Mizuho Systems Debacle

Photo : THE YOMIURI SHIMBUN

People made a long queue to use Mizuho's ATMs

On April 1, Mizuho Bank had major computer problems, causing most of its 7,000 automated teller machines (ATMs) to malfunction across Japan. The bank, the retail banking arm of the Mizuho Financial Group, was also troubled with delays in money transfers for customers' utility and other payments. The group is the world's largest bank in terms of assets.

The total number of pending money transfer orders reached as high as 2.5 million at the peak of the problem at Mizuho Bank and Mizuho Corporate Bank, which serves major corporate clients. There were other problems in which the banks' customers were double-billed for various charges. Mizuho's ATMs had recovered by the morning of April 2, but the backlog of money transfer orders could not be cleared until April 18. It is the first time that settlement systems at major banks in Japan have been disrupted for such a long period of time.

Mizuho Bank and Mizuho Corporate Bank were launched on April 1 under Mizuho Holdings Inc. following the group's reorganization of its three former core banks – Dai-Ichi Kangyo Bank (DKB), Fuji Bank and the Industrial Bank of Japan (IBJ) – into the two Mizuho banks.

Some corporate clients, who have used Mizuho as clearing banks for their customers' bill payments, had to send blank receipts or apology letters to their customers because many money transfers had not been completed by due dates. While the Mizuho banks reimbursed payments on behalf of customers in certain cases, some corporate clients are set to seek damages from Mizuho, making the banking group liable to losses of some hundreds of millions of yen.

The problems were compounded as Mizuho's system integration coincided with the start of a new fiscal year when financial transactions usually become extremely busy just after the March 31 fiscal year-end.

Against this backdrop, Mizuho's relay computers connecting the three banks went down as they were overloaded with the massive volume of data processing, while some human errors, such as erroneous programming and false data inputs, also occurred.

It is becoming clear that the Mizuho fiasco was not simply the result of unfortunate incidents but was caused by a combination of various factors, such as insufficient computer tests, programming defects and human errors. This raises questions about the roles played by the Financial Services Agency and the Bank of Japan as financial regulators and supervisors. It also points to the need for them to strengthen bank inspections.

It is said that one remote cause for the Mizuho trouble is the power struggles among the three constituent banks ahead of the integration. It was indeed a big project for them to reorganize into the two banks under new concepts. One of the largest challenges was how to integrate the three banks' different computer systems. In developing their systems, DKB cooperated with Fujitsu Ltd., Fuji with IBM Corp. and IBJ with Hitachi Ltd. In December 1999, four months after the announcement of the three-way merger, the banks decided that a merged retail bank would adopt the DKB's computer system. But the plan was nullified in November 2000 due to strong opposition from Fuji Bank, which was concerned that the DKB would turn out to play the leadership role in developing a retail banking system – a "vital issue" for any commercial bank. As a result, the three banks reached a compromise that they would install relay computers connecting the three while keeping the existing systems for one year after the April 2002 launch before integrating them fully.

It is believed that the integration plan in itself had fundamental problems, such as delays in decision-making as well as insufficient computer load tests. It was also a poor decision to set the launch date for April 1, the first day of a fiscal year, when heavy data processing is normally required. The Mizuho management also made a mistake in giving the go-ahead to the April 1 launch, although they knew that there had been delays in money transfers toward the end of March. It was revealed that Mizuho turned down the requests by Tokyo Electric Power Co. to conduct computer tests beforehand. A series of those episodes indicate that Mizuho did not seem to have a clear-cut information technology strategy within the framework of the overall management plan.

The Bank for International Settlements plans to include banks' preparedness for a possible operational risk in a new set of guidelines it will adopt in 2006 to assess the integrity and soundness of internationally operating banks.

It is widely believed that Mizuho was not fully aware of operational risks. Japanese banks, whose credit ratings have been lowered due to slow progress in non-performing loan disposals, are now concerned that the Mizuho debacle could further undermine foreign investors' confidence in the Japanese banking industry.

Japanese Economy Seen Bottoming Out

The Japanese government has upgraded its assessment for the Japanese economy, saying there are some signs of bottoming out, though the situation is still severe.

In a Monthly Economic Report for April issued on April 10, the Cabinet Office based its bullish judgment on the recovery of the U.S. economy which is feeding into the recovery in exports and production, mainly in the information technology sector, and improving the employment environment.

