



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
OCTOBER 2016 – MARCH 2017**

Belgrade, June 2017

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 “Know your client” procedure (KYC),
- 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: Data on 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 31 March 2017, the balance sheet total of all financial lessors equalled RSD 65.8 bln, or 2.05% 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 limited (financial leasing, re-leasing and sale of returned lease assets).

The analysis of financial lessors' responses to the NBS Survey indicates that ML/FT risk in the context of financial lessors' operations was relatively low during the observed period, October 2016 – March 2017 (hereinafter: 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;
- all financial lessors pay due attention to AML/CFT training, primarily of client-facing employees or those engaged in transaction activities;
- 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 website of the Administration for the Prevention on Money Laundering (hereinafter: APML), 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;

In the context of financial leasing, real estate transactions 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) As at 31 March 2017, only two financial lessors had receivables on account of 12 active real estate lease agreements, one of which had 11 active agreements and the other had only one. In the reporting period, only one real estate lease agreement was concluded. In the investment structure according to lease asset, on the level of the whole financial leasing sector, real estate leasing accounted for only 4.1% of the total leasing business.

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 which could be threatened by inadequate identification and management of risks related to real estate leasing. When establishing a business relationship with an entity (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 (special attention is given 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 resulted in adequate allocation of human resources, and consequently in high-quality ML/FT risk management.

It should be 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 (372 persons as at 31 March 2017, down by 8 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 by-laws for detecting and preventing money laundering and terrorism financing that could arise 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 (seven of which were in ownership of domestic banks with foreign capital). 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 applied in the territory where the owner of the 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 nine branches which applied ML/FT risk management procedures during the said period.

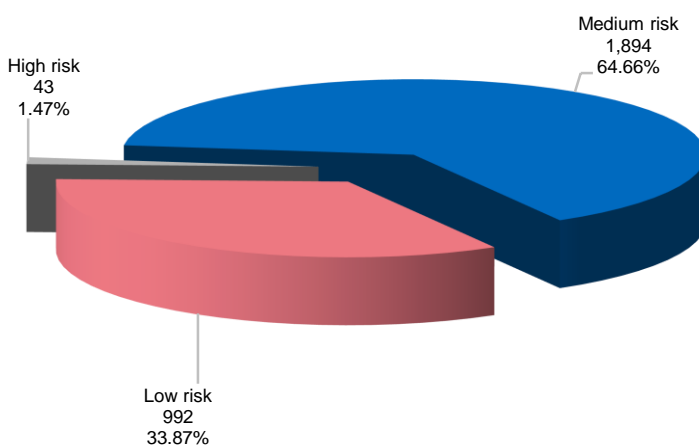
3. Financial lessors' activity

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.

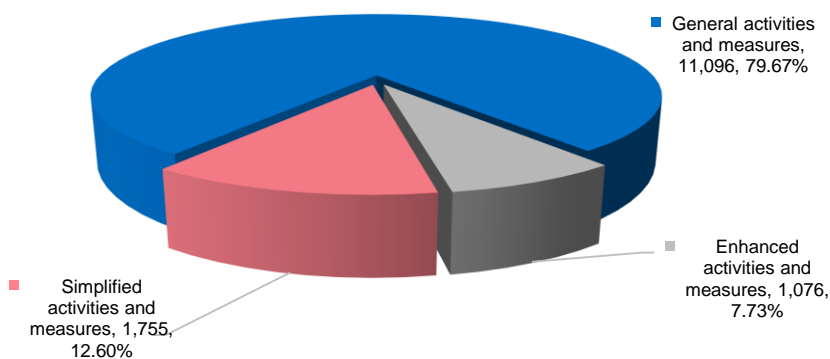
According to the data on client classification by degree of exposure to ML/FT risk, the majority of clients were assessed as medium-risk (64.7%), 33.8% as low-risk, and only 1.5% as high-risk (Chart 1).

