NATIONAL BANK OF SERBIA

AML SUPERVISION CENTRE

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

2022

Belgrade, March 2023

Introductory note

As part of its supervisory function, the National Bank of Serbia (hereinafter: NBS) conducts off-site supervision and analysis of financial lessors' ML/TF risk management activities. At least annually, the NBS publishes the analysis of data from/responses to the Questionnaire on Financial Lessors' ML/TF Risk Management Activities (hereinafter: Questionnaire).

The purpose of analysing the Questionnaire is to understand the role and significance of the financial leasing sector in the overall AML/CFT system. This analysis also helps improve further the risk-based approach to supervising financial lessors' ML/TF risk management activities.

The questions in the Questionnaire are sorted into 10 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 analysing the submitted responses are:

– insight into the state-of-play in terms of identifying, measuring and managing the ML/TF risk in 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 2022, 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. the 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 2022, 15 financial lessors were licensed to perform financial leasing transactions in the Republic of Serbia. There were 354 employees in total, of which 184 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 37 locations in the country and the total number of financial lessors' branches was nine. The total number of clients as at 31 December 2022 was 25,813. There is a trend of increase in the total number of clients in the financial leasing sector – by 3,452 or 15.43%.

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 0.05%).

Resident legal persons accounted for the dominant share (around 67%) in the total number of clients as at 31 December 2022. Within the financial leasing sector, clients are divided into three categories according to the risk analysis: low, medium and high ML/TF risk exposure. The bulk of clients are in the medium-risk category (15,388 clients in total), accounting for a share of almost 60%, followed by the low-risk category (9,058) with a share of around 35%, while those classified as high-risk (1,367) were in the third place, making up more than 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 non-resident clients were classified in the high-risk group, and they were legal persons. As in the previously analysed periods, there were no significant changes in the composition of clients by residence.

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, like in earlier reporting periods, 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 ML/TF risk management and control:

- Financial lessors pay due attention to staff training through which all financial lessors' employees learn about the consequences of non-compliance with laws and ML/TF prevention procedures. Training 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. In the analysed period, 327 out of 354 financial leasing sector employees attended training (92.37%);
- At the end of the reporting period, nine financial lessors had a special AML software/application used for performing ML/TF prevention activities. In seven lessors, this software/application enabled the classification of clients by 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 53% 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. This indicates that financial lessors understood the significance of proper ML/TF risk assessment, which, coupled with enhanced caution, resulted in an adequate allocation of human resources and, by extension, 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, nor were there any refusals of the offer to establish a business relation due to the impossibility to apply the said actions and measures.

Although the ML/TF risk in this area 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 data on financial lessors

As at 31 December 2022, 15 financial lessors[1] had the financial leasing licence, of which five operated through a total of nine branches.

Total financial leasing employment was 354 persons, of which 184 (over 50%) were front-office staff applying some of the CDD actions and measures.

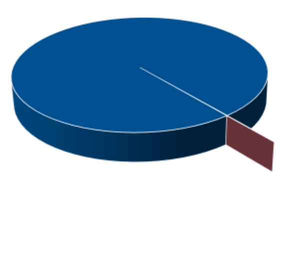
At the sector level, the average number of clients per front-office staff member applying CDD actions and measures was 140 at the end of the reporting period, which is an increase from 2021 (133).

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.

III Clients

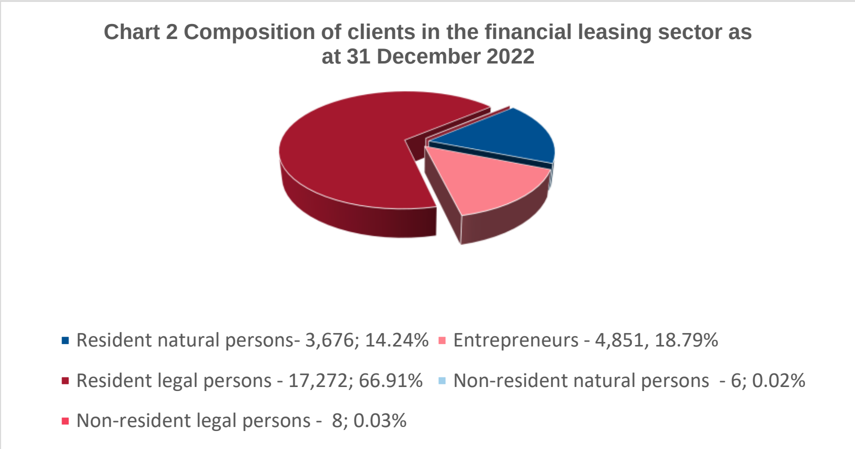
As at 31 December 2022, the total number of clients came at 25,813, of which over 99% were residents (Chart 1). The total number of clients rose by 3,452 or 15.43% relative to the previous reporting period.

