



The **\$1-trillion** Trail of Dirty Money

Crooks exploit weak law enforcement here to launder loot from scams and gangs.

Prevailing press headlines may have encouraged or deterred those looking for a safe spot here to hide ill-gotten gains.

Then again, whether these reports serve as a wake-up call to domestic agencies charged with strengthening and enforcing defenses against more skillful money-launderers remains to be seen.

"Banker off hook in loan-shark money-laundering" was a March headline in *The Japan Times*. Two weeks later, the *Yomiuri Shimbun* weighed in with an analysis: "Court ruling could make Japan a money-laundering haven," questioning a decision by the Tokyo District Court that, experts say, contradicts claims that Japan's financial sector is progressing on

compliance with due diligence-required checks on new customers.

The defendant was self-styled "Loan Shark King" Susumu Kajiyama, who had links with the Kobe-based Yamaguchi-gumi underworld syndicate. He was accused of hiding ¥9.4 billion (\$83.19 million) raised through a network of gangsters who had loaned money at illegally high interest rates.

The funds had been transferred to accounts at a bank in May 2003 as discount bank debentures completed by Atsushi Doden, an employee of the bank's Hong Kong branch. Financial authorities here acted following a report on the scale of the transfer; and in November 2005, Kajiyama received a six-and-a-half-year prison sentence for violating

the financial-investment and organized-crime laws by lending money at exorbitant interest rates and laundering money.

Doden, on the other hand, pleaded not guilty to charges of knowingly assisting a group with organized-crime links to launder money. Even after testifying that he had completed the document required to identify Kajiyama by simply guessing at the details, Judge Yoshinobu Iida surprisingly acquitted Doden.

The judge ruled on March 22, 2006 that "reasonable doubt" existed regarding Doden having known that the money was the profits from criminal activities, and that testimony from another gang member about conspiring with Doden was hearsay.

Prosecutors had been hoping

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for a three-year prison term and a fine of ¥3 million (\$26,500) on the grounds that the accused had played an "indispensable" role in the money-laundering scheme. Prosecutors have appealed. Doden no longer works for the bank, which would not confirm whether he was fired or had resigned. A statement issued by the bank said, "[We are] not a party to this trial; and it is, therefore, not for [us] to comment."

This is just one example of where Japan's authorities have been caught "behind the curve," according to Michael O'Keeffe, managing director of Japanese operations at Kroll International Inc., a risk-consulting company.

Quick cash

"Nigerian scam remittances from abroad are arriving in Japanese banks and being swooshed out again very quickly – too quickly for Japanese banks, who are finding out too late that customer identifications are not right," he adds. "It's impossible to put a number on how often it goes on, but it happens far too often for my liking."

Common practice is being ignored. "'Know your customer' is a key criteria in modern banking, and has been since the mid-1990s," points out O'Keeffe, "but I see a failure in that here."

The problem is not that insufficient Suspicious Transaction Reports (STRs) are being filed, he concedes; but not all those identified by the Japan Financial Intelligence Office (FIO) as requir-

ing further investigation by the National Police Agency (NPA) can be examined adequately. At present, the FIO employs about 20 staff, including analysts looking at suspicious transactions involving Japan.

"Let's be realistic. This is a \$1-trillion-a-year industry worldwide, and there are leaks from the dykes that are substantially not preventable," says O'Keeffe. "But deterrents can be placed into the system – only, Japan isn't plugging the leaks fast enough. To be honest, this has all developed very quickly, and Japan has been caught unawares."

While local authorities are trying to meet their obligations in terms of the Paris-based Financial Action Task Force's (FATF) 40 key recommendations, according to O'Keeffe, financial institutions operating here are still likely to experience a period of "confusion" as laws are rewritten or updated.

More fundamentally, says O'Keeffe, the standards to which financial institutions are expected to adhere are not always clear.

Japan's laws are not at all detailed, he goes on to say, and so it is left to the Financial Services Agency (FSA) to interpret the statutes. "Moreover, current laws relate to foreign exchange controls for outbound money," he continues. "They are silent on what to do about inbound money."

The government framework for its anti-money laundering legal regime is strung across three

statutes: The Law Concerning Confirmation of Client Identity of Fiscal Institutions (Client Identity Law), The Organized Crime Punishment Law, and The Foreign Exchange and Foreign Trade Law.

