NATIONAL BANK OF SERBIA

AML SUPERVISION CENTRE

ANALYSIS OF RESPONSES TO THE QUESTIONNAIRE ON FINANCIAL LESSORS' ML/TF RISK MANAGEMENT ACTIVITIES 2021

Belgrade, May 2022

Introductory note

The Law on Financial Leasing designated the National Bank of Serbia (hereinafter: NBS) as the institution which issues and revokes licences for performing financial leasing transactions, grants consent for the acquisition of shares/stakes in lessors, gives consent to the appointment to managing bodies of lessors, and other types of consents in accordance with the Law on Financial Leasing (RS Official Gazette, Nos 55/200, 61/2005, 31/2011 and 99/2011 – other law).

Pursuant to the Law on the Prevention of Money Laundering and Terrorism Financing (RS Official Gazette, Nos 113/2017, 91/2019 and 153/2020, hereinafter: Law), the NBS is in charge of supervising financial lessors' implementation of the law governing the prevention of money laundering and terrorism financing (hereinafter: ML/TF) in accordance with the Law on Financial Leasing.

In 2010, the NBS established the practice of off-site supervision of financial lessors' ML/TF risk management activities. 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 on ML/TF risk management activities (hereinafter: Questionnaire).

Questions in the Questionnaire are sorted into 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 to third parties

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: Administration)

Part X: Internal audit and internal control

The key objectives of the analysis of data from the Questionnaire:

– insight into the state-of-play in terms of identifying, measuring and managing the ML/TF risk in the financial leasing activities;

– off-site monitoring of the development of the ML/TF risk management system in the financial lessors;

– identification of the possible deficiencies and timely alerting financial lessors to the potential ML/TF risk exposure and

– promotion of adequate implementation of the established rules and principles of the "Know Your Client" procedure (KYC);

The analysis is based on data for the reporting period 1 January – 31 December 2021, which all financial lessors operating in the financial leasing market of the Republic of Serbia submitted as their responses to the Questionnaire.

Contents:

I. Key findings

Based on the analysis, primarily of the inherent ML/TF risk exposure, i.e. quantitative and qualitative data and information from the Questionnaire, as well as data and information related to the management and control of this risk, the overall conclusion is that financial lessors had low exposure to the ML/TF risk in this and in the previously analysed periods.

Low exposure of financial lessors to the ML/TF risk resulted from the following:

In terms of the **business network size**, the financial leasing sector poses a low risk considering the number of clients with whom they established business relations, the small number of branches/branch offices and the total number of front-office employees. As at 31 December 2021, 16 financial lessors were licensed to perform financial leasing transactions in the Republic of Serbia. There were 356 employees in total, of which 168 were front-office staff applying some of the CDD actions and measures. At the end of the reporting period, business relations with clients could be established at 114 locations in the country and the total number of financial lessors' branches was 12.

The **composition of clients** is another factor behind the low ML/TF risk exposure. This refers primarily to the composition of clients by residence and the fact that non-residents account for a negligible share in the total number of clients (around 0.07%).

Resident legal persons accounted for the dominant share (around 66%) in the total number of clients as at 31 December 2021. Within the financial leasing sector, clients are divided into three categories, according to the risk analysis: low, medium and high ML/TF risk exposure. Namely, the bulk of clients are in the medium-risk category (16,798 clients in total), accounting for a share of over 75%, followed by the low-risk category (4,399) with a share of around 20%, while those classified as high-risk (1,164) were in the third place, making up around 5% of the total number of clients. The majority of clients assessed as high-risk clients are resident legal persons who were thus classified mostly due to the risk involved in their business activities. Only three of the non-resident clients were classified in the high-risk group, of which two were legal persons and one was a natural person. 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.

As for **products and services**, since financial leasing is almost the only activity that financial lessors are allowed to provide, and considering the number, total and average value of all concluded financial lease agreements as well as the number, total and average value of these agreements concluded with clients assessed as high-risk, it can be concluded that the ML/TF risk exposure is low on this account as well.

