



NATIONAL BANK OF SERBIA

AML SUPERVISION CENTRE

**ANALYSIS OF FINANCIAL LESSORS' RESPONSES
TO THE QUESTIONNAIRE ON ACTIVITIES
REGARDING ML/TF RISK MANAGEMENT
FOR 2019**

August 2020

Introductory note

The Law on Financial Leasing (hereinafter: the Law) designates the NBS as the institution which issues and revokes licenses for financial leasing, grants consents to the acquisition of ownership over lessors' stakes/shares, grants consents to the appointment of members of lessors' boards of directors, as well as other consents, in accordance with the Law.

Under the Law, the NBS was entrusted with the on-site and off-site supervision of financial lessors.

In 2010, the NBS established the practice of off-site supervision of financial lessors' activities regarding the management of the risk of money laundering and terrorist financing (hereinafter: ML/TF). The supervision is carried out twice a year based on the data submitted to the NBS by these financial institutions in the form of a filled-out Questionnaire (hereinafter: the Questionnaire).

Questions in the Questionnaire are sorted in ten groups:

Part I: General data on financial lessors

Part II: Clients

Part III: Client composition by the assessed ML/TF risk level

Part IV: Client composition by CDD actions and measures

Part V: Products, services and transactions

Part VI: Outsourcing CDD actions and measures

Part VII: Employee training

Part VIII: Organisational structure

Part IX: Reporting to the AML/CFT compliance officer and to the Administration for the Prevention of Money Laundering (hereinafter: the Administration)

Part X: Internal audit and internal controls

The key objectives of the analysis of data from the Questionnaire are as follows:

- getting insight into the state-of-play in terms of identifying, measuring and managing the ML/TF risk in financial leasing activities;
- promoting adequate implementation of established rules and principles of the “know your client” (KYC) procedure;
- off-site monitoring of the development of the ML/TF risk management system in financial lessors;
- identifying possible deficiencies and timely alerting financial lessors to potential exposures to the ML/TF risk.

The Questionnaire for 2019 has been improved and aligned with the results of the National Money Laundering and Terrorist Financing Risk Assessment, and contains questions regarding resident legal persons, non-resident legal persons, non-resident

natural and legal persons, by country. In addition, high-risk clients are covered by a more detailed and complete analysis.

All financial lessors operating in the financial leasing market of the Republic of Serbia submitted their responses to the Questionnaire for the reporting period 1 January – 31 December 2019.

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I Key findings

Based on the analysis of the inherent exposure to the ML/TF risk, i.e. quantitative and qualitative data and information from the Questionnaire, as well as data and information concerning management and control of this risk, a general conclusion was drawn that financial lessors' exposure to the ML/TF risk in this and previously analysed periods is low.

Accordingly, it may be concluded that financial lessors have a relatively low exposure to the ML/TF risk.

Given the **size of its business network**, the financial leasing sector has a low-risk level, given the number of clients with established business relationships, few branches / branch offices, and the total number of front-office staff. As at 31 December 2019, 17 financial lessors were licensed to perform financial leasing operations, employing 349 people in total, of whom 155 front-office staff applying some of the CDD actions and measures. At the end of the reporting period, clients could establish business relationship at 122 locations in the country, and all financial lessors had 13 branches overall.

The composition of clients is another reason why this sector's exposure to the ML/TF risk is low, primarily considering the composition of clients by residence and the fact that non-residents have a negligible share in the total number of clients. In addition, most clients are resident legal persons with a dominant share of around 67.55%. They mainly take the form of limited liability companies which are estimated as risky in terms of ML/TF in the National Risk Assessment, and a particular focus is placed on them. Within the financial leasing sector, clients are divided into three categories, according to the assessed ML/TF risk level – the majority of clients were assessed as medium-risk (14,295), with a share of around 75.44%, followed by clients in the low-risk category (3,519), with a share of around 18.57%, while those classified as high-risk (1,133) were in the third place, making up 5.97% of the total. The majority of clients assessed as high-risk were resident legal persons. They were assessed as such mainly due to their risky activities. As in previously analysed periods, there were no significant changes in the composition of clients by residence, with an upward trend observed in the total number of clients in the financial leasing sector.

Concerning **products and services**, the number and the total and average value of all concluded leasing agreements, and the number and the total and average value of leasing agreements concluded with clients assessed as high-risk indicate a low exposure to the ML/TF risk.