The laws have not been altered substantially over the last two years. Bureaucrats are considering amendments, additions and new legislation that would bring Japan in line with FATF's recommendations. Under consideration are identifying the designated nonfinancial businesses and professions that are required to conduct due-diligence checks on customers and keep appropriate records. The list could include casinos, real-estate agents, dealers in precious metals and stones, lawyers and legal professionals, as well as trusts and company service providers.

Debate in the Diet will commence once the drafting process is completed, which is expected in 2007. Meanwhile, stopgap measures have been introduced in the form of Cabinet Orders or Ministerial Ordinances.

Tougher restrictions

The law says that anyone remitting ¥2 million (\$17,700) or more in cash must provide proof of identity. The government is expected to reduce the reporting threshold, some speculate, to just \$1,000 (¥113,000).

Another ordinance requires businesses that convert more than ¥1 million (\$11,300) a month into foreign currencies to report the transaction(s) to the government regulator. The previous higher

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reporting threshold was set at ¥10 million (\$90,900). Now, the reduced figure also applies to more types and greater numbers of businesses, such as hotels, travel agencies and department stores.

A senior finance official concurs that the new restrictions are “a sensitive issue,” and that there may be resistance from some sectors as to revealing all transactions to the authorities. For that reason, he adds, the financial authorities are refusing to comment on legislation being drafted.

The Japan Federation of Bar Associations (JFBA) has been among the most vociferous opponents of the proposed reporting changes. Outgoing JFBA President Go Kajitani says that the obligation to report suspicious transactions to the police “threatens the independence of lawyers and bar associations from state power, in which independence is the very cornerstone of their existence; undermines the trust of citizens in them; and shakes the very foundations of their profession.”

He believes that the JFBA is, therefore, unable to accept the government’s decision. “While working to obtain the understanding of Japanese ... we intend to mount an energetic campaign of opposition in partnership with lawyers and bar associations in other countries,” he adds.

Ore, ore

Another piece of effective legislation that the NPA believes may have contributed to making



“Hey, it’s me!” – ¥25-billion scam.

illegal transfers more difficult was initially intended to combat a peculiar Japanese scam. The Law Concerning Confirmation of Identity of Mobile-Phone Users by Mobile-Phone Companies and Prevention of Misuse of Mobile Phones, which dates from 2005, requires anyone renting or buying a pre-paid mobile phone to provide verifiable identification.

Authorities were compelled to put in force such an ID requirement in response to a deluge of reports on trusting members of the public – usually the elderly – being scammed. They were receiving phone calls that began with “Ore, ore,” meaning “Hey, it’s me,” and fooling them into believing it was a relative. This “family member” would then quickly relate a tale of woe, such as a car crash or entanglement with gangsters that required a rapid payoff. Remarkably, thou-

sands have fallen prey to the scam, with more than ¥25 billion transferred last year in about 21,000 such cases, according to the NPA. By the time victims realized what was happening, the fraudster had withdrawn the money and vanished. Responding to NPA notification, four banks in March froze accounts containing ¥3.5 billion from suspected fraud and other criminal activity. The total could reach ¥10 billion if smaller banks were included, media reports claim.

Dramatic changes

The NPA, which is preparing to take the lead on the government’s fight against money-laundering from 2007, is doing everything in its power to meet its obligations, according to Katsushi Ikeda, deputy director of the Strategy Planning and Analysis Division of the NPA’s Organized Crime Department. But, he concedes, “It is sometimes difficult to keep up with changes, which have been dramatic since 2003.”

Ikeda looks outside Japan to measure progress here. “The very first thing that we need to do is enact legislation to comply with the FATF’s recommendations,” he says. “I hear that other countries’ law enforcement agencies are clearing a lot of money-laundering cases; but last year in Japan, we cleared only 112 cases.” In 2000, according to Ikeda, that figure stood at just five cases. “It’s clear that we are clearing very few [cases] in comparison to other jurisdictions.”

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Case clearing is one area that he believes FATF and the Asia/Pacific Group on Money Laundering will take up when they conduct a joint evaluation of Japan next year.

There were 98,935 STRs filed by financial institutions here last year, of which 66,812 were referred to the police. In 2003, the number was 43,768, and in 1998 a mere 13.

Media shy

There is some talk of a "nightmare scenario" once the NPA takes over intelligence gathering and investigations into suspicious activities. There would be a reluctance by financial institutions to cooperate for fear of possible public embarrassment. With deep-rooted sensitivity to corporate image, banks, it is feared, would stop reporting suspicious activities to the government because investigations could be leaked to the media.

