



**NATIONAL BANK OF SERBIA**

BANK SUPERVISION DEPARTMENT

**ANALYSIS OF FINANCIAL LESSORS' RESPONSES  
TO THE SURVEY ON ACTIVITIES REGARDING  
MANAGEMENT OF RISKS OF MONEY LAUNDERING  
AND FINANCING OF TERRORISM  
APRIL–SEPTEMBER 2016**

Belgrade, December 2016

## **Introduction**

In 2010, the NBS established the practice of off-site monitoring of financial lessors' activities regarding the management of risks of money laundering (ML) and financing of terrorism (FT) which is carried out twice a year based on the survey response data submitted to the NBS (hereinafter: Surveys).

The Survey analysis aims to:

- provide an overview of the current state of affairs in the process of identifying, measuring and managing ML/FT risk regarding financial leasing activities,
- promote adequate implementation of established rules and principles of the KYC procedure,
- provide off-site monitoring of the development of the ML/FT risk management system by financial lessors,
- detect any weaknesses and timely inform financial lessors of potential risk exposure.

Questions in the Survey are sorted out into four groups:

Part I: General data on lessors

Part II: Lessors' activity

Part III: Lessees

Part IV: Employee training

All lessors operating in the financial leasing market of the Republic of Serbia submitted their responses to the Survey for the reporting period.

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## **1. Overview**

Financial lessors' exposure to ML/FT risk is relatively low, particularly in view of the following:

1) the balance sheet total of the financial leasing sector is significantly lower than that of the banking sector (for instance, as at 30 September 2016, the balance sheet total of all financial lessors equalled RSD 63.2 bln, or 1.99% of the balance sheet total of the banking sector);

2) the organisational network of financial lessors is underdeveloped compared to that of banks;

3) financial lessors do not carry out payment operations, deposit operations or make credit or loan approvals, and the scope of their activities is rather narrow (financial leasing, re-leasing and sale of returned lease assets).

Also, the analysis of financial lessors' responses to the NBS Survey indicates that ML/FT risk arising from fraudulent transactions in the context of financial lessors' operations was relatively low during the observed period (April–September 2016: reporting period), because:

- general acts adopted by financial lessors specify their obligations under law and secondary legislation on the prevention of money laundering and terrorism financing;

- in the course of their activities, financial lessors are mindful of the risks to which both the parent company and the group of companies to which they belong may be exposed. It should be noted that parent companies of all financial lessors in direct or indirect ownership of a foreign entity are headquartered in countries which apply high AML/CFT standards;

- all financial lessors have adopted internal acts establishing the requirement to apply the “Know Your Client” rules and principles;

- all financial lessors adopted procedures regulating this area, and all the procedures contain the elements stipulated by the Decision on Minimum Contents of the “Know Your Client” Procedure;

- all financial lessors pay due attention to AML/CFT training, primarily of client-facing employees or those engaged in transaction activities;

- all financial lessors carried out internal audit that also addressed ML/FT risk;

- all financial lessors have designed checklists of indicators for identifying suspicious transactions pursuant to Article 23 of the Rulebook on methodology for implementing requirements in compliance with the Law on the Prevention of Money Laundering and Terrorism Financing (RS Official Gazette, Nos 7/210 and 41/2011) (hereinafter: Rulebook). All lessors included in their checklists all indicators published on the APML website, and some have even expanded their checklists.

It should be particularly highlighted that, despite conclusions of the National risk assessment regarding money laundering in the context of real estate operations, activities carried out by financial lessors relating to real estate transactions cannot *a priori* be considered as activities with elevated ML/FT risk, given:

1) the nature of financial leasing and authorised activities of financial lessors;

Having in mind the legal nature of financial leasing, real estate transactions in the context of financial leasing can only mean the purchase of real estate by a financial lessor for the purpose of obtaining property rights over that real estate or for leasing such real estate to a lessee;

2) the degree of development of the financial leasing market;

The real estate leasing market is underdeveloped (as at 30 September 2016, real estate leasing accounted for only 4.1% of the total leasing business, only two financial lessors were engaged in activities of leasing real estate – one of which had 22 active agreements and the other one only three).

3) financial lessors' approach to ML/FT risk when leasing real estate.