Only two financial lessors **outsourced CDD actions and measures** (to Raiffeisen bank (Raiffeisen leasing) and to Procredit bank (Procredit leasing), which also indicates a low ML/TF risk exposure.

The analysis of data and information about the measures taken by lessors aimed at adequate ML/TF risk management and control in the observed period, indicates that

the said risk, even though low, was adequately managed. When assessing ML/TF risk management and control, the following indicators were taken into account:

- Employees in all financial lessors were aware of the consequences of non-compliance with law and the procedures governing ML/TF prevention (primarily as a result of training).
- Lessors were dedicated to staff training, usually delivered in the form of workshops, or a combination of workshops and e-learning, at least once a year, and some financial lessors conducted training three or more times a year;
- At the end of the reporting period, ten lessors had a special AML programme, i.e. application for AML/FT activities. In nine, out of ten lessors, this programme allows for the classification of clients by the risk level. After the check-up of data aimed at their identification, clients are classified. The geographic risk, client risk, products and transactions risks, are particularly taken into account, with a special focus on clients who are public officials, as well as legal persons with a complex ownership structure.
- All financial lessors used the list of indicators for detecting suspicious AML/CFT-related transactions, as well as the lists of designated persons, published by the UN Security Council and other international organisations of which Serbia is a member;
- Financial lessors set up their own ML/TF risk management systems, and regulated the internal controls systems by their internal acts.
- The client composition by CDD actions and measures (simplified, general and enhanced) was relatively consistent with the client composition by the assessed ML/TF risk level. Enhanced actions and measures were applied to all clients classified as high-risk, and general CDD to more clients than those classified as medium-risk, meaning that these actions and measures also applied to some low-risk clients. This means that financial lessors understood correctly the significance of proper ML/TF risk assessment, which, together with greater caution, resulted in adequate allocation of human resources, and consequently in high-quality ML/TF risk management.
- In the observed period, no business relationships were terminated due to the impossibility to apply CDD actions and measures referred to in Article 7, paragraph 1, items 1–5 of the Law, while two financial lessors refused the offer to establish a business relationship as they could not apply the said actions and measures;
- In the reporting period, there was one case when clients or persons who tried to establish a business relationship, or any other person with whom a financial lessor had a business or other similar relationship, were designated persons and the financial lessor refused to establish a business relationship with this person. A designated person is a natural person, a legal person and a group or association, registered or unregistered, which is marked and placed on the list of terrorists,

terrorist organisations or terrorist financiers, as well as on the list of persons associated with the proliferation of weapons of mass destruction and special lists based on UN Security Council resolutions or acts of international organisations of which the state is a member, proposals of competent government institutions, or based on the explanation of a foreign country. Special lists are lists based on UN Security Council resolutions or acts of international organisations of which Serbia is a member, and which do not relate to natural or legal persons, groups or associations, but to movable and immovable assets related to the proliferation of weapons of mass destruction, such as ships, planes, etc.

In the National Risk Assessment, financial leasing is assessed as a medium ML/TF risk sector. Under the World Bank methodology, it was estimated as a low vulnerability sector given that along with insurance and voluntary pension funds sectors, it makes up around 9% of balance sheet total of the Serbian financial sector. This assessment was based on general variables which also cover the existence of a comprehensive legal framework in the area of ML/TF prevention measures, efficient entry control mechanisms in licensing, the situation established in on-site and off-site supervision, the analysis of reports and questionnaires delivered by these institutions to the NBS and Administration, activities taken, based on the Moneyval recommendations and inherent variables which affect the final vulnerability assessment.

However, though the ML/TF risk in this area is low, it should by no means be ignored. Financial lessors are obliged to take all stipulated actions and measures necessary for detecting and preventing ML/TF, as obligors under the Law.

II General data on financial lessors

There were 17 licensed financial lessors in Serbia on 31 December 2019¹. At the end of the reporting period, eight lessors operated through 13 branches (47.05%).

There were 349 employees in the financial leasing sector, of whom 155 (44.41%) front-office staff applying some of the CDD actions and measures. The average number of clients per front-office employee applying CDD actions and measures equalled 122.