As for **outsourcing CDD actions and measures to third parties**, only two financial lessors outsourced these activities to a third party – their parent banks/founders, which is also an indicator of low ML/TF risk exposure.

The findings obtained from analysing the data and information on measures taken by financial lessors to adequately manage and control the ML/TF risk in the observed period indicate that this risk, though low, has been adequately managed. Namely, the following indicators were taken into account in the assessment of the ML/TF risk management and control:

- All financial lessors' employees are aware of the consequences of non-compliance with laws and procedures of ML/TF prevention (primarily through trainings). Financial lessors pay due attention to staff training which is carried out through workshops or a combination of workshops and e-learning at least once a year, and in some lessors even three or more times per year;
- At the end of the reporting period, eleven financial lessors had a special AML software/application used for performing the ML/TF prevention activities. In nine lessors, this software/application enabled the classification of clients by the risk degree;
- All financial lessors use the lists of indicators for recognising suspicious ML/TF transactions published on the Administration's website, as well as the lists of designated persons, published by the UN Security Council and other international organisations in which Serbia is a member;
- Financial lessors set up their own ML/TF risk management systems and adequately regulated the internal controls systems in their internal acts;
- Client composition by CDD actions and measures applied (simplified, general and enhanced) is relatively consistent with the client composition by the assessed ML/TF risk level. Financial lessors do not apply simplified actions and measures to all low-risk clients, but to somewhat more than 67% of them. Enhanced actions and measures are applied to all clients classified as high-risk, while the bulk of clients are subject to general actions and measures. The above highlights the fact that financial lessors understood the significance of proper ML/TF risk assessment, which, coupled with stronger caution, resulted in an adequate allocation of human resources, and consequently in high-quality ML/TF risk management.
- In the reporting period, there were no cases of termination of a business relation due to the impossibility to apply CDD actions and measures referred to in Article 7, paragraph 1, items 1–5 of the Law. There were no refusals of the offer to establish a business relation due to the impossibility to apply the said actions and measures.

Although the ML/TF in this area risk is low, it should by no means be ignored. As obligors under the Law on the Prevention of Money Laundering and Terrorism Financing, financial lessors are required to take all prescribed actions and measures necessary for ML/TF detection and prevention.

II. General financial lessors' data

As at 31 December 2021, 16 lessors[1] in Serbia had the financial leasing licence, of which seven (almost 50%) operated through a total of 12 branches.

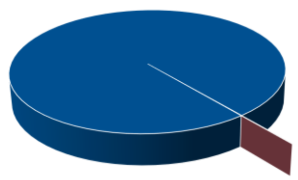
Total financial leasing sector employment was 356, of which 168 (over 47%) were front-office staff applying some of the CDD actions and measures. At the sector level, the average number of clients per front-office staff member applying CDD actions and measures was 133 at the end of the reporting period, which is an increase from 2020 (127).

In this context, given the size of the business network as a factor affecting the ML/TF risk exposure, financial lessors' estimated exposure to the ML/TF risk is low, the same as in the previously analysed period, as at 31 December 2020.

III. Clients

As at 31 December 2021, the total number of clients came at 22,361, of which over 99% were residents (Chart 1). Resident legal persons accounted for the highest share – 66.07% (14.774 in total), followed by entrepreneurs – 17.71% (3,961 in total), resident natural persons – 16.14% (3,610 in total). There were seven non-resident natural persons, and nine non-resident legal persons, with negligible shares (Chart 2).

