

## **SIGNIFICANCE AND ECONOMIC FUNCTIONS OF SECURITIES**

**ABSTRACT:** Globalization of markets and internationalization of trade significantly affect both the regional and national ways of doing business, economic trends, and economic balances, as well as the competitive positions on the world market of knowledge and capital. Securities have a great importance in business. Theory and practice agree that the issuance of securities represents a significant social and economic event, both locally and regionally, as well as globally. Bearing in mind the topic of the paper, in the subheadings there have been analyzed the basic issues related to securities – the concept and essential features of securities, the legal nature and types of securities, the creditworthiness of securities, the legal treatment of securities in Republic of Serbia, as well as the importance and economic function of securities.

**Keywords:** *securities, financial markets, business operations, the Law of Contract, Republic of Serbia.*

### **1. Introduction**

Securities are written documents in which “an indivisible right is incorporated, and with which the issuers undertake to fulfill the obligation written on the paper” (Selak, 2016, p. 16).

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According to Article 234 of the Law of Obligations (1978), “a security is a written document by which its issuer undertakes to fulfill the obligation written on that document to its legal owner”. As Jakovljević (2019) points out, “the jobs of economic entities can be jobs in the circulation of goods and jobs in the circulation of money (banking, bills of exchange and check law)” (p. 85). It is important to point out that “the economy in every society and all stages of its development had great social and political importance. Economic relations in the field of production, distribution, and exchange have always been at the basis of social life, reflecting on numerous social relations and activities” (Vučković, 2014, p. 54).

According to this, “the basic function of financial markets is to direct funds from those who have a surplus to those who have a shortage of funds. Individuals, families, firms, and the public sector, who earned more than they spent, direct excess income to those who have a shortage of resources through the financial market. On one side are lenders who lend funds. On the other side are the borrowers, who have to borrow funds to finance their needs” (Šabović, 2009, p. 61). The same author states that “in direct financing, lenders sell their excess assets to borrowers on the financial market.” Lenders offer financial instruments in the form of the sale of securities, which represent the right to claim future income from the borrower. If the firm needs funds, it issues, for example, bonds as debt securities and undertakes periodic payments to the lender” (Šabović, 2009, p. 61). Theory and practice agree that “issuance of securities represents a significant socio-economic event both within the framework of the business of a legal entity and within the framework of a state community in the implementation of its economic policy” (Jovičević et al., 2019, p. 383).

Securities must have “prescribed elements that constitute the form of a legal transaction. The formality of a security is the right that its legal owner can claim the degree of right up to the limit that is written on the security. Security always refers to a thing, a monetary or commodity claim, a benefit or a value, which indicates a correctly specified property right” (Carić, 2000, p. 125).

Bearing in mind the topic of the paper, the following subheadings will analyze the basic issues related to securities – the concept and essential features of securities, the legal nature and types of securities, the creditworthiness of securities, the legal treatment of securities in the Republic of Serbia, as well as the importance and economic function of securities.

## 2. Concept and essential properties of securities

Securities are “written documents containing some civil right associated with the document itself” (Velimirović, 1996, p. 61; Vasiljević, 1997, p. 747; Jankovec, 1996, p. 563).

From the legal definition of securities, which is stated in the introductory part, it follows “that a security is always a written statement, that the security contains the written permission of the issuer, that the written obligation entered into the security must fulfill its legal owner, i.e. to the legal holder of securities” (Carić et al., 2016, p. 309).

This term of securities contains several shortcomings, “because this term does not indicate all essential properties of securities:

