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Project against Money Laundering and Terrorist Financing in Serbia

MOLI Serbia

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TECHNICAL PAPER

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ASSESSING POSSIBILITIES FOR AN AML/CFT RISK-BASED APPROACH TO THE GUIDELINES FOR OBLIGORS AND TO THE SUPERVISORY INSPECTION REGIMES

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1. Background

Several of the 2012 Financial Action Task Force (FATF) 40 Recommendations and Interpretive Notes (IN) require supervisors, financial institutions or designated non-financial businesses and professions (DNFBPs) to apply the Recommendations in a risk-based manner. These Recommendations mainly concern Recommendations 1 (risk assessment), 10 (customer due diligence), 26 and 28 (supervision).

In order for regulators, supervisors and obliged institutions to fulfill their obligations under the anti-money laundering and combating the financing of terrorism (AML/CFT) legislation and to implement the FATF Recommendations, they should take measures to execute a money laundering and financing of terrorism (ML/TF) risk analysis.

In the Serbian AML/CFT law it is stated that obligors should make a risk analysis that should address groups or types of customers, business relationships, services or transactions. Most guidelines issued by the various Serbian supervisory authorities provide ample examples of high risk situations related to customers, business relationships, services or transactions, and in some cases geographic risk. There is no guidance provided on low, normal and unacceptable risk situations.

Based on a gap analysis of the AML/CFT law and guidelines that are issued by the various Serbian supervisory authorities the conclusion was that the guidance documents for obligors address ML/TF risks but vary in level of depth. Because all documents provide long lists of examples of high risk situations, there is little room for an own risk assessment by the obligors, nor is there guidance on carrying out a overall analysis of ML/TF risks by obligors.

With respect to the guidelines for supervisors on AML/CFT inspections only the NBS Handbook for bank inspections and the Procedures on AML/CFT supervision by the APML address AML/CFT supervision and to some extent a risk-based approach. Guidelines on supervisory procedures by other authorities do not address AML/CFT supervision.

2. Objectives

On 25 and 26 February 2013 the CoE expert visited Belgrade and met with the various AML/CFT supervisory authorities to discuss the risk based approach in their guidelines and in their inspections (see Annex 1 for the meeting program). The objective of the mission was to see if a consolidated guideline or compilation of the guidelines for obligors could be drafted and how a risk based approach to inspections can be incorporated in their inspection regimes.

Meetings were held with the National Bank of Serbia (NBS), the Administration for the Prevention of Money Laundering (APML), the Securities Commission (SC), the Administration of Games of Chance, the Inspectorate for Postal Services, the Inspectorate for Real Estate Intermediaries, and the Foreign Currency Inspectorate.

Objective of the meetings was to discuss the framework of further activities on a compilation and unification of supervisory guidelines in the area of the risk-based approach, particularly for the purpose of:

- a. Reaching agreement to draft a unified guideline(s) for obligors on the risk-based implementation of AML/CFT requirements, defining the scope and structure of this document(s) through discussion with beneficiaries;

- b. Discussing and agreeing individually with AML/CFT supervisors on the structure and scope of targeted guidelines to institute a risk-based AML/CFT inspection regimes tailored to the needs of each supervisory institution.

3. Summary of Recommendations

- With respect to the guidelines for obligors it is recommended to have one general guidance document with a description on ML/TF risks and an overview of AML/CFT requirements. In that general part a description should be made how obligors can make an overall risk assessment of their ML/TF risks.
- Attached to the general document, the existing sectoral guidance documents should be added. These existing guidelines should in some cases be elaborated with guidance on AML/CFT requirements that are now not yet included.
- Additionally, some authorities that have AML/CFT supervision responsibilities of the same entities need to consider combining their guidance documents or ensuring that there are no discrepancies.
- With respect to a risk-based approach to AML/CFT inspections it is recommended for the APML, the Games of Chance Inspectorate and the Postal Services Inspectorate to gain more experience in AML/CFT supervision before working on a risk-based approach.
- Supervisory authorities at the NBS, SC, Inspectorate for Real Estate intermediaries and the Foreign Currency Inspectorate have more experience in AML/CFT supervision. Based on their knowledge of their sectors, the authorities should start developing a risk-based approach to their supervisory efforts. A risk-analysis method and process can be described a targeted document per authority.

