

THE SUSPICIOUS TRANSACTION REPORTING SYSTEM AND ITS EFFECTIVE USE

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I. INTRODUCTION

The countermeasures against money laundering in Japan have just started in recent years. One of the most important pillars among them is the Suspicious Transaction Reporting (STR) system. However, unfortunately, the STR system in Japan has not been utilized effectively yet. In this presentation, the current situation of the Japanese STR system and also its effective use will be examined and studied.

II. SUSPICIOUS TRANSACTION REPORTING (STR) SYSTEM AND FINANCIAL INTELLIGENCE UNIT (FIU)

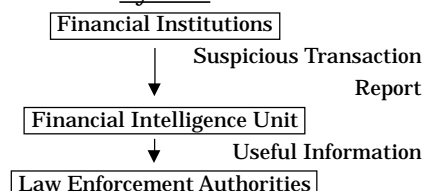
A. STR System

The Suspicious Transaction Reporting (STR) system is the principle mechanism to fight against money laundering. It is designed to use information reported by financial institutions for investigations of money laundering and predicate offences, and to prevent crime organizations from abusing financial services. Its purpose is to get useful financial information concerning money laundering from financial institutions, to utilize the information for actual investigations and to maintain confidence in financial institutions and the overall financial system.

Article 54 of the Anti-Organized Crime Law provides that “*any bank or other financial institution ... shall promptly*

report to the Minister in charge ... when it is deemed that there is a suspicion that the property received by such financial institution ... is crime proceeds.” This Article is the basis of the Japanese STR system. In short, this system requests financial institutions to report suspicious persons and their financial activities to law enforcement authorities. The law enforcement authorities will utilize such information as a clue for their actual criminal investigation.

Figure. 1 Flow Chart of the STR System



The STR system is not a system that was introduced only in Japan. This system is recommended internationally as the effective mechanism to prevent and detect money laundering. The 40 Recommendations of the Financial Action Task Force (FATF), which is the international standard for anti-money laundering measures, states as follows:

Recommendation 14

Financial institutions should pay special attention to all complex, unusual large transactions, and all unusual patterns of transactions, which have no apparent economic or visible lawful purpose. The background and purpose of such transactions should, as far as possible,

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be examined, the findings established in writing, and be available to help supervisors, auditors and law enforcement agencies.

Recommendation 15

If financial institutions suspect that funds stem from a criminal activity, they should be required to report promptly their suspicions to the competent authorities.

This concept is based on the actuality that it is very difficult to chase the money flow, once it enters the financial system. Therefore, it is necessary for the law enforcement authorities to get cooperation (in short, information) from financial institutions before (or when) illegal money enters the financial system. Financial institutions are expected to play a role of a first barrier against illegal money, as they can examine such financial transactions from the viewpoint of their expertise. The cooperation from financial institutions is essential to detect money laundering. In this connection, in the case of Japan, there is no punishment for financial institutions not submitting STRs. Since judgment by financial institutions of whether it is

suspicious or not has ambiguity, it is impossible to impose a punishment on them.

As Japan is the one of the major financial centers of the world, the introduction of the STR system into the Japanese legal system was strongly recommended by related international anti-money laundering forums. As illegal money can cross borders easily, other countries that had already introduced strict anti-money laundering measures, such as the USA and European countries, had concerns that Japan would become a safe haven for illegal money.

In 1992, the STR system was first introduced into Japanese legislation by the enactment of the Anti-Drug Special Law. However, at first, the introduction of this new system created a lot of criticism from Japanese financial institutions. The point of these issues was the relationship between bank secrecy and STRs. As it was obvious that bank secrecy should be disclosed to related authorities in cases where a transaction might be related to a certain crime, financial institutions had resistance to submitting STRs, even after the enactment of the Law.

Table 1. History of Japanese Countermeasures

Year	Name of the Law	Countermeasures
1992	Anti-Drug Special Law	<ul style="list-style-type: none"> • Predicate offences: only drug crimes • STR system was introduced.
2000	Anti-Organized Crime Law	<ul style="list-style-type: none"> • Predicate offences: almost all organized crimes • Comprehensive STR system was introduced. • FIU (JAFIO) was established.

