

FINANCIAL REGULATION BULLETIN

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Publication of draft amendment to money laundering regulations

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I. Introduction

On 19 June 2015, the Japanese National Police Agency (the “**NPA**”) in conjunction with relevant ministries and agencies published a draft amendment to the money laundering regulations set out in the Order for Enforcement of the Act on Prevention of Transfer of Criminal Proceeds (the “**Order**”) and the Ordinance for Enforcement of the Act on Prevention of Transfer of Criminal Proceeds (the “**Ordinance**”). Public comments on the draft amendment were accepted until 18 July 2015, and the final rules together with the NPA’s responses to the public comments will be made public soon.

The draft amendment proposes new rules under the Order and the Ordinance (collectively or individually referred to as the “**Proposed Rules**”) and are based on authorization under the Act on Prevention of Transfers of Criminal Proceeds (the “**Act**”), which was amended in November 2014 (the “**Amended Act**”) as a result of a call for action by the Financial Action Task Force (the “**FATF**”).¹ The Proposed Rules include new rules corresponding to, among others, several findings in the FATF Report² and requirements in the FATF Recommendations adopted in February 2012 (the “**FATF Recommendations**”).³

We discuss below key points of the Proposed Rules, indicating which

¹ <http://www.fatf-gafi.org/countries/j-m/japan/documents/japan-aml-cft-deficiencies.html>

In June 2014, the FATF announced that it was concerned by Japan’s continued failure to remedy the numerous and serious deficiencies identified in its third mutual evaluation report of Japan adopted in October 2008 (the “**FATF Report**”), despite Japan’s high-level political commitment. Pointing out that one of the most important deficiencies which Japan needs to deal with is the lack of satisfactory customer due diligence requirements and other obligations in the area of preventive measures applicable to the financial and non-financial sectors, the FATF encouraged Japan to promptly address these deficiencies. In this context, the Act was amended in November 2014 even though only one and a half years had passed since the effectuation of the previous amendment of the Act.

² <http://www.fatf-gafi.org/countries/j-m/japan/documents/mutualevaluationofjapan.html>

³ <http://www.fatf-gafi.org/topics/fatfrecommendations/documents/fatf-recommendations.html>

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legislative deficiencies pointed out by the FATF have been addressed by the Proposed Rules or remain to be addressed.

The NPA also published for public comment a draft assessment report on the riskiness of criminal proceeds transfers (the “**Assessment Report**”), which will be referred to as necessary below. The Assessment Report is to be annually updated by the Japanese National Public Safety Commission for the purpose of publicly apprising likely risks and triggers for criminal proceeds transfers in relation to each type of money transfer.

II. Key points of the Proposed Rules

1. New rules regarding “Specified Transactions”

(1) Transactions that DO NOT require verification of customer identification

The Act requires financial institutions and other business operators (“**Specified Business Operators**”) to verify customer identification data in connection with certain types of transactions (“**Specified Transactions**”). At the same time, the current rules under the Order and the Ordinance exempt certain types of transactions from classification as Specified Transactions (e.g., transactions through the book-entry system operated by the Bank of Japan) (“**Exempted Transactions**”), given that they are unlikely to be employed for the transfer of criminal proceeds.

The Proposed Rules add the following types of transactions as Exempted Transactions in consideration of the respective riskiness of their use for criminal proceeds transfers described in the Assessment Report.⁴

Additional transactions that DO NOT require verification of customer identification

(a) Payments of utility bills to operators of utilities

(b) Payments of tuition or admissions fees to schools

(2) Transactions that DO require verification of customer identification

The Proposed Rules classify certain additional types of transactions as Specified Transactions for which Specified Business Operators must verify customer identification data under the Act. Among such newly added transactions are concurrent or consecutive transactions that are “obviously”

⁴ Article 7, Paragraph 1, matters in parenthesis of the Proposed Rules relating to the Order; Article 4, Paragraph 1, Item (vii)(c) and (d) of the Proposed Rules relating to the Ordinance.

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divided into multiple transactions in order for the amount of each transaction to fall below the applicable threshold that triggers customer identification requirements.⁵

In this regard, the Japanese Financial Services Agency (the “FSA”) has already recommended in the “points for attention” published in October 2012 (rather than obliged by law) that customer verification measures be taken in situations where a transaction does not fall under the categories of Specified Transactions due to the fact that the transaction amount is slightly below the designated threshold. In response to the FATF’s findings,⁶ the Proposed Rules upgrade the FSA’s recommendation to a legal obligation of customer verification, even where a transaction falls below the designated threshold.

