

September 16, 2011

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

Japanese Bankers Association

Anti-money laundering/counter-terrorist (AML/CFT) is critical issues for Japanese financial institutions. Japanese Bankers Association (JBA) wishes to express its appreciation for being given the opportunity to participate in the revision of FATF Recommendation to create a more effective and practical system. JBA appreciates look forward to continuing the dialogue with FATF to develop recommendation to discuss the market practice and practicalities of the industry.

1. “1.Beneficial Ownership: Recommendations 5, 33, and 34”

(1) “1.1 Recommendation 5”

The main change proposed in Recommendation 5 is to specify more clearly the types of measures that financial institutions (and through R.12, DNFBPs) would be required to undertake in order to (a) identify and verify the identity of customers that are legal persons or legal arrangements, and (b) understand the nature of their business and their ownership and control structure. (*Paragraphs8*)

- Regarding paragraph 8, we believe the financial institutions (FIs) should be provided with more than just specification and clarification on the types of measures to increase the level of customer due diligence. We emphasize the application of risk-based approach in this area. Based on risk associated with legal persons or legal arrangements, the measures and guidance on information that would normally needed to identify and verify the identity of beneficiary owners should be clarified. Specifically, we believe FATF should provide specification and clarification on these measures, and also provide proposal to when and how measures should be applied, for we believe not all measures should be required across the board. The determination on which and how these measures to be applied to that particular legal persons and legal arrangements should be based on risks. (i.e., mitigation on requirements for customer due diligence should be considered according to the risk level).

- When determining the level of customer due diligence according to risks, risk factors, such as organization structure or location of said legal persons or legal arrangements should be taken into consideration.
- For example, the difference in the degree of transparency on funds flow and money laundering risk is apparent when normal “company” (with business activities) and legal arrangement whose ownership structure and actual business status lack transparency with or without clear intentions are compared. Thus, the types of measures to identify the customer and verify its identity should not be “one-size-fits-all”.

To identify the customer and verify its identity: - the name, legal form, and proof of existence; the powers that regulate and bind the entity (*e.g.*, the memorandum and articles of association of a company) and the names of persons holding senior management positions (*e.g.*, senior managing directors); and the address of the registered office (or main place of business).

- Scopes of power, control and responsibilities associated with “senior management positions”, may vary in each legal person and legal arrangement. Moreover, the decisions to execute financial transactions may not be related to a senior management or executive position. Therefore, the definition and scope of "persons holding senior management positions (*e.g.*, senior managing directors)" must be clarified.

(2) “1.2 Recommendation 33 – Legal Persons”

The FATF is considering whether:

(a) Companies should be responsible for holding both basic information and information about their beneficial ownership (as noted above in the context of Recommendation 5); and that beneficial ownership information should also be accessible in the jurisdiction to competent authorities through one or more other mechanisms, including financial institutions, professional intermediaries, the register of companies, or another body or authority which holds such information (*e.g.*, tax authorities or regulators), or

(b) That competent authorities should be able to access beneficial ownership information from one or more of: the company itself; financial institutions, professional intermediaries, the register of companies, another body or authority which holds such information (*e.g.*, tax authorities or regulators); or by using the authorities’ investigative and other powers. (*Paragraphs 10*)

- If companies are to be responsible for holding information about their beneficial ownership in addition to basic information, the definition of "beneficial ownership" should be defined in the way that is practical for companies. Also, if this additional requirements will be implemented as it was proposed above, the arrangements to mitigate additional burden on companies to meet the new requirements should be in placed.
- If these arrangements stated above are difficult to accomplish, the competent authorities should become responsible for identifying the beneficiary ownership information; and the responsibility of the private sector (companies, financial institutions, professional intermediaries) should be limited. In addition, we would note that information that FIs can access is limited in both quantity and in qualities.
- Companies listed on recognized stock exchanges, state-owned companies, and financial institutions and DNFBPs that are subject to AML/CFT supervision should be exempted from the requirements on beneficial ownership identification.

2. "2. Data protection and privacy: Recommendation 4"

The FATF is aware that the interplay between AML/CFT and data protection requirements is of particular concern for international financial services groups seeking to transfer information across borders for consolidated AML/CFT risk management, and has considered how to ensure that such cross-border flows of information are permitted, subject to appropriate safeguards. (*Paragraphs 14*)

- If FATF is requiring FIs to transfer information across borders for consolidated AML/CFT risk management, FATF should acknowledge the differences of laws and regulations on data protection and privacy in various jurisdictions, and then provide clear and effective framework for these transfers of information for this purpose.
- For example, regarding the proposal to change Recommendation 15, if the Financial Group will be required to share information on clients, accounts, transactions to oversea branches and subsidiaries in different jurisdictions for purpose of global risk management, the changes on data protection and privacy regulations would be the precondition of the implementation of this requirement.

3. “3. Group-wide compliance programmes: Recommendation 15”

It is proposed that financial groups (which are subject to group supervision under the Core Principles) should be required to have group-wide programmes against money-laundering and terrorist financing; and that these should include policies and procedures for sharing information within the group for purposes of global risk management. *(Paragraphs16)*

- "Financial groups (which are subject to group supervision under the Core Principles)" requires a clear definition.

It is proposed that, at a minimum, group-level compliance, audit, and/or AML/CFT functions should be provided with customer, account, and transaction information from branches and subsidiaries when necessary for AML/CFT purposes. *(Paragraphs16)*

- Please refer to the comments on 2:2 above.

4. “4. Special Recommendation VII (Wire transfers)”

SRVII should be applicable to all types of EFT, including serial and cover payments, taking into account the guidance issued by the Basel Committee on Banking Supervision¹.