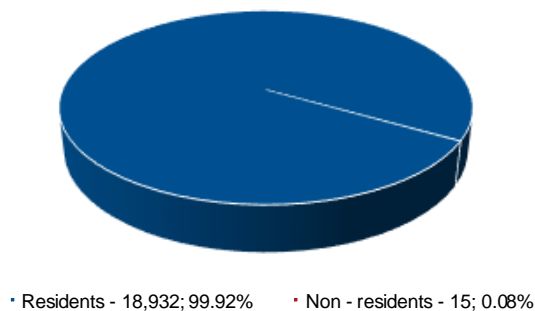
Based on the size of the business network, as a factor affecting the ML/TF risk exposure, the exposure of financial lessors to the ML/TF risk is judged to be low, as assessed in the previous reporting period (as at 30 September 2018).

¹ Four lessors were undergoing voluntary liquidation, approved by the NBS.

III Clients

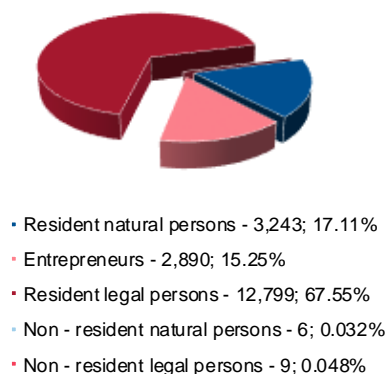
The total number of clients was 18,947 at the end of the reporting period. Residents made up over 99% (Chart 1). Resident legal persons had the largest share in the total number of clients (67.55% or 12,799), followed by resident natural persons with a 17.11% share (or 3,243), operating resident natural persons with 15.25% (or 2,890), and six non-resident natural and nine non-resident legal persons (a negligible share), as shown in Chart 1.

Chart 1 Composition of clients in the financial leasing sector by residence as at 31 December 2019



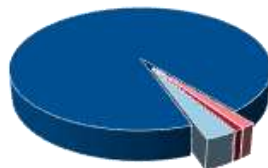
Compared to the previously observed period (as at 30 September 2018), the number of clients went up by 7,300, or by almost 62.67%.

Chart 2 Composition of clients in the financial leasing sector as at 31 December 2019



As most residents were legal persons, they are classified as follows: legal persons in the form of limited liability companies, legal persons in the form of joint-stock companies, legal persons in other forms (such as limited partnerships, partnership companies), and those that did not take any of the said forms, but are, for instance, associations, foundations, endowments, sports associations, etc. (“others”) (Chart 3).

Chart 3 Composition of resident legal persons by type of their organisation as at 31 December 2019



- Legal persons organised as limited liability companies - 12,089; 94.45%
- Legal persons organised as joint stock companies - 186; 1.45%
- Legal persons organised in other legal forms - 115; 0.90%
- Others (associations, endowments, foundations, sports associations, etc.) - 409; 3.19%

The majority of resident legal persons (12,089) were limited liability companies (94.45%), while legal persons in the form of joint-stock companies made up around 1.45% (186), legal persons in other legal forms – around 0.90% (115), and “others” made up 3.20% (409).

None of the non-resident natural persons was assessed as a high-risk client. Non-resident natural persons came from the countries classified by lessors as medium-risk, medium-low and low-risk – two persons from France (low-risk) and one from Croatia (medium-risk), Brazil (medium-risk), Macedonia (medium-risk), and Romania (medium-low risk).

At the end of the reporting period, there were nine non-resident legal persons – two from Bosnia and Herzegovina (assessed as high-risk by one lessor and as medium-risk by another), and one from Belgium (classified into the medium-risk level), Germany (medium-risk), Italy (medium-risk), France (low-risk), Slovenia (medium-low-risk), Sweden (medium-low-risk), and Bulgaria (low-risk).

According to the Questionnaire, there were two non-resident legal persons in the entire financial leasing sector which in their ownership structure had persons from high-risk countries, and there were no non-resident legal persons with a trust in their ownership structure.

As in previously analysed periods, there were no significant changes in the composition of clients by residence, with an upward trend observed in the total number of clients.