4. Guidelines for obligors

A condition for drafting a unified guideline is that all supervisory authorities should agree that such a guideline would indeed be suitable for their sector(s). The meetings therefore focused on the question whether the authorities would agree to unified guideline for all obligors in which a risk based approach is further elaborated upon.

The authorities welcomed the idea of expanding and improving the guidelines and would welcome suggestions for improvement and more practical examples. All authorities acknowledged that some sort of compilation of the guidelines could be beneficial for the obligors and that it could be useful to bring together different experiences and improve quality.

However, most authorities did not agree or see the benefit of having one unified guidance document for all obligors. Reasons stated were that a unified guideline would lack specificity as obligors differ substantially and different guidance is therefore required.

Also the fact that the procedure of drafting, and even more having such a unified document approved by their various managements, would be practically impossible and would take a long time. For instance, the Foreign Currency Inspectorate indicated that because they were recently moved to the Tax Administration they believed that having AML/CFT guidelines approved for exchange offices (which do not yet exist) would be a lengthy process. Additionally, the

AML/CFT law is in process of being changed, and some supervisory authorities indicated that they would prefer to wait for the law to be changed before changing the guidance.

The reasons, both on substance and process, for not having a unified guideline are valid. Nevertheless, it would be necessary for obligors to have more general guidance on ML/TF risk and a risk assessment. Also, for those obligors that have more than one AML/CFT supervisor, more uniform guidance from their authorities would be helpful. For instance, the money transfer providers have the APML as supervisor for their domestic transactions, but for their international activities the Foreign Currencies Inspectorate is in charge. Similarly, banks that are also custodian banks have both the NBS and the SC as supervisory authority with both authorities having their own guidance documents. Moreover, the smaller authorities could benefit from bundling experience and efforts.

4.1. Risk assessment for obligors

The existing guidelines for obligors mainly provide list of high risk situations that obligors have to apply to their customers when assessing the customer risk. The supervisory authorities do not expect their obligors to make an overall risk assessment of their business to evaluate the ML/TF risks. Such a risk assessment would comprise an analysis by the obligor of the ML/TF risk of their types of customers, their products and services, and the jurisdictions they or their customers do business in. Based on such an overall risk assessment, obligors can determine risk scenarios and take measures to prevent and mitigate ML/TF commensurate with the risks identified.

Even more, some authorities indicated that article 7 of the AML/CFT law¹ does not require obligors to make such an overall risk assessment. These authorities indicated that article 7 requires obligors to make a risk analysis per individual customer based on the client characteristics. The new AML law will probably extend this article to require a more overall risk assessment.

The NBS indicated that some, especially the larger, international banks, do indeed have some ML/TF risk assessment of their business. However, the NBS was not clear whether these are indeed a comprehensive ML/TF risk assessment as required by FATF Recommendation 1. Furthermore, it was indicated that some (smaller) obligors in general have a legalistic approach which called for providing many examples in the guidance documents because, according to the NBS, only when requirements are explicitly mentioned in the law, they will be implemented. Inspections therefore also focused on informing obligors of their duties and getting them to maturity on AML/CFT issues.

4.2. Recommendations

As there is no consensus on drafting a unified guideline, the best approach will be to make a compilation of the existing sectoral guidelines and adding to that compilation a general part relevant for all obligors.

- A compilation of the existing guidelines should have a new general part that provides information on ML/TF risks and AML/CFT requirements. The information in the NBS Handbook for inspections (chapter 1-4) is a good basis for such a new general part.

¹ Article 7 (Risk analysis)

(1) The obligor shall conduct an analysis of the money laundering and terrorism financing risk in accordance with the guidelines adopted by the body competent for the supervision of the implementation of this Law.