Chart 1 Lessees by risk degree
(from 1 October 2016 to 31 March 2017)



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

Chart 2 Lessees by applied CDD activities and measures
(as at 1 March 2017)



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 13,927 clients classified, lessors applied general CDD activities and measures to 11,096 clients, simplified CDD activities and measures to 1,755 clients and enhanced CDD activities and measures to 1,076 clients.

As shown in Chart 2, in terms of the entire financial leasing sector, general activities and measures are applied to 79.67% of all clients, irrespective of their classification as low- or medium-risk, simplified activities and measures are applied to 12.60% of clients, which is by 15.34% less than in the previous reporting period, and enhanced to 7.73%, which is 6% more than in the previous reporting period. This indicates that the financial lessors apply stricter client monitoring measures. 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, four lessors analysed 43 suspicious transactions, yet none reported a client to the Administration for Prevention of Money Laundering.

According to the submitted data, six lessors carried out internal audit in respect of ML/FT prevention. Irregularities were detected with four 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.
- incomplete status documentation (indicators list missing, copies of ID cards for client and guarantor missing, documents without signature of the person that checked the documents).

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.

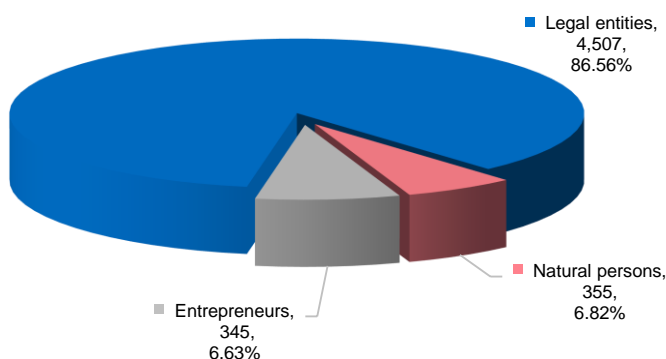
According to the Survey response, there were no cases during the reporting period of financial lessors terminating business relationship with clients due to indications that pointed to money laundering or financing of terrorism. This is the result of adequate assessment of ML/FT risk.

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 5,072 lease agreements, of which 4,344 with legal entities, 317 with natural persons and 411 with entrepreneurs. (Chart 3).

Chart 3 Lessees by number and user (legal entity, natural person and entrepreneur) of concluded lease agreements
(from 1 October 2016 to 31 March 2017)

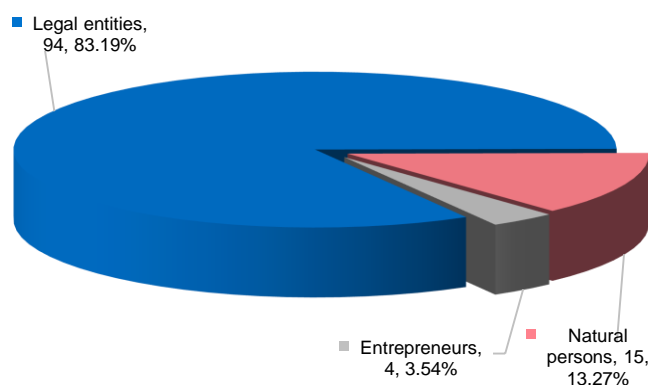


During the reporting period, two lessors entered into 12 agreements on re-leasing returned lease assets with legal entities, one of which concluded 11 agreements, and the other concluded only one.

During the reporting period, lessors entered into 113 agreements on sale of returned lease assets, for a charge of returned lease assets, out of which 94 with legal entities, 15 with natural persons and 4 with entrepreneurs (Chart 4).

Chart 4 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 2,741 lease agreements, and, as assessed by financial lessors, the relationship between lessees and guarantors was clear.

The Survey data also 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).

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 31 March 2017, the financial leasing sector employed a total of 372 persons, down by 8 from the previous reporting period, showing a constant downward trend. A total of 174 employees carry out activities related to the prevention of money laundering and financing of terrorism, by 14 more comparing to the previous reporting period. This points to the fact that financial lessors enhanced monitoring in such activities.

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.

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