Financial lessors take a proactive approach to protect their financial and legal interests from the threat of inadequate identification and management of risks related to real estate leasing. When establishing a business relationship with an entity for the purpose of real estate leasing (real estate sellers and entities to whom such real estate is leased), financial lessors carry out not only the activities and measures prescribed, but also those stipulated by special internal acts aiming to protect financial lessors' interests such as: assessing all facts of significance for the lawful transfer of property rights over real estate from the seller to the financial lessor so that property rights of the financial lessor cannot not be challenged (and paying particular attention to the verification of data from the real estate cadastre and other data of which competent authorities keep records); minimising operational risks that may arise from the transfer of rights to use such real estate to the lessee, particularly ML/FT risk.

It is important to note that the percentage of activities and measures applied (simplified, general and enhanced) corresponds to the percentage of ML/FT risk. The above highlights an encouraging fact that lessors understood correctly the significance of proper ML/FT risk assessment, which led to adequate allocation of human resources, and in turn to high-quality ML/FT risk assessment.

It should be particularly underlined that although the ML/FT risk is low in the financial leasing sector, by no means should it be ignored, particularly given the relatively small number of employees in the sector (380 persons as at 30 September 2016, down by 27 employees from the previous reporting period).

Being the obligors under the Law on the Prevention of Money Laundering and Terrorism Financing (RS Official Gazette, Nos 20/2009, 72/2009, 91/2010 and 139/2014) (hereinafter: Law), financial lessors are obliged to take all actions and measures envisaged by the Law and secondary legislation for detecting and preventing

money laundering and terrorism financing that could ensue from financial leasing activities.

## 2. General data on financial lessors

A total of sixteen financial lessors operated in the Republic of Serbia during the reporting period. Eight lessors were in full or majority ownership of foreign legal entities, and another eight were in full or majority ownership of domestic entities. Most lessors whose equity is, directly or indirectly (through domestic banks), in the ownership of foreign entities, adequately understood and implemented ML/FT risk management standards, policies and procedures in force in the territory where the owner of the domestic lessor is headquartered. All foreign credit/financial institutions – direct and indirect owners of domestic lessors are headquartered in the EU.

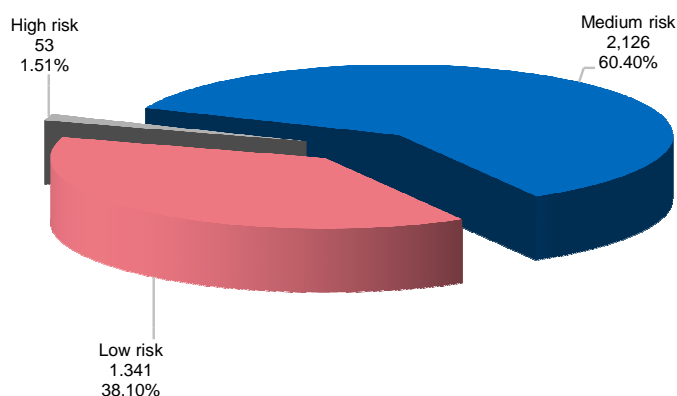
Of all lessors, only five operated through branches during the reporting period. These worked through a total of ten branches which applied ML/FT risk management procedures during the said period.

## 3. Financial lessors' activity

Based on adopted internal acts regulating ML/FT risk management, all financial lessors prepared ML/FT risk assessment pursuant to the Decision on the Guidelines for Assessing the Risk of Money Laundering and Terrorism Financing (RS Official Gazette, Nos 46/2009 and 104/2009) issued by the NBS.

According to the data on client classification by degree of exposure to ML/FT risk, the majority of clients were assessed as medium-risk (60.4%), 38.1% as low-risk, and only 1.5% as high-risk (Chart 1).

