

Risk Assessment of Money Laundering in Legal Practice

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I. Introduction

Japan Federation of Bar Associations (“JFBA” hereinafter) has established the Rules Concerning Verification of Client Identity and Retention of Records (the “Rules” hereinafter) and the Regulations Concerning Verification of Client Identity and Retention of Records (the “Regulations” hereinafter) to prevent attorneys from getting involved in or used for money laundering. Prevention of money laundering requires the risks inherent in legal practice to be captured accurately. This paper assesses the risk (existence and degree) of money laundering for legal practice in Japan.

II. Risk-based Approach and the Need for Risk Assessment

1. What Is Risk-based Approach

The Financial Action Task Force (“FATF” hereinafter) has established 40 Recommendations as the standard for measures to be taken by each country for the purpose of international collaboration against money laundering. The Recommendations adopt risk-based approach (“RBA” hereinafter) which is assessing the risk of money laundering and implementing measures corresponding to such risk, from the perspective of effective prevention of money laundering through efficient utilization of limited resources.

2. Prerequisite for RBA: Risk Assessment by Country and Business Operator (see Figure 1)

(1) National Risk Assessment

RBA requires each country to assess their risk of money laundering. In response, National Public Safety Commission prepares and publishes the National Risk Assessment of Money Laundering and Terrorist Financing (Paragraph 3, Article 3 of the Act on Prevention of Transfer of Criminal Proceeds (“Criminal Proceeds Act” hereinafter)). This is risk assessment for the country, and not limited to legal practice.

(2) Business Operator Risk Assessment

Apart from the national risk assessment in (1), the interpretive note on Recommendation 1¹ requires business operators to “take appropriate steps to identify and assess their money laundering and terrorist financing risks ... for ... products (and) services.” In response, JFBA required its members to endeavor to review and analyze Asset Management Acts or preparation for or carrying out of Transactions, use the results to change the measures as necessary, and to collect, sort out and analyze of such information that is necessary to implement Measures for Identity Verification, taking into consideration National Risk Assessment of Money Laundering and Terrorist Financing (Item 5, Article 9 of the Rules; Items 1 and 2, Article 10 of the Regulations) These provisions require each member as a business operator to assess the risk of money laundering. On the other hand, the interpretive notes above sets forth that “self-regulatory bodies may determine that individual documented risk assessments are not required, if the specific risks inherent to the sector are clearly identified and understood” (Paragraph 8 of the interpretive note on Recommendation 1). Therefore, JFBA’s Working Group on Anti-Money Laundering will explain the specific risks inherent to the legal practice in Japan in the following pages for the convenience of risk assessment by each member.

Figure 1. Framework of Regulatory Risk Assessment

	FATF Recommendations	Japan
National Risk Assessment	Necessary (Recommendation 1)	National Risk Assessment of Money Laundering and Terrorist Financing (Paragraph

¹FATF Recommendations comprise the text of 40 recommendations and accompanying interpretive notes. Temporary translation of the Recommendations and interpretive notes are posted on the Ministry of Finance website below.
http://warp.ndl.go.jp/info:ndljp/pid/11194366/www.mof.go.jp/international_policy/convention/fatf/fatf-40_240216.htm
 Original version of the Recommendation and interpretive notes can be found on the following website.
<http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF%20Recommendations%202012.pdf>

		3, Article 3 of Ordinance for Enforcement of the Criminal Proceeds Act)
Business Operator Risk Assessment	Principle: Documented risk assessments by an individual (Interpretive notes for Recommendation 1)	(Non-attorneys) Document Prepared by Specific Business Operators (Items 1 and 2, Article 32 of the Criminal Proceeds Act)
	Exception: Individual documented risk assessments are not required, if the specific risks inherent to the sector are clearly identified and understood” (Paragraph 8 of the interpretive note on Recommendation 1).	(Attorneys) Collection, sorting out and analysis of information (Items 1 and 2, Article 10 of the Rules)

III. Risks which are particular to Legal Practice in Japan

This paper will provide explanation on the following two documents to identify the risks inherent to the legal practice in Japan.