The Cabinet Office is cautious about predicting when the economy will "bottom out," because consumer spending and corporate capital investment, which constitute the pillar of the economy, remain flat. It only said, "The economy would bottom out if the current trend continues." However, private-sector economists generally take the view that it would come some time during the second quarter (April-June).

As for short-term prospects, the report expressed concern over downward pressures on private demand in view of slow growth in income amid deflation and the still severe employment situation.

The report revised upward its assessment for the employment situation by describing it as "remaining severe," compared with the previous month's wording of "becoming increasingly severe," as the unemployment rate has remained flat. "It is still too early to say the employment situation is improving," the Cabinet Office said.

The report also upgraded its assessment for exports and production, saying that the pace of decline in exports is slowing down, as the world economy, led by the United States, improves, and that production has ceased falling, as inventory adjustment, mainly in the information-technology sector, progressed.

The report regarded private consumption as "remaining flat" and described the business investment situation as "substantially declining."

Meanwhile, the Policy Board of the Bank of Japan forecast that the economy will stop shrinking toward the second half of fiscal 2002, but will probably not gain much momentum toward a self-sustaining recovery.

The central bank's semiannual Outlook and Risk Assessment of the Economy and Prices report issued on April 30 also said prices would probably continue to fall.

According to the report, most members of the Policy Board projected gross domestic product would grow in the minus 0.5% - plus 0.1% range, up slightly from the minus 1.1% - plus 0.1% range predicted in the previous report issued in October 2001.

Meanwhile, the Group of Seven (G-7) economic powers held a meeting of finance ministers and central bank governors in Washington April 19-20 and adopted a joint statement that the G-7 confirmed a growing global economic recovery in overcoming the impact of the Sept. 11 terrorist attacks, though downside risks remain, including those arising from rising oil prices. It urged Japan and other G-7 nations to sustain economic recovery by implementing sound macroeconomic policies and structural reforms.

Prior to the G-7 meeting, Japanese Finance Minister Shiokawa Masajuro met with U.S. Treasury Secretary Paul O'Neil and promised to draw up a list of measures to boost the Japanese economy. The measures will feature four areas – industrial revitalization, comprehensive tax reforms, deregulation and the disposal of non-performing loans at banks.

In what amounted to an international commitment to tax cuts to boost the Japanese economy, Shiokawa told a news conference following the G-7 meeting that he was considering tax cuts ahead of other measures.

Era of Self-Responsibility

The president of a major Japanese non-life insurance company said recently that, when he traveled around the nation to explain his company's merger plan, he was reminded that the two major concerns haunting the average Japanese were the problem of post-retirement years and the Japanese financial system. There are a number of problems affecting the people's life, such as the extended economic slump, deflation, an uncertain outlook for structural reforms, corporate bankruptcies and high unemployment rates. On top of that, the buzzword "self-responsibility" is making the Japanese feel more uneasy recently.

A defined contribution pension plan – the Japanese equivalent of the 401k pension plan in the United States – was introduced for major Japanese companies this January and for smaller firms and self-employed individuals in February. Given the sluggish stock market, many companies remain cautious about the new pension plan. But there are some exceptions, such as Toyota Motor Corp., that decided to introduce it in July.

On April 1, the government abolished its full protection of time deposits at financial institutions and capped the guarantee at ¥10 million per account in the event of a bank failure. The full protection of ordinary deposits will be lifted in April 2003. This means that financial risks are shifting away from companies and the government to employees and depositors and that individuals are required to assume responsibility for their own acts.

In the field of taxation, the principle of self-responsibility is also emphasized. For example, the government's Tax Commission, which is now working on comprehensive tax reforms, plans to propose that the government encourage salaried workers to file income tax returns themselves, rather than sticking to the current system under which their income tax is withheld at source. The proposal is expected to be included in a report to be adopted by the commission in June. The proposal would reduce income tax deductions and require workers to declare expenses in their tax returns. But many people would feel uncomfortable if they were suddenly required to take responsibility for their acts as there are many aspects that they do not know how to deal with.

On the education front, an increasing number of schools are introducing social studies classes to teach stock market transactions so as to enable students to deal better with the new era of self-responsibility. In fiscal 2001, there were about 1,200 junior and senior high schools as well as universities that have adopted such classes.

The securities industry is also making efforts to educate the Japanese people on financial matters. Association for the Promotion of Financial Literacy, a non-profit organization, was recently launched in the Kabuto-cho financial district in Tokyo to promote the public's financial knowledge including that of taxation and pensions. The Association is planning to offer correspondence courses and conduct tests for that purpose.