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Japanese Regulators Squeeze Banks on Yakuza Ties

Recent media has highlighted the intensifying scandal over Japanese banks' potential ties to organized crime groups (also known as anti-social forces or the yakuza). Sparked by a business improvement order issued by Japan's Financial Services Agency (FSA) to Mizuho Bank on 27 September 2013, investigations of several major Japanese banks are now also underway, emphasizing the need for strengthened compliance throughout the local financial industry. Amidst this heightened crackdown by authorities, clients should ensure they have the appropriate measures in place to safeguard their interests and expose potential vulnerabilities.

Banks' Compliance Failures and Organized Crime Links

The latest crackdown originated when the FSA ordered Mizuho to improve its internal compliance procedures following an incident with Orient Corporation, the bank's consumer credit company. Orient Corporation had been issuing loans totaling JPY 200 million to individuals associated with organized crime groups. Although the bank admitted to being aware of the issue as far as back as 2010, it failed to cancel the contracts or raise the issue with the Japanese authorities citing complicated internal structures and insufficient compliance measures. Mizuho is currently addressing the situation, albeit internally, and has ended the contracts in question. As a result, the bank's president, Yasuhiro Sato has forgone his salary for six months; the bank's chairman, Takashi Tsukamoto although having resigned his post remains chairman of the bank's holding company, Mizuho Financial Group Inc; while Mizuho has made salary deductions to over 50 executives, who were involved. Yet however lenient the response, Mizuho continues to attract criticism.

The FSA's current investigation of the company is understood to be ongoing and will likely continue for approximately the next month, with authorities said to determine any further penalties for the bank by the end of 2013.

Subsequent to the Mizuho probes, the FSA has taken the decision to widen its investigation to include The Bank of Tokyo-Mitsubishi UFJ and Sumitomo Mitsui Banking, which along with Mizuho make up Japan's three largest banks. All the investigations are to focus on the banks' internal compliance measures, risk management systems and transactions with yakuza-linked individuals.

These scandals embarrass not only the banks involved, but also the FSA as they undergo a discomforting shift in focus back to investigating and clamping down on links between corporations and organized crime in Japan.

FSA Tightens Regulations

The FSA has been alert to yakuza links in the Japanese financial industry for many years.

In 1997, a flurry of similar investigations occurred when a forerunner of Mizuho, the Dai-Ichi Kangyo Bank (later absorbed into Mizuho in 2000), was discovered to have offered JPY 11.8 billion in illegal loans to the leader of a racketeer group (also known as *sokaiya*), resulting in heated public criticism, the arrest of 11 executives and the suicide of the company's chairman. In the same year, four major securities houses, Nomura Securities, Daiwa Securities, Nikko Securities and Yamaichi Securities, were discovered to have provided favors to the same racketeer group leader, resulting in the arrest of 25 associated executives.

Regulations introduced from 2007 to 2011 had intended, but evidently failed, to adequately address the governance of conducting business with organized crime groups. The most recent regulations, grouped under the Organized Crime Exclusion Ordinance implemented on 1 October 2011, came in the wake of suspicions – which were later cleared – involving Japanese optics manufacturer, Olympus Corporation's potential links with organized crime concealed in improper accounting practices. Along with other measures intended to curb criminal groups' power and business dealings, these regulations prohibited corporations from knowingly engaging in business transactions benefiting anti-social forces, as well as including contractual clauses in business transactions allowing for termination of a contract should it be discovered that one party holds links to organized crime.

Mitigating the Potential Risk

As Mizuho's case illustrates, even established entities in Japan can be affected by organized crime related issues; indeed all companies operating in the finance industry should be aware of the risks. The recent sanctions placed on some yakuza members by the U.S. administration and weakening internal controls at many financial institutions in recent years partly as a cost saving exercise, are likely to encourage organized crime syndicates in Japan to further infiltrate the domestic financial sector.

It is therefore important for clients, both domestic and international to ensure comprehensive compliance measures are in place to mitigate the risk to their business operations at this critical time.

Engagement of specialist external risk consultants, such as FTI Consulting, can assist financial institutions operating in Japan to develop an effective, anticipatory, and holistic risk mitigation program. The key factor for any such program is to ensure an informed and proactive but efficient approach to encompass the following:

- ***Risk Assessment and Review:*** Review, testing and assessment of existing policies and procedures to include the protocols that manage risk and subsequent decision making, along with all related documentation and systems, including due diligence procedures and monitoring mechanisms to assess and analyze potential risk factors and variations. Review should be considered as a regular event to ensure a system that is constantly seeking improvement.
- ***Enhance Compliance:*** Informed by a comprehensive risk assessment enhancement of existing compliance systems, to include ethical conduct, whistleblower program and benchmarking of industry best practice, along with the development of guidelines and procedures to ensure compliance procedures are communicated and understood. Customer due diligence is an integral part of compliance and it is essential to have the necessary policies and framework in place to ensure effective and proactive identification, verification and monitoring of customers, business partners and service providers along with their activities, thereby considerably reducing any potential risk.
- ***Business intelligence:*** In-depth due diligence investigations into potential transactions or clients to identify links with organized crime groups or other potential reputational issues. FTI Consulting has significant experience in identifying business risks that are not visible or immediately obvious from financial or legal reviews and draw on professional discreet investigative expertise to gain deep insight into potential risk factors.
- ***Customer Screening:*** Deployment of a comprehensive screening program enables a suitable level of comfort regarding any potential risk factors. FTI Consulting in Japan maintains an Anti-Social Forces Database, which comprises individuals and entities identified in the public domain as having connections (direct or indirect) to Japanese organized crime groups and groups deemed to hold extreme political or social agendas. The database is updated through regular monitoring of relevant resources enabling clients to check all existing and potential third parties in an efficient and proactive manner to develop an understanding of the potential criminal network that may be acting against their interests.
- ***Learning and Embedding Compliance Culture:*** The best policies and procedures are meaningless without the people expected to implement them being unaware or unclear on their use and application. Regular operational training for all relevant staff members should be considered a key area of any compliance program. This should seek to include background on risk factors and tactics that may be employed to fraud the system, knowledge of the key laws and regulations that exist to enable prevention, high risk factors to ensure vigilance and an accessible support mechanism to allow for high level assistance in decision making and customer interaction, as well as day to day training on operational process to embed a culture of enhanced awareness and pro-active diligence.

To avoid potentially severe consequences, institutions must proactively design and implement robust safeguards and compliance frameworks to counter illegal financing. With proactive and well-designed policies and procedures in place with measures to ensure an environment of education and training to support it, financial institutions can be well positioned to understand where the potential risks lie and to take the necessary measures and preventative actions to mitigate against them. Along with the increasing pressure for more transparency in the financial sector and the potential financial and reputational damage that even the slightest discrepancy can amount to, there is today no margin for error and every reason to address current practice and take relevant action to avoid risk.

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