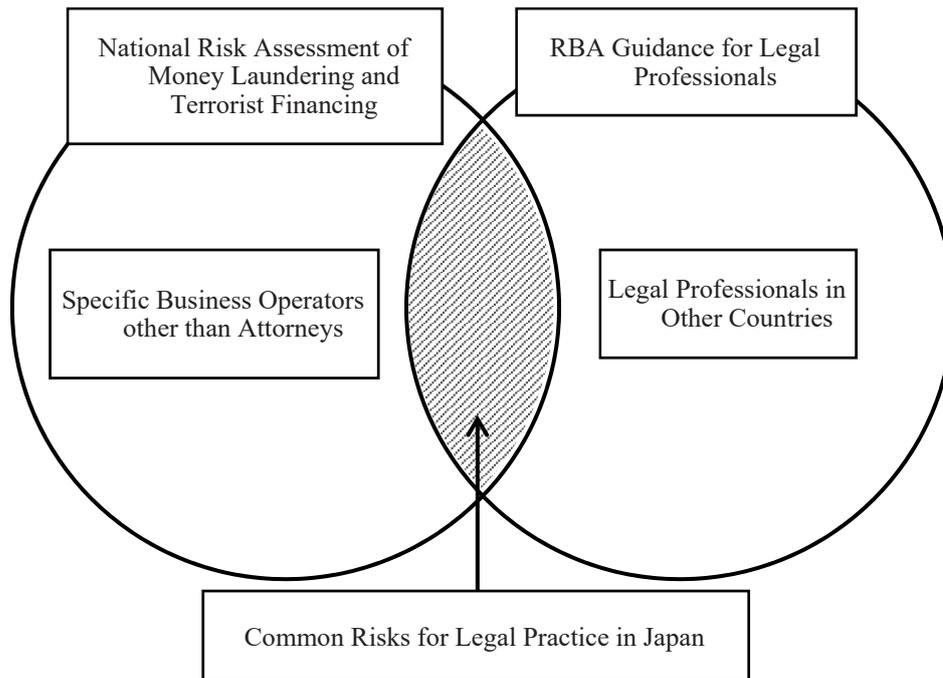
- (1) National Risk Assessment of Money Laundering and Terrorist Financing (November 2017)²
- (2) Financial Action Task Force (FATF) Risk Based Approach Guidance for Legal Professionals (“RBA Guidance for Legal Professionals” hereinafter)³

²<http://www.npa.go.jp/sosikihanzai/jafic/nenzihokoku/risk/risk291130.pdf>

³Temporary translation by the Committee on International Criminal Legislation is available on the member’s page of JFBA.
(Members Page: HOME(会員専用ページHOME)>>forms/manuals(書式・マニュアル)>>Attorney Ethics/Management of Client Information/Deposits(弁護士倫理／顧客情報・預り金等の管理)>>Temporary Translation of Financial Action Task Force (FATF) Risk Based Approach (RBA) Guidance for Legal Professionals(金融活動作業部会(FATF)法律専門家向けリスク・ベース・アプローチ(RBA)ガイダンスの仮訳について))

(1) is a national risk assessment, and overview on the risk of money laundering in Japan. (2) assesses the risks inherent in legal practice in each country based on the research by FATF. Common risk for legal practice in Japan can be captured by referencing these documents (see Figure 2). As the types and contents of business handled differ for each attorney, the risk of money laundering should also vary. Members can perform risk assessment required under the Rules and the Regulations for themselves by applying the risks identified in this paper to their business.

Figure 2. Common Risks for Legal Practice in Japan



IV. National Risk Assessment of Money Laundering and Terrorist Financing

National Risk Assessment of Money Laundering and Terrorist Financing identifies products or services provided by business operators that have risks of money laundering, and provides further analysis on transactions with high and low risks. See “National Risk Assessment of Money Laundering and Terrorist Financing” (by *Kensuke Kawate*, Assistant Director, the Organized Crime Policy Planning Division, the Organized Crime Department, the Criminal Investigation Bureau of the National Police Agency; page 67-70, August 2018 edition of this magazine) for details.

1. Transactions, etc. misused for money laundering

National Risk Assessment of Money Laundering and Terrorist Financing presents the statistics in Figure 3 as transactions misused for money laundering. This is useful for capturing the substance of money laundering in Japan.

