



Unauthorised Trading Policy

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Quote Nick Leeson:

“It is not a great advertisement either for the bank or the banking industry as a whole.”

It is an understatement to say that an organisation’s greatest asset is potentially its employees. It is also fair to say that those very employees could also be considered its greatest liability.

Businesses place huge responsibility in the hands of their employees. Scandals in financial organisations such as Allied Irish Bank and National Australia Bank show that, nearly 10 years after the collapse of Barings, companies are still not managing the risks posed by rogue employees.

Most businesses place faith in their internal controls in order to address the issue of unauthorized trading. However the situations at Barings, AIB and NAB have proved that no system or procedure can fully protect against a trader who finds a way of conducting unauthorised trades and who is unscrupulous or desperate enough to use it regardless of how thorough the controls are deemed to be.

INSURING CLAUSE

“By reason of and solely and directly caused by **Unauthorised Trading** by any **Trader** while **Trading** for the **Assured** which **Unauthorised Trading** either was **Concealed** or was **Falsely Recorded**.”

WHAT IS COVERED?

Losses caused by an employee trading with an authorised counterparty which transaction is knowingly:

- in excess of permitted financial limits; or
- outside of permitted product lines; or
- not with a Designated Counterparty.

HOW THIS COVERAGE “FILLS THE VOID” OF EXISTING PRODUCTS

- Objective test of coverage – what the trader did and the outcome as opposed to the subjective, motivational evidence required under a fidelity policy of whether it was the intention to cause the loss and obtain improper personal financial gain
- A Professional Indemnity policy insures an institution’s liability to clients for wrongful acts that affect their interest as opposed to the heavily publicised losses of “rogue trading” which occur in the institutions own proprietary account.

EXAMPLES OF UNAUTHORISED TRADING

- In 1995 the derivatives trader Nick Leeson brought down Barings Bank by falsifying accounts and making misrepresentations of losses amounting to £830m.
- 2002 saw the Allied Irish Bank (AIB) trader John Rusnak attempt to cover up the loss of £529m. His losses occurred in foreign exchange deals which he offset with options deals and artificial purchase orders entered into the bank's system.
- In January 2004 National Australia Bank (NAB) traders incurred losses of AUD\$360m and chose to conceal their true positions. They positioned NAB's foreign currency options portfolio in the expectation that the prior falls in the US dollar would reverse and volatility would stabilise.
- In June 1996, Japanese industrial and commodities giant Sumitomo Corporation revealed that unauthorised trades by its former head of copper trading caused it to lose US\$2.6 billion. The trades spread across a ten year period and the individual had falsified corporate records to conceal his losses. Sumitomo's chairman resigned in February 1997 in the wake of this disaster.
- In 1994, the British subsidiary of UBS took a EURO 9.3m loss when two former traders concealed losses in their trading books.
- In February 1993, Showa Shell Sekiyu reported it had lost US\$1.06 billion as a result of unauthorised foreign exchange contracts entered into by the company.
- In December 1996, NatWest Markets reported a loss of over US\$151m due to a former trader's unauthorised trades. The trader deliberately mis-priced and overvalued Mark and Sterling options contracts and concealed losses.
- In September 1996, Morgan Grenfell lost nearly EURO 430m when a trader broke investment rules by exceeding limits on unquoted securities and hiding unauthorized trades in a network of holding companies.
- In September 1995, Daiwa Bank reported a loss of \$1.1 billion in unauthorised trades of US securities. The trader engaged in 30,000 unauthorised trades over an 11 year span and concealed his losses through the falsification of account records.

UNDERWRITING INFORMATION REQUIRED BY LAU IN ORDER TO PROVIDE AN INDICATION OF TERMS

- Number of traders
- Minimum/maximum value any one trader / any one day
- Overall trading value across all traders on a daily basis
- Product type traded
- Confirmation that reconciliation of all trades occurs daily at close of business
- Loss history (minimum 5 years)

ADDITIONAL LAU INFORMATION REQUIREMENTS TO TAKE UP TO QUOTE STAGE

A.) LAU UT Proposal Form (to be provided)

B.) Survey – scope to include:

- Entity history and culture
- Trading activities – number of locations and traders; trading policies and processes; department structure
- Risk management – overview, trading limits, counterparty and credit limits, revaluation processes, new product approval
- Internal Audit – structure & supervision, resources, reporting
- Corporate Compliance – Regulators, Personal Dealing Rules, Control processes and posttrade monitoring, trader registration and surveillance
- Information Systems – access and control
- Human Resources – trader recruitment and screening, remuneration, departure of personnel
- Loss history – trading related losses

Cost of survey usually rebated upon purchase of UT product and adherence to any recommendations/observations made. Often survey is done post purchase of the UT product.

COVERAGE REQUIREMENTS OF LAUW

- Minimum AUD \$10,000,000 attachment point
- Client must purchase standalone Fidelity coverage (no lesser limit than UT limit purchased nor greater retention for Fidelity programme than UT programme)
- Minimum rate on line is 1%
- AUD \$20,000,000 line size
- Will consider both Financial and Non Financial Institutions (ie Retail / Energy companies considered)

Contact

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