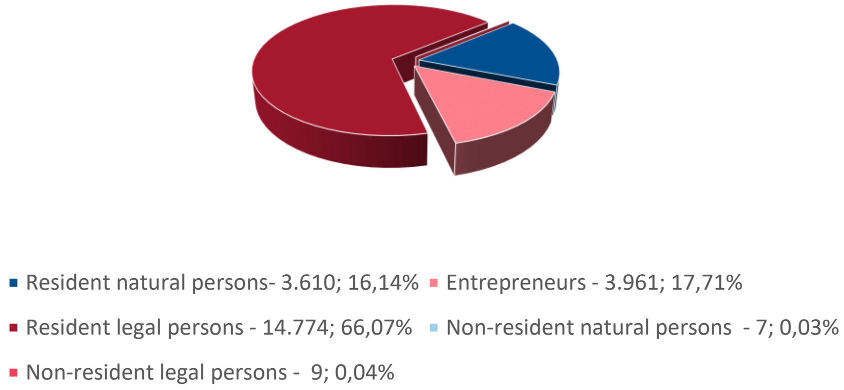
Chart 1 Composition of clients by residence as at 31 December 2021



Compared to the previous reporting period (as at 31 December 2020), the number of the financial lessors' clients grew by 1,954.

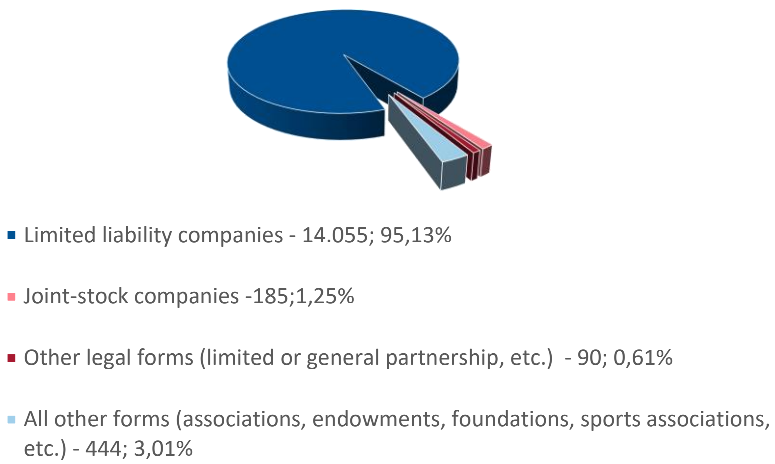
[1] Three lessors are undergoing voluntary liquidation, approved by the NBS.

Chart 2 Composition of clients in the financial leasing sector as at 31 December 2021



As the bulk of residents are legal persons, the following chart presents their classification into: legal persons organised as limited liability companies, legal persons organised as joint-stock companies, legal persons organised in other forms (such as limited and general partnerships) and those that do not belong to any of the said categories, such as associations, endowments, foundations, sport associations, etc. (categorised as "others") (Chart 3).

Chart 3 Composition of resident legal persons by legal form as at 31 December 2021



The bulk of resident legal persons (14,055 or 95.13%) are limited liability companies. It should be noted that the National Risk Assessment estimates them as being risky from the ML/TF perspective. The share of legal persons that are organised as joint-stock companies amounts to 1.25% (185). Th share of legal persons organised in other legal forms was 0.61% (90), and "others" accounted for around 3.01% (444 legal persons).

Non-resident natural persons are from the countries classified by financial lessors into the high-, medium- and low-risk category, one person coming from each of the following countries: Romania, Poland, Australia, Portugal and US (assessed as medium-risk country), UK (assessed as medium-low risk) and Lithuania (assessed as high-risk).

Non-resident legal persons are from the countries classified by financial lessors into the medium-low, medium- and high-risk category, one person coming from each of the following countries: Sweden and Bulgaria (assessed as a medium-low risk country), Slovenia, Italy, Belgium and Germany (assessed as a medium-risk country), Bosnia and Herzegovina and Macedonia (assessed as a high-risk country).

According to the Questionnaire, there are two non-resident legal persons classified as high-risk in the entire financial leasing sector – one due to the country risk (of the founder/beneficial owner) and one due to other reasons in accordance with the risk analysis. There were no non-resident legal persons with a trust in their ownership structure.

As in the 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.