According to the statistics, domestic exchange transactions, cash transactions, and deposit transactions comprise the overwhelming majority of money laundering transactions. These match risks (vii) to (x) and (xiv) identified in RBA Guidance for Legal Professionals discussed below. Use of corporate status corresponds to risks (xii) and (xix) under RBA Guidance for Legal Professionals.

Figure 3. Transactions, etc. Misused for Money Laundering (2014-2016)

Misused transactions	Domestic exchange transactions	Cash transactions	Deposit transactions	International transactions (such as foreign exchange)	Precious metals and stones	Postal receiving service	Corporate status	Investment	Electronic money	Money lending	Funds transfer services	Insurance	Real estate	Legal/accounting professions	Note/check	Credit card	Safe-deposit box	Call forwarding service	Transfer of goods	Physical concealment	Total
Number	455	291	101	59	27	17	17	6	6	5	5	4	4	4	3	3	2	1	64	62	1,136

(Source: National Risk Assessment of Money Laundering and Terrorist Financing prepared by National Public Safety Commission (November 2017), page 5)

2. Risks of legal services dealt with by legal professionals

National Risk Assessment of Money Laundering and Terrorist Financing lists 16 products and services with recognized risk of money laundering. Legal services dealt with by legal professions are positioned among them.

Attorneys possess high level of legal expertise and have good social credibility. For those who attempt money laundering, involvement of legal professions in transactions or asset management can be used to make up legitimate appearance. It is pointed out that with effective implementation of banking regulations, those who attempt money laundering have converted to engaging legal professions for execution of money laundering instead of through banks. Based on the past cases, following services are considered to involve risks of money laundering⁴.

⁴National Risk Assessment of Money Laundering and Terrorist Financing (November 2017), page

- Acts or procedures concerning buying and selling of building lots and buildings
- Acts or procedures concerning the establishment or merger of companies, etc.
- Management or disposition of cash, deposit, securities and other assets

Above matches the contents of Asset Management Acts and Transactions that the members are required to verify the identity of the client and retain records for pursuant to the Rules.

3. High Risk Transactions

National Risk Assessment of Money Laundering and Terrorist Financing analyzes high risk transactions by transaction type, country/region, and customer type.

Transaction type: With respect to transaction types, non-face-to-face transactions, cash transactions, and some of the international transactions are deemed to be high risk. Non-face-to-face transactions may have less accuracy of customer identification; and cash transactions have high liquidity and anonymity which makes identification of flow of criminal proceeds. Therefore, it is understandable that these transactions involve higher risks. Among international transactions, those related to countries and regions where proper anti-money laundering measures are not implemented; international remittance originated from large amount of cash; and transactions for which the customer is suspected to have provided false information about the purpose or source of funds of overseas remittance are deemed to be high risk⁵.

Countries/Regions: Countries and regions identified by FATF as having deficiencies of anti-money laundering policy, etc. are deemed to have high risk. At present, Iran and North Korea have been identified as such countries/regions. Under the Rules, strict client identity verification is required for transactions with clients residing or located in Iran or North Korea; or transactions involving transfer of assets to persons residing or located in Iran or North Korea (Item 4, Article 3 of the Rules; Paragraph 2, Article 5 of the Regulations).

Customer type: Anti-social forces (including organized crime groups), international terrorists (including Islamic extremists), non-residents, foreign politically exposed

48,49

⁵National Risk Assessment of Money Laundering and Terrorist Financing (November 2017), page 56-58

persons (PEPs), and legal persons without transparency of beneficial ownership are deemed to be high risk. Under the Rules, strict client identity verification is required for transactions with foreign PEPs (Item 3, Article 3 of the Rules).

4. Low Risk Transactions

National Risk Assessment of Money Laundering and Terrorist Financing lists the following as factors that mitigates risks.

i.	Transactions having clear source of funds
ii.	Transactions with the State or a local public entity
iii.	Transactions in which customers etc. are limited by laws etc.
iv.	Transactions in which the process is supervised by the State etc. based on laws, etc.
v.	Transactions that is difficult to disguise the actual status of legal persons, etc.
vi.	Transactions with low or no fund accumulation features
vii.	Transactions below the regulation threshold
viii.	Transactions in which customer identification measures are secured by laws, etc.

