

# FEDERAL RESERVE press release



For immediate release

October 2, 1995

The Federal Reserve Board and the New York State Banking Department today issued an enforcement order against Daiwa Bank and its New York branch in connection with unauthorized trading activities by an official in the New York branch.

To support its action of a temporary Cease and Desist Order, the Board also issued a Notice of Charges and Hearing against the bank and its New York branch.

The joint order of the Board and the State Banking Superintendent is attached, along with the Board's Notice of Charges and Hearing.

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Attachments

**NEW YORK STATE BANKING DEPARTMENT**  
**NEW YORK, NEW YORK**  
**and**  
**UNITED STATES OF AMERICA**  
**BEFORE THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM**  
**WASHINGTON, D.C.**

_____	)	
In the Matter of	)	
	)	
THE DAIWA BANK, LIMITED	)	DOCKET NO. 95-028-C-FB
Osaka, Japan	)	95-028-C-FBR
	)	
and	)	
	)	Order Issued
THE DAIWA BANK LIMITED	)	Pursuant to the New York
NEW YORK BRANCH	)	State Banking Law and the
New York, New York	)	Federal Deposit Insurance
_____	)	Act, as amended

**WHEREAS**, The Daiwa Bank, Limited., Osaka, Japan ("Daiwa") and its branch located in New York, New York (the "New York Branch") have acknowledged that the New York Branch has suffered a loss of about \$1.1 billion as a result of unauthorized trading of U. S. Treasury securities;

**WHEREAS**, such loss purportedly remained undetected by Daiwa and the New York Branch for a number of years;

**WHEREAS**, such failure to detect the loss is evidence of an unsafe and unsound condition;

**WHEREAS**, as set forth in the Notice of Charges and of Hearing (the "Notice") issued by the Board of Governors of the Federal Reserve System (the "Board of Governors"), which is attached hereto and made a part hereof, such loss resulted from the failure by Daiwa and the New York Branch to implement the controls and supervision necessary to conduct the branch's trading and custodial operations in a safe and sound manner;

**WHEREAS**, Daiwa and the New York Branch violated Part 300 of the Regulations of the Superintendent of Banks of the State of New York (the "Superintendent") and section 211.24(f) of Regulation K of the Board of Governors (12 C.F.R. 211.24(f)) by not reporting the circumstances surrounding this loss to the appropriate law enforcement and bank regulatory authorities as required by the rules and regulations of the Superintendent and the Board of Governors;

**WHEREAS**, Daiwa and the New York Branch may have knowingly submitted to the Superintendent and the Federal Reserve Bank of New York (the "Reserve Bank") a misleading and inaccurate report of the branch's condition, as of June 30, 1995;

**WHEREAS**, the Superintendent possesses the authority under section 39 of the New York Banking Law to order the discontinuance of unsafe and unsound practices;

**WHEREAS**, the Board of Governors may, pursuant to sections 8(b)(4) and (c) of the Federal Deposit Insurance Act, as amended (the "FDI Act") (12 U.S.C. 1818(b)(4) and (c)), issue a temporary order to cease and desist against a foreign bank doing business in the United States, and its state licensed, uninsured branch in response to unsafe and unsound practices and violations of law that will likely result in the weakening of the condition of the branch, or in the significant dissipation of its assets or earnings, or both; and

**WHEREAS**, the Superintendent and the Board of Governors believe that prompt interim action is necessary to address their supervisory concerns, and duly note that additional formal enforcement actions may be necessary to address the unsafe and unsound practices and violations described in the Notice.

**NOW, THEREFORE**, the Superintendent and the Board of Governors hereby jointly issue this Order (the "Order") pursuant to section 39 of the New York Banking Law and sections 8(b)(4) and (c) of the FDI Act, respectively, and order that:

1. (a) Within five days of this Order, Daiwa and the New York Branch shall jointly submit to the Superintendent and the Reserve Bank an acceptable

written plan for the orderly reduction of all of the branch's trading activities to the minimum levels necessary to service customers, conduct asset-liability management and manage the risk in existing trading positions of the New York Branch. The plan shall, at a minimum, include target dates for specified reductions of trading activities, an explanation of the levels of trading activities proposed at each target date and means by which the New York Branch will decrease the amount and market risk exposure of its trading activities.