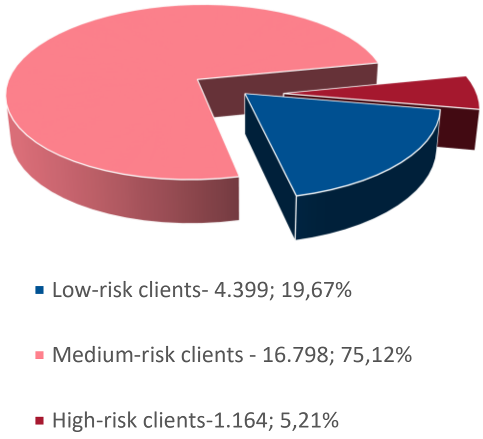
When assessing the composition of clients, as a factor affecting the ML/TF risk exposure, numerous indicators are taken into account, such as the number of high-risk clients, clients who are officials (domestic and foreign), high-risk legal persons: with a complex ownership structure, with persons from off-shore geographical areas or with a trust in their ownership structure, with an official in the management 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 the above 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 is low.

IV Client composition by the assessed risk level

According to the ML/TF risk analysis, financial leasing clients are divided into three categories: low, medium and high.

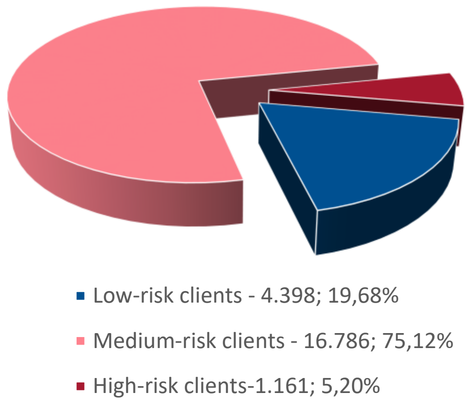
The majority of clients are classified in the medium-risk category, a total of 16,798, accounting for a share of around 75.12%, followed by clients in the low-risk category (4,399) with a 19.67% share, while those classified as high-risk (1,164) were in the third place, making up around 5.21% of the total number of clients, as shown in Chart 4.

Chart 4 Composition of clients by risk level as at 31 December 2021



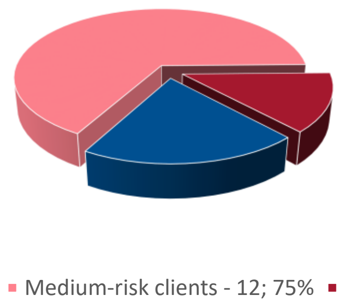
Relative to the previously analysed period, there were no significant changes in the composition of clients by risk level. Charts 5 and 6 show the composition of clients in the financial leasing sector by risk level – for residents and non-residents.

Chart 5 Composition of resident clients by risk level as at 31 December 2021



The bulk of residents were classified as medium-risk (16,786 clients or 75.12%), followed by low-risk clients (4,398 or 19.68%), while the smallest number were classified as the high-risk category (1,161 or 5.2%).

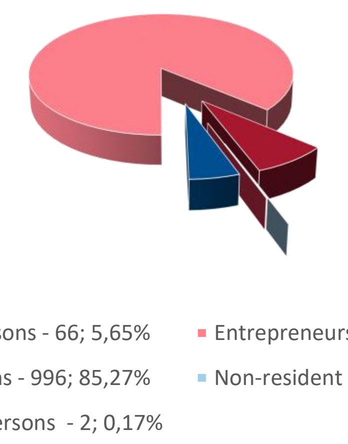
Chart 6 Composition of non-resident clients by risk level as at 31 December 2021



The majority of non-residents (12 clients – 75%) were classified in the medium-risk category, three non-residents were classified in the high-risk category, and one in the low-risk category.

Chart 7 shows the composition of high-risk clients.