1. It does not indicate the type and nature of the obligation of the issuer of securities. In the case of securities, we cannot deal with every type of obligation, but only with certain that are predominantly and primarily of a property nature. Securities may contain, in addition to property obligations, some other obligations, but they cannot be without property obligations.
2. Securities may contain certain authorizations for the holder of securities that are not at the same time direct and immediate obligations of the issuer of securities. For example, stockholders can manage a joint stock company based on the authority and share as a security, and not based on the direct and immediate obligation of the issuer of this security.
3. One of the important properties of securities is related to a very high degree of formal strictness of securities, which is not stated in the aforementioned term of securities. A security that does not have all the essential elements does not exist because securities are strictly formal documents.
4. Securities create a very strict obligation not only for the issuer, but also for every debtor under that security, which deprives the debtor of the possibility of certain types of securities, but this strictness is much more pronounced with all types of securities than with written documents.
5. In every legal concept of securities, one of the most important properties of securities is not emphasized, which is the principle of incorporation, i.e. the principle that the right established in writing on the security cannot be exercised in any other way, but only by using the security. The principle of incorporation distinguishes security from several other written documents in which the obligation

of the issuer towards the holder of that written document can be ascertained. While other written obligations of the issuer of the written document towards the holder of the written document can be realized in other ways, in the case of securities, this obligation cannot be realized without securities” (Ristić et al., 2013, pp. 157-158).

The essential properties of securities, “which must exist in every single form of securities, are:

1. The security must always be in the form of a written document.
2. A property or material right must be established in the security, although in addition to the property right in the security, another right, a right of a different type, can also be established at the same time. Their property rights must be stated in each security.
3. The right stated in the security cannot be exercised and cannot be transferred to another without the same temporal transfer and possession of the security. This is the principle of incorporation, which is one of the essential principles of all emerging forms of securities” (Carić et al., 2016, pp. 311-312).

### **3. Legal nature and types of securities**

In explaining the legal nature of securities, “contract theory and the theory of unilateral declaration of will stand out” (Babić, 2006, p. 325).

According to the contract theory, “the obligation of the issuer of the security arises based on the contract between the issuer and the holder of the security.” Contracts are also concluded in favor of later holders of securities who are authorized to demand immediate fulfillment of the obligation from the debtor” (Babić, 2006, p. 325; Radojčić, 1922, p. 570).

According to the unilateral declaration theory of will “an obligation from securities is created by a unilateral declaration of will of its signatory as the issuer, as well as every subsequent signatory of that document, and not by the conclusion of a contract between two parties” (Babić, 2006, p. 325). This theory is accepted by the current Law on Obligations (1978) and is applied exclusively to monetary securities (promissory note, check, etc.).

Regarding the types of securities and their division, it should be emphasized that in the commodity-money circulation of modern economic systems, a large number of various securities are in circulation. There are different criteria for the classification of securities. Table 1 shows the basic criteria for the division and types of securities according to each criterion.

**Table 1.** Criteria for division and types of securities

	<b>Criteria for dividing securities</b>	<b>Types of securities according to individual criteria</b>
1.	According to the method of determining the holder of rights from the security	<p>Registered securities, where the right holder is always indicated on the security;</p> <p>Securities by order, in which the holder of rights is indicated on the security, but the right holder is considered to be any other person designated by the designated holder of rights from the security by his order;</p> <p>Bearer securities are securities where it is considered that the holder of rights from the security is every bona fide owner of that security;</p> <p>Alternative securities, in which the holder of the right is determined in an alternative way, by a combination of the aforementioned ways of determining the holder of the right of the security;</p> <p>Mixed securities, which consist of two or more parts, and for those parts, the right holder is determined in different ways.</p>
2.	According to the character of the incorporated right in the security	<p>Obligational-legal securities that incorporate some bond right, most often it is a monetary claim;</p> <p>Real-legal securities contain some real rights. According to the types of real rights, these securities can be further divided into proprietary and lien securities. Pledged securities are further divided according to whether it is a right of pledge concerning movable or immovable property;</p> <p>Securities with the right to participate in the so-called corporate effects, ie. corporate securities. In all securities, in addition to some property rights, the right of management and decision-making in certain legal entities is also incorporated, hence the name of these securities. The most distinctive security with the right to participate in a share that gives the holder of that security the right to participate in the management of the joint stock company. With us, this group of securities includes the certificate of joint money means, as one of the forms of pooling work and funds, based on the appropriate self-governing agreement on pooling.</p>

