

**Japan: Report on the Observance of Standards and Codes—FATF Recommendations
for Anti-Money Laundering and Combating the Financing of Terrorism**

This Report on the Observance of Standards and Codes on the FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism for **Japan** was prepared by a staff team of the International Monetary Fund as a background documentation of the periodic consultation with the member country. It is based on the information available at the time it was completed on **June 9, 2004**. The views expressed in these documents are those of the staff team and do not necessarily reflect the views of the government of **Japan** or the Executive Board of the IMF.

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JAPAN

**Report on Observance of Standards and Codes
FATF Recommendations for Anti-Money Laundering and Combating the Financing
of Terrorism**

Prepared by the Monetary and Financial Systems Department, IMF

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June 9, 2004

EXECUTIVE SUMMARY

This report provides a summary of the assessment of Japan's observance of the FATF 40 Recommendations for Anti-Money Laundering and 8 Special Recommendations on Combating the Financing of Terrorism (FATF 40+8 Recommendations).

Japan has made good progress in bringing its regime for anti-money laundering and combating the financing of terrorism (AML/CFT) into compliance with international standards. A comprehensive legal and institutional framework is in place and Japan has achieved a good level of compliance with the FATF 40+8 Recommendations.

Some weakness is noted in the area of international cooperation, the supervision of AML/CFT compliance for postal banks, and resources for the financial supervisors and the financial intelligence unit. *In addition, to date, the effective application of legal powers appears to be limited as evidenced by the low numbers of investigations and prosecutions, which may be due, inter alia, to the limited resources allocated and to the insufficient level of coordination among the different agencies involved in AML/CFT.*

Contents	Page
Acronyms	3
I. Introduction	4
II. Main findings	4
A. Criminal Justice Measures and International Cooperation	5
B. Preventive Measures for Financial Institutions	7
C. Summary Assessment against the FATF Recommendations	9
D. Authorities' Response	11
Text Tables	
1. Recommended Action Plan to Improve Compliance with the FATF Recommendations	9
2. Other Recommended Actions	11

ACRONYMS

AML	Anti-money laundering
CFT	Combating the financing of terrorism
Egmont Group	Egmont Group of Financial Intelligence Units
FATF	Financial Action Task Force
FIU	Financial intelligence unit
FSA	Financial Services Agency
JAFIO	Japan Financial Intelligence Office (JAFIO)
LEG	IMF Legal Department
MFD	IMF Monetary and Financial Systems Department
ML	Money Laundering
MOF	Ministry of Finance
MOU	Memorandum of understanding
MPHPT	Ministry of Public Management, Home Affairs, Posts and Telecommunications
NSL	Law Concerning Special Provisions for Narcotics and Psychotropic Control Law etc. and Other Matters for Prevention of Activities Encouraging Illicit Conduct and Other Activities Involving Controlled Substances through International Cooperation
Palermo Convention	UN Convention against Transnational Organized Crime
POCL	Law for the Punishment of Organized Crimes, Control of Crime Proceeds and Other Matters
Vienna Convention	UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances 1988
40+8 Recommendations	FATF 40 Recommendations for AML and Eight Special Recommendations on CFT

I. INTRODUCTION

1. This Report on the Observance of Standards and Codes for the FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) was prepared by a team composed of staff of the International Monetary Fund and an independent expert not under the supervision of the Fund staff who was selected from a roster of experts in the assessment of criminal law enforcement and non-prudentially regulated financial activities.¹

2. The report provides a summary of the level of compliance with the FATF 40+8 Recommendations and provides recommendations to strengthen compliance. The views expressed in this document are those of the assessment team and do not necessarily reflect the views of the government of Japan or the Board of the IMF.

3. To conduct the assessment, staff reviewed the relevant AML/CFT laws and regulations and supervisory and regulatory systems in place to deter money laundering and the financing of terrorism among prudentially regulated financial institutions. The independent expert reviewed the capacity and implementation of criminal law enforcement systems. The assessment is based on the information available at the time the assessment mission concluded on September 11, 2003. Some additional information was provided by the Japanese authorities following the conclusion of the mission that now has been taken into account in finalizing the assessment.