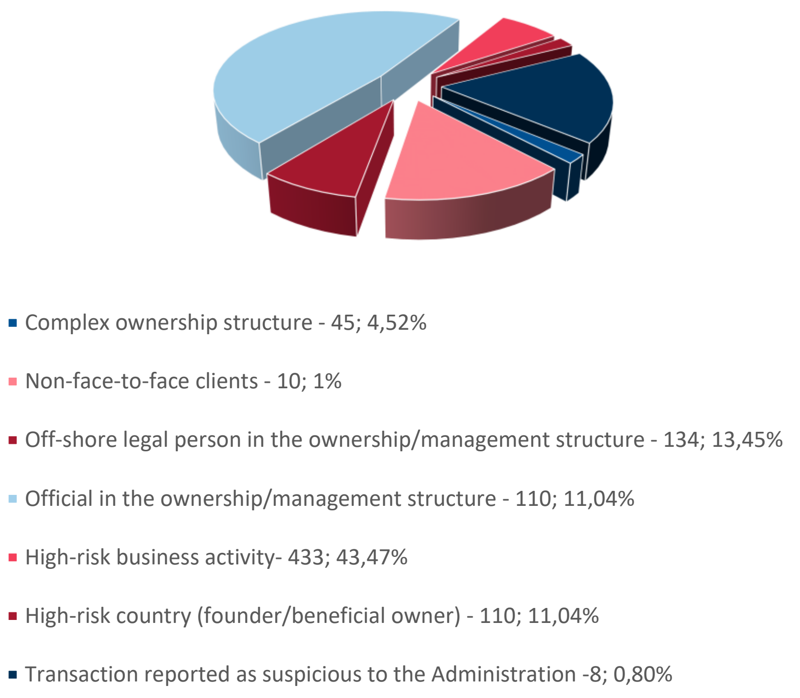
Chart 7 Composition of high-risk clients as at 31 December 2021



Resident legal persons are dominant among clients in the high-risk category (996 of 1,168), accounting for an 85.27% share.

As the majority of high-risk clients are resident legal persons, Chart 8 shows their composition by various indicators for this classification.

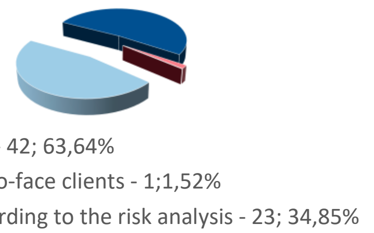
Chart 8 High-risk clients - Resident legal persons as at 31 December 2021



The largest percentage of resident legal persons are classified as high-risk due to risky nature of their activity (almost half of them, around 43.47%). The remaining resident legal persons are classified into the high-risk category on other grounds in accordance with the risk analysis (14.66%), because of an off-shore legal person in the ownership structure (13.45%), officials in their ownership/management structure and high country risk of its founder/beneficial owner (11.04%), complex ownership structure (4.52%), establishing business relations through their authorised persons without being physically present (1%), and transactions reported as suspicious to the Administration (0.8%). There were no suspicious transactions of clients reported to the Administration in the observed period.

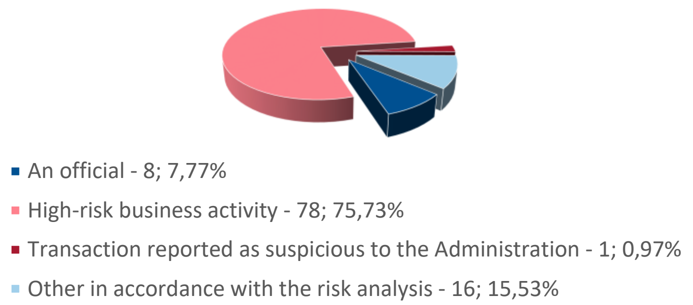
Resident natural persons were classified into the high-risk category mostly because they are officials (63.64%), while around 34.85% belong to this risk category on some other grounds in accordance with the risk analysis, as presented in Chart 9.

Chart 9 High-risk clients - Resident natural persons as at 31 December 2021



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

Chart 10 High-risk clients - Entrepreneurs as at 31 December 2021



V. Client composition by CDD actions and measures

Simplified CDD actions and measures were taken in respect of 2,972 clients, general in respect of 18,140 clients and enhanced in respect of 1,249 clients. In percentage terms, general CDD actions and measures were applied to 81.12% of clients, simplified to 13.29% and enhanced to 5.59% of clients (Chart 11).

