Financial Services Agency

Web site search (e-Gov)

(Provisional Translation)

September 17, 2004
Financial Services Agency
The Government of Japan

Administrative Actions on Citibank, N.A. Japan Branch

I. Description of the Administrative Actions

1. Revocation and Suspension Order based on Article 47-(2) and Article 27 of the Banking Law

Effective September 30, 2005, the approvals issued to the Marunouchi branch and its business offices of Nagoya, Osaka and Fukuoka will be revoked. In addition, all operations at the said branch and the said business offices must be suspended during the period between September 29, 2004 and September 29, 2005 inclusive
(with the exception of work performed to terminate existing transactions and any other work incidental to such termination).

2. Business Improvement Order based on Article 47-(2), and -(3) and Article 26-(1) of the Banking Law

(1) Between September 29, 2004 and October 28, 2004 inclusive, no transactions with new customers may be conducted by the Consumer Bank Department in connection with foreign currency deposits. (Transactions with existing customers are exempted from the suspension.)

(2) In order to ensure thorough compliance with laws and regulations, preserve public confidence, and protect depositors/investors, as well as ensure sound and proper management of operations at the Citibank, N.A. Japan Branch [hereinafter referred to as the "Japan Branch"], proper governance and internal control systems must be established (and include adequate staffing and the construction of a proper organization and structure) with due emphasis on the following points:

- (i) An unequivocal statement of commitment by the management regarding compliance with laws and regulations; cultivation of a corporate climate that places importance on compliance with laws and regulations, and re-examination of the organization and structure to unfailingly realize such goals.
- (ii) Creation of governance and internal control systems and establishment of a clear system of responsibility at the Japan Branch, predicated upon a fundamental re-evaluation of the roles assumed by the bank's New York headquarters (hereinafter referred to as the "Bank Headquarters") in the management.
- (iii) A fundamental re-evaluation and an optimization of the current sales system under which the Japan Branch, together with its affiliated securities firm and trust bank in Japan, operate as though they are united, with a view toward eliminating violations of laws and improper transactions.
- (iv) Improvement and reinforcement of the structure of the legal and compliance departments and the internal controls and internal audit functions that cover all the business departments of the Japan Branch, and implementation of follow-up.
- (v) Establishment of business and control systems to ensure proper performance of the duty to identify customers as required by the Law on Customer Identification and Retention of Records on Transactions by Financial Institutions (Law No. 32, effective 2002), and the duty to report suspicious transactions pursuant to the Law for Punishment of Organized Crimes, Control of Crime Proceeds and Other Matters (Law No. 136, effective 1999).
- (vi) Establishment of a system to ensure that accurate information is furnished and that proper explanation is provided to depositors and others, and development of a system to respond properly to customer complaints.

(vii) Building keen awareness among officers and employees about proper control of customer information, and creation of a system to ensure proper control.

(viii) Truthful and accurate responses in the course of inspections and supervision, including the giving of appropriate responses in inspections and the giving of accurate status reports to supervising authorities, and development of a system which ensures such responses.

(ix) Thorough understanding of and compliance with laws, regulations and rules by officers and employees, and development of a system to ensure the same.

(3) Responsibilities of the officers and employees that gave rise to the problems described in "II. Reasons for the Administrative Actions" hereunder, including violations of laws and regulations, must be clarified.

(4) A plan to improve business operations pertaining to (2) and (3) described above, as well as matters that are described in the notice of inspection results and the report ordered based on Article 24-(1) of the Banking Law, must be submitted by October 22, 2004 and implemented promptly. (The improvement plan must encompass the development and establishment of a governance system to ensure the implementation of the plan, as well as a clear assignment of responsibilities to ensure the execution of the plan.)

(5) Subsequent to the implementation of (4) described above and until the plan to improve such operations is fully carried out, a summary outlining the progress and implementation of the plan, etc. and the status of improvement must be prepared every three months, starting with the end of December 2004, and submitted by the 15th day of the following month.

II. Reasons for the Administrative Actions

Fundamental problems were discovered in connection with the compliance and governance systems of the Japan Branch as stated hereinbelow, based on incident reports furnished by the Japan Branch, an inspection of the Japan Branch conducted by the Financial Services Agency [hereinafter referred to as the "FSA"](notification dated May 21, 2004), and a report submitted by the Japan Branch pursuant to the provisions of Articles 24-(1) and 48 of the Banking Law. In particular, a number of acts injurious to public interests, serious violations of laws and regulations, and extremely inappropriate transactions were uncovered at the Private Bank Group [hereinafter referred to as the "P.B. Group"] (the Marunouchi branch, the business offices of Nagoya, Osaka and Fukuoka), which led us to conclude that continued future operations are inappropriate. It was further confirmed that the Consumer Bank Department lacked a system of internal controls pertaining to foreign currency depository operations. Necessity to have it dedicate its efforts on operational improvement was thus confirmed.