II. MAIN FINDINGS

4. The Japanese authorities have made good progress in the past few years in bringing the AML/CFT regime into greater compliance with international standards. Institutional arrangements are in place to ensure effective implementation of AML/CFT requirements of the FATF 40+8 Recommendations. These legislative initiatives and establishment of institutions represent major progress toward broad compliance with the FATF standards.

5. The main institutions responsible for carrying out AML/CFT activities are the Japan Financial Intelligence Office (JAFIO), the National Police Agency, the Office of the Public Prosecutors, the Financial Services Agency (FSA), and the Ministry of Finance (MOF). The FSA is the primary financial regulator and is responsible for monitoring of AML/CFT compliance by non-government-owned banks, insurance, and securities firms.

6. Though there has been good progress overall, the assessment identified significant weaknesses related to resources for supervision and JAFIO, a weak arrangement for

¹ The assessment was conducted by Mr. Michael Moore (mission chief) and Ms. Maud Bökkerink (both MFD); Mr. Nadim Kyriakos-Saad (LEG); and Mr. Jean-Pierre Michau (Banque de France). Throughout this report, portions of the assessment attributable to the independent expert are shown in italicized text. The assessment was conducted on the basis of the October 2002 common methodology endorsed by the FATF and the IMF.

AML/CFT at the Japan Post, and insufficient implementation of arrangements for international cooperation.

A. Criminal Justice Measures and International Cooperation

Criminalization of ML and FT

7. Japan has ratified the UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances 1988 (Vienna Convention) and the UN International Convention for the Suppression of the Financing of Terrorism. The UN Convention against Transnational Organized Crime (Palermo Convention) has been signed, and the bills for ratification of this Convention are scheduled to be submitted to the Parliament in 2004.

8. The legal provisions for the criminalization of money laundering and terrorist financing are in place in a manner which is largely consistent with the FATF standard. Japan had criminalized money laundering related to drug offences through the Law Concerning Special Provisions for Narcotics and Psychotropic Control Law etc., and Other Matters for Prevention of Activities Encouraging Illicit Conduct and Other Activities Involving Controlled Substances through International Cooperation (NSL) as early as 1992. The Law for the Punishment of Organized Crimes, Control of Crime Proceeds and Other Matters (POCL), enacted in February 2000, broadened the scope of predicate offences beyond drug-related offences to include among others, organized crime and financial crime. The financing of terrorism became a criminal offence through the Law on Punishment of the Financing of Offences of Public Intimidation in 2002, and terrorist financing was added to the list of predicate offences.

Confiscation of proceeds of crime or property used to finance terrorism

9. The NSL and POCL provide powers for freezing, seizure, and confiscation of the proceeds of crime and property of corresponding value. *The lack of specified and itemized statistics on money laundering and financing of terrorism related to seizure and confiscation is one shortcoming that should be addressed. In general, confiscation of proceeds of crime or property used to finance terrorism appears to be relatively low.*

10. With respect to the freezing of funds in accordance with the UN Security Council Resolutions relating to the prevention and suppression of financing of terrorism, the MOF and the FSA have distributed the UN lists of terrorist individuals and organizations to financial institutions. Freezing is effected on the basis of the Foreign Exchange and Foreign Trade Law, as amended in May 2002.

The FIU and processes for receiving, analyzing, and disseminating intelligence

11. Japan established its financial intelligence unit, JAFIO, in the FSA in February 2000, and shortly thereafter, JAFIO became a member of the Egmont Group. JAFIO's main tasks are to receive, analyze, and disseminate reports on suspicious transactions from financial institutions. Furthermore, JAFIO is participating in awareness raising and training activities

among financial institutions. *JAFIO is currently staffed with 18 persons. Given Japan's large and sophisticated financial system and the evolving importance of financial intelligence units for AML/CFT purposes, the number of staff of JAFIO appears minimal. In addition, the high turnover in JAFIO's staff necessarily results in a loss of depth of expertise and institutional stability necessary for JAFIO to adequately fulfil its functions.*

