

January 7, 2011

Comments on the FATF Consultation Paper, “The Review of the Standards-Preparation
for the 4th Round of Mutual Evaluations”

Japanese Bankers Association

Anti-money laundering/counter-terrorist financing is a very important issue for financial institutions. The Japanese Bankers Association expresses its support for reviewing the FATF Recommendations in order to increase their effectiveness. We also are grateful for this opportunity to submit our opinion from a practical point of view during this review process. Hereafter, we comment on the inquiry items as indicated below, and ask that you kindly examine them. Going forward, we hope that you will continue to grant opportunities for consultation with the private sector regarding this issue.

1. “2. Recommendation 5 and its Interpretative Note”

It is proposed that, taking these elements into account, as well as the ownership or control structure of a legal person or arrangement, financial institutions should:

- First identify and take reasonable measures¹ to verify the identity of the natural persons who ultimately have a controlling ownership interest.
 - Where the ownership interest is too dispersed to exert control or there are other persons who have control of the legal person or arrangement, then it would be necessary to identify and take reasonable measures to verify those other persons that have effective control through other means (e.g. by exerting influence over the directors of a company). (*Paragraphs21*)
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- A risk-based approach is effective and practical in raising the accuracy of customer due diligence. Therefore, the risk-based approach should be introduced to clarify methods and information for “identifying and verifying beneficial owners of legal persons or arrangements.”
 - When determining the appropriate level of customer due diligence, risk factors,

such as form or location of said legal persons or legal arrangements should be taken into account.

- For example, there is a clear difference in the transparency of flow of funds and money laundering risks between a legal arrangement, whose ownership structure and actual business status is obscure (or is aimed to appear obscure), and of an ordinary company. Due to this, a “one-size-fits-all” customer due diligence should not be conducted.

2. “3. Recommendation 6: Politically Exposed Persons”

(i) to leave the FATF requirements related to foreign PEPs as they are, i.e. foreign PEPs are always considered to be higher risk; (*Paragraphs29*)

- If the revision of recommendation regarding PEPs is to be considered, then the scope of public functions of politically exposed persons (PEPs) must be clarified in the Recommendation. This is because, from a practical perspective, it is difficult to determine said scope.

(ii) to require financial institutions to take reasonable measures to determine whether a customer is a domestic PEP; and (iii) to require enhanced CDD measures for domestic PEPs if there is a higher risk. (*Paragraphs29*)

- The money laundering risks of domestic PEPs varies depending on the corruption level of the respective country. Therefore, Recommendation 6 should accept discretionary powers of each country regarding the customer due diligence to be applied to domestic PEPs. If domestic PEPs are going to be added to the targets of Recommendation 6, then we think that the risk-based approach should be applied in this case. This is so that governments or financial institutions can decide on the scope of domestic PEPs and business relationships, to which the enhanced customer due diligence is applied, in accordance with the actual circumstances of the respective country, such as corruption level.

The FATF is also reviewing the obligation with respect to family members and close associates of PEPs. Instead of requiring financial institutions to determine whether a customer or beneficial owner is a family member or close associate of a PEP, it proposes to focus on the cases where the PEP (either foreign or domestic) is a beneficial owner of the account, i.e. on situations where a family member or close associate has a business relationship with a financial institution and a PEP is the

beneficial owner of the funds involved in such a relationship. *(Paragraphs30)*

- In the case of family members and close associates of PEPs, it is especially difficult to confirm whether the PEPs are beneficial owners. In particular, for family members of a single household, there are many cases where it is difficult to determine whether the provider of funds is the PEP who is the head of the household, or the dependent family member who is the account holder.
- For this type of account, rather than a financial institution confirming whether the PEP is the beneficial owner or not at the time of establishing a business relationship by acquiring additional information, etc., it is more effective to conduct monitoring. By monitoring, the financial institution should be able to detect unusual transactions which differ from the normal flow of funds with the family member or close associate and determine whether the PEP is the beneficial owner.

