

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

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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 and Foreign Trade Act and the Act on Prevention of Transfer of Criminal Proceeds (hereinafter referred to as the “Foreign Exchange Act, etc.”). 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. The collection centers on defects pointed out in Foreign Exchange Inspections after the development of the Foreign Exchange Inspection Manual (hereinafter referred to as the “Inspection Manual”) in 2013.

I. Defects related to economic sanctions such as asset freeze

1. Management of deposit account names

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

While public notices from the Ministry of Foreign Affairs name those subject to economic sanctions such as asset freeze in English and the Japanese kana, United Nations Security Council resolutions basically names those subject to economic sanctions such as asset freeze in English. Given this, the Inspection Manual requires that in order to appropriately check the existence or absence of deposit accounts for those subject to economic sanctions such as asset freeze when public notices from the Ministry of Foreign Affairs expand or change those subject to regulations by such measures as the addition of those subject to economic sanctions such as asset freeze, financial institutions register names written in the Latin Alphabet as well as in the Japanese kana based on identify confirmation documents in information systems, etc. as for non-residents’ deposit accounts and deposit accounts that are recognized as appropriate for management based on the names of foreign nationals as residents written in the Latin Alphabet.

Matters pointed out in inspections

A financial institution failed to appropriately verify a deposit account due to the absence of a registered name written in the Latin Alphabet for the account that should be managed based on a name written in the Latin Alphabet because the name was written in the Latin Alphabet in identification documents presented or sent by the customer.

2. Checking existing deposit accounts upon addition of those subject to economic sanctions such as asset freeze

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

The Inspection Manual requires that in order to appropriately check existing deposit accounts upon addition of those subject to sanctions such as asset freeze, financial institutions use names written not only in the Japanese kana but also in the Latin Alphabet for checking deposit accounts not by searching exact-match names but by first extracting similar deposit account names through search by each word and then narrowing down extensive candidates one by one and recording the content and results of checking conducted from the viewpoint of their administrative risk management.

Matters pointed out in inspections

- (1) A financial institution used only account names written in the Japanese kana for checking existing deposit accounts despite the existence of registered account names written in the Latin Alphabet, failing to find a deposit account of a person subject to economic sanctions such as asset freeze, whose name was registered in the Latin Alphabet.
- (2) A financial institution excluded deposit accounts opened in the names of other financial institutions for checking of existing deposit accounts under a preconception that deposit accounts opened in the names of financial institutions do not include accounts of those subject to economic sanctions such as asset freeze, failing to find existing accounts of those subject to economic sanctions such as asset freeze.

3. Management of deposit accounts subject to economic sanctions such as asset freeze

[See II. 4. of the Inspection Manual (Attachment 2)]

Given that permission under the Foreign Exchange and Foreign Trade Act (hereinafter referred to as the “Foreign Exchange Act”) is required for a withdrawal from a deposit account of a person subject to economic sanctions such as asset freeze at any financial institution, the Inspection Manual requires that any financial institution make arrangements for its Asset Freeze Administrator to confirm permission under the Foreign Exchange Act and approve the withdrawal. It is necessary to pay attention to the point that even transactions whereby no funds directly fall to the other party, such as withdrawals of account management fees, may fall under capital transactions under the Foreign Exchange Act and thus require permission.

Matters pointed out in inspections

While deposit accounts of those subject to economic sanctions such as asset freeze were frozen, account management fees were withdrawn from these accounts with no permission acquired under the Foreign Exchange Act.

<Reference> Withdrawals from deposit accounts of those subject to economic sanctions such as asset freeze amount to transactions involving the extinction of claims based on deposit contracts and are subject to permission under Article 21 of the Foreign Exchange Act.

4. Payments to those subject to economic sanctions such as asset freeze

[See II. 5, 8 of the Inspection Manual (Attachment 2)]

Given that permission under the Foreign Exchange Act is required for a withdrawal from a deposit account of a person subject to economic sanctions such as asset freeze at any financial institution, the Inspection Manual requires that any financial institution including its overseas branches make arrangements for its Asset Freeze Administrator to confirm permission under the Foreign Exchange Act and approve the withdrawal. It is necessary to pay attention to the point that even transactions whereby no funds directly fall to the other party, such as paying-in of interest on a deposit, may fall under payment under the Foreign Exchange Act and thus require permission.

