also far from necessary, as the definition of financial instruments already covers "derivative financial instruments for transfer of credit risk" (Article 2, paragraph 1, 1 (8)). Moreover, the new term "credit default swap" is not used anywhere in the law. Even the new provisions on market abuse refer to the old term "derivative financial instruments for transfer of credit risk" and not to more specific "credit default swaps". In any event, cross-border payments and netting under credit default swaps are not permitted, given that the by-law of the National Bank of Serbia only permits cross-border payments under financial derivative transactions concluded for the purposes of hedging specific risks, excluding the risk of default or other credit risk.

Turning to the new market abuse provisions,a significant change is brought about by inclusion of **commodity spots** under the coverage of market abuse provisions. Specifically, the provisions on insider trading and market manipulation now explicitly cover "spot contracts for commodities other than those traded on the organized markets for electricity, natural gas, oil and oil derivatives when a transaction, order or proceedings has or is likely to have, or has been undertaken with the intention of creating influence on the price or the value of financial instrument." Spot contract is defined as "contract for delivery of commodities traded on the spot market and deliverable immediately upon the cash settlement, as well as contract for delivery of goods which is not a financial instrument, including physically settled term contract". Spot market is defined as "market of commodities on which commodities are sold for money and delivered immediately upon the contract being cash settled, and other markets at which financial instruments are not traded".

Market abuse provisions also extend to "derivative contracts and derivative financial instruments for transfer of credit risk where the conclusion of transaction, issuance of order, provision of bid or other action has, or is likely to have, influence on the price or value of commodity sport, where such price e depends on the value of financial instrument". Finally, "actions having or likely to have influence on benchmarks" are also caught by market abuse provisions. Benchmark is "any rate, index or number that is published or made available to the public and that is determined, regularly or periodically, by the application of a formula on the following values or based on them: value of one or more underlying assets, or prices, including estimated prices, actual or estimated interest rates, or other values or surveys", based on which one determined the amount to paid for a particular financial instrument or the value of financial instruments."

Specifically, the definition of **inside information** is upgraded to include spot contracts. Inside information is deemed precise if it points to a set of existing circumstances or those that can be reasonably expected to come to existence, or to an event which has taken place or can be reasonably expected to take place, provided it is sufficiently specific to enable conclusions as to the likely influence of that set of circumstances or events on the prices of financial instruments, related derivative contracts or related spot contracts for commodities.

The Capital Markets Act adds-on the provisions from MAR on **legitimate behavior.** According to these provisions, it shall not be deemed from the mere fact that a legal person is or has been in possession of inside information that that person has used that information when trading and engaged in insider dealing, where that legal person has established, implemented and maintained adequate and effective internal arrangements and procedures that effectively prevent abuse of inside information. Internal arrangements and procedure preventing abuse of inside information shall be of such nature so to ensure that neither the natural person who made the decision on its behalf to acquire or dispose of financial instruments to which the information relates, nor another natural person who may have had an influence on that decision, was in possession of the inside information, nor has it encouraged, made a recommendation to, induced or otherwise influenced the natural person who, on behalf of the legal person, acquired or disposed of financial instruments to which the information relates. The time-period during which the issuer is obliged to periodically publish inside information on its web-site, has been specified to last for 5 years. However, in a departure from MAR, the new legitimate behavior provisions do not extend to situations where the person in possession of inside information is an individual acting as market maker or as party authorized to execute orders on behalf of third parties.

A further important novelty is the introduction of MAR-inspired provisions on **managers' transactions**. A person discharging managerial responsibilities within an issuer is prohibited from conducting any transactions on its own account or for the account of a third party, directly or indirectly, relating to the shares or debt instruments of the issuer or to other financial instruments linked to them during a closed period of 30 calendar days before the announcement of a year-end report or an interim semi-annual or quarterly report which the issuer is obliged to make public according to the provisions of the Capital Markets Act. Subject to further conditions still to be prescribed by the Securities Commission, the issuer may allow a person discharging managerial responsibilities within it to trade on its own account or for the account of a third party during a closed period in case of the existence of exceptional circumstances requiring an urgent sale or if the relevant trade is of significance for a program for redemption of shares from the employees "or in similar cases".

Along the lines of MAR, the amendments to the Capital Markets Act introduce new provisions regulating **market sounding**, a narrow exception to the prohibition of disclosing inside information. Further conditions and methods for market soundings will be regulated by the Securities Commission's bylaws, which are expected to be enacted at the beginning of February.

Market manipulation section of the statute, which now covers manipulative behavior related to spot contracts for commodities and inputs in relation to a benchmark. It is also specified that misleading transactions can take place not only at the closing of the market but also at the opening of the market.

Finally, **powers of the Securities Commission** have been beefed-up by a new authority to request from the court a warrant authorizing the Commission to get hold of telephone and data traffic records from an investment firm, a credit institution or a financial institution and other entities under its supervision if there is a reasonable suspicion of breach of the provisions prohibiting market abuse.

BDK Serbia
Majke Jevrosime 23
11000 Belgrade
Tel: +381 11 3284 212
Fax: +381 11 3284 213
office@bdkadvokati.com

BDK Montenegro
Bul. Džordža Vašingtona 51
81000 Podgorica
Tel: +382 20 230 396
Fax: +382 20 230 396
office.cg@bdkadvokati.com

BDK Bosnia and Herzegovina (Advokat Dijana Pejić u saradnji sa BDK Advokati AOD)
Gundulićeva 6
78000 Banja Luka
Tel: +387 51 250 641
Fax: +387 51 250 642
office.banjaluka@bdkadvokati.com