Chart 1 Composition of clients by residence as at 31 December 2022

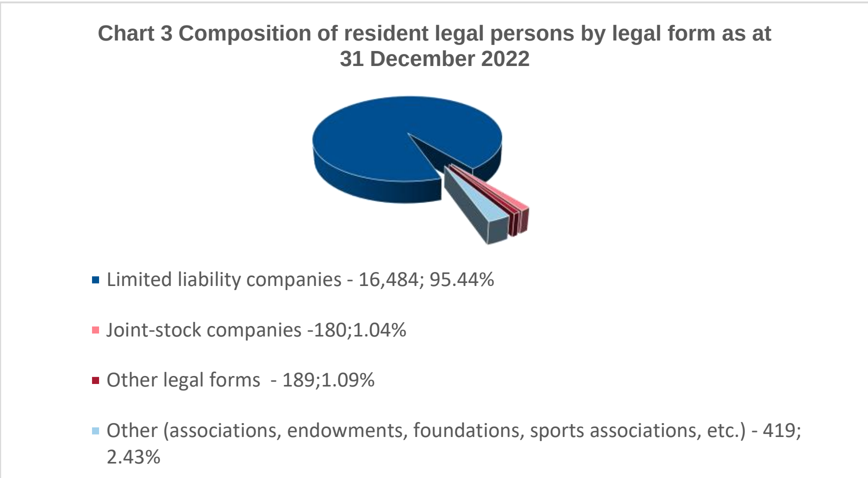


[1] Three lessors are undergoing voluntary liquidation, approved by the NBS.

Resident legal persons accounted for the highest share – 66.91% (17.272 in total), followed by entrepreneurs – 18.79% (4,851 in total) and resident natural persons – 14.24% (3,676 in total). There were only six non-resident natural persons, and eight non-resident legal persons, with negligible shares (Chart 2).



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 "other") (Chart 3).



The bulk of resident legal persons (16,484 or 95.44%) are limited liability companies. The share of legal persons organised as joint-stock companies was 1.04% (180). The share of legal persons organised in other legal forms was 1.09% (189), while category "other" accounted for around 2.43% (419 legal persons).

Non-resident natural persons are from the countries classified by financial lessors into the high-, medium- and medium-low risk category. One person comes from each of the following countries: Brazil (assessed as medium-low risk), Poland (assessed as medium-risk), Australia (assessed as a medium-risk) and the UK (assessed as medium-low risk), and two persons come from the USA (assessed as medium-risk).

There were eight non-resident legal persons. One person comes from each of the following countries: Belgium (assessed as medium-risk), Slovakia (assessed as medium-risk), Bulgaria (assessed as high-risk), Hungary (assessed as low-risk), Sweden (assessed as low-risk) and Slovenia (assessed as low-risk), and two persons come from Bosnia and Herzegovina (assessed as medium-high risk and high-risk).

According to the Questionnaire, there are three 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), one because there is an off-shore legal person in its ownership structure and one because it performs a high-risk activity. There were no non-resident legal persons with a trust in their ownership structure.

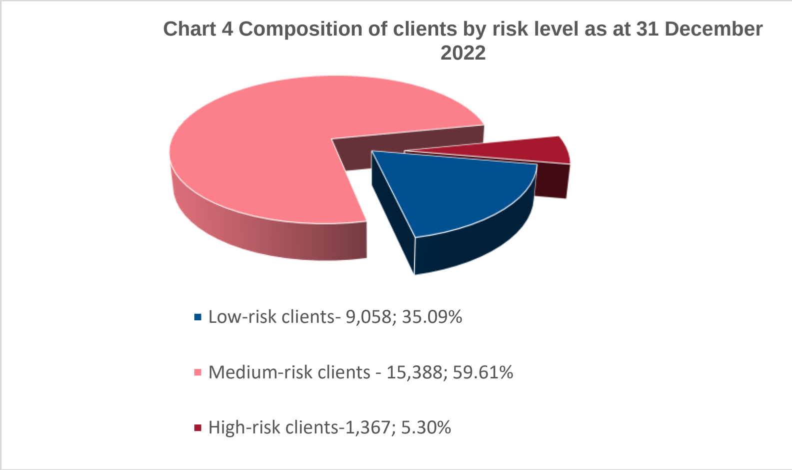
As in the previously analysed periods, there were no significant changes in the composition of clients by residence.