(b) Unless otherwise agreed to in writing by the Superintendent and the Reserve Bank, for purposes of this paragraph, the reductions of the New York Branch's trading activities shall not be accomplished by moving or transferring the activities, in any manner, to any current or future U.S. office of Daiwa, including, but not limited to its branches in Chicago, Illinois, Boston, Massachusetts, Philadelphia, Pennsylvania, Pittsburgh, Pennsylvania and St. Louis, Missouri; its agencies in Los Angeles, California, Atlanta, Georgia, Dallas, Texas, Miami, Florida, Tampa, Florida and San Francisco, California, its nonbank subsidiary, Cosmo Securities (America), Inc. (collectively referred to herein as the "Other U.S. Offices"), and Daiwa Bank Trust Company (the "Trust Company"), a New York State-chartered trust company.

(c) Daiwa and the New York Branch may, upon the written permission of the Superintendent and the Reserve Bank, modify the plan required by this

paragraph. The decision to permit any particular trading activity is within the sole discretion of the Superintendent and the Reserve Bank.

2. Unless otherwise agreed to in writing by the Superintendent and the Reserve Bank, as of the date of this Order, the New York Branch shall not increase, and Daiwa shall not allow the New York Branch to increase, the amount and market risk exposure of its trading activities above the daily average for the two week period prior to the date of this Order.

3. The New York Branch shall submit to the Superintendent and the Reserve Bank, on a daily basis, a written report detailing the branch's trading activity, including its positions relative to the levels established by the plan required by paragraph 1 hereof.

4. (a) Unless otherwise agreed to in writing by the Superintendent and the Reserve Bank, the New York Branch shall not, directly or indirectly, in any manner move or transfer its trading operations to any of the Other U.S. Offices or the Trust Company.

(b) Unless otherwise agreed to in writing by the Reserve Bank, Daiwa shall not, directly or indirectly, establish or expand trading activity at any of its Other

U.S. Offices and shall not, directly or indirectly, move or transfer, in any manner, the trading operations of the New York Branch to any of its Other U.S. Offices.

5. Unless otherwise agreed to in writing by the Superintendent and the Reserve Bank, the New York Branch shall not, directly or indirectly, in any manner engage in or initiate any new line of business.

6. Within five days of this Order, Daiwa and the New York Branch shall engage an independent third party not associated with Daiwa, the New York Branch or the Trust Company, acceptable to the Superintendent and the Reserve Bank, to monitor the custody business conducted by Daiwa and the New York Branch and to submit written reports to the Superintendent and the Reserve Bank on a weekly basis, until such time as the Superintendent and the Reserve Bank otherwise direct.

7. (a) It is understood that, within 10 days of this Order, the Superintendent will engage the services of an independent certified public accounting firm (the "CPA"), acceptable to the Superintendent and the Reserve Bank, to:

(i) Conduct a review of the approximate \$1.1 billion loss from U.S. Treasury securities trading, that, at a minimum, will include a detailed, forensic review of the transactions giving rise to the trading losses, an analysis of the accuracy of

branch records and a complete reconciliation and verification of New York Branch assets and all other assets entrusted to the branch for safekeeping;

(ii) conduct a comprehensive audit of the internal controls, custody business, risk management and management information systems of the New York Branch; and

(iii) submit to Daiwa, the New York Branch, the Superintendent and the Reserve Bank a written report of its findings pursuant to the review and the audit required by paragraphs 7(a)(i) and (ii) hereof, respectively.

(b) Daiwa and the New York Branch shall pay for the services of the CPA within five days of the presentation of an invoice by the Superintendent, and shall cooperate fully with the CPA in its efforts.