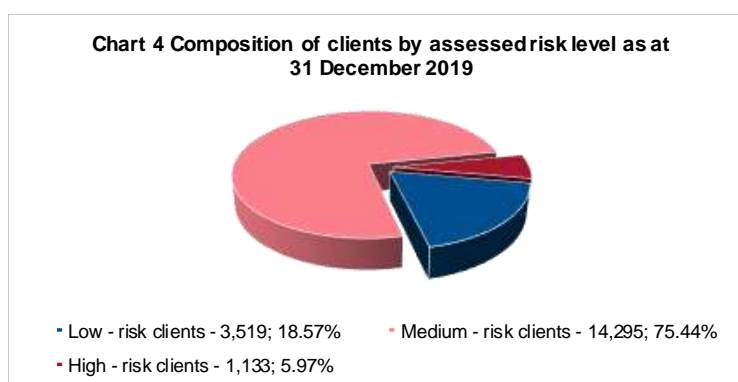
When assessing the clients' structure as a factor affecting the ML/TF risk exposure, many indicators are used, such as the number of high-risk clients, clients who are officials (domestic and foreign), high-risk legal persons with a complex ownership structure, with persons from off-shore geographical areas or with a trust in their ownership structure, with an official in the governance structure, non-resident natural and legal persons from high-risk and off-shore geographical areas and countries with strategic deficiencies, the number of clients organised as limited liability companies, entrepreneurs. Looking at these indicators, it can be concluded that the risk

exposure is low, given that the individual share of each of them in the total number of clients in the financial leasing sector was low.

IV Client composition by the assessed risk level

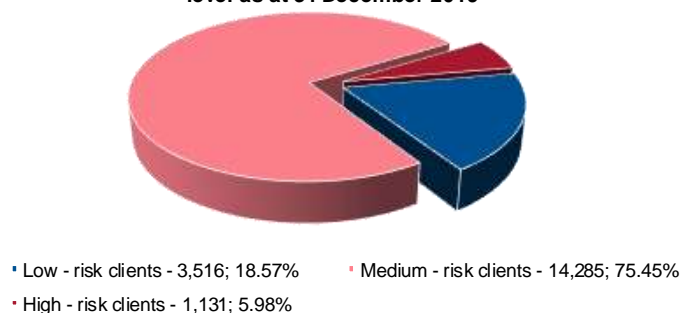
Within the financial leasing sector, clients are divided into three categories, according to the assessed ML/TF risk level – low, medium and high.

The majority of clients were assessed as medium-risk (14,295), with a share of around 75.44%, followed by clients in the low-risk level (3,519), with a share of around 18.57%, while those classified as high-risk (1,133) were in the third place, making up around 5.97% of the total number of clients, as shown in Chart 4.



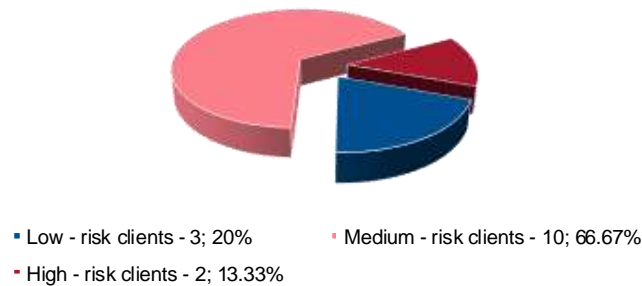
Relative to the previously analysed period, there were no significant changes in the composition of clients by the risk level. Charts 5 and 6 give an overview of the composition of clients in the financial leasing sector by the risk level – for residents and non-residents.

Chart 5 Composition of resident clients by assessed risk level as at 31 December 2019



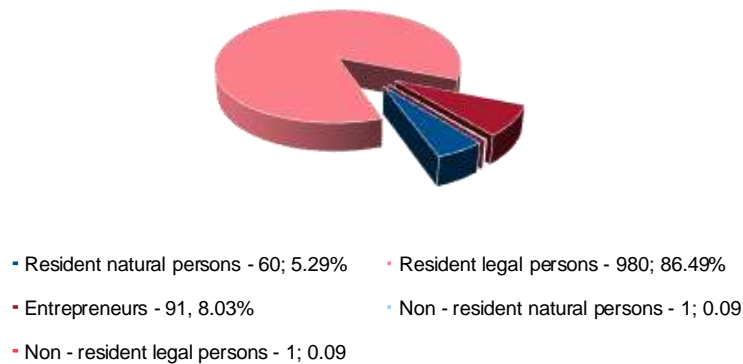
The bulk of residents are classified into the medium-risk level – 14,285 of them or 75.45%, followed by clients in the low-risk level (3,516 or 18.57%), while clients classified as high-risk were the fewest – 1,131 or 5.97%.