Chart 11 Composition of clients by CDD actions and measures as at 31 December 2021

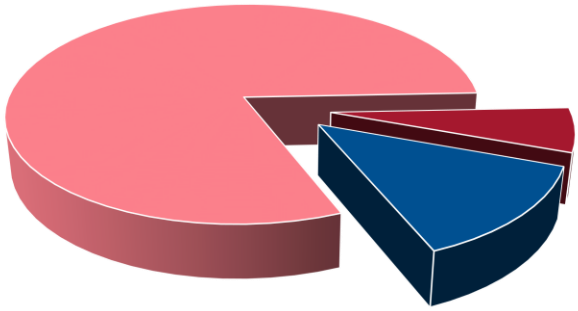


Table 1 shows CDD actions and measures applied in respect of clients by residence.

Table 1 **Applied CDD actions and measures by residence as at 31 December 2021**

Clients	Simplified CDD actions and measures	General CDD actions and measures	Enhanced CDD actions and measures
Resident natural persons	771	2,773	66
Resident legal persons	1759	11,959	1056
Natural persons engaged in a business activity	441	3,396	124
Non-resident natural persons	0	5	0
Non-resident legal persons	2	7	2
Total	**2973**	**18,140**	**1248**

Table 2 shows a comparative overview of the number of clients by risk level and CDD actions and measures as at 31 December 2021.

Table 2 **Composition of financial leasing sector clients by risk level and CDD actions and measures applied**

Level of risk	No of clients	Share	Customer due diligence actions and measures	No of clients	Share
Low	4,399	19.67%	Simplified	2,973	13.30%
Medium	16,798	75.12%	General	18,140	81.12%
High	1,164	5.21%	Enhanced	1,248	5.58%
	22,361	100.00%		**22,361**	**100%**

Based on the analysis of data from the Questionnaire, it can be concluded that financial lessors do not apply simplified actions and measures to all low-risk clients but to 67.58% of them. Enhanced actions and measures are applied to all clients classified as high-risk, while the bulk of clients are subject to general actions and measures. Accordingly, client composition by CDD actions and measures applied mostly corresponds to client composition by the assessed ML/TF risk level, given that enhanced CDD actions and measures are applied to more clients than are classified as high-risk, and general measures to more clients than are classified as medium-risk. This means that these actions and measures are also applied to a part of low-risk clients.

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

VI Products and services

The total number of concluded lease agreements in the reporting period amounted to 16,321, up by 2,754 from 2020 (13,567 contracts). Of that number, 2,157 or 13.22% were concluded with high-risk clients. Some respite in the spread of the infectious disease caused by the COVID-19 in 2021 is probably the main reason why the number of concluded financial lease agreements increased relative to 2020, returning to the levels typical for the pre-pandemic period.

In the reporting period, the number of lease agreements in which the amount of the lease fee exceeds EUR 1,000 for natural persons was 91 (down from 121 on 31 December 2020), while the number of agreements in which the fee exceeds EUR 5,000 was 590 (up from 444 on 31 December 2020).

In the reporting period, 9 financial lessors had cases in which third parties provided a guarantee for the lessee. In all such cases, the relationship between the lessee and the guarantor was clear.

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 stemming from the products and services offered by the financial leasing sector is judged to be low.

VII Outsourcing CDD actions and measures to third parties

Only two financial lessors outsourced some of the CDD actions and measures to a third party – their parent banks/founders, which is also an indicator of low ML/TF risk exposure.

As 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

Based on the responses to the Questionnaire, it can be concluded that all employees from the financial leasing sector are aware of the consequences of non-compliance with laws and procedures regulating AML/CFT.