12. JAFIO's inspectors review every suspicious transaction report by hand. In light of the increasing number of reported transactions, JAFIO should develop additional analytical tools to select transactions for further analysis and to enhance its output. In addition, the lack of access to law enforcement and administrative information also impairs JAFIO's ability to analyze suspicious transaction reports, resulting in a very high number of reports forwarded to law enforcement. Additional resources and access to law enforcement and administrative information would enable JAFIO to develop adequate typologies of money laundering and guidelines to assist financial institutions to identify patterns of suspicious transactions. Thus, JAFIO's information efforts and feedback to financial institutions could be significantly increased.

13. JAFIO's cooperation with its foreign counterparts is constrained. Even though the existence of an MOU does not appear to be a legal prerequisite for the exchange of information, in practice, it appears that JAFIO will not engage in such exchanges unless an MOU is in place. To date only three MOUs are in place. JAFIO should augment its efforts for international sharing of information, either by entering into a much larger number of MOUs or by making use of the framework enabling it to exchange information. *JAFIO maintains statistics on the number of suspicious transaction reports received as well as the number of reports analyzed and disseminated. Recently, it has begun to collect the number of cases originating from suspicious transaction reports that result in successful investigations. Over time the quality of JAFIO's statistics should evolve and provide more depth in order to enhance JAFIO's effectiveness and its ability to evaluate the results of its activities.*

14. JAFIO disseminates suspicious transaction reports to the Public Prosecutor's Office and five different law enforcement agencies. These agencies do not coordinate further criminal investigations of the disseminated transactions, which appears to be resulting in duplication of work and efficiency losses. Only recently have they started providing feedback to JAFIO. Consideration should be given to setting up a coordination mechanism among these agencies and JAFIO.

Law enforcement and prosecution authorities, powers, and duties

15. Under the Criminal Procedure Code, public prosecutors and law enforcement authorities are able to use a range of investigative techniques, including controlled delivery, and have the ability to compel production of bank accounts and financial transaction records. *However, there is an absence of adequate law enforcement results in terms of specific money laundering or financing of terrorism prosecutions and convictions. The work of JAFIO has not been met with an effective law enforcement response; this is a matter of concern which should be addressed. A proper evaluation of the reporting system would benefit from more*

detailed statistics on the performance and characteristics of all the components of the AML/CFT efforts.

International cooperation

16. Although the Law for International Assistance in Investigations provides requirements and procedures under which Japan can execute a request for legal assistance in criminal cases from a foreign country even in the absence of a bilateral mutual legal assistance treaty, all requests for assistance must be submitted through diplomatic channels unless otherwise required by conventions or treaties. In this regard, Japan has only recently entered into one mutual legal assistance treaty with the United States (this treaty has not yet been approved by the Diet). There is significant scope for enhancing Japan's ability to engage more actively in mutual legal assistance in the area of AML/CFT, including through the conclusion of additional bilateral mutual legal assistance treaties with other countries.

17. *The authorities are not in a position to provide specific information regarding the financial, human, or technical resources that are allocated to ensure adequate oversight to conduct investigations and to respond promptly and fully to requests for assistance received from other countries. The authorities should evaluate their needs with a higher degree of precision and determine more precisely the amount of resources devoted to AML/CFT.*

B. Preventive Measures for Financial Institutions

18. The FSA has prudential regulation responsibilities for the banking, securities, and insurance activities for private financial institutions and has been designated as the main authority responsible for checking compliance by financial institutions with AML/CFT requirements. The government has made substantial efforts to increase the inspection resources devoted to supervision since the creation of the FSA in 2000. That said, the staffing resources for AML/CFT remain strained, and continued efforts to augment staff are needed. The assessors also encourage the authorities to strengthen the inspectors' knowledge and expertise in AML/CFT.