(2) The analysis referred to in paragraph 1 of this Article shall contain a risk assessment for each group or type of customer, business relationship, service offered by the obligor within its business, or transaction.

- In the new general part a section should be added with guidance for obligors on how to perform an overall ML/TF risk assessment with respect to their business operations and which factors can be taken into account.
- All sectoral guidelines should address more topics on compliance, internal controls, record keeping, cooperation and other requirements from the AML/CFT Law. The guidelines of the Foreign Currency Inspectorate and the SC provide good examples of other topics that should be addressed.

With respect to the existing sectoral guidelines recommendations are:

- It is recommended that the NBS and the SC look into combining sectoral guidance with respect to the authorized banks en custody banks they both inspect for AML/CFT purposes (or at least ensure that their guidance is in agreement with each other).
- It is recommended that the APML and the Foreign Currency Inspectorate look into combining sectoral guidance with respect to obligors (money transfer services and factoring & forfeiting) they both inspect for AML/CFT purposes.
- It is recommended that the APML works with other smaller supervisory authorities (games of chance, postal services, real estate) and combine their guidance documents for the non-financial obligors into one guidance document with specific examples per type of obligor.

5. Risk-based approach to supervision

It was also discussed whether the authorities take a risk-based approach in their supervision and if this can be addressed in inspection guidelines.

None of the AML/CFT supervisory authorities takes a fully risk-based approach to AML/CFT supervision whereby obligors that pose a higher ML/FT risk because of their types of business, products, clients are inspected more frequent or more comprehensive. Several supervisors do take some basic risk approach in selecting obligors for inspections. This is sometimes called for because of the large number of entities under their remit. For instance, the APML supervises more than 7000 accountants for which it uses criteria as number of employees, annual turnover to prioritize inspections.

5.1. APML

The APML is supervisor for a range of different type of entities, some of which also have another supervisory authority for AML/CFT purposes. E.g., domestic money transfers are under the remit of the APML whereas for international money transfer the Foreign Currency Inspectorate is the supervisor. The APML indicated that they are working on the new AML/CFT law and are looking into allocating AML/CFT supervision to less supervisory authorities then is currently the case.

The APML has since 2010 been tasked by law with AML/CFT supervision and has 4 staff for this supervisory task. The supervision department started its inspections in 2012. Knowledge and awareness of ML/FT risks is adequate, but they need to build experience in inspecting their sectors and therefore taking a full risk based approach might take some time.

The APML has focused in 2012 on accountants and auditors. There are 7000 accountants that

they are aware of (there is no required registration or certification) and 56 auditors. They have sent a questionnaire to the auditors and the 100 largest accountants to assess the level of implementation of the AML/CFT law. They prioritize their inspections of this group on indicators as number of employees, yearly turnover, business relationships that are politically-exposed persons. They also make use of the STRs in their selection of auditors and accountants to be visited. The annual plan is to have a team of two inspectors do one onsite inspections per week.

For the other obligors, such as domestic factoring & forfeiting, domestic money transfers and domestic postal communications, the APML has not undertaken anything on AML/CFT supervision, except for issuing the guidelines. For the legal professions, they plan to issues guidelines this year.

Recommendations

- Because of the large number of entities under supervision and the very little resources available to AML/CFT supervision, a risk-based approach will not be feasible for the time being as the APML will need those resources to at least get some grasp on the level of AML/CFT compliance in their sectors. The working method of collecting offsite data to prioritize inspections is indeed the best way for now to approach these numbers of obligors.
- Once the APML has gained more experience and knowledge of their sectors, they can develop a ML/TF risk analysis method to select themes for AML/CFT supervision to focus on those sectors or obligors with higher ML/TF risks. A theme could for instance be ‘real estate investments’ whereby information and resources of all supervisors for obligors that deal with real estate is combined.

5.2. NBS

The NBS is in charge of AML/CFT supervision of banks, insurance companies, pension funds and leasing companies.