1. Compliance

(1) Acts Injurious to Public Interests

In the P.B. Group at the Japan Branch, developing customers and securing profits were given unduly heavy importance. Advance review of customers and that of the nature of transactions (including verification of risks and suitability), and lending screening (confirmation and investigation of the intended use of funds and transaction purposes) were virtually skipped. Accordingly, a loan was made to clients who were subsequently prosecuted for manipulating the price of a publicly traded stock with the proceeds of that loan. In addition, a loan was made at the request of one of those same prosecuted clients for purposes of obtaining a grant of public funds from a regional government entity based on false representation (the so-called "bogus loan"). These acts are deemed to constitute "infliction of injury to public interests" as defined in Article 27 of the Banking Law.

(2) Violations of Laws and Regulations

a. Violations of Laws and Regulations in Connection with the Duty of Customer Identification and the Duty to Report Suspicious Transactions

The P.B. Group at the Japan Branch is found to have committed numerous acts in violation of laws in connection with its duty to identify customers pursuant to Article 3 of the Law on Customer Identification and Retention of Records on Transactions by Financial Institutions, and the duty to create records of customer identification pursuant to Article 4 of the law, and the duty to report suspicious transactions pursuant to Article 54 of the Law for Punishment of Organized Crimes, Control of Crime Proceeds and Other Matters. Included among such acts were promotion of transactions with a party about whom reports of suspicious transactions had been filed repeatedly by an overseas branch of the CitiBank, N.A. with its local competent authorities, and allowing transactions that could be suspected of being associated with money laundering by permitting an account to be opened without proper account procedures, etc.

b. Violation of Laws and Regulations in Connection with Information Offered to Depositors and Others

(i) Numerous acts in violation of laws and regulations pertaining to the duty to provide information as provided for in Article 12-2-(1) of the Banking Law, Article 13-3-(1)-4 and -5 of the enforcement regulations of the law, and Article 13-5-(2) of the enforcement regulations were found to have been committed by the P.B. Group at the Japan Branch. Included among such acts were solicitation and sale of transactions that were not accompanied by presentation or explanation of risks and important facts concerning deposits and other financial products.

(ii) Such solicitation and sale of financial products that were conducted by the P.B. Group constitute breach of the duty to explain important facts as set forth in Article 3-(1) of the Law on Sales of Financial Products (Law No. 101, 2000). The sales system in which adequate efforts are not made to ensure that solicitation for the sale of financial products is conducted properly violates Article 7 of the law.

(iii) The fact that the P.B. Group has yet to construct a basic system or mechanism to closely monitor individual sales activities, that no internal regulations that effectively ensure sound and proper operations are in place, and that a system is yet to be developed to enable conduct of operations in accordance with such internal regulations, etc., including training of bank employees, are deemed to constitute violations of Article 12-2-(2) of the Banking Law and Article 13-7 of the enforcement regulations of the law.

c. Violation of Laws and Regulations Relating to Prohibition of Engagement in Non-Banking Operations through Systematic Collaboration among Citigroup Entities in Japan.

In spite of the fact that, based on the results of a prior on-site inspection by the FSA, the P.B. Group at the Japan Branch had been issued an order for partial suspension of its operations and business improvement for violation of Article 12 of the Banking Law in August 2001, the latest on-site inspection revealed that the P.B. Group at the Japan Branch had played a central role in conducting numerous transactions in violation of Article 12 of the Banking Law, including brokering of and solicitation for foreign real estate investment projects, solicitation of subscription to foreign life insurance policies, and brokering of deals in connection with art objects, by systematically collaborating with a security firm and a trust bank in its group, and that large profits were amassed illegally.

(3) Unfair Transactions

No suitability rules or rules on proper computation of fair prices are established at the P.B. Group at the Japan Branch. Numerous instances of unfair transactions were found in which large profits were obtained through unsound means while undue burdens were imposed upon customers in transactions that converted fixed assets to liquid assets and derivatives-related transactions under the company's system in which fairness and validity of contract prices or those of market price data that are furnished to customers are not properly verified and the management places highest priority on making profits in selling its products.

(4) Improper Transactions

A business improvement order was issued in August 2001, based on the results of a prior on-site inspection by the FSA, as the result of a discovery of problems in connection with the entity's legal and compliance systems, as evidenced by the fact that improper transactions were structured and executed in spite of the potential of their being abused by a customer to willfully manipulate financial statements. In spite of such an improvement order, the latest on-site inspection of the P.B. Group at the Japan Branch by the FSA and a report submitted by the Japan Branch revealed financing to aid customers with their wrongdoing and a number of other improper transactions that were used to manipulate accounting records and defer loss recognition.