19. The MOF has inspection authority for private financial institutions for narrower financing of terrorism issues under the Foreign Exchange and Foreign Trade Law. The typical scope of MOF inspections includes the review of wire transfer activities, accounts of non-residents, and ensuring that financial institutions can impose freezing requirements, as necessary.

20. Japan Post, wholly-owned by the government and operating from over 24,000 branches, is subject to supervision by the Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHPT). However, under the arrangement between FSA and MPHPT of April 2003, the FSA is responsible for the inspection of risk management, while the inspection of compliance, including for AML/CFT requirements, remains with the MPHPT. At the time of the mission, the MPHPT had only just begun its first onsite inspection of Japan Post and AML/CFT inspection procedures were not available for review

by the mission team. The staffing resources available to MPHPT are not adequate to provide a meaningful supervisory role.

21. To the extent that MPHPT retains a supervisory role of Japan Post, MPHPT will need to develop onsite inspection processes to ensure compliance with customer identification, record keeping, and suspicious transaction reporting requirements. In light of the decision to delegate the inspection of some prudential risks to the FSA, there is a good case for also turning over the compliance area as well (at least with respect to AML/CFT) to the FSA to ensure greater consistency and efficiency in the supervision of Japan Post relative to the private banks.

22. To ensure the integrity of financial institutions, the financial supervisors check the knowledge, experience, and social standing of proposed management and major shareholders. The supervisors have sufficient enforcement powers to enforce compliance with the AML/CFT requirements. Although there is no legal impediment, there seems to be no sharing of information between the FSA, MOF, or MPHPT on AML/CFT issues. These authorities are encouraged to cooperate and share information and experience on financial institutions' compliance on an ongoing basis.

23. The POCL imposes an obligation on financial institutions, including banks, insurance companies, and securities firms, to provide suspicious transaction reports directly to JAFIO. However, the regional and governmental financial institutions are subject to indirect reporting through their primary regulator, such as the MPHPT and the MOF. Further streamlining of reporting procedures by requiring that all financial intermediaries report directly to JAFIO would strengthen efficiency of the reporting system.

24. The Law on Customer Identification and Record Retention which entered into force in January 2003 provides for sufficient requirements with respect to customer identification and record keeping. The financial institutions have made notable efforts in raising awareness by their staffs with respect to the suspicious transaction reporting duty and the new customer identification law, although these efforts do not appear, to date, to have been expanded consistently in all financial institutions or to all levels in their respective organizations.

25. The monitoring of accounts and transactions is applied in practice by some financial institutions, as it is addressed in the internal manuals of some financial institutions and the examples of suspicious transactions issued by JAFIO call for financial institutions to pay attention to all complex, unusual large transactions, or to those that have unusual patterns. However, to ensure that this is implemented across the entire financial sector, the Japanese AML/CFT system would benefit from the introduction of requirements regarding the ongoing monitoring of accounts and transactions and provisions that would ensure that financial institutions pay special attention to business relations and transactions with persons and legal entities in jurisdictions that do not have adequate systems in place to prevent and deter money laundering or financing of terrorism.

26. The FSA and MOF have issued guidelines on general compliance issues, including customer due diligence, for banks, securities, and insurance companies. JAFIO, in cooperation with the supervisors, should provide the financial institutions with additional guidance on complying with the AML/CFT requirements to raise awareness of money laundering and financing of terrorism.

C. Summary Assessment against the FATF Recommendations

27. The assessment shows Japan to have a broad level of compliance with the FATF 40+8 Recommendations for AML/CFT. Shortcomings have been identified in the areas of international cooperation, resources for supervision and JAFIO, the reporting process, and the supervision of AML/CFT compliance for Japan Post. *In addition, the level of legal compliance has not yet translated into law enforcement results.*

Table 1. Recommended Action Plan to Improve Compliance with the FATF Recommendations