2. Additional High-Risk Transactions

The Act requires Specified Business Operators to conduct enhanced customer due diligence if a transaction falls within certain high-risk categories (“**High-Risk Transactions**”), which include a transaction with a party who is suspected of not being a bona fide customer or a transaction with a customer who is suspected of having given false customer identification information at the time of the relevant transaction. The Proposed Rules add the following types of transactions as High-Risk Transactions.⁷

Newly added High-Risk Transactions
(a) Transactions with a foreign “politically exposed person” (Foreign PEP), such as a high-level government official
(b) Transactions with a family member of a Foreign PEP
(c) Transactions with a legal entity beneficially owned by a Foreign PEP or family member thereof

The FATF defines a politically exposed person (“**PEP**”) as an individual who is or has been entrusted with a prominent public function. Due to the fact that a PEP’s position and influence could be abused for money laundering purposes, the FATF requires countries to ensure that financial institutions and

⁵ Article 7, Paragraph 3 and Article 9, Paragraph 2 of the Proposed Rules relating to the Order.

⁶ The FATF Reference Document “Methodology for Assessing Compliance with the FATF 40 Recommendations and the FATF 9 Special Recommendations” published in February 2004 and updated as of February 2009 (the “**FATF Methodology**”) 5.2 (pages 15-16) (<http://www.fatf-gafi.org/media/fatf/documents/reports/methodology.pdf>), and the FATF Report 492-499 (pages 96-98).

⁷ Article 12, Paragraph 3 of the Proposed Rules relating to the Order; Article 15 of the Proposed Rules relating to the Ordinance.

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other businesses and professions implement measures to prevent the misuse of the financial system and other businesses and professions by PEPs, and to detect such potential abuse if and when it occurs.⁸ In this regard, the FATF does not differentiate between domestic PEPs and foreign PEPs. Therefore, the Proposed Rules regarding High-Risk Transactions only partially satisfy the FATF's requirements above because a transaction with a domestic PEP is still excluded from High-Risk Transactions requiring enhanced customer due diligence. Further discussions and developments, including the FATF's response, are expected on this point.

3. Enhanced methods of verification of customer identification data by means of an identification document without a photo

Under the current Ordinance, when Specified Business Operators are offered certain documents for verification of customer identification that have low probative value (e.g., a seal registration certificate, a copy of resident registration book), they must take additional measures such as sending a document pertaining to the transaction to the residence of the customer identified in the offered identification documents by registered and transfer-prohibited mail.

Corresponding to the FATF's findings,⁹ the Proposed Rules further require such additional measures when Specified Business Operators are offered certain other types of identification documents that do not have a photo (e.g., an insurance policy of the National Health Insurance, a pension handbook). At the same time, the Proposed Rules allow certain measures other than sending a document by registered and transfer-prohibited mail (e.g., being offered a certificate of tax payment or a utility receipt), thereby easing measures to verify customer identification data.¹⁰ Further discussions are expected on whether these new rules fully satisfy the FATF's findings mentioned above.

4. New rules regarding a beneficial owner

Under the current Ordinance, when a customer is a legal entity (as

⁸ Recommendation 12 and Interpretive Note to Recommendation 12 (Politically Exposed Persons) in the FATF Recommendations. Also see "FATF Guidance Politically Exposed Persons (Recommendations 12 and 22)" published in June 2013.

(<http://www.fatf-gafi.org/media/fatf/documents/recommendations/guidance-peg-rec12-22.pdf>)

⁹ The FATF Methodology 5.3 (page 16) and the FATF Report 500-510 (pages 98-100).

¹⁰ Article 6, Paragraph 1 of the Proposed Rules relating to the Ordinance.

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opposed to an individual), Specified Business Operators are required to verify its beneficial owner when a transaction with the customer falls within the category of Specified Transactions. Specifically, Specified Business Operators must verify any beneficial owner (including both an individual and a legal entity) who owns, in principle, at least 25% of the voting rights of a customer applying majority voting (e.g., a stock corporation).