For the 32 banks there is a team of 14 AML/CFT inspectors, plus 1 head of department and 1 support staff. All banks are supervised for AML/CFT purposes approximately once every two years. These are full scope AML/CFT inspections whereby all types of customers, products and business lines (e.g., retail, wholesale, correspondent banking, deposits, loans and credits) are inspected. Inspections generally take 3 to 4 weeks, and follow-up inspections take 1 to 2 weeks.

With respect to banking supervision, the NBS Handbook describes the method to prioritize AML/CFT inspections based on information, such as size of the bank, number of customers, and number of transactions. This information is also used for selecting and sampling customer files or transactions during inspections. The NBS does not, based on overall assessment of prior inspections or a risk analysis of external ML/TF risks, take a risk-based approach in its bank inspections by for instance focusing inspections on certain types of customers, products or business areas. Because the NBS has experience in AML/CFT supervision and knows the level of compliance by banks, they could make a risk analysis and focus inspections on themes. Examples of themes can be ‘wholesale customers with links to high risk countries’, ‘new payment methods’, or ‘correspondent banking in banks with a large international networks’.

There are 16 leasing companies. These are all domestic companies but with EU ownership. The NBS has 7 staff for leasing inspections of which 2 have an AML/CFT focus. Up to now leasing companies have not been inspected onsite for AML/CFT purposes. The NBS has sent a questionnaire and requested the leasing companies to submit their relevant AML/CFT

documents.

Of the 28 insurance companies, 7 provide only life insurance, 11 are non-life and 10 offer both life and non-life products. The NBS has 9 staff (of which 2 are long term absent) for insurance supervision. In 2012, there has been one onsite AML/CFT inspection. In general AML/CFT supervision will be part of the full scope inspections.

During full scope onsite inspections of voluntary pension funds AML/CFT is cursorily inspected. In addition, once per year pension funds have to answer a questionnaire on AML/CFT.

For leasing, insurance and pension funds some experience and knowledge has been built on AML/CFT during the course of their overall inspections. Similarly as in some other countries, the NBS estimates the ML/FT risks in these sectors as low. Seeing the small number of entities and also the (estimated) low risk, a risk-based approach for those sectors could exist of collecting offsite information analysis and based on that information annually select a number of obligors for inspections. These inspections could also be based on themes.

Recommendation

- The NBS could for all 4 sectors under its remit elaborate the method to prioritize AML/CFT inspections used by the banking supervision department.
- This method can be further developed into a ML/TF risk analysis method to select themes for AML/CFT supervision. In such a method use should also be made of STR information and information from other sources.
- The NBS and the SC are advised to cooperate on AML/CFT supervision of authorized banks en custody banks.

5.3. SC

The supervisory department of the SC has 6 inspectors of which one is focused on AML/CFT, 2 financial analysts and a head of department. They supervise 34 brokerage dealer companies, 6 investment companies, 11 custody banks, 17 authorized banks, also the stock exchange and the central depository agency.

During full scope inspections AML/CFT is also addressed. The SC has only done onsite inspections, and no offsite. The SC is still working on its first round of AML/CFT inspections and up to now has done 53 AML/CFT inspections and issued 22 sanctions. They plan to collect offsite data by way of (monthly) reports on for instance turnover and number of new clients.

The SC indicates that they probably use an inherent risk approach because the inspectors will focus their efforts on obligors with high volumes and large number of transactions and make use of results of previous inspections. Also, because it is not feasible to inspect all obligors for all AML/CFT issues, they are looking into the best way to take a risk-based approach.

Recommendation

- Develop a ML/TF risk analysis method to select themes for AML/CFT supervision. In such a method use should also be made of STR information and information from other sources.
- The SC and the NBS are advised to cooperate on AML/CFT supervision of authorized banks en custody banks.

5.4. Games of Chance Administration

The Administration of Games of Chance was recently merged into the Tax Administration. They have 20 staff and have to review 800,000 to 1 million betting transactions per day. Supervision, including for AML/CFT, takes place offsite by way of an automatic control system of sold betting tickets. The Administration indicated that there are loopholes in the IT-system (for instance changing of selling dates and number of sold tickets). Because betting shops are not a source of reliable information, the Administration cannot assert if they indeed comply with the AML/CFT law.