(c) Within 30 days of receipt of CPA's report pursuant to paragraph 7(a)(iii) hereof, Daiwa and the New York Branch shall jointly submit to the Superintendent and the Reserve Bank an acceptable written plan to address any deficiencies or criticisms contained in such report.

8. (a) Within 10 days of this Order, Daiwa shall engage the services of an independent certified public accounting firm (the "Auditor"), acceptable to the



Reserve Bank, to conduct and complete a comprehensive audit of the internal control, risk management and management information systems at the Other U.S. Offices and shall submit to the Reserve Bank an acceptable engagement letter outlining the scope of the Auditor's assignment, which shall also provide that the Auditor will submit its written report to Daiwa's board of directors and the Reserve Bank.

(b) Within 30 days of the receipt of the Auditor's report, Daiwa shall submit to the Reserve Bank an acceptable written plan to address any deficiencies or criticisms contained in the Auditor's report.

9. (a) Within five days of this Order, Daiwa and the New York Branch shall initiate a joint internal review of the actions of Daiwa and the branch from the time when they learned of the approximate \$1.1 billion loss from U.S. Treasury securities trading in July 1995 until they notified banking authorities in September 1995. Daiwa and the New York Branch shall complete the review required by this paragraph within 30 days of this Order and shall submit to the Superintendent and the Reserve Bank a joint written report of their findings along with a written description of any management or operational changes, including any disciplinary actions, that will be instituted as a result of the findings of this review.

(b) Daiwa and the New York Branch shall provide to the Superintendent and the Reserve Bank copies of any and all reports, in both Japanese and

English, that result from any internal review of the circumstances surrounding the \$1.1 billion trading losses as soon as any such report has been completed.

10. Daiwa shall take such actions as are necessary to ensure the New York Branch's full compliance with the provisions of this Order.

11. Each written plan required by this Order shall be submitted to the Superintendent and the Reserve Bank for review and approval. Within 10 days of approval, Daiwa and the New York Branch shall adopt each plan and then shall comply fully with each.

12. All communications regarding this Order shall be sent to:

- (a) Mr. Robert H. McCormick  
Deputy Superintendent of Banks  
New York State Banking Department  
Two Rector Street  
New York, New York 10006
- (b) Mr. William Ryback  
Associate Director  
Division of Banking Supervision and Regulation  
Board of Governors of the Federal  
Reserve System  
20th and C Streets, N.W.  
Washington, D.C. 20551

- (c) Mr. Donald T. Vangel  
Senior Vice President  
Federal Reserve Bank of New York  
33 Liberty Street  
New York, New York 10045
- (d) Mr. Akira Fujita  
President  
The Daiwa Bank, Limited  
2-1, Bingomachi 2-chome  
Chuo-ku, Osaka 541, Japan
- (e) Mr. Masahiro Tsuda  
Director and General Manager  
The Daiwa Bank, Limited  
New York Branch  
666 Fifth Avenue  
New York, New York 10103

13. The provisions of this Order shall be binding on Daiwa and the New York Branch and each of their institution-affiliated parties, including their officers, directors, employees and agents, in their capacities as such, and their successors and assigns.

14. This Order shall become effective immediately upon service on Daiwa and the New York Branch, and shall remain in full force and effect pending the completion or termination of the administrative proceedings initiated pursuant to the foregoing Notice, except to the extent that, and until such time as, any provision of this Order shall have been stayed, modified, suspended, or set aside by the Superintendent and Board of Governors, or, with respect to the Board of Governors, by a court in proceedings authorized by section 8(c)(2) of the FDI Act (12 U.S.C. 1818(c)(2)).

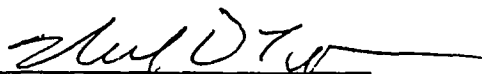
15. Notwithstanding any provision of this Order to the contrary, the Superintendent and the Reserve Bank may, at their sole discretion, grant written extensions of time to Daiwa and the New York Branch to comply with any provision of this Order.