In accordance with the FATF Recommendations,¹¹ the Proposed Rules require Specified Business Operators to verify the chain of beneficial owners up until they reach an individual, as indicated in the table below.¹² The required method of verifying identification data of a beneficial owner is the same as under the current Ordinance (i.e., being offered necessary information by a customer) as long as a transaction does not fall under any of the High-Risk Transactions.¹³ Since there is no institutional framework to obtain an accurate picture of beneficial owners of a legal entity in Japan, the method of identifying beneficial owners of a customer may become a problem in certain situations.

Beneficial Owner under the Current Rule	Beneficial Owner under the New Rule
(a) A person (including both an individual and a legal entity) who owns 50% or more of the voting rights of a customer (legal entity)	(a) An individual who directly or indirectly owns 50% or more of the voting rights of a customer (legal entity)
(b) A person (including both an individual and a legal entity) who owns 25% or more of the voting rights of a customer (legal entity) if no one falls under the above item (a)	(b) An individual who directly or indirectly owns 25% or more of the voting rights of a customer (legal entity) if no one falls under the above item (a)
	(c) An individual who has a dominant influence on the business activities of a customer (legal entity) through capital or financial contribution, or transactional or other relationships with the customer if no one falls under the above items (a) or (b)

¹¹ FATF Recommendation 24 and Interpretive Note to Recommendation 24 (Transparency and Beneficial Ownership of Legal Persons) in the FATF Recommendations, the FATF Methodology 5.5.2 (pages 16-17), and the FATF Report 514-516 (page 101). Also see "FATF Guidance Transparency and Beneficial Ownership" published in October 2014.

(<http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-transparency-beneficial-ownership.pdf>)

¹² Article 11, Paragraph 2 of the Proposed Rules relating to the Ordinance.

¹³ Article 11, Paragraph 1 of the Proposed Rules relating to the Ordinance.

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5. New rules regarding verification of a representative

Under the current Ordinance, Specified Business Operators must verify that a representative agent or any other person actually conducting Specified Transactions on behalf of a customer (a “**representative**”) is so authorized by the methods set forth in the table below. However, the FATF requires a more appropriate document indicating that the representative is so authorized.¹⁴ In response, the Proposed Rules disallow possession of an employee ID card as a method of verification of the representative.¹⁵ This change could affect the scope and the degree of the methods in items (d) and (e) below.

Allowed Methods under the Current Rule	Allowed Methods under the New Rule
(a) A proxy demonstrating that the representative is authorized to act on behalf of a customer	(a) The same as the left column
(b) An identification card of the representative issued by a customer	(b) Deleted
(c) Registration of the representative as an officer of a customer	(c) Registration of the representative as a representative officer of a customer only (i.e., excluding registration as a non-representative officer)
(d) Confirmation that the representative is authorized to act on behalf of a customer by telephoning the head office of the customer	(d) The same as the left column
(e) Obviousness that the representative is authorized to act on behalf of a customer based on recognition of the relationship between the customer and the representative	(e) The same as the left column

6. New rules regarding reporting requirements for Suspicious Transactions

The Amended Act requires Specified Business Operators to promptly report

¹⁴ The FATF Methodology 5.4 (page 16) and the FATF Report 511-513 (pages 100-101).

¹⁵ Article 12 of the Proposed Rules relating to the Ordinance.

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to the respective regulators if property accepted from a customer is suspected of being criminal proceeds or the customer is suspected of having committed certain types of crimes, after confirming certain points and using certain methods set out in the ministerial ordinances.¹⁶ The Proposed Rules stipulate such points and methods in more detail as set out in the table below.¹⁷

Before the amendment of the Act in November 2014, there were no provisions setting out any particular standards to judge whether a transaction should be considered a suspicious transaction (“**Suspicious Transaction**”). Accordingly, financial institutions referred to reference cases regarding Suspicious Transactions published by the FSA and others, and developed their own determination framework concerning Suspicious Transactions. Financial institutions will need to check whether their existing frameworks meet the new standards.

