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Japan AML /CFT and FATF recommendations

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The Financial Action Task Force (FATF) will conduct a mutual evaluation this year.

If Japan is pointed out non-compliance with the FATF Recommendations in the upcoming mutual evaluation report, then Japan will be virtually forced to implement corrective measures including potential amendment of AML related laws and regulations.

Thus, in order to predict potential government actions, I would like to discuss discrepancies between Japan's laws, regulations and situations with the FATF Recommendations.

(1) In relation with money transfer business, many businesses that may be regarded as money transfer business, payment services (EU) or money services business (US) in other countries, are not regulated at all in Japan. Of all money services, only those that are similar to wire transfer (which are defined as "*Kawase Torihiki*") are regulated and all other money transfer businesses are basically unregulated. If a business entity characterize itself as an agent of the payor or payee, then such business entity will not likely be regulated. Judgement by the Tokyo Appellate Court on July 19, 2013 has judged that if a business entity is an agent of the payor, then such business entity will not be regarded as engaging in "*Kawase Torihiki*" and judged that it would not be illegal to engage in money transfer even if such business entity does not have a bank license nor a money transmitter license. (By the way, when I made an inquiry with the Financial Services Agency as to whether they support the above view, their comment was that they are of different view.)

(a) Convenience stores provide "*shuno-daiko*" service by which consumers can pay bills of electricity service company, gas service company, and fees for other variety of services. Such convenience stores characterize themselves as agent of payee. Thus, they maintain that they are not engaging in "*Kawase Torihiki*" and they do not

need any money transmitter license although they receive real cash from consumers and wire transfer them to their client companies.

(b) Banks know that the convenience stores are making wire transfer to such stores' clients (i.e. real beneficiary), but they cannot identify the real beneficiary because usually the convenience stores would not tell such information to the banks unless strongly demanded.

(c) Telecommunication companies, internet malls, C2C internet auction sites, and many other payment related services characterize themselves as agent of payee (or agent of payor) and conduct similar businesses as the above without any bank license or money transmitter license.

(d) Some of such "payee agent" receive fees from the payor as well, so the concept of money transfer service ("*Kawase Torihiki*") and "payee agent"/"payor agent" is very difficult to distinguish.

(e) Issuers, acquirers and sub-acquirers of prepaid cards (or prepaid value), including open-loop prepaid cards, are not regulated at all under AML related act. Thus, anonymous prepaid cards may be issued in any amount. It is reported that anonymous prepaid cards, including gift cards, are often used by crime groups. For example, on June 24, 2017, *Kawakita Shinpo*, a local newspaper, reported that a woman living in Fukushima was defrauded of approximately 10 million yen by a crime group¹. The victim woman was reported to have purchased 10-million-yen worth anonymous gift cards (Amazon Gift Cards) at a convenience store and sent it to the crime group who deceived the victim by telling her that they would wire transfer 90 million yen to her, in return.

Also, there are many money transfer services that allow users to fund his/her account by using anonymous prepaid cards. One can purchase anonymous prepaid cards and then transfer such prepaid card to some other person, and such other person can fund his/her own account at a money transfer service.

One can also purchase virtual currency using anonymous prepaid cards. The seller will find someone to purchase virtual currency on the internet, then ask the purchaser to send anonymous prepaid cards or anonymous prepaid value.

¹ <https://salat.co.jp/bokumetsu/10242/>

(f) Acquirers and sub-acquirers of credit cards are not regulated under AML related acts. They need registration (or authorization) under the Installment Sales Act, but they are not included in the obliged entity list in the AML Act (“*Hanzai Shueki Iten Boshi Hou*” or the “Act for Prevention of Transfer of Criminal Proceeds”). Credit card companies are not required to obtain ID documents of merchants that they acquire.

(g) Individual Credit (*kobetsu-credit*) businesses, which characterize themselves as agent of payor are not designated as Obligated Entity under the AML Act, since they characterize themselves as agent of payor.

(h) Payment initiation service provider (“PISP”) and account information service providers (“AISP”) are characterized as payment institutions in the EU, but in Japan, they are not characterized as money transfer services. They are not Obligated Entities and no AML requirements are imposed.

(2) Pachinko, which is a type of casino, is not regulated under AML related acts. Many Pachinko business owners are said to be North Korean or have origins in North Korea.

No permit or license is required for operation of Pachinko.

(3) Risk based approach is not prescribed in AML Act.

(a) Adoption of Risk Based Approach is not mandated in the AML Act.

(b) Risk Based Approach is required in Financial Services Agency’s governmental guideline, which is applicable to financial institutions, but this guideline was just implemented in February 2018 and many financial institutions are suffering in complying with this guideline².

² Especially, assessing the risk of customers (e.g. depending on nationalities and such) is a very hard task to realize. In relation with sanction related issues, **North Korea** is a sanctioned country and areas close to it (e.g. part of South Korea and China) pose high risk, but not all financial institutions are adapting sufficiently to RBA. Because it is difficult to adapt to RBA and other sanction related issues, many local banks are reported to have quit handling cross border money transfer services. Also,

(c) The Ministry of Economy Trade and Industry which regulates the issuance of credit cards is issuing a guideline (which draft was publicized in June, 2019) which will be applicable to the issuers of credit cards that require them to adopt RBA, but this guideline will not be applicable to acquirers of credit card who do not issue credit cards.

(d) The Ministry of Finance which regulates cross border transactions has issued a guideline last year which is applicable to business entities engaging in cross border transactions to implement RBA, but this guideline has just been implemented and most entities including currency exchange businesses seem to be suffering in complying with this guideline.

(e) Most other obliged entities including DNFBPs are not required to implement RBA.