The Administration has good notion of the ML risks in the betting and online gambling sectors and is working with the APML and the Banking Association to address those risks. For instance by having the banks report or block all transactions of foreign persons betting online in Serbia. With respect to internet gambling, the Administration indicated that there is a need for more EU/international cooperation.

There is one casino in Belgrade with a license from the APML, and they cooperate with the casino and APML on accessing information in the casino's IT systems. Cooperation has also been sought with the Foreign Currency Inspectorate as there is some overlap with the supervision of exchange houses.

They indicated that the merger into the Tax Administration and as such less funds and autonomy and different IT systems has hindered their progress in AML/CFT supervision. The Administration of Games of Chance would welcome training in the area of AML/CFT supervision, especially since the expanding number of betting and online gambling possibilities, the lack of resources would call for a thorough risk-based approach.

Recommendation

- The Administration of Games of Chance has only little resources to deal with substantial ML risks. Enhanced cooperation with other authorities and the private sector, as they already do, is a prerequisite. By sharing knowledge and building up more experience the Administration of Games of Chance can start developing a risk-based approach.

5.5. Postal Services Inspectorate

The Postal Services Inspectorate has 3 inspectors to inspect the post offices and 50+ couriers for the Law on Postal Services and the AML/CFT Law. Their main work focuses on checking if the conditions of the postal services license are adhered to and if there are illegal couriers. Contrary to Customs, the Postal Services Inspectorate is not authorized to check the contents of parcels. Their only indicator is the insured value or the weight of a parcel which does not give information to assess ML/TF risks (especially when uninsured parcels contain value). AML/CFT inspections therefore focus on formalities as checking procedures of the couriers. The Postal Services Inspectorate started its AML/CFT work in 2012 and they have centered on explaining requirements to the obligors. Since there are only 3 inspectors, they have no choice but to only inspect a few obligors per year. Nevertheless, the Inspectorate indicated that the aim is to inspect all.

Recommendation

- It is difficult for now to assess how the Postal Services Inspectorate can take a risk-based approach to AML/CFT supervision. Only by gaining more experience on AML/CFT supervision and by cooperating with the APML and other authorities a risk based approach can be developed.

5.6. Inspectorate for Real Estate Intermediaries

The Inspectorate for Real Estate Intermediaries has 6 inspectors who in 2009, 2010 and 2011 inspected all known real estate agents, which means that the approximately 270 agents were inspected every year for AML/CFT compliance. These inspections focused on checking whether the obligors had appointed a compliance officer, had indicators in place in accordance with the law, and if agent fees were paid in cash or by bank transfer.

Because the Inspectorate visited all agents several times over the past years, they concluded that the AML/CFT Law is complied with and that there is no ML/TF risk as agent fees are generally not paid in cash but via banks. Consequently, in 2012 they conducted no AML/CFT inspections of intermediaries.

The Inspectorate indicated that ML risks are more likely in the area of real estate development and construction, especially where foreign parties are involved. Also, lawyers have more details on real estate deals as they arrange the contracts.

Recommendation

- The Inspectorate for Real Estate Intermediaries has built up knowledge of their sector through their inspections over the past years and as such is in a good position to assess the ML/TF risks of agents. To implement a risk-based approach they could choose to collect offsite information, for instance on types of customers and transactions and based on the analysis of that information focus their inspections on specific agents. In such an analysis they should make use of STR information (for instance by looking into real estate transactions that are reported by banks but not by an agent).

5.7. Foreign Currencies Inspectorate

The Foreign Currency Inspectorate is in charge of AML/CFT supervision of factoring & forfeiting services, money transfer operators and exchange offices. For the first two sectors they only supervise the international activities; the APML is in charge of supervision of domestic activities. AML/CFT supervision of (2500) exchange offices was transferred per 1-1-2012 to the Inspectorate from the NBS.