Points to be confirmed to identify Suspicious Transactions
(a) Comparison with typical transactions with other customers
(b) Comparison with other transactions with the same customer
(c) Consistency with information obtained through customer due diligence

Methods of identifying Suspicious Transactions	
(a) Transactions other than the below items (b) or (c)	(a) Confirming whether there is any suspicious aspect in a transaction based on the points to be confirmed to identify Suspicious Transactions
(b) Transactions with an existing customer excluding the below item (c)	(b) In addition to the above item (a), due diligence of verification records of a customer
(c) High-Risk Transactions, Suspicious Transactions, transactions performed in a manner remarkably different from similar types of transactions, transactions regarded as being at high risk for money laundering taking into consideration the Assessment Report	(c) In addition to the above item (a) (and the above item (b) in case of transactions with an existing customer), questioning a customer or its representative and confirmation by a supervisor

¹⁶ Article 8, Paragraph 2 of the Amended Act.

¹⁷ Articles 26 and 27 of the Proposed Rules relating to the Ordinance.

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7. New rules regarding transactions with foreign correspondents

The Amended Act provides that Specified Business Operators who wish to deal in foreign exchange transactions with a party who resides in a foreign country and engages in the foreign exchange business (a “**foreign correspondent**”) must verify the following:

- (i) the foreign correspondent has adopted a similar level of internal money laundering measures (including customer due diligence, record keeping, and reporting requirements for suspicious transactions) (“**similar measures**”); and
- (ii) the foreign correspondent does not engage in transactions with a party engaging in the foreign exchange business without being subject to appropriate supervision by a competent authority.¹⁸

If Specified Business Operators learn that a foreign correspondent has not implemented similar measures, they may not engage in a transaction with the foreign correspondent. The Proposed Rules set out methods to confirm the above items (i) and (ii) (e.g., being offered necessary information by a foreign correspondent, obtaining public information regarding a foreign correspondent through the internet) and standards of appropriate performance of similar measures by a foreign correspondent (e.g., existence of a business office, appointment of a supervisor, and appropriate supervision by a competent authority).

Specified Business Operators are recommended (i.e., obliged to make efforts) to implement internal controls over due diligence of foreign correspondents under the current Ordinance. The above new rules will upgrade this into a legal obligation in line with the FATF’s findings.¹⁹

8. New measures regarding ongoing customer management

Before the amendment of the Act in November 2014, the Act had originally recommended that Specified Business Operators (i) train employees in relation to money laundering issues and measures; the Amended Act additionally recommends that Specified Business Operators (ii) implement

¹⁸ FATF Recommendation 13 and Interpretive Note to Recommendation 13 (Correspondent banking) in the FATF Recommendations, the FATF Methodology 18.2 (page 29), and the FATF Report 546-547 (page 108).

¹⁹ FATF Recommendation 13 and Interpretive Note to Recommendation 13 (Correspondent banking) in the FATF Recommendations, the FATF Methodology 18.2 (page 29), and the FATF Report 546-547 (page 108).

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internal rules regarding customer due diligence, (iii) appoint a supervisor in charge of anti-money laundering issues, and (iv) implement other measures provided by the ministerial ordinances.

The Proposed Rules specify the measures set out below as those to be implemented taking into account the Assessment Report, depending on the business performed by each Specified Business Operator. Such measures are partially the same or similar to the standards indicated in the FSA's supervisory guidelines.

Although the new measures have been introduced in response to the FATF's findings which encourage Japan to require implementation of the ongoing customer management by law rather than unenforceable administrative guidelines,²⁰ it should be noted that the obligation to implement the new measures remains in the form of a recommendation (i.e., an obligation to make efforts) rather than an enforceable legal obligation.

Specified Business Operators should:

- ✓ (i) Check and analyse a transaction purported to be dealt with, (ii) produce documents regarding the results of the check and analysis of the riskiness of the transaction (the "**SBO Documents**"), and (iii) review and revise the SBO Documents as needed;
- ✓ Obtain information necessary for customer due diligence in consideration of the SBO Documents, and organize and analyse such information;
- ✓ Continuously check records of customer verification and transactions in consideration of the SBO Documents;
- ✓ In case of High-Risk Transactions, Suspicious Transactions, transactions performed in a manner remarkably different from similar types of transactions, and transactions regarded as being at high risk for money laundering in consideration of the Assessment Report, ask a person conducting the Specified Transaction on behalf of a customer to obtain confirmation from a supervisor;
- ✓ Keep records of required information regarding the transactions mentioned in the preceding item;
- ✓ Employ proper persons capable of performing customer due diligence; and
- ✓ Conduct an audit as necessary for appropriate performance of customer due diligence.