B. Financial Intelligence Unit (FIU)

In February 2000, the Anti-Organized Crime Law was newly established in Japan and this law introduced a comprehensive STR system. The scope of predicate offence of money laundering was expanded to almost all organized crimes. Based on the law, the Japan Financial Intelligence Office (JAFIO) was established in the Financial Services Agency (FSA) as the Japanese Financial Intelligence Unit (FIU). What is the FIU? The role of the FIU is:

- (i) to correct STRs from financial institutions;
- (ii) to analyze STRs;
- (iii) to disseminate the results of the analysis of STRs to law enforcement authorities.

In other words, the role of the FIU is a bridge between financial institutions and law enforcement authorities. The first FIU in the world was the FinCEN (Financial Crime Enforcement Network) in the USA, established in 1990. At present, more than 50 countries have FIUs; but the ministries to which the FIUs belong differ among these countries. In the case of the USA and France, their FIUs belong to the Department of Treasury or the Ministry of Finance. On the other hand, in the case of the UK, the FIU belongs to the Home Office. In any case, the FIU is the central national authority to act in the aforementioned role, and it does not matter where it belongs.

The absence of FIUs means that there are no authorities to analyze STRs. Not only is the introduction of the STR system an essential instrument to fight against money laundering but so is the establishment of FIUs. Therefore, the establishment of FIUs in Japan has also been strongly requested by related international anti-money laundering forums. FIU is an essential unit in the STR system. Regarding the STR system and

FIU, the United Nations Convention against Transnational Organized Crime requires member countries as follows;

Article 7, Paragraph 1: Each State Party:

(a) Shall institute a comprehensive domestic regulatory and supervisory regime for banks and non-bank financial institutions ... which regime shall emphasize requirements for customer identification, record-keeping and the reporting of suspicious transactions;

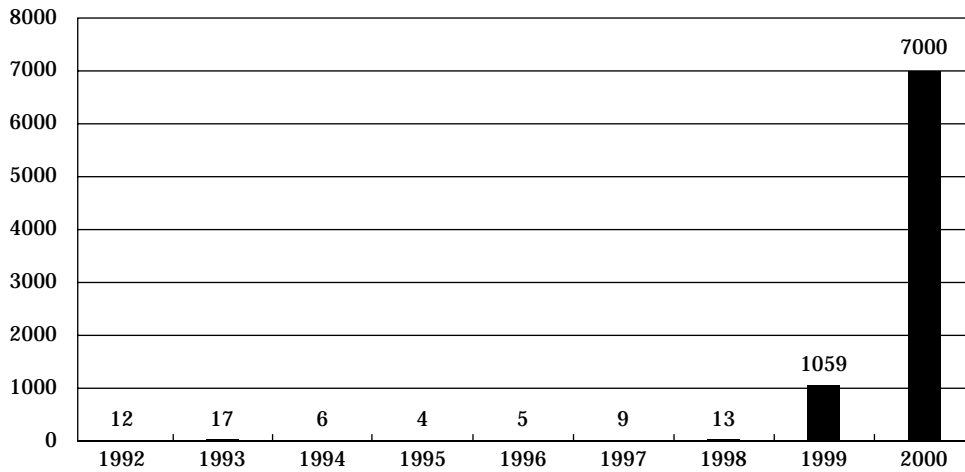
(b) ... shall consider the establishment of a financial intelligence unit to serve as a national center for the collection, analysis and dissemination of information regarding potential money-laundering.

III. CURRENT SITUATION OF THE STR SYSTEM IN JAPAN

Figure 2 shows the transition of the number of STRs. Before 1999, the number of STRs was very small. As I mentioned before, the main reason for the small number of STRs at that time was the reluctance of financial institutions to disclose bank secrecy. The following points are considered as the reasons for that:

- (i) Lack of awareness about the STR system by financial institutions.
- (ii) Financial institutions could not judge whether transactions were related to "drug crimes" or not, even when very suspicious.

Figure. 2 Suspicious Transactions Reporting



Source: Financial Services Agency (The data in 2000 is provisional.)

The data shows a drastic increase in the number of STRs after the enactment of the Anti-Organized Crime Law in 2000. The present number of STRs, several thousands per year, is equal level to the number of other developed countries. The JAFIO (Japan Financial Intelligence Office) in the Financial Services Agency receives a large number of STRs from many financial institutions. At present, the JAFIO is composed of thirteen staff members, some of whom are dispatched from law enforcement authorities such as the Police, Public Prosecutor's Office, and the Customs and Narcotics Control Office. Others are from the Financial Services Agency. People from the law enforcement authorities function as experts in criminal investigation; whereas, those from the Financial Services Agency have the role of financial experts.