Chart 6 Composition of non-resident clients by assessed risk level as at 31 December 2019



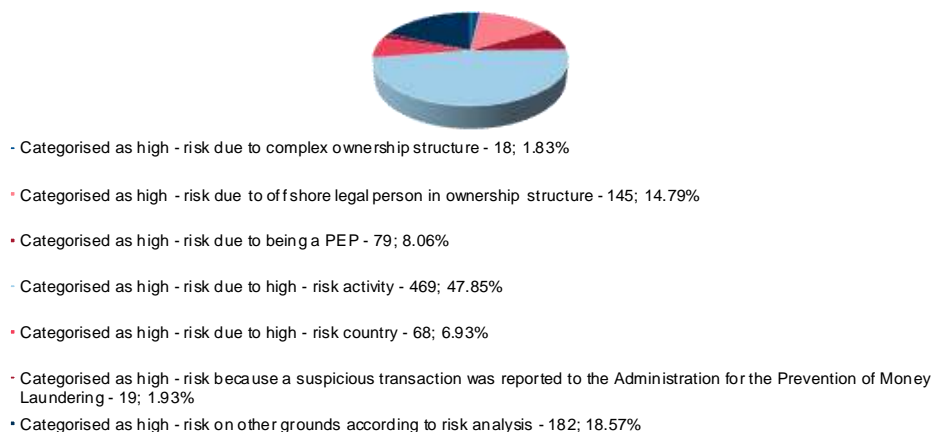
The majority of non-residents (10 clients – 66.67%) belonged to the medium-risk level, three non-residents were in the low-risk level and two in the high-risk level.

Chart 7 Composition of high-risk clients as at 31 December 2019



The majority of high-risk clients were resident legal persons (980 of 1,133), making up around 86.49% of high-risk clients.

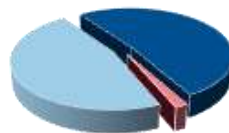
Chart 8 High - risk countries - Resident legal persons as at 31 December 2019



The bulk of resident legal persons were classified as high-risk, due to their high-risk activities (almost a half of them, around 47.86%). The remaining resident legal persons were classified into the high-risk level as they had a public official in their ownership/governance structure (8.06%), had a high-risk country founder/beneficial owner (6.94%), reported suspicious transactions to the Administration (1.94%), had a complex ownership structure (1.84%) or were high-risk on other grounds in accordance with the risk analysis. In H1 2019 there were no suspicious transactions reported to the Administration, while at the end of the reporting period, 19 suspicious transactions were reported, all of them by a single lessor.

Resident natural persons were mostly classified in the high-risk category because they were public officials (around 51.67%), while close to 47% belonged to this risk level on other grounds, as shown in Chart 9.

Chart 9 High - risk countries - Resident natural persons as at 31 December 2019



- Categorized as high - risk due to being a PEP - 31; 51.67%
- Categorized as high - risk because the business relationship was established without the physical presence of the party - 1; 1.67%
- Categorized as high - risk because a suspicious transaction was reported to the Administration for the Prevention of Money Laundering - 0
- Categorized as high - risk on other grounds according to risk analysis - 28; 46.67%

The majority of entrepreneurs (natural persons engaged in a business activity) were classified as high-risk due to their high-risk activities (Chart 10).

Chart 10 High - risk countries - Entrepreneurs as at 31 December 2019

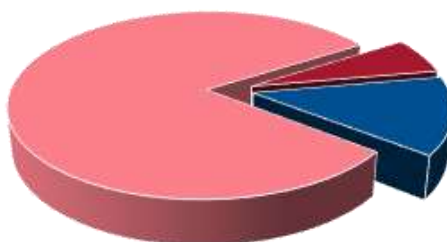


- Categorized as high - risk due to being a PEP - 8; 8.79%
- Categorized as high - risk due to high - risk activity - 71; 78.02%
- Categorized as high - risk because a suspicious transaction was reported to the Administration for the Prevention of Money Laundering - 2; 2.19%
- Categorized as high - risk due to other bases according to risk analysis - 10; 10.98%

V Client composition by CDD actions and measures

Simplified CDD actions and measures were applied to 2,510 clients, general CDD to 15,263 clients and enhanced to 1,174 clients. In percentage terms, general CDD was applied to 80.55% of clients, simplified measures to 13.25% of clients and enhanced to 6.20% of clients (Chart 11).