²⁰ The FATF Methodology 5.7 (page 17) and the FATF Report 520-525 (pages 102-103).

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Specified Business Operators engaged in business overseas should:

- ✓ Take precautions to avoid criminal proceeds transfers involving their overseas offices and implement customer due diligence similar to that required by Japanese laws and regulations unless doing so violates any foreign laws and regulations; and
- ✓ Report to the Japanese regulators if they cannot implement customer due diligence in their overseas offices as mentioned above due to prohibition by any foreign laws and regulations.

In entering into a correspondence agreement with a foreign correspondent, Specified Business Operators which are deposit-taking institutions or funds transfer providers should:

- ✓ Obtain information about precautions taken by the foreign correspondents to avoid criminal proceeds transfers, about the business conditions of the foreign correspondents, and about the supervision of the foreign correspondents by foreign organizations;
- ✓ Assess precautions taken by the foreign correspondents to avoid criminal proceeds transfers based on the information obtained above;
- ✓ Implement internal rules regarding screening procedures for entering into contracts, including confirmation by a supervisor; and
- ✓ Create clear documents setting out who is responsible for implementation of customer due diligence by Specified Business Operators and the foreign correspondents.

9. Date of enforcement

The Proposed Rules are scheduled to come into force on 1 October 2016.

III. Conclusion

The Proposed Rules are to be revised and finalized soon based on the public comments. Considering the scheduled date of enforcement of the Proposed Rules, it would be advisable for financial institutions to begin preparations for compliance as soon as possible, taking into consideration the implications and impact of the Proposed Rules on their current practices and internal rules.

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NEWS

- **Firm receives award at Chambers Asia-Pacific Awards 2015**
Mori Hamada & Matsumoto received the "Japan National Law Firm of the Year" award at the Chambers Asia-Pacific Awards 2015 held in Hong Kong on 4 May 2015.

- **Top rankings received from Best Lawyers in the sixth edition of "The Best Lawyers in Japan"**
57 lawyers from our firm were selected for the sixth edition of "The Best Lawyers in Japan" by the Best Lawyers survey. Hideki Matsui and Daisuke Oda were selected in the area of Financial Institution Regulatory Law.

- **Firm receives awards at ALB Japan Law Awards 2015**
Mori Hamada & Matsumoto earned 8 awards at the ALB Japan Law Awards 2015 organized by Asian Legal Business (ALB), an internationally-recognized legal journal and a part of the Thompson Reuters Group. Our awards included Regulatory and Compliance Law Firm of the Year, Japanese Deal Firm of the Year and Japan Law Firm of the Year.

- **MHM ranked 3rd in the FT Law 25 Asia-Pacific Headquartered Law Firms, and receives high commendation for work in corporate, commercial and finance law**
The Financial Times published its second annual Asia-Pacific Innovative Lawyers Report on 11 June 2015. Mori Hamada & Matsumoto was ranked 3rd in the FT Law 25 list of Asia-Pacific Headquartered Law Firms, after two Australian headquartered firms and well ahead of all Japanese and other Asian headquartered firms. In the Report, we received commendations for our corporate, commercial and finance work, in respect of five submissions, one of which was ranked standout and two of which were highly commended.

- **Opening of Nagoya Office**
As announced on 27 April 2015, Mori Hamada & Matsumoto will open an office in Nagoya, Japan.

The Nagoya Office will assist clients with the full range of services

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provided by the firm generally, in fields including mergers & acquisitions, corporate practice, antitrust matters, crisis management, finance, tax, intellectual property, litigation and other forms of dispute resolution, as well as assistance that addresses other legal needs of our clients. For multi-jurisdictional matters, including cross-border mergers & acquisitions and matters in other regions of Asia, the Nagoya Office will provide clients with cutting-edge legal support and services in close coordination with the firm's lawyers in Tokyo and other offices located within and outside Japan, including those in Beijing, Shanghai, Singapore, Bangkok and Yangon.

The Nagoya Office will initially be staffed by Yoshihiro Kojima, Mikio Sonoda and Tomoaki Murai, who have extensive experience in handling mergers & acquisitions, corporate legal affairs, matters involving Asia, tax practice and other legal services in a wide range of fields.

The Nagoya Office is scheduled to open in September 2015, and further details about the office will be announced at a later date.

The Nagoya Office will be established as a branch office of Mori Hamada & Matsumoto LPC.

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