

Newsletter

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Unauthorised Trading Losses

The UBS unauthorised trading loss of almost \$2bn may be shocking in terms of size but, perhaps surprisingly, not that it actually occurred. There is now a reasonable history of these types of events. Here are just a few examples:

1. Nick Leeson: Barings Bank; losses of £827m
2. Jérôme Kerviel: Societe Generale cost €4.9bn.
3. London CDO traders at Credit Suisse forced company to write down its assets by \$2.65bn.
4. John Rusnak: Allied Irish Bank; \$691m in trading losses
5. Yasuo Hamanaka: Sumitomo Corporation; losses of \$2.6bn
6. Toshihide Iguchi: Daiwa Bank; losses of \$1.1bn.
7. David Bullen, Vince Ficarra, Luke Duffy, Gianni Gray: NAB; losses of \$326 million
8. Evan Dooley: MF Global losses of almost \$US141 million.
9. Steve Perkins: PVM Oil Futures; losses of almost \$US10 million
10. Alexis Stenfors: Merrill Lynch forced to make a \$US456 million write down.
11. Scott Szach: Griffin Trading Co losses of \$US5.56m.
12. Joseph Jett: Kidder Peabody; losses of \$US350m.

So are unauthorised losses insurable?

The answer is yes, there is insurance available to cover unauthorised losses. However, it's not your standard Crime/Fraud policy or Professional Indemnity ('PI') policy. This raises the following questions:

- a) Why does the standard PI or Crime policy not cover these types of criminal event?
- b) What policy does cover them?
- c) Do all Banks/Investment Banks etc purchase this type of cover?

Standard PI and Crime policies

Most unauthorised trading losses have typically been at the expense of the company's own funds not third parties (i.e. customers). Given a customer has not lost money there is no cause for a third party to sue the company for the loss and therefore the PI policy is not triggered.

The Crime policies in place for Financial Institutions are fairly broad, and certainly, unauthorised trading is a criminal act committed by an employee. However, all Crime policies require one of two fundamental things to have occurred - the criminal act must have been committed by the employee with the intent to have either:

- (a) caused a loss to the insured; or
- (b) to obtain an improper financial gain for themselves (and salaries, bonuses, fees, commissions, promotion, emoluments or other remuneration do not constitute improper financial gain).

In unauthorised trading situations, the person committing the act is not trying to lose money. In fact it's the opposite – they are trying to make money (they just do it badly!). Nor do they do it to benefit themselves directly - they don't reap the reward of the trade directly. So, on that basis no Crime policy covers unauthorised trading.

What does cover unauthorised trading?

It's a specialist product called, somewhat unsurprisingly, an Unauthorised Trading Insurance policy!

Unauthorised Trading insurance covers direct financial loss to the insured caused by concealed or falsely reported unauthorised trading. There is no requirement for the dishonest act to have either been either for personal gain or malicious damage to the company.

The number of insurers offering this type of insurance is relatively limited. I recall in the past there was talk of putting together \$1bn policies, but I think that now \$150m/\$300m would be a stretch. This is clearly not enough to cover a Societe Generale or even UBS, but material enough for many of the others on the list above.

Why not buy it?

There are many reasons why companies don't purchase this type of insurance, ranging from:

- Not aware of its existence;
- Too expensive (and it is an expensive product);
- Can't purchase enough cover to make it meaningful;
- The company believes its controls and procedures are so tight that there is no chance of loss (or at least no chance of catastrophic loss)

For these reasons and more, many companies don't buy this type of insurance. However, as a shareholder of a listed financial institution with 'trading' risk I would expect at the very least my Board to have clearly considered and documented their thoughts on this type of insurance.