

**Collection of Defects Pointed out in Foreign Exchange
Inspections**

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Abbreviations of laws and regulations

In this report, the following laws and regulations are abbreviated as follows:

Foreign Exchange and Foreign Trade Act: Foreign Exchange Act

Act on Prevention of Transfer of Criminal Proceeds: Criminal Proceeds Act

Foreign Exchange Inspection Manual: Inspection Manual

This English translation is as unofficial translation and to be used solely as reference material to aid in the understanding of the Collection of Defects Pointed out in Foreign Exchange Inspections.

The government of Japan will not be responsible for any consequence resulting from use of this translation.

Collection of Defects Pointed out in Foreign Exchange Inspections

Objective of Collection of Defects Pointed Out in Foreign Exchange Inspections

The Collection of Defects Pointed out in Foreign Exchange Inspections covers major defects pointed out in Foreign Exchange Inspections on financial institutions regarding the status of their compliance with the Foreign Exchange Act and the Criminal Proceed Transfer Prevention Act. Its objective is to provide reference materials for financial institutions' expansion and enhancement of their internal control systems for compliance with the Foreign Exchange Act, etc.

After the publication of the previous Collection (in June 2012), a principle prohibition on payments to North Korea was introduced (in February 2016) and the revised Criminal Proceeds Act was implemented (in April 2013 and October 2016). This Collection publishes major defects pointed out in Foreign Exchange Inspections conducted between July 2012 and June 2017.

The previous two collections (June 2012 and June 2009) covered different types of defects and should be used along with this collection as reference materials for compliance with the Foreign Exchange Act and the Criminal Proceeds Act.

I. Defects Related to Internal Control System

[See I. 2. of the Inspection Manual (Attachments 1, 3-2, 5)]

Any financial institution is required to provide for specific administrative procedures to comply with obligations (including obligations to conduct verification at the time of transaction, to identify customers and to give notification of suspicious transactions) for currency exchange business under the Foreign Exchange Act and the Criminal Proceeds Act. Provisions on administrative work must be revised to meet changes in these obligations.

Matters pointed out in inspections

A financial institution failed to develop sufficient provisions on administrative work in regard to obligations for currency exchange business, including obligations to conduct verification at the time of transaction, to identify customers and to give notification of suspicious transactions. (As a result, employees in charge of the business failed to sufficiently understand administrative work pertaining to compliance with the Foreign Exchange Act, etc. and to fulfill these obligations appropriately.)

II. Defects Related to Economic Sanctions Such as Asset Freeze

1. Developing a list of those subject to sanctions

[See 11. 1. (2) of the Inspection Manual (Attachment 2)]

When those subject to economic sanctions such as asset freeze were expanded or changed through addition or any other measure by public notices from the Ministry of Foreign Affairs, any financial institution is required to update their list of those subject to economic sanctions such as asset freeze containing information such as the names, addresses, etc. of those subject to economic sanctions such as asset freeze and make the updated list available for the Sales Division and sales branches engaged in deposit transactions, remittance services, etc. to confirm whether transactions are with those subject to economic sanctions such as asset freeze or not.

When an Automatic Checking System is introduced or replaced, any institution is required to confirm that the list of those subject to economic sanctions such as asset freeze has been accurately registered in the system.

Matters pointed out in inspections

When replacing an Automatic Checking System used for implementing remittances, a financial institution allowed massive information on those subject to economic sanctions such as asset freeze to be omitted from a list of those subject to economic sanctions such as asset freeze to be registered in the new system, leading to insufficient checking using the list.

2. Checking dormant accounts, etc.

[See II. 3. (2) ① b (Note) of the Inspection Manual (Attachment 2)]

The Inspection Manual requires that any financial institution in its internal provisions on administrative work clearly provide for checking whether a so-called dormant account that sees no deposit or withdrawal for a long time is of any one subject to economic sanctions such as asset freeze at the time of the customer's request for a withdrawal from the account, even if it is difficult to make this account subject to checking of the name against those subject to economic sanctions such as asset freeze as information thereon is not left in the information system, etc. that manages deposit accounts.

This is because any withdrawal even from dormant accounts, etc. is subject to a permit under the Foreign Exchange Act if the customer making the withdrawal request is one of those subject to economic sanctions such as asset freeze.