V. RBA Guidance for Legal Professionals

RBA Guidance for Legal Professionals was prepared by FATF to analyze the vulnerability of legal professionals including attorneys, and to promote use of risk-based approach for efficient allocation of resources corresponding to the size of the risk. It states where the high and low risks are involved among the services offered by legal professionals, and can be referenced for risk assessment by members.

1. Three Risk Criteria

According to RBA Guidance for Legal Professionals, there are various risks surrounding the legal professionals, and they may be categorized using the following criteria. The most commonly used risk criteria are: country or geographic risk; client risk; and risk associated with the particular service offered.

2. Country or Geographic Risk

RBA Guidance for Legal Professionals lists the following as country or geographic risks:

i. Countries subject to sanctions, embargoes or similar measures issued by the United Nations (UN);
ii. Countries identified by credible sources as being a location from which funds or support are provided to terrorist organizations;
iii. Countries identified by credible sources as having significant levels of corruption or other criminal activity.

3. Client Risk

RBA Guidance for Legal Professionals lists the following as client risks:

iv. Clients who are PEPs;
v. Clients who are listed companies for which PEPs are participating as directors;
vi. Clients having convictions for proceeds generating crimes;
vii. Clients using financial intermediaries, financial institutions or legal professionals that are not adequately supervised by competent authorities or self-regulatory organizations;
viii. Money services businesses (e.g. remittance houses, currency exchange houses, money transfer agents and bank note traders or other businesses offering money transfer facilities);
ix. Casinos, betting and other gambling related activities;
x. Businesses that generate substantial amounts of cash;
xi. Charities and other “not for profit” organizations (especially those operating on a “cross-border” basis);
xii. Clients with unexplained use of legal persons;
xiii. Clients with unexplained use of nominee shares or bearer shares.

4. Service Risk

RBA Guidance for Legal Professionals lists the following as service risks:

xiv. Services where legal professionals handle the receipt and transmission of funds through accounts they manage for settlement of transaction;
xv. Services to conceal improperly beneficial ownership from competent authorities;

xvi.	Transfer of real estate between parties in a time period that is unusually short with no apparent legitimate reason;
xvii.	Payments received from third parties and payment for fees in cash where this would not be a typical method of payment;
xviii.	Transactions where there is inadequate consideration;
xix.	Shell companies, companies with ownership through nominee shareholding and control through nominee and corporate directors;
xx.	Situations where it is difficult to identify the beneficiaries of trusts; unexplained use of express trusts; express trusts with unexplained relationship between a settlor and beneficiaries.

5. Variables that May Impact Risk

RBA Guidance for Legal Professionals lists the following as variables that may increase or decrease perceived risks:

I.	Client's need for the legal professional to provide specified activities
II.	Level of regulation to which a client is subject
III.	Reputation of the client
IV.	Regularity or duration of the client relationship
V.	Providing limited legal services in the capacity of a local or special counsel as part of a large scheme;
VI.	Significant and unexplained geographic distance of the client;
VII.	Non-face-to-face transactions;
VIII.	The nature of the referral or origination of the client, such as contact without introduction or referrals;
IX.	Structure of a client or transactions that is clear to the legal professional.

These variables must be considered to determine if they increase or decrease a client transaction.

VI. Conclusion

It must also be noted that attorneys face risks that differ from financial institutions. According to the National Risk Assessment of Money Laundering and Terrorist Financing, those who attempt money laundering can use the involvement of legal

professions in transactions or asset management to make up legitimate appearance in transactions. Attorneys cannot determine if they are being used for money laundering if they do not inquire about the hidden intention behind a client's instruction. Attorneys must carefully examine whether the purpose of such instruction relates to a transfer of criminal proceeds in view of the attributes of the client, business relationship with the client, the details of the instruction, and other circumstances (Articles 6 of the Rules). High risk transactions pointed out by the National Risk Assessment of Money Laundering and Terrorist Financing, and risks identified in RBA Guidance for Legal Professionals by country/geography, client and service should be referenced when reviewing the purpose of the instruction.

(Chair of the Working Group on Anti-Money Laundering)

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