Brief description

Issues and practices for dialogue on validation of effectiveness of AML/CFT frameworks;

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Financial Crimes Office
Risk Analysis Division
Strategy Development and Management Bureau
Financial Services Agency

Introduction

- Most financial institutions (FIs) completed the development of basic AML/CFT frameworks by March 2024; the deadline for framework development based on "Guidelines for AML/CFT" (AML/CFT Guidelines).
- It is important for FIs themselves to conduct "validation of effectiveness" in order to maintain and enhance AML/CFT frameworks. The FSA will monitor the effectiveness of FIs' AML/CFT frameworks through dialogues with them.
- In order to encourage FIs to conduct "validation of effectiveness," FSA published a document to explain the concept of "validation of effectiveness" and how to proceed with dialogue between FIs and FSA regarding "validation of effectiveness."

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1. Positioning and overview of the document

2. Structure of the document

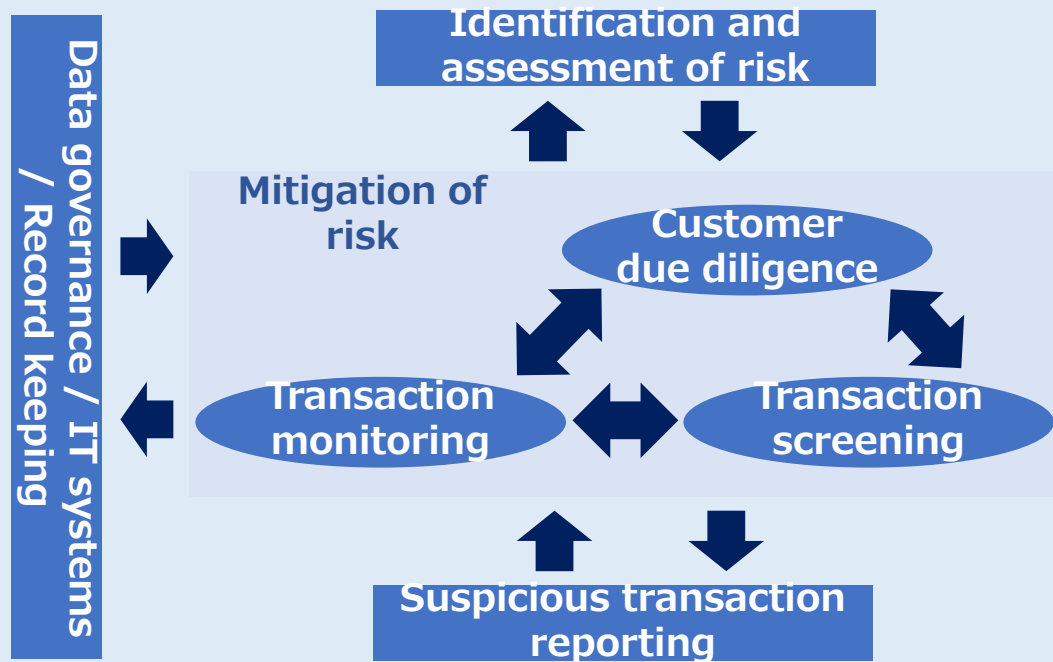## 3. "Validation of effectiveness" at FIs

4. Dialogue between FIs and FSA

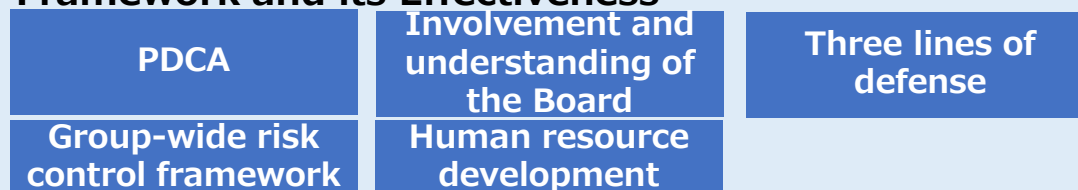# 1. Positioning and overview of the document

Guidelines for AML/CFT（FAQ）

【Required actions】（≒ minimum standards）

I. General Concepts

II. Risk-based approach

Data governance / IT systems / Record keeping

Identification and assessment of risk

Mitigation of risk

Customer due diligence

Transaction monitoring

Transaction screening

Suspicious transaction reporting

III. Evaluation and Review of the ML/TF Risk Control Framework and its Effectiveness

PDCA

Involvement and understanding of the Board

Three lines of defense

Group-wide risk control framework

Human resource development

IV. Monitoring and Public Private Partnership

This document

（≠ minimum standards）

"Validation of effectiveness" at FIs (= concept)
- Objectives and perspectives on validation of effectiveness
- Expected implementation

Plan → Do → Action

Development of validation implementation framework

Identification and assessment of risk

Timely validation of effectiveness
※When serious breach of laws or regulations, money laundering offenses occurs

Mitigation of risk
※Use of quantitative indicators for validation

Case Studies (Appendix)

(Reference for this document)

- Examples of financial institutions' efforts on validation of effectiveness

Basic approach to dialogue between FIs and FSA
- Objectives and Perspectives of Dialogue
- Methods of dialogue

Complement

Complement

2. Structure of the document

◆ Overall structure

1. **"Issues and practices for dialogue on validation of effectiveness of AML/CFT frameworks"**
   - Indicate the purpose and positioning of the document, the concept of conducting validation of effectiveness, how to proceed with the dialogue, etc.

