In recent weeks, major French bank Societe Generale has revealed that it has incurred a €4.9bn loss due to Unauthorised Trading of one employee.

Jerome Kerviel allegedly took advantage of his back office knowledge to hide the scale of his exchange-traded equity futures. It has been reported that at one point, his trading gave the bank an exposure of above €50bn, which is greater than the market capitalisation of the bank.

Since Nick Leeson’s unauthorised trading at Barings in 1995 caused the institution to fail and ultimately be taken over, we have seen a series of infrequent yet very severe losses.

The latest incident demonstrates that large, well-established banks with rigorous risk management procedures face serious risks and that risk management procedures can, and do, fail. The Societe Generale revelations raise major questions about the nature of risks that financial institutions are facing and how they can mitigate these risks.

Unauthorised Trading Insurance was launched at the end of 1997 by Lloyd’s underwriters in response to the Nick Leeson incident at Barings.

The insurance provides protection to the institution in the event that an employee trades the bank’s own funds (proprietary trading) in excess of financial limits, outside of permitted lines of business or non designated counterparty which is concealed or falsely recorded.

Unauthorised Trading does not provide coverage where:

- An employee makes a financial gain for themselves – this is covered by the Fidelity insuring clause of a Bankers Blanket Bond.
- A customer makes a claim that the employee is trading dishonestly with their funds – this is covered by a Professional Indemnity policy.

The market capacity for Unauthorised Trading Insurance for a financial institution is between GBP 150 million and GBP 200 million.

The vast majority of major financial institutions have decided not to purchase Unauthorised Trading Insurance and rely on risk management processes to ensure they did not suffer a loss.

From our recent experience, we know that a number of financial institutions are reviewing their position on Unauthorised Trading and their mitigation strategies following the Societe Generale revelation.

Willis has extensive experience in placing Unauthorised Trading insurance for major financial institutions and is ideally positioned to offer advice on Unauthorised Trading coverage.
UNAUTHORISED TRADING INCIDENTS

1995  Barings lost £827m in futures trading by Nick Leeson, from their Singapore office.
1996  Sumitomo Corporation recorded a deficit of £2.6bn for copper trading.
2003  Allied Irish Bank incurred trading losses of $691m. John Rusnak is sentenced to seven and a half years in prison after admitting concealment at Allfirst Financial, the bank’s US subsidiary.
2004  National Australia Bank’s former head of foreign currency options desk, Luke Duffy, in collusion with three other traders, falsified trading losses resulting in losses of $266m for NAB.
2007  Calyon disclosed a €250m loss after a trader made unauthorised credit market transactions.
2007  West LB suffered losses exceeding €600m after failed investments by its proprietary trading desk.

If you would like to discuss the issue of Unauthorised Trading, please contact the individuals listed below to discuss further.

Christopher Root
+44 (0) 20 7975 2098
rootc@willis.com

Hugh Wilson
+44 (0) 20 7975 2898
wilsonh@willis.com

Mark Pearce
+44 (0) 20 7975 2726
pearcem1@willis.com

www.willis.com