3. “Special Recommendation VII and its Interpretative Note”

(1) “6.1 Beneficiary Information”

(i) whether financial institutions require accurate information on beneficiary names in order to process a transaction; *(Paragraphs47)*

- The originator bank and intermediary bank have no direct points of contact with the beneficiary and is hardly able to confirm beneficiary information with that individual. Thus it is not reasonable to make it the obligation of the originator bank and intermediary bank to confirm the authenticity of the said information, and neither do we think that it is effective.

(ii) whether it would be feasible and useful, in managing the ML/FT risks associated with the beneficiary party, for financial institutions to have additional beneficiary information (i.e. for the purpose of detecting suspicious activity and screening prohibited transactions) ;*(Paragraphs47)*

- We think that the holding of (1) beneficiary’s account number, (2) beneficiary’s name and (3) beneficiary’s address (or customer identification number) is feasible. Furthermore, (3) will become feasible in future if legal systems are developed.
- The national identity number is not feasible since there are cases where the beneficiary does not have any.

(iii) what additional beneficiary information could be required that would be feasible, useful to financial institutions, practical for originating parties, and proportionate

so as not to push transactions underground: *(Paragraphs47)*

- We think that requiring “national identity number, customer identification number, or date and place of birth” is either unfeasible or will place inordinate burdens on parties to the transaction, and that it would not be practical for the originating side.

(2) “6.2 Obligations to screen wire transfers against financial sanctions lists”

(iv) when screening wire transfers, whether financial institutions detect incomplete data fields and, if so, how they respond when incomplete data fields are detected (e.g. file a suspicious transaction report, process the transaction, suspend the transaction, request complete information from ordering financial institution, etcetera)? *(Paragraphs49)*

- We will be able to detect “incomplete data,” if this indicates that required fields for originator information or beneficiary information is completely missing. If that is the case, we would discontinue processing the transaction and demand complete information from the originator bank.
- If “incomplete data” refers to questionable originator information or beneficiary information, then it would be difficult to detect whether the information is indeed incomplete or to respond. This is because the originator bank has no points of contact with the beneficiary, the intermediary bank has no points of contact with the originator or beneficiary, and the recipient bank has no points of contact with the originator.

(3) “6.3 Other Issues”

(i) considering whether there are sound reasons for making distinctions as to how these requirements should be applied in different market contexts (e.g. in cases where the payment service provider of the originator is also the payment service provider of the beneficiary); *(Paragraphs50)*

- With regards to the obligation of screening sanctions lists, the handling of screening of domestic wire transfers should be reviewed separately from cross-border wire transfers, including making it outside of the target of Special Recommendation VII. This is because screenings are domestically being implemented effectively based on Special Recommendation III. Furthermore, AML/CFT risks of domestic wire transfers differs from that of cross-border wire transfers and screening needs varies by country depending on its domestic

transfer system.

- For example, the majority of domestic wire transfers in Japan are carried out through the Zengin System. In the case of transfers through the Zengin System, the originator bank screens the originator's account and the recipient bank screens the beneficiary's account pursuant to Special Recommendation III. As a result, the screenings of the sanctions list is functioning effectively. Therefore, in the Zengin System, transfers of funds are not made to or from persons on sanctions lists. Furthermore, there are no intermediary banks in the Zengin System and so speedy tracing after transactions is ensured.
- The obligation of screening is equally placed on a limited number of Zengin System members and who are under the same legal jurisdiction. Under such circumstances, the government's supervision over the screening obligation is being implemented effectively and our screening system is already functioning effectively without having to wait for discussions on Special Recommendation VII.
- When reviewing the screening for domestic wire transfers, the efficiency of settlements must be taken into account. For example, real-time payments and deposits are conducted through the Zengin System and the business custom of Japan is based on such for inter-company settlement. However, in the event that the originator bank is required to screen the beneficiary before executing a transfer, there exists the possibility that transfer processing may be discontinued or settlement may be delayed as a result of having to conduct confirmations, etc. with the recipient bank in tandem with the occurrence of a false positive. Moreover, the convenience of real-time payments and deposits of the Zengin System may be undermined.