JAFIO has its own database in which enormous data on STRs can be stored. JAFIO also has computer software to analyze STRs. This software was originally developed by JAFIO; it can automatically connect related transactions with persons.

JAFIO provides the results of their STRs analysis to each law enforcement authority every two weeks, in the form of electromagnetic data.

IV. PROBLEMS

Although the number of STRs is quite large, the number of exposed cases of money laundering in Japan has remained small. In addition, there are no cases where the results of analysis by JAFIO have been used to instigate investigations by law enforcement authorities. This means that the STR system does not contribute to law enforcement authorities investigation nor do the law enforcement authorities utilize the information obtained by JAFIO. The following are my personal observations of each organization.

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Table 2. Number of Exposed Cases of Money Laundering

Year	1992	1993	1994	1995	1996	1997	1998	1999
Number of exposed cases of money laundering	0	1	0	2	2	0	2	1

Source: National Police Agency

A. Financial Institutions

As I mentioned before, after the enactment of the Anti-Organized Crime Law, the predicate offences of money laundering were expanded to almost all organized crimes. However, Japanese financial institutions may misunderstand the new Law. They seem to be under pressure to submit STRs, even if there is "little" suspicion. The original idea of the STR system is that financial institutions carry out first screening of suspicious transactions. STR should be submitted to JAFIO only when "really" suspicious. According to what I have heard from my colleagues in JAFIO, the quality of STRs is still low. Therefore, the rapid increase in the number of STRs submitted from financial institutions does not necessarily present a good sign.

The Post Offices are also included in financial institutions under the Law, and they have a duty to submit STRs. However, until now, there have been only 2 cases of STRs from Post Offices since 1990. This extremely small number clearly shows their negative stance against the STR system. The Postal Service still has difficulties concerning the disclosure of customer's secrecy.

B. JAFIO

The JAFIO in the Financial Services Agency also has some problems. STRs are submitted from financial institutions in the form of a paper or document on floppy disc. If on a floppy disc, JAFIO can easily store the information in their database. However, according to what I have heard

from my colleagues in JAFIO, 90% of the STRs are still submitted in the form of a paper. As the total number of staff in the JAFIO is only thirteen, the manual storing of such an enormous number of STRs into their database is a heavy burden for JAFIO.

The analysis of STRs by JAFIO is also insufficient. For this reason, JAFIO analyzes only information contained in the STRs submitted by financial institutions. In other words, their present methodology of analysis is carried out only from the point of financial aspects.

As I mentioned before, the original concept behind the JAFIO is as a bridge between financial institutions and law enforcement authorities, and JAFIO has the role of providing high-quality information about money laundering to law enforcement authorities. For their mission, not only financial analysis but also criminal analysis has to be carried out.

However, JAFIO is not authorized to carry out their own investigations nor official inquiries to financial institutions. During the drafting of the Bill of the Anti-Organized Crime Law, there was a discussion that such power should be given to the JAFIO. As a result, JAFIO was not given such power because it was considered that only law enforcement authorities should carry out such "criminal" investigations, in compliance with criminal procedures not administrative procedures. As JAFIO is itself an administrative organization, not a law enforcement

organization, its powers are limited.

It is necessary to analyze STRs to check suspicious persons against existing criminal databases. FinCEN in the USA can access various governmental databases to analyze STRs. However, JAFIO cannot access related national or local databases, such as criminal records, drivers license records etc. The reason for this is simple. JAFIO is not a law enforcement organization. Under such conditions, JAFIO cannot attach additional informational value to STRs submitted from financial institutions. The JAFIO, with its present power, cannot provide high-quality information about money laundering to the law enforcement authorities. Presently, the JAFIO cannot attach additional information to their analyses, which is limited to correcting STRs from financial institutions and putting STRs in order.

C. Law Enforcement Authorities

As I mentioned before, JAFIO provides the results of their analyses of STRs to each law enforcement authority every two weeks, in the form of electromagnetic data. In the case of the Narcotics Control Department (NCD), the results of their analysis are stored in NCD's database server, and every Narcotics Agent can access the data through an intranet. However, access to it still remains at a low level. In the case of the Police, the National Police Agency (NPA) receives data from JAFIO in the first instance, and the NPA distributes the data to each Prefectural Police Headquarters.