Matters pointed out in inspections

When a withdrawal was requested from a dormant account for which customer information was not kept in an information system, etc. to manage deposit accounts, a financial institution failed to check if the customer was subject to economic sanctions such as asset freeze.

3. Status of management of payments to those subject to economic sanctions such as asset freeze

[See II. 5 of the Inspection Manual (Attachment 2)]

The Inspection Manual requires that a financial institution make arrangements to withhold payments to those subject to economic sanctions such as asset freeze unless an Asset Freeze Administrator, etc. confirms permission under the Foreign Exchange Act and approves the payments.

As a financial institution is required to prevent any deposit into or withdrawal from deposit accounts of those subject to economic sanctions such as asset freeze without permission under the Foreign Exchange Act by such means as setting a code to suspend any deposit into or withdrawal from these accounts, a financial institution must confirm a code, etc. set for an information system to manage deposit accounts and confirm whether all deposits or withdrawals can be suspended.

Given that permission under the Foreign Exchange Act may be required for payments subject to a principle prohibition on payments to North Korea in some cases, a financial institution must confirm not only the name but also the address, etc. of a person inheriting a deposit account.

Matters pointed out in inspections

- ① While a financial institution had obliged its employees to take procedures for freezing deposit accounts of those subject to economic sanctions such as asset freeze that are found through checking of existing deposit accounts, withdrawals from such accounts were left to be made even after such procedures were taken.
- ② While a financial institution had established procedures for freezing deposit accounts of those subject to economic sanctions such as asset freeze that are found through checking of existing deposit accounts, the procedures failed to be communicated thoroughly to its employees, allowing interest on deposits to be put into such accounts.
- ③ After a deposit account was inherited, a financial institution made payments to the inheritor whose address was located in North Korea without getting permission under the Foreign Exchange Act.

4. Understanding of remittance information

[See II. 7. (1) ① of the Inspection Manual (Attachment 2)]

The Inspection Manual requires that a financial institution understand the purpose of a remittance, the names of the remitter and the receiver, their addresses, locations (countries) of their head offices and other information necessary to confirm that a remittance is not subject to economic sanctions such as asset freeze, including regulations on trade-related payment (checking whether permission under the Foreign Exchange Act is required).

Given that careful checking about remittances to cities in the neighborhood of North Korea may be required based on the principle prohibition on payments to North Korea, a financial institution is required to understand the names of cities for the addresses, whereabouts or locations of the receivers of remittances to countries neighboring North Korea and receiving banks' branches.

Matters pointed out in inspections

- ① A financial institution implemented outgoing remittances accepted from customers by phone, internet, etc. without understanding the addresses, whereabouts or locations of their receivers.
- ② A financial institution limited necessary information to be specified on a written remittance request to the name of the receiver, the receiving country and the purpose of the remittance and implemented an outgoing remittance without understanding the address, whereabouts or location of the receiver.

5. Response to payment regulations on those subject to economic sanctions such as asset freeze

[See II. 5. (2) and 7. (1) ② of the Inspection Manual (Attachment 2)]

The Inspection Manual requires that a financial institution acquire permission under the Foreign Exchange Act before making payment to those subject to economic sanctions such as asset freeze.

When payments, including those destined to deposit accounts opened under the names of some of those subject to economic sanctions such as asset freeze, are made through a head office or branch account of a financial institution to an overseas bank head office or branch, the payments, even if including those that are not directly put into the deposit accounts, amount to payments to those subject to economic sanctions such as asset freeze and are subject to permission under the Foreign Exchange Act.

Matters pointed out in inspections

Without acquiring permission under the Foreign Exchange Act, a financial institution made payments through its head office or branch account to deposit accounts opened under the names of some of those subject to economic sanctions such as asset freeze at an overseas bank head office or branch.

6. Careful checking

[See II. 7. (1) ③ and ④ of the Inspection Manual (Attachment 2)]

The Inspection Manual requires that a financial institution acquire the purpose of a remittance (if the purpose is trade, the name of a good, the place of origin, the region of shipment, etc.), the addresses

or locations of the remittance receiver and the receiving bank and other information from the remittance customer and confirm whether the remittance violates the regulations on trade-related payment and the Regulations on the Purpose of Use of Funds. If the remittance is suspected to violate these regulations, a financial institution is required to request the customer's presentation of necessary documents for confirmation and conduct careful checking.