2. **Appendix "Case Studies on validation of effectiveness of AML/CFT frameworks"**
   - Provide examples of financial institutions' efforts on validation of effectiveness

◆ Structure of the document

I.   Introduction

II. Purpose and positioning of this document
   1. Purpose 2. Positioning

III. Validation of effectiveness at FIs
   1. Objectives and perspectives on validation of effectiveness
   2. Expected implementation
      (1) Validation of identification and assessment of ML/FT risks, (2) Validation of mitigation of ML/FT risks, (3) Timely validation of effectiveness

IV. Basic approach to dialogue between FIs and FSA
   1. Objectives and perspectives of dialogue
   2. Method of dialogue
      (1) Dialogue on identification and assessment of ML/FT risks (2) Dialogue on mitigation of ML/FT risks (3) Dialogue on timely validation of effectiveness
   3. Points to keep in mind when engaging in dialogue
   4. Communicating the authorities' awareness of the issues
   5. Establishment of a framework for monitoring

3. "Validation of effectiveness"

Definition	Validation of effectiveness refers to the process by which FIs confirm that "they appropriately identify, assess, and mitigate the ML/FT risks they face" in order to maintain and enhance their AML/CFT framework in response to changes in ML/FT risks.
Key Points	FIs prepare their own plans on validation of effectiveness, perform validation in accordance with the plans, and make improvements based on the results of validation.

Specific issues	Premise 1: It is necessary to determine the scope and method of validation (=preparation of implementation plan) in accordance with the risks FIs face. Premise 2: It is important for the board to lead the allocation of resources and for each division to cooperate according to their roles and responsibilities, to establish a validation implementation framework. Premise 3: The entity conducting the validation does not necessarily have to be independent from the business subject to validation (as long as it can conduct the validation appropriately).

Identification and assessment of risk	Mitigation of risk	Timely
【Actions based on the AML/CFT Guidelines】 FIs prepare risk assessment documents based as a result of identification and assessment.	【Actions based on the AML/CFT Guidelines】 FIs develop and implement risk mitigation measures based on the results of identification and assessment.	【Actions based on the AML/CFT Guidelines】 FIs identify, assess, and mitigate risks when risks are actualized.
【Expected implementation】 Validate the preparation process of risk assessment documents - Validating whether information used in identification and assessment is sufficient - Validation of timely updates when risks change	【Expected implementation】 Verify the validity of "development" and "implementation" qualitatively and quantitatively (using indicators) ①Development of risk mitigation measures Validate the appropriateness of the scope and content of mitigation measures for identified and assessed risks. ② Implementation of risk mitigation measures Validation of whether mitigation measures have been implemented in accordance with established mitigation measures	【Expected implementation】 In the event of an incident, re-examine the effectiveness of existing AML/CFT measures and make improvements - Based on the details of the incident, re-examine the appropriateness of existing identification, assessment, and mitigation (implement improvements when issues are identified). - Analyze the causes that could not be discovered in advance in the existing validation of effectiveness, and improve the validation of effectiveness method, etc.

Result	FIs can maintain and enhance their AML/CFT framework and reasonably and objectively explain the effectiveness of the framework (see next page for details)

4. Dialogue between FIs and FSA

Significance	The FSA confirms through dialogues with FIs whether identification, assessment, and mitigation of ML/FT risks at FIs are appropriate in order to support FIs' proactive maintenance and enhancement of their AML/CFT framework.
Key Points	The FSA confirms, based on the explanation from FIs, that "FIs prepare an implementation plan for validation of effectiveness, perform validation according to the plan, and make improvements based on the results"
Specific issues	Premise 1: Emphasize the explanations from FIs and hold dialogues based on the rationality and objectivity of the explanations. Premise 2: In order to provide reasonable and objective explanations, it is useful to utilize the results of qualitative and quantitative validation. Premise 3: For issues identified through dialogues, FIs will identify the causes and implement improvement measures.

Dialogue with the Board	**Dialogue with division in charge and related divisions**	**Dialogue with the Internal Audit Division**
【Roles based on the AML/CFT Guidelines】 Adequate allocation of resources, establishment of programs for coordination between the executives and divisions, taking the initiative, etc.	【Roles based on the AML/CFT Guidelines】 Planning, implementation, and improvement for validation of identification, assessment, and mitigation, as well as timely verification	【Roles based on the AML/CFT Guidelines】 Independently audit the appropriateness of planning, implementation, and improvement for validation of effectiveness
【How to proceed with dialogue】 The FSA receives explanations focusing on the role of the board in validation of effectiveness, and hold dialogues based on the explanation. - Adequate allocation of resources for validation of effectiveness (planning, implementation, and improvement) - Establishment of programs for validation of effectiveness through coordination between the executives and divisions - Understanding and discussing the status of validation, and taking the initiative in providing instructions for additional measures as necessary	【How to proceed with dialogue】 The FSA holds dialogues based on explanations of the content and results of validation of effectiveness. - Appropriateness for identification and assessment of risk - Appropriateness for development and implementation of risk mitigation measures - (In the case of risks being actualized, etc.) Appropriateness for timely validation of the background to the occurrence and action	【How to proceed with dialogue】 The FSA receives explanations focusing on the implementation status and results of audits conducted independently on the appropriateness of planning, implementation, and improvement for validation of effectiveness, and holds dialogues mainly on whether the implementation framework for validation of effectiveness is appropriate.