16. The provisions of this Order shall not bar, estop or otherwise prevent the Superintendent or the Board of Governors, or any federal or state agency or department, from taking any other action affecting Daiwa, the New York Branch, the Other U.S. Offices, or the Trust Company, or any of their current or former institution-affiliated parties, or their successors or assigns, including, but not limited to, the actions and


penalties authorized for violations or noncompliance with this Order under sections 40, 44 and 606 of the New York Banking Law or applicable federal law .

By order of the Superintendent and the Board of Governors of the Federal Reserve System, effective this 2<sup>nd</sup> day of October, 1995.

New York State Banking Department

By:   
Neil D. Levin  
Superintendent of Banks of  
the State of New York

Board of Governors of the  
Federal Reserve System

By:   
William W. Wiles  
Secretary of the Board

UNITED STATES OF AMERICA  
BEFORE THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM  
WASHINGTON, D.C.

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In the Matter of )

DAIWA BANK, LTD. )  
Osaka, Japan )

and )

DAIWA BANK, LTD. NEW YORK BRANCH )  
New York, New York )

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DOCKET NO. 95-028-B-FB  
95-028-B-FBR

Notice of Charges and of  
Hearing Issued Pursuant  
to the Federal Deposit  
Insurance Act, as Amended

The Board of Governors of the Federal Reserve System (the "Board of Governors") is of the opinion or has reasonable cause to believe that Daiwa Bank Ltd., Osaka, Japan ("Daiwa"), a foreign bank doing business in the United States, and its New York, New York branch (the "New York Branch") have engaged in unsafe and unsound practices and violations of law and regulation in conducting the business of the New York Branch which resulted in approximately \$1.1 billion in trading losses and that the unsafe and unsound practices and violations have had, and could in the future continue to have, adverse effects on Daiwa's operations in the United States.

Accordingly, in conjunction with the Superintendent of Banks of the State of New York (the "Superintendent"), the Board of Governors hereby institutes this proceeding by issuing this Notice of Charges and of Hearing (the "Notice") for the purpose of determining whether an appropriate order to cease and desist

should be issued by the Board of Governors against Daiwa and the New York Branch requiring them to cease and desist the unsafe and unsound practices and violations and to take affirmative action to correct the unsafe and unsound practices and violations of law and regulation, pursuant to the provisions of section 8(b) of the Federal Deposit Insurance Act, as amended (the "FDI Act") (12 U.S.C. 1818(b)).

In support of this Notice, the Board of Governors alleges the following:

#### JURISDICTION

1. Daiwa is a foreign bank that is incorporated and doing business in Japan. The New York Branch is licensed by the State of New York and supervised by the Superintendent and the Board of Governors.

2. At all times pertinent to the charges herein, Daiwa, as a foreign bank, and the New York Branch, as an uninsured branch of a foreign bank, are and each have been, respectively, subject to section 8 of the FDI Act (12 U.S.C. 1818), and the rules and regulations of the Board of Governors (12 C.F.R. 201 et seq.), pursuant to sections 3(q)(2) and 8(b)(4) of the FDI Act (12 U.S.C. 1813(q)(2) and 1818(b)(4)).

ALLEGATIONS

3. Daiwa has informed the Federal Reserve Bank of New York (the "Reserve Bank") that a senior official of the New York Branch, Toshihide Iguchi ("Iguchi"), submitted a written confession to the President of Daiwa. The written confession detailed Iguchi's unauthorized trading of U.S. Treasury securities in which, over an 11-year period, he lost approximately \$1.1 billion. The written confession detailed how he secretly traded U.S. Treasury securities in an unauthorized manner and then misappropriated securities from Daiwa, as well as from customers of the branch for whom the New York Branch was acting as custodian, in order to cover the losses. The confession also described how Iguchi falsified branch records and lied to examiners and auditors in order to hide the trading losses.