	<b>Criteria for dividing securities</b>	<b>Types of securities according to individual criteria</b>
3.	According to the degree of connection with the basic legal work for which there was an issue of securities and according to the possibility of the influence of the basic legal work on the realization and transfer of rights from the securities	Abstract securities where the basic legal transaction is not visible from the security and does not affect the realization and transfer of rights from the security;
		Causal securities are securities that are legally dependent on the basic legal transaction from which they were issued, both in terms of the realization and transfer of rights from the security. While causal securities may be more equitable, abstract securities create a higher degree of legal certainty.
4.	According to the method of creation of rights from securities	Constitutive securities in which the issuer of these securities must be constituted by some new right that is stated in the security;
		Non-constitutive or declaratory securities contain a right that was not constituted by the issuance of the securities but existed upon the issuance of the securities, and by the issuance of the securities, this right is only declared against third parties.

Source: Ristić, Ž, Srdić, M. & Ristić, K. (2013). *Akcionarstvo i hartije od vrednosti* [Shareholding and securities]. Beograd: EtnoStil, pp. 162-163.

#### 4. The creditworthiness of securities and bond rating systems

The creditworthiness of the security depends on the “assessment of the business of the issuer, that is, the issuer of the security.” Stock indices are used to monitor the creditworthiness of securities on the capital market. The most famous stock market indices are New York: Standard & Poor’s Composite 500 index -SPCI; London: FTSE index; Tokyo: NIKKEI; Paris: CAC 40 index; Frankfurt: DAX; Singapore: SIMEX and Hong Kong: Hang Seng” (Šabović, 2009, p. 65).

Investments in securities “may involve several types of risk. The risk is especially high with those securities issued by private corporations and some local governments. The risk that the issuer will not fulfill the obligation for the principal or interest owed on the security, necessitated the introduction of adequate control” (Šabović, 2009, p. 65). To adequately protect himself from risk, “an investor should have information about the rating of a particular security.” The bond rating system is used for such information (Lekić & Vapa-Tankosić, 2017, p. 511). The bond rating system has four levels. The first rating is marked with the letter A, the second rating with the letter B, the third

rating with the letter C, and the fourth rating with the letter D. In practice, there are two bond rating systems and they are marked with different letters. These are a) “Moody’s” bond rating system, marked with the letters Aaa, Baa, and Caa, and b) “Standard & Poors” rating system, marked with the letters AAA, BBB, CCC, D” (Šabović, 2009, p. 65). Table 2 presents the rating of the bond system.

**Table 2.** Bond system rating

	“Moody’s”	“S&P”	Meaning
1	Aaa	AAA	Bonds of the best quality. It offers the lowest level of placement risk. Publishers are extremely stable and reliable.
2	Aa	AA	Bonds of high quality by all standards. Slightly higher degree of riskiness of long-term placement.
3	A	A	Bonds with favorable placement attributes.
4	Baa	BBB	Bonds with a medium level of quality. Security is currently adequate, but may be unrealistic in the long term.
5	Ba	BB	Bonds with speculative elements. Moderate payment security. It is insufficiently protected.
6	B	B	The bond cannot be considered desirable for purchase. It has short-term payment security.
7	Caa	CCC	Bonds in weak condition. Issuers may be unable to pay or at risk of default.
8	Ca	CC	The bonds are of highly speculative quality. They are often unable to fulfill their obligations.
9	C	C	Bonds are the lowest rated. They have poor prospects for fulfilling the payment obligation.
10	-	D	Impossibility of fulfilling the payment obligation.

Source: Šabović, Š. (2009). Upravljanje rizikom hartija od vrednosti [Securities risk management]. *Ekonomski pogledi*, 11 (3), p. 66.

## 5. Legal treatment of securities in the Republic of Serbia

In addition to the definition stated in the introductory part of the paper, the Law of Obligations (1978) regulates other important issues related to securities.

According to Article 235, “the security must contain the following essential ingredients: 1) designation of the type of security; 2) the company, that is, the name and headquarters, that is, the name and residence of the

issuer of the security; 3) the company, that is, the name or name of the person to whom, that is, on whose order the security is issued, or the indication that the security is issued to the bearer; 4) correctly marked obligation of the issuer arising from the security; 5) place and date of issuance of the security, and in the case of those issued in series, its serial number; 6) signature of the issuer of the securities, i.e. a facsimile of the signature of the issuer of the securities issued in the series”.