Training in financial lessors is usually carried out by compliance officers and their deputies. According to the Law, a compliance officer means a person employed at the obliged entity in a position with powers allowing for an effective, efficient and good quality performance of all tasks laid down in this Law, who has not been sentenced by a final court decision or subject to any criminal proceedings, and who is professionally qualified for the tasks of prevention and detection of money laundering and terrorism financing and is familiar with the nature of the obliged entity's business in the areas vulnerable to ML/TF risks. Deputy compliance officer shall meet the same requirements. Financial leasing training is conducted in the form of workshops, or a combination of workshops and e-learning, at least once a year. Training of compliance officers/their deputies is conducted in the form of presentations, direct trainings, seminars, conferences and lectures. All lessors test their employees who have completed training, except for those currently undergoing liquidation.

At the end of the reporting period, eleven financial lessors had a special AML software/application for performing activities regarding ML/TF prevention. In nine of them, the software/application enables the classification of clients by the risk degree. Clients are classified after verification of data used for identification, particularly taking into account the geographical risk, client, product and transaction risk, with special attention to clients who are officials and legal persons with a complex ownership structure.

All financial lessors use the lists of indicators for recognising suspicious ML/TF-related transactions, published on the Administration's website. Apart from the mentioned indicators, six financial lessors included their own indicators in the mentioned lists. In the reporting period, most (13) financial lessors prepared official notes on the performed transactions analyses.

All financial lessors use the lists of designated persons, published by the UN Security Council and other international organisations of which Serbia is a member. Thirteen of the financial lessors use some of the commercial databases for filtering designated persons, including the Administration's software, as an additional element of client verification.

In the reporting period, there were no cases that clients or persons who tried to establish a business relation or any other person with whom a financial lessor has or had a business or other similar relationship were designated persons. A designated person is natural person, legal person, or a group or an association, registered or unregistered, designated and listed as a terrorist, terrorist organisation or terrorist financier, and listed on the list of persons linked to proliferation of weapons of mass destruction and special lists based on: relevant UN Security Council Resolutions or acts of international organisations of which Serbia is a member, proposal of competent state authorities or a justified request of a foreign state. Special lists are the lists drawn up based on UN Security Council Resolutions or acts of international organisations of which Serbia is a member, other than those listing natural or legal persons, groups or associations, which list movable and immovable property linked to proliferation of weapons of mass destruction, e.g. vessels, airplanes, etc.

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

IX Organisational structure

In addition to performing activities in detecting and preventing ML/TF, the majority of compliance officers and their deputies also perform other activities on a daily basis.

Staff numbers changed in eight financial lessors, but these changes were insignificant.

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

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

In the reporting period, employees submitted a total of 10 reports on suspected money laundering, and the Administration was not provided with data related to these reports. Besides, no internal reports on suspected terrorism financing were submitted to compliance officers in the reporting period.

XI Internal audit and internal control

During the past year, four financial lessors carried out internal audit, while in the remaining 12 lessors, it took place two or three years ago. These audits identified irregularities in eight financial lessors and in more than half of them they were removed, while in the other half of them the set deadline has not yet expired.

Irregularities mainly relate to the following: inadequate client assessments, inadequate client screening, irregularities made while opening accounts for natural and legal persons, incomplete KUS forms, partial harmonisation of internal acts, insufficiently transparent monitoring of indicators and completeness of a file, etc.

Fifteen out of sixteen financial lessors declared that their compliance officers and their deputies participate in internal control. In all of the 15 lessors, the compliance officer reports internal control results to the management. In the past two years, all financial lessors performed internal control, and in nine of them irregularities were established. Most often these irregularities concern: untimely insight into the documents of the Business Registers Agency, incomplete documents for establishment the ownership structure and beneficial owner, inadequate classification of clients by risk degree, AML assessment not in line with internal acts, etc. Deadlines for eliminating these irregularities were set and seven financial lessors eliminated them.

The board of directors was informed about AML/CFT-related audit findings in all lessors, while the findings of the external auditor regulated this area in four lessors. There are no disciplinary proceedings conducted against financial lessors due to issues with employees' integrity (participation in fraud, theft, corruption, etc.), which is unchanged from the past period under review.

Given the above, it can be concluded therefore that 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 deviations from the application of procedures so that they can take the necessary measures. Financial lessors also periodically carry out internal audits covering the key elements of the ML/TF risk management and control.

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