Matters pointed out in inspections

(1) An overseas branch of a Japanese bank failed to fully understand that permission under the Foreign Exchange Act is required for payments to those subject to economic sanctions such as asset freeze and implemented a payment to a person subject to economic sanctions such as asset freeze. (The payment was frozen at an intermediate bank and fell short of reaching the person subject to economic sanctions such as asset freeze.)

(2) While a deposit account of a person subject to economic sanctions such as asset freeze was frozen, interest on a deposit was put into the account with no permission acquired under the Foreign Exchange Act.

<Reference> An interest payment on a deposit account of a person subject to economic sanctions such as asset freeze amounts to a payment from a financial institution to the person and is subject to permission under Article 16 of the Foreign Exchange Act.

5. Confirmation obligation pertaining to foreign exchange transactions

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

The Inspection Manual requires that when a financial institution that has no Automatic Checking System checks whether a customer falls under those subject to economic sanctions such as asset freeze, both a person in charge at the Sales Division or a sales branch who has received a request from a customer and a person in charge at a division in charge of remittance affairs use a list of those subject to economic sanctions prepared through electromagnetic means (including spreadsheet software) to make an appropriate check not by searching exact-match names but by first extracting similar deposit account names through search by each word and then narrowing down extensive candidates one by one.

Matters pointed out in inspections

- (1) In checking whether a remittance receiver falls under those subject to economic sanctions such as asset freeze, a financial institution searched exact-match names alone without first extracting similar deposit account names through search by each word and then narrowing down extensive candidates one by one, failing to make an appropriate check.
- (2) In handling a bundled remittance in which multiple remitters and receivers were bundled into one remitter and one receiver, a financial institution failed to check if the other remitters and receivers than the remitter and the receiver specified in a written remittance request fall under those subject to economic sanctions such as asset freeze. (The institution failed to appropriately fulfill the obligations to identify and give a notification on original remitters other than the single remitter specified in the written remittance request).

(Note) The Automatic Checking System is an information system programmed to discontinue administrative processes pertaining to a remittance with information subject to search when the similarity between the information subject to search, such as the names and addresses of the remitter and the receiver, and information in the “List of Those Subject to Sanctions” exceeds a certain pre-set ratio, in order to confirm that the remittance is not an outgoing remittance to a person subject to economic sanctions such as asset freeze.

6. Confirmation of regulations on trade-related payments and purposes of use of funds

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

The Inspection Manual requires that financial institutions understand information necessary to confirm that a remittance is not an outgoing remittance subject to economic sanctions such as asset freeze (hereinafter referred to as “Necessary Information”), such as the country of destination, the

purpose of remittance, the place of origin of import cargo, and the region of shipment, when regulations on payments related to trade or to purposes of remittance (hereinafter referred to as “Trade Regulations, etc.”) are in force.

In addition, the Inspection Manual requires that financial institutions request a customer to present a sales contract, an import permit, a bill of lading and other documents giving reasons for a remittance when there is a doubt about the truth of the Necessary Information obtained from the customer or when careful checking is recognized as necessary as a remittance could violate the “Trade Regulations, etc.”

Matters pointed out in inspections

Regarding the confirmation obligations of banks, etc. pertaining to regulations on import and other payments:

- (1) A financial institution misunderstood that the place of origin and the region of shipment should be confirmed only for remittances whose receivers are determined as related to North Korea subject to regulations on trade-related payment and failed to confirm the place of origin and the region of shipment for other remittances, falling short of fulfilling the confirmation obligations pertaining to remittances of import and other payments.
- (2) A financial institution misunderstood that the place of origin and the region of shipment should be confirmed only for major products in North Korea and failed to confirm the place of origin and the region of shipment for other products whose categories were confirmed, falling short of fulfilling the confirmation obligations pertaining to remittances of import and other payments.
- (3) A financial institution completed the execution of confirmation obligations without requesting documents pertaining to the purpose of remittance from a customer who had continuously remitted import and other payments to North Korea, in spite of the situation where the reported purpose of remittance was easily interpreted as conflicting with trade and other regulations and should have been prudently confirmed.