Reference FATF Recommendation	Recommended Action
40 Recommendations for AML	
General framework of the Recommendations (FATF 1-3)	As the procedures involved in obtaining information through diplomatic channels are complex and lengthy, efforts should be made in concluding additional bilateral treaties on mutual legal assistance with other countries to enhance further Japan's ability to engage in mutual legal assistance.
Customer identification and record-keeping rules (FATF 10-13)	Ensure that financial institutions verify the legal structure and principal owners and beneficiaries of corporate clients and review the methods of identification and verification in case of non face-to-face transactions and non-photo IDs.
Increased diligence of financial institutions (FATF 14-19)	<p>Introduce requirements in the AML/CFT framework on ongoing monitoring of accounts and transactions, specifically by ensuring that all financial institutions pay special attention to all complex, unusual large transactions or unusual patterns of transactions that have no apparent or visible economic or lawful purpose, examine as far as possible the background and purpose of such transactions, set forth their findings in writing, and keep such findings available for competent authorities.</p> <p>Streamline reporting procedures by requiring that all financial intermediaries report directly to JAFIO to strengthen efficiency of the reporting system.</p> <p>Ensure that appropriate training is delivered to all levels in financial institutions and explore the possibilities of removing legal impediments to enable financial institutions to put in place adequate screening procedures when hiring employees.</p>

Reference FATF Recommendation	Recommended Action
Measures to cope with countries with insufficient AML measures (FATF 20-21)	Introduce provisions in the AML/CFT framework to require financial institutions to pay special attention to business relations and transactions with persons and legal entities in jurisdictions that do not have adequate systems in place to prevent and deter ML or FT. Specifically, the authorities should ensure that all financial institutions record the background and purpose of such transactions that do not appear to have an apparent economic or visible lawful purpose and to set forth findings in writing and make them available to assist competent authorities.
Implementation & role of regulatory and other administrative authorities (FATF 26-29)	<p>JAFIO should have sufficient resources, a permanent staff, develop analytical tools, and have access to law enforcement and administrative information to develop typologies of money laundering and provide guidelines and an annual report to financial institutions.</p> <p>The authorities involved in supervising and enforcing compliance with AML/CFT requirements are encouraged to cooperate and share information and experience on financial institutions' compliance.</p> <p>The supervisors are encouraged to undertake more proactive and in-depth on-site and off-site inspections in financial institutions and to provide additional guidance to financial institutions in order to ensure a better implementation of the preventive measures against ML and FT.</p> <p>MPHPT needs to further develop its on-site inspection processes to ensure compliance with customer information, record keeping, and reporting requirements.</p>
Administrative Cooperation – Exchange of information relating to suspicious transactions (FATF 32)	Greater effort is needed to establish a more effective mechanism for information exchange with foreign FIUs either through the increase of MOUs or the streamlining of sharing of information which is allowed under the law.
Other forms of cooperation – Basis & means of cooperation in confiscation, mutual assistance, and extradition (FATF 33-35)	Japan's willingness and ability to engage more actively in mutual legal assistance in the area of AML/CFT needs to be achieved in practice.
Other forms of cooperation – Focus of improved mutual assistance on money laundering issues (FATF 36-40)	<p><i>Coordination and information sharing among the different agencies involved in AML/CFT should be stepped up, and human and material resources allocated to the implementation of ML and FT laws should be increased.</i></p> <p><i>Consider designating a central authority in charge of assigning suspicious transaction reports to the various law enforcement agencies to ensure swift and adequate follow up.</i></p> <p>Additional consideration should be given to enhancing Japan's ability to cooperate more actively in the area of seizure, forfeiture, and sharing of assets.</p>

Reference FATF Recommendation	Recommended Action
8 Special recommendations on terrorist financing	
III. Freezing and confiscating terrorist assets	<i>Put in place a complete and adequate system of collecting and reporting data relating to property frozen, seized, and confiscated relating to predicate offences and financing of terrorism.</i>
VII. Wire transfers	Requirements for Special Recommendation VII should be put in place in early 2005, in accordance with FATF Interpretative Note.