Matters pointed out in inspections

A financial institution made an outgoing remittance suspected as related to North Korea without conducting careful checking appropriately even though it had to request the presentation of necessary documents for confirming the details of the remittance and conduct careful checking.

(Note) It should be noted that careful checking is required on "asari clam," "sea urchin," "Smilax china leaves" and "matsutake mushroom" recognized as special North Korean products among imports subject to Foreign Exchange Act violations related to North Korea (as of October 2, 2017).

7. Administrative work outsourcing contractors' response to economic sanctions such as asset freeze
[See II. 3. 3-1 (3) ③ of the Inspection Manual (Attachment 1) and II. 3. (3) of the Inspection Manual (Attachment 2)]

A financial institution is required to develop an internal control system to manage outsourced administrative work appropriately according to the content, etc. of the outsourced administrative work so as not to violate any provision of the Foreign Exchange Act, etc.

Matters pointed out in inspections

While a financial institution had arranged for a deposit business outsourcing contractor to confirm whether a customer opening a new deposit account falls under those subject to economic sanctions such as asset freeze, the outsourcing contractor failed to appropriately preserve any record of such confirmation.

8. Response to economic sanctions such as asset freeze at overseas branches of Japanese banks
[See II. 8. of the Inspection Manual (Attachment 2)]

Foreign Exchange Act provisions on confirmation obligation of banks, etc. regarding payments requested by customers apply to overseas branches of Japanese banks. Therefore, overseas branches as well as domestic branches of Japanese banks are required to develop internal control systems to appropriately implement administrative processes pertaining to compliance with the Foreign Exchange Act, etc.

Matters pointed out in inspections

An overseas branch of a Japanese bank checked customers against a list of those subject to economic sanctions such as asset freeze and prepared SWIFT messages while part of the information on remittance receivers was lost due to malfunctions of a system to convey transaction information from remitters to the branch.

III. Defects Related to Obligation of Financial Institutions, etc. to Conduct Verification at the Time of Transaction Pertaining to Currency Exchange Business

[See II. of the Inspection Manual (Attachment 3-2)]

Since the revised Criminal Proceeds Act was implemented in 2013, matters for verification at the time of transaction have been expended to include not only customer identification data, which had already been subject to verification before the revision, but also the purpose of transaction, occupation/contents of business, the person who has substantial control of the customer, etc. The Inspection Manual specifies matters for verification, verification methods, and the preparation and preservation of verification records as the matters to keep in mind for conducting verification at the time of transaction, etc. appropriately based on the Criminal Proceeds Act. Therefore, financial institutions, etc. are required to conduct verification at the time of transaction, etc. pertaining to currency exchange business while keeping in mind provisions pertaining to these matters for verification, verification methods, verification records, etc.

Matters pointed out in inspections

- ① Without conducting verification at the time of transaction required for a currency exchange transaction worth more than 2 million yen, a financial institution implemented such transaction with a customer who refused to accept the verification.
- ② Without verifying some of the matters (customer identification data, the purpose of transaction, occupation/contents of business, a person who has substantial control of the customer, etc.) subject to verification at the time of transaction, a financial institution implemented a currency exchange transaction.
- ③ A financial institution failed to record some of the matters subject at the time of transaction.

IV. Defects Related to Obligation to Give Notification of Suspicious Transactions, etc. Pertaining to Currency Exchange Business

[See I. 2. (1) and II. 1. (1) of the Inspection Manual of the Inspection Manual (Attachment 5)]

The Inspection Manual requires that a financial institution prepare a specific administrative

procedure for notification of suspicious transactions pertaining to currency exchange business, including a reference casebook depicting examples of suspicious transactions to be used to determine whether an individual transaction falls under suspicious transactions.

A specified business operator is required to determine whether a transaction is subject to notification of suspicious transactions, based on a reference casebook depicting examples of suspicious transactions and information on the transaction.

Matters pointed out in inspections

A financial institution failed to appropriately determine whether a currency exchange transaction involving the receipt of counterfeit currency was a suspicious transaction for notification or give notification of the currency exchange transaction as a suspicious one.