II. Accounting, etc. of special international transactions accounts (offshore accounts)

[See the Inspection Manual (Attachment 4)]

To ensure appropriate accounting of special international transactions accounts (hereinafter referred to as “offshore accounts”), the Inspection Manual cites such check items as the eligibility of transactions or behaviors subject to accounting of offshore accounts, compliance with the Accounting Criteria pertaining to fund transfers between offshore and other accounts and foreign exchange rates

used for accounting of offshore accounts.

Matters pointed out in inspections

1. Booking non-eligible assets

A financial institution booked accrued interest paid to the seller of foreign public and corporate bonds, etc. (outstanding bonds) that the institution acquired for accounting in the offshore account as a temporary payment among assets in the offshore account.

2. Violating the regulations on a net transfer from an offshore account to other accounts (see Note)

(1) A financial institution failed to find a violation of the regulations on a net transfer from an offshore account to other accounts due to insufficient collaboration between front and back offices in the management of the payment-receipt balance for the offshore account.

(2) As different foreign exchange rates were used for accounting of an offshore account and other accounts, the right rate was used for recalculation that resulted in a violation of regulations on a net transfer from the offshore account to other accounts.

(3) Securities issued by non-residents (foreign bonds) were acquired from a resident (a financial institution for which an offshore account was not approved) for booking, resulting in a violation of regulations on a net transfer from an offshore account to other accounts.

<Reference> The acquisition of securities in an offshore account is admitted only when a financial institution acquires securities from eligible non-residents or other financial institutions for which offshore accounts have been approved. In this case, securities acquired from other financial institutions with offshore accounts are limited to those subject to accounting in offshore accounts of the other institutions.

(Note) Regulations on a net transfer from the offshore account to other accounts

While fund transfers between an offshore account and other accounts are prohibited in principle to secure offshore-offshore transactions in the offshore market, a specified scope of transfers between an offshore account and other accounts is admitted due to a potential situation in which payments from an offshore account cannot be completely covered with receipts from other accounts.

Paragraph 7 of Article 11-2 of the Foreign Exchange Order imposes the following regulations on fund transfers between an offshore account and other accounts:

(1) The amount pertaining to the transfer of funds from the offshore account to other accounts at the closing time of every day shall not exceed the amount calculated by multiplying the previous month's average balance of assets pertaining to the operation of funds to non-residents (the average balance slipping below 10 billion yen shall be considered as 10 billion yen) by the rate of 10%.

- (2) The monthly total transfer from an offshore account to other accounts shall not exceed the monthly total transfer to the offshore account from other accounts.

III. Defects related to notification obligation pertaining to foreign exchange transactions

[See the Inspection Manual (Attachment 6)]

To ensure the secure fulfillment of the notification obligation pertaining to foreign exchange transactions under Article 10 of the Act on Prevention of Transfer of Criminal Proceeds, the Inspection Manual cites the status of the fulfillment of the notification obligation pertaining to foreign exchange transactions and the development of an internal control system to fulfill the notification obligation as check items.

Matters pointed out in inspections

Insufficient understanding about the notification obligation led to the following cases:

- (1) Instead of official corporate names, abbreviated names were notified.
- (2) When new and old addresses were specified in a written remittance request, the old address was notified instead of the new one that should have been notified.
- (3) Instead of an account number for a withdrawal for a payment, an account number for a remittance fee withdrawal was notified.
- (4) Regarding an outgoing remittance accepted from a customer, the sending bank failed to clarify the content of the notification when faxing a written remittance request to an intermediate bank, leading the intermediate bank to fail to notify the customer's account number or the transaction reference number at the sending bank. (The sending bank commissioned the intermediate bank to prepare and transmit a SWIFT telegram.)