The Inspectorate closely follows the law during inspections by checking procedures, indicators and the appointment of a compliance officer. In addition, they also collect detailed offsite information once per year from all obligors. For selecting obligors to be inspected they check the amount of total transactions and the currencies the obligor trades in. With respect to factoring services they select obligors based on geographical risk (country of origin of obligor) and whether the services are also provided for foreign currencies. The inspectors used to do 2 to 3 inspections per week, but since they merged into the Tax Administration no more onsite inspections were performed and focus was more on offsite.

The Foreign Currency Inspectorate assesses that the exchange offices pose the highest ML risk because of the cash involved and the fact that it concerns instant/occasional transactions.

They have not sought cooperation with another AML/CFT supervisory authority. Reason stated for this is that the AML/CFT authorities all have their own sectors under the law and that they cannot venture into other sectors.

Recommendation

- The Foreign Currency Inspectorate seems experienced in their AML/CFT inspections and as such is in a good position to assess the ML/TF risks of their obligors. They should be able to take a risk-based approach using offsite information, for instance on types of customer and transactions and information from STRs and other sources, and based on the analysis of that information focus their inspections on specific obligors.

Annex 1

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MISSION PROGRAMME: 2274 MOLI-Serbia

Belgrade, Serbia 25-26 February 2013

Ms Maud Bökkerink

Date	Project / Meeting / Participants	Time / Venue
Monday 25/02/2013	Meeting with the National Bank of Serbia <i>Ms Silviya Duvančić-Gujaničić, Head of Division, Division for Supervision of Payment and Exchange Operations, Banking Supervision Department</i> <i>Mr Dušan Aleksić, Senior Supervisor, Banking Supervision Department</i> <i>Mr Milan Žunić, Supervisor, Department for Special Control</i> <i>Ms Kornelija Novaković, a.i.. Director, Department for supervision of financial leasing companies</i> <i>Ms Gordana Dragić, Adviser, Department for Supervision of Financial Leasing Companies</i> <i>Ms Una Lasković, Supervisor, Department for Supervision of Voluntary Pension Fund</i> <i>Mr Draško Stijović, Supervisor, Department for On-site Supervision of Insurance Companies and other subjects</i> <i>Mr Bojan Randić, Supervisor, Department for On-site Supervision of Insurance Companies and other subjects</i>	09:00-11:00 <i>Nemanjina 17</i>
	Meeting with the Administration for the Prevention of Money Laundering <i>Ms Milunka Milanović, Head of Supervision Department</i> <i>Ms Danijela Tanić-Zafirović, Head of Division for Supervision of Accountants and Auditors</i>	11:30-13:00 <i>Masarikova 2</i>
	Meeting with Securities Commission <i>Ms Zorica Krnjević-Mišković, Commissioner</i> <i>Ms Irena Radulović</i> <i>Mr Vladislav Stanković</i>	14 :00-16:00 <i>Omladinskih brigada 1/VII</i>
Tuesday 26/02/2013	Meeting with Administration of Games of Chance (Tax Administration) <i>Ms Slađana Filipović, Head of Off-site Inspection Department</i>	09:30-11:00 <i>Omladinskih brigada 1</i>
	Meeting with Ministry of Foreign and Home Trade and Telecommunications (postal) <i>Ms Biljana Stanković-Matović, Inspector for Postal Parcels</i> <i>Ms Tanja Stefanović, Inspector</i>	11:30-12:30 <i>Pariska 7</i>
	Meeting with Ministry of Foreign and Home Trade and Telecommunications (real estate) <i>Ms Mirjana Veljović, Head of Section, Department for General Supervision</i>	13:00-14:30 <i>Nemanjina 22-26</i>
	Meeting with Foreign Currencies Inspectorate (Tax Administration) <i>Ms Snezana Đurić-Radulović, Head of Supervision Department</i> <i>Ms Aleksandra Japundžić, Supervisor</i>	15:00-16:30 <i>Bulevar Kralja Aleksandra 15</i> <i>Room 420</i>