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, the risk exposure can be said to be low as the individual share of each of them in the total number of clients in the financial leasing sector is low.

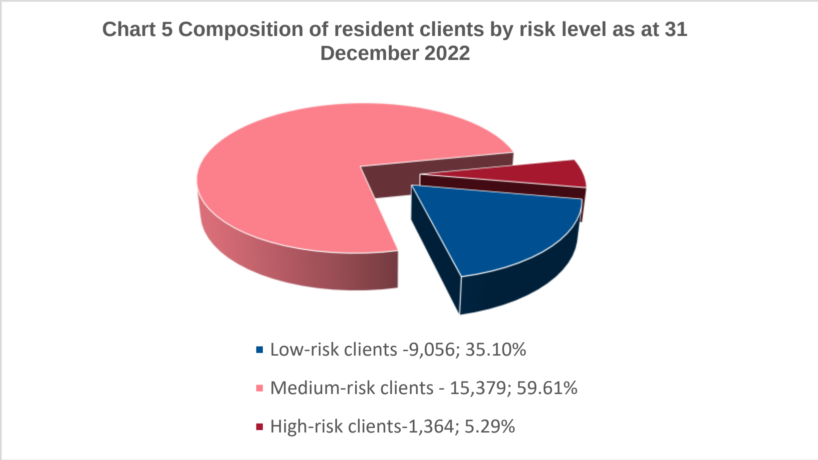
IV Client composition by the assessed risk level

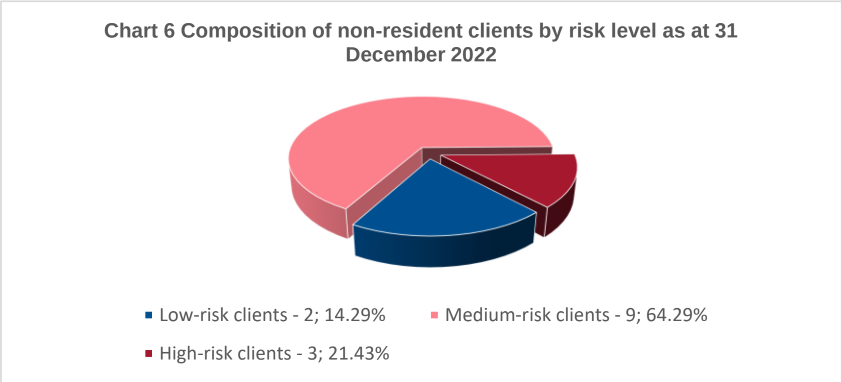
According to the ML/TF risk analysis, financial leasing clients are divided into three categories: low, medium and high.

The majority of clients are classified in the medium-risk category – a total of 15,388, accounting for a share of 59.61%. Next are clients in the low-risk category (9,058) with a 35.09% share, while those classified as high-risk (1,367) were in the third place, making up around 5.30% 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 risk level. Charts 5 and 6 show the composition of clients in the financial leasing sector by risk level – for residents and non-residents.