The biggest problem that law enforcement authorities have is the lack of interest in the STRs. It seems that many law enforcement officers still do not know about the STR system and the existence of JAFIO. Though this situation might be compounded by the low-quality of analysis

by the JAFIO, law enforcement authorities should gain more interest in the information forwarded by the JAFIO.

As Japanese anti-money laundering measures have just started, law enforcement authorities still seem not to be interested in money laundering, or they do not still have enough expertise to carry out money laundering investigations.

V. PROPOSALS TO SOLVE THESE PROBLEMS

The following are my proposals to improve the present STR system in Japan and the activities of the JAFIO.

A. Financial Institutions

The STRs submitted from financial institutions are the basis of the STR system. Therefore, the quality of STRs is very important. As I mentioned before, the number of STRs from financial institutions might be sufficient, but its quality is still low. To improve the quality, I propose the following measures.

1. Increase Attention to Money Laundering Prevention

As the countermeasures against money laundering in Japan have just started in recent years, the attention paid by financial institutions to money laundering detection or prevention is still inadequate. To enhance their attention, the authorities concerned should provide education about money laundering and its countermeasures. Seminars for financial institutions should be improved so that they will be able to better understand their important role in money laundering prevention. Not only financial authorities but also law enforcement authorities should be involved in such seminars.

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2. Improve the Quality of STRs

In the seminar, law enforcement authorities have to provide current information about money laundering for them. For example, actual cases of money laundering, including the *modus operandi* of money laundering abusing legal financial systems, should be introduced in seminars, whereby financial institutions can better understand their obligations and role in such transactions.

3. Involvement of the Post Office

The Post Office is a major and important financial institution in Japan. Their involvement in countermeasures against money laundering is crucially important. Like private financial institutions, seminars concerning money laundering for their staff are necessary to enhance their attention to money laundering. In addition, the Post Office should establish a central unit for anti-money laundering activities. Their lack of attention or drive, due to the nature of the Post Office as a nationalized organization, will cause crucial damage to national countermeasures against money laundering.

B. JAFIO

The JAFIO is the most important organization in the Japanese anti-money laundering scheme. Their reinforcement is essential to improve the current situation of money laundering Japan.

1. Strengthening of Human Resources of the JAFIO

The human resources of the JAFIO should be reinforced. As the lack of attention to the issues of money laundering in the Financial Services Agency (FSA) itself, the position of the JAFIO is less appreciated. Therefore, sufficient human resources are not allocated to the JAFIO within the FSA. However, as money laundering damages the confidence of

Japanese financial systems, the FSA should allocate more people to the JAFIO. In addition, as users of information from JAFIO, law enforcement authorities should dispatch more people to JAFIO.

2. Power of Investigation to the JAFIO

Power of investigation is necessary for JAFIO to effectively carry out their analysis. With such, the JAFIO will be able to get the necessary, complementary information from financial institutions. In addition, the JAFIO should be able to obtain information related to crimes, such as personal criminal records from law enforcement authorities. Thus, JAFIO would be able to carry out high-quality analysis of STRs and provide useful information to law enforcement authorities for their investigation. Needless to say, the JAFIO itself is not a law enforcement body, but a minimum power of investigation is necessary to improve the ability of its analysis.

C. Law Enforcement Authorities

1. Enhance their Attention to Money Laundering

First, like financial institutions, their attention to money laundering is still insufficient. Law enforcement authorities are required to study money-laundering investigations and also examine the effective use of JAFIO information. Therefore, each law enforcement authority should more actively conduct educational programs for their officers, to improve their expertise on money laundering.

In addition, the distribution of JAFIO information to each law enforcement authority must be improved. Information should be accessed by or distributed to all the law enforcement officers. These measures will contribute to the elevation of anti-money laundering awareness in all law enforcement officers.

All law enforcement authorities should contact JAFIO more actively. Their requests or inquiries to JAFIO are expected to contribute to the close relationship between law enforcement authorities and the JAFIO. Regular meetings between law enforcement authorities and the JAFIO should be held more frequently.

VI. CONCLUSION

In Japan, the countermeasures against money laundering have just started and fruitful outcomes have not yet been seen. Though it might be too early to judge the present STR system, several problems have already appeared. The STR system is a key mechanism of the countermeasures; thus the improvement of the STR system will boost the nationwide anti-money laundering movement.