Table 2. Other Recommended Actions

Reference	Recommended Action
Palermo Convention	The Convention against Transnational Organized Crime should be ratified.
Statistics	<i>JAFIO's statistics should be expanded to include statistics on the number of suspicious transaction reports resulting in investigations, prosecutions, or convictions; on requests for assistance received by JAFIO or other competent authorities from both domestic and foreign authorities, on the number of responses provided to the requests received; and on spontaneous referrals made by JAFIO or other competent authorities to both domestic and foreign authorities.</i>
Japan Post	Given the significant size of Japan Post and the extent of its branch structure, greater attention to the compliance activities is needed. In light of the decision to move supervision for some prudential risks to the FSA, there is support for also turning over the compliance area (at least with respect to AML/CFT) to ensure greater consistency and efficiency in the supervision of Japan Post relative to the private banks.
Resources	Continued efforts to augment numbers staff both in the FSA and MPHPT are needed. <i>The human and technical resources for JAFIO need to be increased; in addition, the rotation of staff needs to be reduced in order for staff to acquire sufficient expertise.</i>

D. Authorities' Response

The Japanese authorities welcomed the assessment and appreciate the efforts of IMF staff and of the independent expert. We note the assessment that Japan has a comprehensive legal and institutional framework for AML/CFT and has achieved a good level of compliance with the FATF 40+8 recommendations, and take useful advice in order to strengthen our AML/CFT system, although some of these views are not shared by the authorities.

International Cooperation

The authorities consider that Japan's legal framework for and implementation of mutual legal assistance (MLA) shows no deficiencies, or at least no significant shortcomings, in relation to international standards. With regard to the legal framework, it is recognized that Japan has satisfactorily implemented every legal requirement stipulated in relevant international treaties, including United Nations (UN) conventions. The authorities have also been effectively responding to requests from foreign countries for MLA based on its domestic legislation on MLA. This has been clearly demonstrated by the relevant statistics. We share the mission's view, however, that it would be useful for Japan to conclude bilateral treaties on MLA with other countries in order to enhance its MLA activities further.

Limited Effectiveness of Law Enforcement

Unfortunately, the law enforcement authorities have not been provided with any clear evidence why this assessment was made. These years, the authorities have accelerated further their efforts to detect money-laundering cases and to punish the criminals, as demonstrated by the relevant statistics.

Moreover, when plural relevant authorities are found to be involved in criminal cases, it is common that these agencies consult with each other and start a joint investigation in order to ensure effective law enforcement. Also, prosecutors can coordinate all law enforcement agencies in such situations, as stipulated in the Rule of Criminal Investigation and the Criminal Procedure Code. Through this mechanism, the authorities believe that law enforcement agencies effectively cooperate in investigations and sharing of information.

As to the recommended actions, the authorities have the following specific comments:

- ***Freezing and confiscating terrorist assets:*** The authorities have started operation of a new mechanism where relevant data can be collected comprehensively.
- ***Palermo Convention:*** The Diet has already approved the conclusion of the Convention. Therefore, Japan will be able to conclude this Convention as soon as the Diet approves corresponding national legislation, the draft of which was submitted by the Cabinet in February 2004.
- With respect to the mission's recommendation that JAFIO maintain the *statistics* on STRs resulting in investigations, prosecutions, or convictions, JAFIO has already been receiving the data concerning the cases that originated from STRs and resulted in arrests since last year. However, the authorities have reservations about the need to tally the number of cases resulting in investigation but not in arrests because of practical difficulties in compiling such data. The authorities point out that this view was shared internationally in the deliberations of the new Methodology for the revised 40 Recommendations: the statistics on "STRs resulting in investigation, prosecution, or

convictions” was moved from “essential criteria” to “additional elements” of Recommendation 32 in the final version of the methodology.

- It is the MPHPT that is in charge of supervising *Japan Post*. The authority to supervise Japan Post has not been transferred to the FSA, even though the former has delegated to the latter the authority to inspect the risk management of Japan Post. In the area of compliance, the MPHPT has inspection manuals and conducts inspection of Japan Post. The MPHPT does not think that the current arrangement is insufficient, nor does it find it necessary to change supervision of the compliance area.