4. (a) The unauthorized trading and the resulting losses, and the misappropriation of securities from Daiwa and customers occurred due to the failure of Daiwa and the New York Branch to establish and maintain adequate controls over the branch's securities trading operations and custodial services.

(b) According to Iguchi, during the time period in which he was responsible for the New York Branch's U.S. Treasury trading operations, he was also the head of the branch's custodial department which held securities, including U.S.



Treasury securities, for the branch's customers, as well as those which the branch held for its own accounts. Consequently, at times pertinent to the charges herein, Iguchi asserts that he was responsible for the New York Branch's U.S. Treasury securities trading and for the actual securities that the branch held, as a fiduciary, for its customers as well as for its own accounts. Iguchi also asserts that he was able to influence the performance of the New York Branch's backroom operations for U.S. Treasury securities trading activities.

5. According to Iguchi's written confession, from 1984 until the middle of 1995, he cumulatively lost about \$1.1 billion in trading of U.S. Treasury securities. Due to the lack of controls necessary for a safe and sound trading operation, Iguchi asserts that he was able to hide the losses from others at the branch, auditors, and examiners from the Reserve Bank and the Superintendent. Iguchi states that, because he was responsible for the branch's custodial department, he was able to sell securities from Daiwa's own accounts, as well as securities of customers for which the branch acted as custodian, in order to cover his losses. Iguchi further states that, because he was able to influence the performance of the branch's backroom operations, he was in the position to falsify accounting and other branch records in order to hide from auditors and examiners the trading losses and the misappropriation of securities.

6. In November 1992 and again in November 1993, the Reserve Bank and the Superintendent criticized the poor internal controls at the New York Branch. Both the Reserve Bank and the Superintendent were led to believe by Iguchi and other officials at the New York Branch that lines of authority were changed in November 1993 so that Iguchi no longer was responsible for both the branch's trading and custodial operations. The Board of Governors has reasonable cause to believe that Daiwa and the New York Branch did not change the reporting lines and that, in fact, Iguchi continued to exercise control over the branch's custodian operations as well as some of its U.S. Treasury securities trading operations.

7. By at least July 1995, Daiwa and the New York Branch were aware of Iguchi's unauthorized trading, the resulting losses of about \$1.1. billion, the misappropriation of securities from Daiwa's accounts and from its customers' accounts, the falsification of branch records and the misrepresentations to auditors and examiners. Notwithstanding the fact that this information was material to the veracity of the New York Branch's books and records and the ability of the Reserve Bank and the Superintendent to supervise adequately the New York Branch, Daiwa and the New York Branch failed to provide the regulators with timely and adequate notice of this matter.

**UNSAFE AND UNSOUND PRACTICES AND VIOLATIONS OF LAW**

8. As set forth in this Notice, Daiwa and the New York Branch have engaged in unsafe and unsound practices in conducting the business of the New York Branch. In particular, Daiwa and the New York Branch permitted an official to engage in the trading of U.S. Treasury securities without adequate supervision. Moreover, contrary to safe and prudent banking practices, Daiwa and the New York Branch did not adequately separate the trading function from the backroom operations, thereby permitting Iguchi to influence the performance of recordkeeping and internal controls over his own trades. In contravention of safe and prudent banking practices, Daiwa and the New York Branch permitted Iguchi to oversee the branch's custodial operations, thereby giving him unlimited access to Daiwa's, as well as customers', securities held in custody. As a result of these unsafe and unsound practices, Iguchi was able to engage in unauthorized trading activities that resulted in losses of approximately \$1.1 billion and was able to hide the losses by misappropriating securities from Daiwa and its customers, by falsifying the branch's records, and by lying to the Reserve Bank, the Superintendent and auditors.