A Ministry of Justice official, who requested anonymity, says Japan is actually on target to implement comprehensive legislation. He suggests that the rise in reported suspected cases is probably more a result of stepped-up measures to spot them.

But while Japan is catching up with the pace on intent, it still lags behind on enforcement of regulations, according to the head of anti-money laundering for the Asia-Pacific region at an international accounting firm in Tokyo. Like many experts interviewed, he requested anonymity.

"Many governments around

the world think that terrorism happens elsewhere; and while Japan may say it looks into its financing, it doesn't really think terrorism impacts them here," he explains. "Japan needs to remember that it's not just Middle Eastern terrorists that we're dealing with. While institutions here may be carrying out all the identity checks on the person who remits funds overseas, they're not digging deeper to see whether anyone else further back in the transaction raises any flags."

He adds that the awareness may be there among companies; but he doesn't think they will get to full implementation unless there is increased scrutiny. "But it will happen – they will probably be getting close to best-practice standards in 2007," he believes. "With a global economy demanding that level, Japan will need to be in compliance."

As in any "local" economy context, however, there are some uniquely Japanese twists that have an impact on the struggle against money laundering and questionable financial transfers.

"One of the biggest issues for the Japanese authorities is income from the pachinko industry that is funneled back to North Korea," says Stuart Witchell, Japan representative of International Risk Limited, a business intelligence and investigation consultancy.

In the last couple of years, the authorities here have managed to financially pressure North Korean Premier Kim Jong Il, he

says. "However, the amount that is being sent to North Korea is impossible to estimate. It is probably in the trillions of yen; and a pretty sophisticated underground banking system operates here, linked with Bangkok and Macau." The U.S. took action against Banco Delta Asia S.A.R.L. in Macau in September 2005, freezing an estimated \$25 million in North Korean assets; and Japan's financial authorities followed suit with a ban on transactions with the institution.

Previously, hard cash destined for Pyongyang was simply carried aboard North Korean ships at Japanese ports; while counterfeit currency and drugs were allegedly being moved in the other direction. But the biggest source of income for the regime was from pachinko, a form of gambling to which the Japanese government seemingly turns a blind eye.

Pyongyang plays hardball

According to Witchell, as much as 30% of the pachinko industry is controlled by North Koreans, who have become more devious since the Japanese government increased controls on their transactions. Many are opting to take South Korean nationality to appear "clean" to investors and banks, although their ideology has not changed, and their earnings still find their way back to Pyongyang.

"I'm not at all confident that all the appropriate due-diligence checks are being done in this area; and there needs to be more

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concern with financial institutions that are dealing with pachinko-parlor operators, particularly if they're among those that are planning to list on the Tokyo Stock Exchange, because something like this could be very damaging to their reputation," says Witchell. "To be frank, it's not just the pachinko industry. The same due-diligence investigations should be applied to most transactions in Asia."

Ironically, five laws unrelated to money laundering passed in 2003 have made it much harder for financial institutions to carry out thorough checks on customer backgrounds, according to Kroll International's O'Keeffe. The Act on the Protection of Personal Information – widely criticized,

particularly by the media, as draconian – declares that companies with information on more than 5,000 individuals must inform people recorded why their data is being collected, and not share that data with a third party without the individual's consent. Personal data is defined as anything from a person's name and address to their credit-card details and medical records.

"The FSA is encouraging corporations to carry out due diligence; but it won't tell companies how to go about it, and turns a blind eye when they can't," says O'Keeffe. "We need to be able to assess court decisions, for example, because the people who have the most to lose [by any effective enforce-

ment] are the malefactors who are making the most [money] out of this privacy act."

Another hitch is the spelling of foreigners' names in *katakana* characters required for Japanese records. The use of a single alternative but similar-sounding character, for example, can open up what Witchell stops short of calling a loophole, but is certainly a "cultural fault that is very difficult to change."

Many in the international banking industry, however, have broadly welcomed Japan's efforts so far at improving standards, and are optimistic that the government's compliance targets will soon be met.

"I have only heard of complete commitment; and international banks are aggressively pursuing enhanced governance programs," says an expert in the field who has recently been relocated to oversee his bank's operations here. "The Japanese have a strong focus on compliance with all the regulations; and that's good because it creates a level playing field and helps to ensure that people trying to launder money face the same identification requirements wherever they go."

The simple message is that the prevention of crime and the avoidance of terrorism is not a spectator sport, he adds. "You have to be an active participant in these programs."

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