1 Due diligence and transparency regarding cover payment messages related to cross-border wire transfers (May 2009).

- With regards to SRVII, we should view “Wire transfers” as cross-border transfers that will not include domestic transfers. Domestic transfers should be discussed separately, for payment systems and transaction processing methods varies from country to country. Any study of effective AML/CFT management, the FATF should take these differences in payment systems and transaction processing methods into considerations.

Ordering financial institutions (FIs) should be required to include, on all cross-border EFT, full originator information (name, account number or unique transaction reference number, and address, as currently required) and full beneficiary information (name, and account number or unique transaction reference number). *(Paragraphs17)*

- In paragraph 17, if to “including full beneficiary information” should be interpreted as “to assure that there are no missing fields on beneficiary information”, this suggestion is a workable practice.

Intermediary financial institutions (FIs) should be required to screen cross-border transactions in a manner which is consistent with straight-through processing². *(Paragraphs 17)*

2 To take freezing action and comply with prohibitions from conducting transactions with prohibited parties, as per the obligations which are set out in the relevant UNSCRs, such as S/RES/1267(1999) and its successor resolutions, and S/RES/1373(2001).

- The Foreign Exchange Trade Act of Japan requires screening against asset freeze provided by Japanese Ministry of Finance which includes list of subjects designated by UNSCRs, as it is described in footnote 2 of The Consultation Paper. Thus the procedures to screen against cross-border transactions in line with UNSCRs have been already implemented in Japanese banking industry. Nonetheless, if the proposal also includes requirement to assure there is no unusual information on originator or beneficiary, it is not feasible.
- When cover payment instruction is sent by MT202 instead of MT202COV, because there is no information on originator or beneficiary, it is impossible for FIs to distinguish between cover payment related to interbank settlements from customer related cover payment; and for this reason the detection is difficult.

Beneficiary FIs receiving EFT which do not contain full originator or beneficiary information, as required, should be required to take measures that are consistent with automated processes. *(Paragraphs 17)*

- The definition of “automated process” is not clear, we would ask FATF to provide specific and descriptive definition.
- With respect to full originator information, the process to detect missing mandatory fields, and revert Ordering FIs if there is missing information is feasible to Beneficiary FIs.

The FATF is also seeking input on: (i) what types of procedures are currently being used by intermediary FIs for dealing with EFT which lack full originator information as required, and whether any of these procedures are risk-based; *(Paragraphs 18)*

- With respect to dealing with EFT which is missing mandatory originator information, and if the transaction was processed through serial payment, the process will be held and the intermediately FIs will request the Ordering FIs for full originator information.
- When cover payment instruction is sent via "MT202COV", detection of missing fields by intermediary FIs are possible. However, current practice does not require Intermediary FI to request full originator information from Ordering FIs (If the cover payment instruction was sent via MT202, it is impossible for Intermediary FIs to even detect missing field).

(ii) whether and what kind of procedures FIs apply to cross-border EFT to detect whether information with respect to parties that are not their customers is meaningful; *(Paragraphs18)*

- In many cases, it is impossible for the FIs itself to determine whether information on parties that are not their customers is "meaningful," partly because of linguistic issues. If FIs are to detect whether information is “meaningful”, authorities need to provide guidelines or relative rules that contain narrow definition of “meaningful.” The definition of “Meaningful” should also be clear as black and white to maintain the practicalities of the practice or authority should by narrowing the subject of detection by applying risk-based approach.

and (iii) whether financial institutions apply screening procedures to cross border EFT below the threshold, and if so, how such procedures are applied. *(Paragraphs18)*

- FIs use screening procedures for all cross-border wire transfers, and there are no thresholds in these screening procedures.

5. “5. Targeted financial sanctions in the terrorist financing and proliferation financing contexts”

Respect prohibitions on making any funds or other assets, economic resources, or financial or other related services, available, directly or indirectly, wholly or jointly, for the benefit of designated persons; entities owned or controlled, directly or indirectly, by designated persons; and persons and entities acting on behalf of or at the direction of designated persons, unless licensed, authorised or notified or otherwise, in accordance with the relevant UNSCRs. *(Paragraphs20)*

- "Directly or indirectly" requires a clear definition and scope.
- FIs would be able to refuse any funds or other assets, economic resources, or financial or other related services, available, only when FIs learned that entities owned or controlled "directly or indirectly" as the result of investigations or reviews. However, there are limitations to the scope of the investigations or review that financial institutions should undertake; the detailed and practical guidelines should be provided to define the subject and extent of investigations or reviews by FIs.

6. "8. Other Issues included in the revision of the FATF Standards"

(1) "8.2 Risk-based approach in supervision"

The FATF has considered how the risk-based approach affects supervision, including risk as a basis for the allocation of supervisory resources, and the supervision of how financial institutions themselves apply a risk-based approach to AML/CFT. It is proposed that a risk-based approach should apply to the supervision of financial institutions and DNFBPs, including by Self-Regulatory Organisations. *(Paragraphs29)*

- The specific content of "a risk-based approach" should be clarified.

(2) "8.3 Further consideration of Politically Exposed Persons:"

It is proposed that individuals who have been entrusted with prominent functions by an international organisation should be treated in the same way as domestic PEPs. It is also proposed that the requirements for foreign and domestic PEPs should apply equally to family members or close associates of such PEPs. This would mean that enhanced CDD measures would be required automatically for family members and close associates of a foreign PEP, and could be required (on a risk-based approach) for family members and close associates of a domestic PEP. *(Paragraphs30)*

- The definition and scope of "international organisation" and "prominent functions" require further clarification.
- 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.
- 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.

- 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.