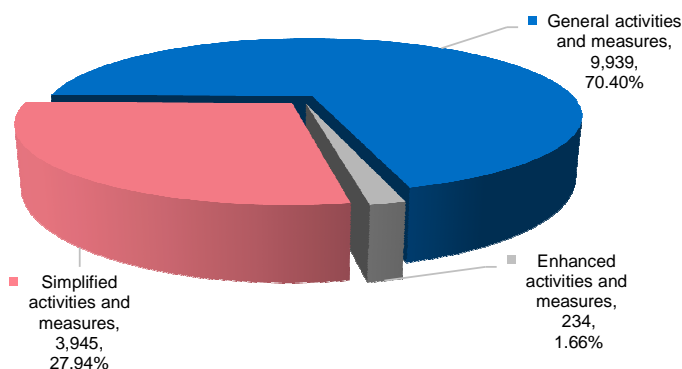
**Chart 1 Lessees by risk degree**  
(from 1 April to 30 September 2016)



A rather high percentage of clients classified as medium-risk stems from the provision of Article 5a of the Guidelines which promulgates obligors' autonomy in assessing client risk according to their own criteria.

Pursuant to the Law, lessors are obliged to apply general, simplified and enhanced CDD activities and measures. The assessment of the Survey responses indicates that, of the total of 14,118 clients classified, lessors applied general CDD activities and measures to 9,939 clients, simplified CDD activities and measures to 3,945 clients and enhanced CDD activities and measures to 234 clients.

Chart 2 **Lessees by applied CDD activities and measures**  
(as at 30 September 2016)



As shown in Chart 2, in terms of the entire financial leasing sector, general activities and measures are applied to 70.40% of all clients, irrespective of their classification as low- or medium-risk, simplified activities and measures are applied to 27.94% of clients, and enhanced to 1.66% of all clients. Judging by the responses to the Survey regarding the frequency of client monitoring, it can be concluded that human resources have been adequately allocated in terms of the frequency of monitoring low-risk clients (in respect of whom simplified CDD activities and measures are applied) – financial lessors use resources optimally, as CDD measures are applied in an adequate manner, in accordance with the level of risk.

During the reporting period, six lessors analysed 24 suspicious transactions, yet only one lessor reported a client to the Administration for Prevention of Money Laundering because of his bad reputation stemming from the fact that Interpol issued an arrest warrant against him in 2012.

According to the submitted data, all lessors carried out internal audit in respect of ML/FT prevention, and one lessor is currently carrying out internal audit. Irregularities were detected with three lessors. Most findings of the internal audit related to:

- inadequate updating of internal regulations and misapplication of procedures in practice, amending and automation of the scoring system to replace manual completion of information in order to facilitate adequate client identification,

- misapplication of AML/CFT regulations, inadequate approach to ML/FT risk. In fact, the internal audit examined the application of regulations governing AML/FT, and approach to ML/FT risk. The findings showed no crucial omissions in this area, and some omissions of lesser importance have in the meantime been rectified,
- inadequately performed classification of clients by ML/FT risk degree.

All lessors found by the internal audit to have made omissions in their work took measures to rectify them and these irregularities were remedied.

No lessor established a business relationship (entered into a lease agreement, supply agreement, agreement on sale of returned lease asset or agreement on re-leasing returned lease assets) when suspecting that a client or a transaction might be linked to money laundering or financing of terrorism.

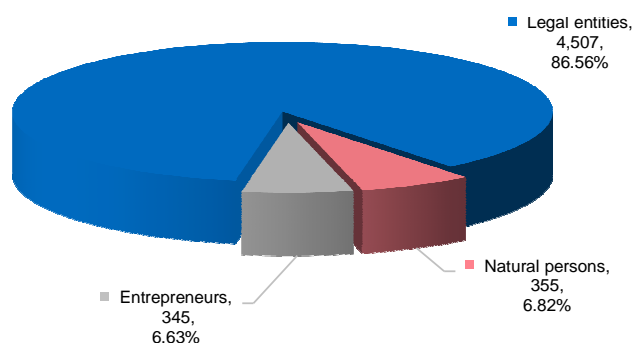
According to the Survey response, there were no cases during the reporting period of financial lessors terminating business relationship with clients due to indications that pointed to money laundering or financing of terrorism. This is the result of adequate assessment of ML/FT risk.

According to the submitted Survey data, three lessors entrusted some of the CDD activities and measures to third persons – parent banks/their founders, i.e. to entities that these activities can be entrusted to according to the Law.

#### 4. Lessees

During the reporting period, lessors entered into 5,207 lease agreements, of which 4,507 with legal entities, 355 with natural persons and 345 with entrepreneurs.