(5) Inappropriate Customer Information Control System

In the P.B. Group at the Japan Branch, the customer information control system is improper and fails to provide adequate customer protection, as evidenced by lax control of customer identification numbers by sales persons, creation of a "List of Assets on Deposit" whose contents can mislead customers into making wrong investment decisions, and improper sharing of customer information between the P.B. Group at the Japan Branch and a foreign branch "Japan Desk" (which provides sales-related customer services to Japanese customers residing abroad) and inadequate transaction controls by the two entities.

(6) Weakness of the Internal Control System Relating to Foreign Currency Deposit Operations

a. In the Consumer Bank Department at the Japan Branch, a fraud was uncovered in which the branch manager, who was thoroughly familiar with the fact that internal controls were inadequate, fraudulently accepted more than ¥1.8 billion of money received from plural depositors for foreign currency deposits over an approximately seven year period starting in 1995, by using "deposit advices" that he stole from inside the bank, instead of giving an official company-sanctioned response to a party that demanded money as reimbursement for a loss from foreign exchange transaction of foreign currency deposits.

b. It has also been found that an internal verification system is not adequately developed at the Consumer Bank Department to determine whether or not advertisement of foreign currency deposit products violates the provisions of Article 4 (Misleading to Advantage) of the Law for Preventing Unjustifiable Extra or Unexpected Benefit and Misleading Representation.

c. Furthermore, complaints by customers concerning basic and fundamental sales steps, as well as conflicts with customers in foreign currency deposit and other branch operations at the Consumer Bank Department, have not seen a decrease. In numerous instances, not only rank-and-file bank employees but also managers are found to have failed to respond properly.

2. Governance System

(1) Problems with the Control System at the Japan Branch

The management committee at the Japan Branch does not have authority to direct and supervise the business operation of various departments at the Japan Branch, and operations are not controlled in an integrated manner. The supervisory system thus exhibits serious flaws.
Furthermore, no proper self-inspection or follow-up is performed because the branch lacks the organization and staff to conduct self-inspections or audits that are in accord with the laws and regulations of Japan or the market practice. By and large, internal controls at the Japan Branch are not functioning properly.

(2) Problems with the Collaborative Sales System of the P.B. Group at the Japan Branch and Companies in Citi's Group.

In a management environment in which profits are given undue importance by the Bank Headquarters, a law-evading sales system that disregards the laws and regulations of Japan was constructed with the P.B. Group at the Japan Branch playing a central role and its affiliated securities firm and trust bank in Japan collaborating with the P.B. Group. The system has been left in neglect without proper sales controls year after year.

(3) Problems of Management Control by the Bank Headquarters

The Bank Headquarters imposes on P.B. Group at the Japan Branch sales targets that are much higher than the preceding year's actual sales figures, ties the salary system and employee appraisals closely to sales performance, and presses for sales while emphasizing profits and deprecating compliance. However, the top management of the Bank Headquarters is found to be not fulfilling its supervisory responsibility over the business operation of the Japan Branch. A problem is recognized in that the organization and the structure are such that managerial responsibilities of the top management at the Japan Branch, which is charged with the branch operations, and those of the top management at the Bank Headquarters, are extremely ambiguous.

3. Violation of Business Improvement Orders and Inappropriate Response to Inspections, etc.

(1) Violation of Business Improvement Orders Pursuant to Article 26-(1) of the Banking Law

a. In August 2001, following an on-site inspection conducted by the FSA, the Japan Branch was served a partial business suspension order pursuant to Article 27 of the Banking Law for violation of Article 12 of the Banking Law, as well as a business improvement order pursuant to Article 26-(1) of the law. The business improvement order consisted of a fundamental reform of the organization and management of the operations at the Japan Branch; thorough recognition of the reform by the top management; and development of a compliance system.

b. However, the latest on-site inspection by the FSA (notification dated May 2004) found that the entity had not performed a proper investigation, an analysis of cause or an audit that would have been necessary to make the improvements that had been pointed out as described in the preceding paragraph, and that neither the management control and internal control systems pertaining to compliance, nor the realities of sales activities that had been found to be in violation of Article 12 of the Banking Law had actually been rectified.

c. It has also been determined that, notwithstanding such a situation, the entity represented to the FSA that all required improvements were complete in its reports on the progress of the improvement plan, starting with the initial report (September 2001) and ending with the final report (March 2003), when in fact such was not true, and that a reporting order relating to the status of implementation of the business improvement plan was rescinded by the FSA (June 2003).

(2) Improper Response to Inspection, etc.

The latest on-site inspection by the FSA and subsequent requests for reports encountered acts by some managers in charge of sales and other bank employees that obstructed inspectors from developing an understanding of the operational realities and the supervisory authority from implementing verification. These acts included providing responses that differed from truth and failing to disclose information that should have been furnished.

Financial Services Agency, The Japanese Government