(4) Many businesses that need to be registered do not require any registration.

For example, operation of finance lease business, factoring business, currency exchange business (including currency exchange with foreign currencies), notary business, issuance of credit cards to business entities, issuance of charge cards to consumers and to business entities, and issuance of prepaid cards to consumers (including open-loop prepaid cards) do not require any license, permit, authorization, nor registration by the government.

(5) Requirements Relating to Reliance on Third Party - not complied with

Article 13 of the Cabinet Enforcement Order of the AML Act prescribes that a financial institution may rely on previous customer due diligence results of agents, intermediaries, and such of a financial transaction, that is an Obligated Entity.

However, the requirements set out in FATF recommendation 17 is not required.

Also, Article 13 of the Cabinet Enforcement Ordinance of the AML Act prescribes

implementation of Risk Based Approach as a corporate group is another hard task to realize. For example, names of customers that a financial institution has submitted SAR may not be shared with another financial institution inside the same corporate group. It is often the case that systems of financial institutions inside the same corporate group are developed independently, and necessary customer information to combat ML/TF may not be exchanged among such financial institutions.

that an Obligated Entity may rely on the customer due diligence result of a bank or credit company if the transaction is paid through such bank or credit card company. However, the requirements set out in FATF recommendation 17 is not required.

- (6) Transactions with foreign PEP - too strict regulations that cause refusal of transaction
FATF, by its guideline on Politically Exposed Persons, requires Obligated Entities do not to refuse PEPs irrationally.

However, since the Japanese government has required that financial institutions to verify two kinds of ID documents every time the customer (i) borrows money from financial institutions through ATM or otherwise (in any amount), (ii) receives insurance payment from insurance company, including monthly payment (in any amount), (iii) purchases securities through securities companies and such, some financial institutions are forced into refusing contracts with foreign PEPs, because it is impractical to demand customers to submit two kinds of ID documents every time.

- (7) Requirements Relating to PEPs - not complied with

Japan is not complying with FATF Recommendation pertaining to domestic PEPs.

(a) FATF requires that transactions with domestic PEPs to be regarded as high risk transactions. Japan has not complied with this requirement. Under the AML Act, transactions with foreign PEPs are regarded as high risk transaction, but transactions with domestic PEPs are not.

(b) The concept PEPs under the AML Act of Japan, does not include senior officials of international organization.

(c) Transactions with family members of foreign PEP are regarded as high risk transaction under the AML Act of Japan, but transactions with close associates of a PEP is not regarded so.

- (8) CDD of Beneficiary - no provision

In the AML Act of Japan, there is a provision requiring verification of the ID of agent and substantial owner of a legal entity together with ID verification of the

principal, but there is no regulation requiring the CDD of beneficiary³.

(9) CDD of trust entities

There is no provision in the AML Act that requires CDD of the beneficial owner of trust entities.

(10) CDD of Legal Entities

There is no regulation in the AML Act that requires verification of ownership structure of customer. Also, Obligated Entities are not required to verify the ID of the substantial owner.

(11) Transactions Subject to CDD Measures

FATF Recommendation 10 and 22 require CCD procedures for establishment of a business relationship. Establishment of business relationship for bank accounts, and issuance of credit cards is covered by the AML Act, but not in relation with currency exchange services and such, where the establishment of business relationship is not covered.

(12) Virtual Currency

In the year 2018, most of the virtual currency exchanges operating in Japan were subject to administrative measures. Some went out of business, and some are still operating, but effective AML measures are hard to implement because Peer to Peer transfer of virtual currency allows any crime organization to transfer virtual currency anonymously and across different countries.

Also, no one owes declaration obligation even if such person carries to another country a wallet containing keys for billion dollar worth virtual currency. Criminals insist that the value is stored on the internet and that they are not carrying the value with them.

(13) Effectiveness of Supervision

³ The interpretive note of the AML Act states that if the customer is acting on behalf of another person, then the Obligated Entity should treat the beneficiary as the customer and conduct CDD measures in relation with such beneficial owner. This means that the Obligated Entity will have to conduct CDD measures in relation with the beneficial owner and not that of the person acting on behalf of the beneficiary. Anyways, the above is just an interpretation and this interpretation may not be complied with widely.

To the extent of my knowledge, no fine has been imposed on financial institution for violation of AML Act. Sanctions seem to be lighter compared to US and EU and seem to be ineffective.

(14) Money Laundering Crime

FATF Recommendation 3 requires that each country criminalize money laundering.

Japan has criminalized money laundering and the receipt of criminal proceeds. However, in order to be guilty, the government says that the accused needs to have been aware of individual predicate offence. Thus, it is very difficult to prosecute an officer of financial institution for Money Laundering Offence. For example, an officer of Standard Charter Bank was accused of receiving criminal proceeds in the past, but the sentence was not guilty.

The proceeds were from illegal predatory lending, but the accused insisted he did not think of such possibility. He admitted the recognition of the possibility that the funds could have been the result of some illegal activity (e.g. tax evasion), but he got away.

(15) NGO

There are NGOs in Japan that are closely related with North Korea and Korea. The danger of such NGO is not warned sufficiently.

Terrorists are not prohibited to become senior officers of NGO. (On the other hand, Japanese gangs [or *bouryokudan*] are prohibited.)

(16) Terrorist

Since there are many unregulated money services in Japan that do not conduct CDD measures, I presume that it is not difficult for Terrorists to transfer illegal money into or out of Japan.

(17) Lawyers

Lawyers do not owe obligations to file suspicious transaction report (“STR”)

As described above, it seems that there are many things that needs to be amended in relation with Japan’s AML/CFT laws and regulations.