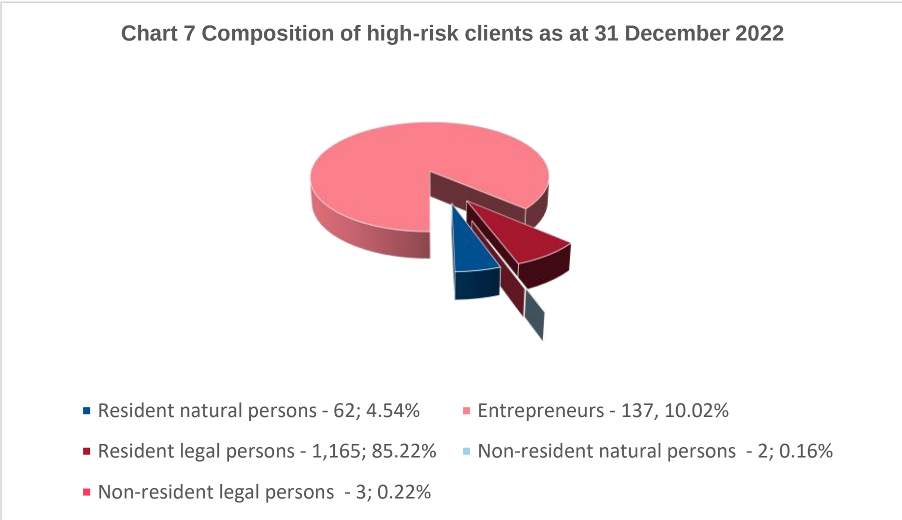




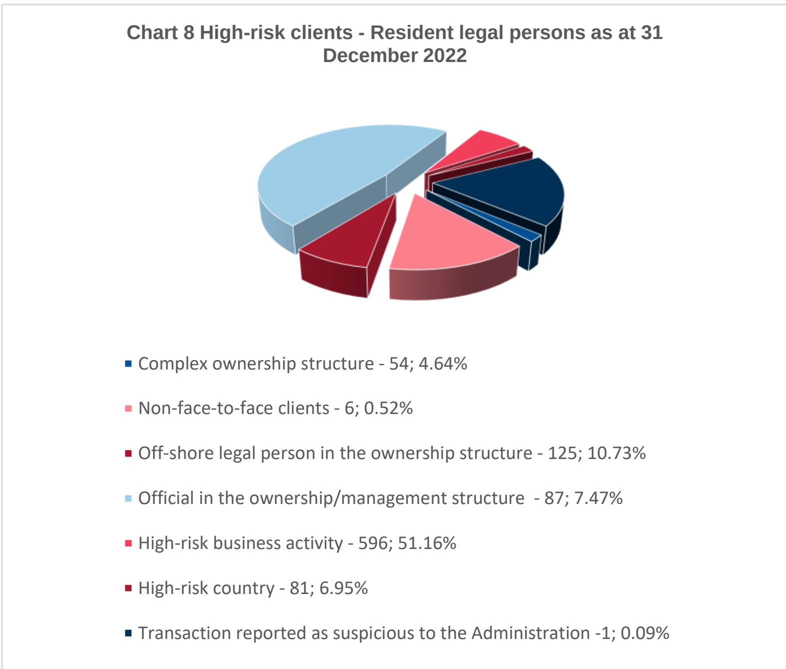
The bulk of residents were classified as medium-risk (15,379 clients or 59.61%), followed by low-risk clients (9,056 or 35.10%), while the smallest number were classified in the high-risk category (1,364 or 5.29%).

The majority of non-residents (nine clients – 64.29%) were classified in the medium-risk category, three non-residents were classified in the high-risk category, and two in the low-risk category.

Chart 7 shows the composition of high-risk clients.



Resident legal persons are dominant among clients in the high-risk category (1,165 of 1,367), accounting for an 85.22% share.

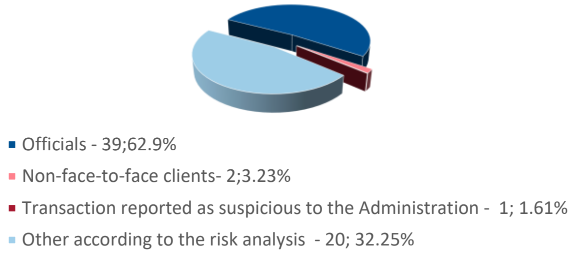


As the majority of high-risk clients are resident legal persons, Chart 8 shows their composition by various indicators for this classification.

The largest percentage of resident legal persons are classified as high-risk due to the risk involved in their activity (more than half of them, 51.16%). The remaining resident legal persons are classified into the high-risk category on other grounds in accordance with the risk analysis (18.45%), because of an off-shore legal person in the ownership structure (10.73%), officials in their ownership/management structure (7.47%), high country risk of their founder/beneficial owner (6.95%), complex ownership structure (4.64%), establishing business relations through their authorised persons without being physically present (0.52%), and transactions reported as suspicious to the Administration (0.09%).

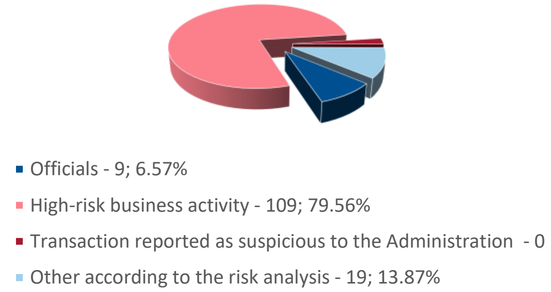
Resident natural persons were classified into the high-risk category mostly because they are officials (62.90%), while around 32.26% belong to this risk category on some other grounds in accordance with the risk analysis, 3.23% are in the high-risk category for establishing business relations through their authorised persons without being physically present, and 1.61% because of transactions reported as suspicious to the Administration, as presented in Chart 9.