Chart 11 Composition of clients by CDD actions and measures applied as at 31 December 2019



• Simplified - 2,510; 13.25% • General - 15,263; 80.55% • Enhanced - 1,174; 6.20%

Table 1 Overview of applied CDD actions and measures by residence as at 31 December 2019

Clients	Simplified CDD actions and measures	General CDD actions and measures	Enhanced CDD actions and measures
Resident natural persons	695	2,494	60
Resident legal persons	1,456	8,828	1,012
Natural persons engaged in a business activity	356	3,931	100
Non-resident natural persons	2	3	1
Non-resident legal persons	1	7	1
Total	2,510	15,263	1,174

Table 2 Structure of financial leasing sector clients by risk level and actions and measures applied as at 31 December 2019

Risk level	No of clients	Share in %	Applied measures	No of clients	Share
Low	3,519	18.57%	Simplified	2,510	13.25%
Medium	14,295	75.45%	General	15,263	80.55%
High	1,133	5.98%	Enhanced	1,174	6.20%
	18,947	100%		18,947	100%

Judging by responses to the Questionnaire, financial lessors did not apply simplified actions and measures to all low-risk clients, but to 71.33% of them. Lessors applied enhanced actions and measures to all clients classified as high-risk, while the bulk of clients were subject to general CDD. Accordingly, the client composition by CDD actions and measures mostly corresponds to the client composition by the assessed ML/TF risk level, given that enhanced CDD actions and measures were applied to more clients than those classified as high-risk, and general to more clients than those classified as medium-risk, meaning that these actions and measures were also applied to some low-risk clients.

In the reporting period, there were no cases of termination of a business relationship due to the impossibility to apply CDD actions and measures referred to in Article 7, paragraph 1, items 1–5 of the Law. Two financial lessors refused the offer to establish a business relationship due to the impossibility to apply CDD actions and measures referred to in that Article. Data were not submitted at the request of the Administration for any of the clients with which a business relationship was established.

VI Products and services

The number of lease agreements concluded in the reporting period was 17,249, with the total value of EUR 2,751,532,314.34, of which 2,421, or 14.03% were signed with clients classified as high-risk. The average value of leasing agreements was EUR 159,518.36.

The total number of lease agreements in which the amount of the lease fee exceeded EUR 1,000 for natural persons was 187, with the total value of EUR 6,221,149.12, while the number of those in which the fee exceeded EUR 5,000 was 299, with the total value of EUR 160,636,880.20.

Eleven financial lessors had cases in which third parties provided a guarantee for the lessee, and the relationship between the lessee and the guarantor was clear in all cases.

Taking into account all the above and the fact that the scope of financial lessors' activities is rather limited and includes financial intermediation between financial lessors and lessees, the risk based on the products and services offered by the financial leasing sector is judged to be low.

VII Outsourcing CDD actions and measures

Only two lessors outsourced CDD actions and measures – to Raiffeisen bank (Raiffeisen leasing) and to Procredit bank (Procredit leasing), with 17 clients, at the level of the financial leasing sector, who outsourced the provision of data and documents. At the end of the previous reporting period, three lessors outsourced CDD actions and measures.

Given that only a small number of financial lessors entrusted CDD actions and measures to third parties, it is estimated that the ML/TF risk exposure on this account is low as well.

VIII Employee training

According to the responses to the Questionnaire, all employees from the financial leasing sector were aware of the consequences of non-compliance with law and procedures regulating AML/CFT. Training was usually carried out by compliance officers and their deputies. According to the Law, a compliance officer is a person employed with an obligor, who is entrusted with the powers allowing for effective, prompt and quality execution of tasks prescribed by this Law, who has not been convicted by a final judgement or has not been prosecuted, and who is professionally trained for AML/CFT operations and is familiar with the obligor's operations in areas that are vulnerable to the ML/TF risk. These conditions must also be met by the compliance officer deputy.