Article 236 stipulates that “a security may be issued to the bearer, in the name or by order”, while Article 237 stipulates that “the obligation arising from the security arises at the moment when the issuer hands over the security to its beneficiary”.

In addition to the aforementioned issues, the Law of Obligations (1978) also regulates the exercise of rights, the transfer of securities, changes in securities, as well as the fulfillment of obligations arising from securities.

## **6. Significance and economic function of securities**

Securities “have enormous importance in every society in which the commodity-money market is organized. Throughout the world, there is a constant tendency to increase the importance of securities due to increasingly complex relationships due to the constant increase in values found in commodity-money circulation” (Ristić et al., 2013, p. 158).

Originally, the economic function of securities “was related to finding non-cash forms of payment and exchange functions, i.e. maintaining the constancy of purchasing power in certain values, regardless of the monetary and currency differences that exist in certain countries” (Carić et al., 2016, p. 308). These payment functions “are very important functions that are performed through securities in the modern economy. The payment function of securities is very complex and multifaceted, and because of this, in legal theory, they are broken down and demarcated into a larger number of independent economic functions” (Carić et al., 2016, p. 308).

Securities are extremely important instruments for the “mobilization of free, available funds. “In this respect, the securities are the whole world. Securities have special functions in the area of monetary and credit policy and protection of liquidity in the economy. With the help of securities, the needs of the economy in terms of mutual payments can be met without additional new emissions, which, if not controlled, can often be the focus of inflationary tendencies” (Ristić et al., 2013, p. 159).



Securities are instruments “that satisfy various credit functions because they are simultaneously very important credit instruments, and in connection with mutual credit relations, also extremely important security instruments. “In this area of commodity circulation, securities are also of particular importance because they ensure commodity circulation without the physical presence of goods on the market and in this way affect the temporal and business balancing of supply and demand of certain types of goods on certain markets” (Carić et al., 2016, p. 309).

## 7. Conclusion

Globalization of markets and internationalization of trade significantly affect regional and national ways of doing business, economic trends, economic balances, as well as competitive positions on the world market of knowledge and capital.

Business operations of subjects due to globalization, deregulation, and expansive development of information and communication technologies have gone through a developmental path from the traditional concept of business to modern ways of the commodity-money framework of business (with the primary goal of preserving its competitive positions and expanding its business activities to new areas by expanding already existing influence in current operations).

Securities have great importance in business. In the professional literature, there are big differences in the understanding of the concept of securities. A much higher degree of unity in understanding exists when determining certain properties of securities. Theory and practice agree that the issuance of securities represents a significant social and economic event, both locally and regionally, as well as globally.

Bearing in mind the topic of the paper, the subheadings analyzed the basic issues related to securities – the concept and essential features of securities, the legal nature and types of securities, the creditworthiness of securities, the legal treatment of securities in the Republic of Serbia, as well as the importance and economic function of securities.

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## **ZNAČAJ I PRIVREDNE FUNKCIJE HARTIJA OD VREDNOSTI**

**REZIME:** Globalizacija tržišta i internacionalizacija trgovine u značajnoj meri utiču na regionalne i nacionalne načine poslovanja, privredna kretanja, ekonomske bilanse, kao i na konkurentske pozicije na svetskom tržištu znanja i kapitala. Hartije od vrednosti imaju veliki značaj u poslovanju. Teorija i praksa se pri tome slažu da emitovanje hartija od vrednosti predstavlja značajno društveno-ekonomsko dešavanje, kako na lokalnom, tako i na regionalnom, kao i na svetskom nivou. Imajući u vidu temu rada analiziramo osnovna pitanja u vezi sa hartijama od vrednosti – pojam i bitne osobine hartija od vrednosti, pravnu prirodu i vrste hartija od vrednosti, bonitet hartija od vrednosti, zakonski tretman hartija od vrednosti u Republici Srbiji, kao i značaj i privrednu funkciju hartija od vrednosti.

**Ključne reči:** *hartije od vrednosti, finansijska tržišta, privredno poslovanje, Zakon o obligacionim odnosima, Republika Srbija.*

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