Chart 9 High-risk clients - Resident natural persons as at 31 December 2022



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

Chart 10 High-risk clients - Entrepreneurs as at 31 December 2022



V Client composition by CDD actions and measures

Simplified CDD actions and measures were taken in respect of 4,782 clients, general in respect of 19,664 clients and enhanced in respect of 1,367 clients. In percentage terms, general CDD actions and measures were applied to 76.18% of clients, simplified to 18.53% and enhanced to 5.30% of clients (Chart 11).

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

Table 1 Applied CDD actions and measures by residence

Clients	Simplified CDD actions and measures	General CDD actions and measures	Enhanced CDD actions and measures
Resident natural persons	663	2.951	62
Resident legal persons	3.059	13.047	1.166
Entrepreneurs	1.058	3.657	136
Non-resident natural persons	0	6	0
Non-resident legal persons	2	3	3
Total	**4,782**	**19,664**	**1,367**

Table 2 shows a comparative overview of the number of clients by risk level and CDD actions and measures as at 31 December 2022.

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

Risk level	Number of clients	Share	CDD actions and measures	Number of clients	Share
Low	9.058	35,09%	Simplified	4.782	18,53%
Medium	15.388	59,61%	General	19.664	76,18%
High	1.367	5,30%	Enhanced	1.367	5,30%
	25.813	100,00%		**25.813**	**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 52.79% 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 all clients classified as high-risk, and general actions and measures to more clients than are classified as medium-risk. This means that these actions and measures are also applied to a large 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, and there were no financial lessors that refused the offer to establish a business relation due to the impossibility to apply CDD actions and measures. Data were not submitted to the Administration at its request for any client with which a business relation was established.

VI Products and services

The total number of concluded lease agreements in the reporting period amounted to 18,066, up by 1,745 from 2021 (16,321 agreements). Of that number, 2,683 or 14.85% were concluded with high-risk clients. Some respite in the spread of the infectious disease caused by COVID-19 in 2021 and 2022 is the 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 69 (down from 91 on 31 December 2021), while the number of agreements in which the fee exceeds EUR 5,000 increased to 748 (590 on 31 December 2021).

In the reporting period, eight 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

As in the previously observed reporting period, 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 obligor 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 lessors conduct training 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, nine financial lessors had a special AML software/application for performing activities regarding ML/TF prevention. In seven of them, the software/application enables the classification of clients by risk degree. Clients are classified after the 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. In addition to the listed indicators, eight financial lessors added their own indicators to the lists during this observed period (while in the previous period, six financial lessors did so). Most financial lessors (12 of them) prepared official notes on the performed transactions analyses which, based on the indicators applied by financial lessors and employees' experience, indicated a suspicion of money laundering. A total of 2,330 official notes on performed analyses were prepared in the reporting period.

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. According to the

Law on Restrictions on Disposal of Property with the Aim of Preventing Terrorism and Proliferation of Weapons of Mass Destruction (RS Official Gazette, Nos 29/2015, 113/2017 and 41/2018), 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, proposals 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 the proliferation of weapons of mass destruction, e.g. vessels, airplanes, etc.

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.

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.

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 nine 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 in two financial lessors submitted a total of 14 reports on suspected money laundering, and 11 reports were submitted to the Administration. Also, no internal reports on suspected terrorism financing were submitted to compliance officers in the reporting period. A total of 14 suspicious transactions were reported to the Administration in the reporting period.

XI Internal audit and internal control

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

Irregularities mainly relate to the following: lesser irregularities made when identifying natural and legal persons and officials, inadequate client classification, partial harmonisation of internal acts, inadequate insight into documents, inadequate implementation of risk assessment, insufficiently transparent monitoring of indicators, incomplete documents in the files of the supplier of the lease asset which need to be obtained in the client identification process before establishing business cooperation, etc.

Twelve out of 15 financial lessors declared that their compliance officers and their deputies participate in internal control. In all of the 12 lessors, the compliance officer reports internal control results to the management. In the past two years, all financial lessors performed internal control, and irregularities were established in 10 of them. Most often these irregularities concern: incomplete documents when identifying clients, incomplete programme records of clients despite the data collected when establishing a business relation, untimely insight into the documents of the Business Registers Agency, lack of saved searches in the internet browser, as well as cases when the beneficial owner was not determined in accordance with law – e.g. when other business documents are missing based on which management bodies are determined, when documents pertaining to the change of the beneficial owner are not duly updated, when an excerpt from the Central Registry of Beneficial Owners was not obtained, etc. Deadlines for eliminating these irregularities were set and a half of 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 six lessors. There are no disciplinary proceedings conducted against financial lessors or their employees 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 therefore be concluded 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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