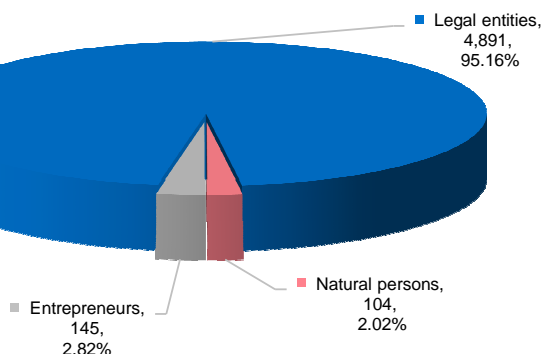
**Chart 4.1 Lessees by number and user (legal entity, natural person and entrepreneur) of concluded lease agreements**  
(from 1 April to 30 September 2016)



During the reporting period, lessors entered into 5,140 supply agreements, of which 4,891 with legal entities, 145 with entrepreneurs and 104 with natural persons.



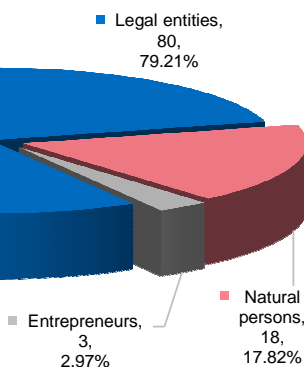
**Chart 4.2 Lessees by number and user (legal entity, natural person and entrepreneur) of concluded supply agreements**  
(from 1 April to 30 September 2016)



During the reporting period, lessors entered into no agreements on re-leasing returned lease assets.

During the reporting period, lessors entered into 101 agreements on sale of returned lease assets, of which 80 with legal entities, 18 with natural persons and 3 with entrepreneurs.

**Chart 4.3 Lessees by number and user (legal entity, natural person and entrepreneur) of concluded agreements on sale of returned lease assets**  
(from 1 April to 30 September 2016)



During the reporting period, 15 lessors accepted joint and several liability as a collateral when entering into 2,392 lease agreements, and, as assessed by financial lessors, the relationship between lessees and guarantors was clear.

The Survey data indicate that in cases where there were legal grounds for payment by the third persons, financial lessors received payments from persons who did not have the status of lessees – contract on assuming debt, contract on debt assignment, etc. As with the collateral, in most cases, the reason for allowing payments to be made

on behalf of lessees was consanguinity (for natural persons), and belonging to the same group (for legal entities).

During the reporting period, nine lessors reported no significant changes in the number of clients relative to the prior period, five lessors saw this figure drop due to regular and early purchase of lease assets, contract termination due to non-compliance with contractual obligations and also due to the change in the business strategy of the lessor's owner in terms of providing support to the existing clients and gradual narrowing of the portfolio of contracts and clients. Two lessors recorded an increase in the number of clients, which they attribute to their good business approach.

Lessors recorded no case in which a client was not physically present during identity verification and at the time of establishing a business relationship, and they did not set up business relationships with foreign officials.

During the reporting period no transfer was contracted and/or executed for any lessor from an offshore destination on account of collateral activation, nor was any transfer of funds (in case of collateral activation) contracted/executed from a country that did not apply stringent AML/FT rules.

## **5. Employee training**

As at 30 September 2016, the financial leasing sector employed a total of 380 persons, down by 27 from the previous reporting period, showing a constant downward trend. A total of 126 persons employed by 16 lessors are engaged in client-facing services. Of the total, 160 employees carry out activities related to the prevention of money laundering and financing of terrorism.

Lessors prepared annual programmes of professional education, training and development for employees engaged in detection and prevention of money laundering and terrorism financing. All employees are aware of the consequences of non-compliance with law, other regulations and procedures on prevention of money laundering and financing of terrorism.

Lessors carry out employee training according to their annual plans and programmes. They organise training at least once a year, while five lessors organise training twice a year, or more often if the need arises. Training is most often given by authorised persons and their alternates, through presentations in training centres, lectures and online presentations, group and individual consultations, through in-house portals and individual (face-to-face) training.

AML/CFT knowledge testing is carried out once a year, and the completed tests are stored in paper or electronic form for the duration of five to 10 years.