The training is usually delivered in the form of workshops, or a combination of workshops and e-learning, at least once a year and in the case of some financial lessors three or more times a year. The training of compliance officers and their deputies is organised in various ways and carried out in the form of presentations, direct training, seminars, conferences and lectures. The number of lessors who tested their staff upon training completion was 14. Two lessors, in the process of voluntary liquidation, did not provide the answer to this question, and only one lessor did not test staff knowledge.

At the end of the reporting period, ten lessors had a special AML programme, i.e. application for AML/FT activities. In nine lessors, this programme allowed for the classification of clients by the risk level. After the check-up of data aimed at their identification, clients are classified. The geographic risk, client risk, products and

transactions risks, are particularly taken into account, with a special focus on clients who are public officials, as well as legal persons with a complex ownership structure.

All financial lessors used the lists of indicators for detecting suspicious AML/CFT-related transactions, published on the website of the Administration. Apart from these indicators, seven financial lessors included their own indicators in these lists. In the reporting period, most financial lessors prepared official notes on the performed transactions analysis (14). Total 551 notes on the performed transactions analysis were prepared in the reporting period.

All financial lessors used the lists of designated persons, published by the UN Security Council and other international organisations of which Serbia is a member. Eleven lessors used some of the commercial databases for filtering designated persons, including the software of the Administration, as an additional element of client verification. Thirteen financial lessors had in place internal procedures on restrictions of the disposal of assets.

There was one case when clients or persons who tried to establish a business relationship or any other person with whom a financial lessor had a business or other similar relationship were designated persons, and the financial lessor refused to establish a business relationship with this person.

The financial leasing sector established efficient ML/TF risk exposure identification and assessment processes, as well as adequate employee training programmes on this risk. The sector has adequate information systems with regular reporting on the ML/TF risk to relevant management levels and employees responsible for managing this risk.

IX Organisational structure

The majority of compliance officers and their deputies, who should exclusively perform activities of detecting and preventing ML/TF, as defined by the Law, also performed other activities on a daily basis (in 16 out of 17 financial lessors). In six lessors the number of staff changed, but these changes were insignificant. In four lessors, employment increased, while in two it negligibly decreased.

The financial leasing sector applied generally defined, clear lines of responsibility in identifying, measuring, monitoring and reporting on the ML/TF risk, and the risk management system is based on adequate human and technical resources. Accordingly, the ML/TF risk exposure is estimated as low.

X Reporting to the AML/CFT compliance officer and to the Administration

Employees submitted 189 reports on suspected money laundering to compliance officers and four suspicious client transactions were reported to the Administration. No internal reports on suspected terrorism financing were submitted to compliance officers in the reporting period.

XI Internal audit and internal controls

Ten financial lessors carried out internal audit last year and the remaining seven two or three years ago. Irregularities were identified in ten financial lessors, and removed in nine of them (90% of cases), while in one financial lessor the deadline has not yet expired.

Irregularities mainly pertained to the following: inadequately assessed clients, irregularities which occurred at the stage of account opening for natural and legal persons, irregular checks and revisions of implemented indicator set-ups, minor irregularities in the identification of public officials, uneven practice for keeping the ID copies of non-clients, deficiencies in terms of implementation of AML policies in the event of client identification and file completeness, deficiencies concerning note taking (form of notes), entry of data about ML risk levels in the application, etc.

Fifteen of 17 financial lessors stated that compliance officers and their deputies participated in the implementation of internal controls. In all 15 financial lessors, the compliance officer reported to the management on the results of internal controls. In the past two years, all lessors were subject to internal audit and irregularities were established in five of them. These irregularities mainly related to the following: unsatisfactory document quality, incomplete documents for the establishment of the ownership structure and identification of the beneficial owner, inadequate client classification by the risk level, non-updated KYC forms, etc. Deadlines for the elimination of these irregularities were set and four lessors removed them.

The boards of directors were informed about AML/CFT-related audit findings in all lessors, and the external auditor's report regulated this area in five lessors. None of the financial lessors or their employees was being prosecuted for ML/TF-related matters, and one disciplinary procedure was conducted due to employee integrity (participation in fraud, theft, corruption, etc.), the same as in the previous reporting period.

Given the above, an adequate and comprehensive internal controls system is in place in the financial leasing sector, with mechanisms to ensure that appropriate levels of management are timely informed about any breach of procedures so that they can take the necessary measures. Financial lessors periodically carry out internal audits, covering the key elements of ML/TF risk management and control.