9. Section 211.24(f) of Regulation K of the Board of Governors (12 C.F.R. 211.24(f)) requires foreign banks operating in the United States and their agencies and branches to file with the appropriate law enforcement authorities and the Federal

Reserve reports of suspected criminal activity within 30 days of learning of such activity. Notwithstanding this regulatory requirement, neither Daiwa nor the New York Branch filed the appropriate criminal referral form, thereby delaying informing U.S. law enforcement and bank regulatory authorities about a matter that materially impacts on the safety and soundness of the operations of Daiwa and the New York Branch.

#### ENFORCEMENT PROCEEDINGS

10. Notice is hereby given that a hearing will be held on December 27, 1995 in New York, New York, or any other place designated by the presiding administrative law judge, for the purpose of taking evidence on the charges hereinbefore specified in order to determine whether an appropriate order should be issued under the FDI Act requiring Daiwa and the New York Branch to cease and desist from the unsafe or unsound practices and violations of law herein specified and to take affirmative action to correct the conditions resulting from such practices and violations. Appropriate corrective action may include the issuance of a cease and desist order:

(a) Requiring the orderly reduction of certain of the New York Branch's trading activities;

(b) prohibiting Daiwa from starting or expanding any trading activity in any of its offices in the United States

until such time as it has implemented adequate plans, policies and procedures to ensure that any trading and the accompanying backroom operations are conducted in a safe and sound manner;

(c) requiring Daiwa and the New York Branch to correct all of the branch's false books and records and to refile all regulatory reports filed since 1984;

(d) requiring Daiwa and the New York Branch to implement adequate plans, policies and procedures to ensure that the branch's custodial operations are conducted in a safe and sound manner; and

(e) providing for such other relief as may be appropriate under the circumstances of this matter.

11. The hearing referred to in paragraph 10 hereof will be held before an administrative law judge to be appointed from the Office of Financial Institution Adjudication ("OFIA"), pursuant to section 263.54 of the Board of Governors Rules of Practice for Hearing (the "Rules of Practice") (12 C.F.R. 263.54). The hearing will be public, unless the Board of Governors determines that a public hearing would be contrary to the public interest, and in all other aspects will be conducted in compliance with the provisions of the FDI Act and the Rules of Practice.

Answer to Notice and Request for Private Hearing

12. Daiwa and the New York Branch are each directed to file an answer to the Notice within 20 days of the service of this Notice as provided by section 263.19 of the Rules of Practice (12 C.F.R. 263.19) with the OFIA, 1700 G Street, N.W., Washington, D.C. 20552. Pursuant to section 263.11(a) of the Rules of Practice (12 C.F.R. 263.11(a)), any answer filed with the OFIA shall also be served on the Secretary of the Board of Governors. As provided in section 263.19(c) of the Rules of Practice (12 C.F.R. 263.19(c)), the failure of any party to file an answer required by this Notice within the time provided herein shall constitute, as to such party, a waiver of the right to appear and contest the allegations of this Notice, and authorization for the administrative law judge, upon proper motion, to find the facts as alleged in the Notice and to file with the Secretary of the Board of Governors a recommended decision containing such findings and appropriate conclusions.

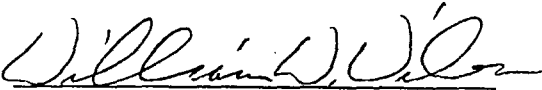
13. Daiwa and the New York Branch may each submit, within 20 days after the service of this Notice, to the Secretary of the Board of Governors a written statement detailing the reasons why the hearing described in paragraph 10 hereof should not be public. The failure by any party to submit such a statement within the aforesaid period shall constitute a waiver, as to such party, of any objection to a public hearing.

Delegation of Authority

14. Authority is hereby delegated to the Secretary of the Board to take any and all actions that the presiding officer would be authorized to take under the Rules of Practice with respect to this Notice and any hearing to be conducted hereon, until such time as a presiding officer shall be designated by the OFIA as provided herein.

Dated at Washington, D.C., this 2<sup>nd</sup> day of October, 1995.

BOARD OF GOVERNORS OF THE  
FEDERAL RESERVE SYSTEM

  
William W. Wiles  
Secretary of the Board