



# Introduction to the Theories and Varieties of Modern Crime in Financial Markets

Marius-Christian Frunza



# INTRODUCTION TO THE THEORIES AND VARIETIES OF MODERN CRIME IN FINANCIAL MARKETS

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FIRST EDITION

*Edited by*

MARIUS-CHRISTIAN FRUNZA



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# Preface

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Following my previous book *The Carbon Connection* about the fraud on carbon markets [1], I decided to pursue the review of crime typologies in financial markets and to use the experience gathered in analyzing the missing trader fraud to other investment clusters and crimes.

In the aftermath of the financial crisis a series of crimes and misdemeanors were revealed by regulators and investigators. All these white-collar offenses are small pieces of a bigger puzzle depicting a vulnerable state of financial markets to internal and external threats.

Some quantitative methods and exploratory methods are introduced along with various examples of crimes. The book aims to present a balance between qualitative and quantitative analysis described in a language accessible to an average red person in both areas of financial crime and statistics. Beyond the technicalities introduced in the textbook it should be noticed that data mining and statistical analysis alone cannot tackle the full complexity of crime on financial markets. They need to be accompanied by comprehensive knowledge of the criminal

phenomena along with all elements involved in an offense.

The book covers a number of geographical regions starting with the United Kingdom, and proceeding to Continental Europe, Central Asia, Turkey and the Russian Federation on both sides of the Urals, Central and South East Asia, and the United States. A number of people were interviewed including financial regulators, investigators, and individuals with knowledge about the world of organized crime.

The research process involved two major challenges. One the one hand, gathering sufficient intelligence relating to various crimes and trying to interact with persons involved as offenders, whistleblowers, investigators or victims in financial offenses was difficult due to the reluctance of these people to talk about crime in the context of the financial industry. One the other hand, finding the right balance between the qualitative descriptions of offenses in financial markets and introducing the more technical aspects of the investment industry was another challenge to meet.

# Prologue

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The perception in certain circles of financial crime as a softer non-violent crime creates a false impression. White-collar crime as opposed to blue-collar crime introduces a bias in the way financial offenses are analyzed.

Firstly, both white- and blue-collar crimes are highly interconnected, with each generating externality in the other category. On one hand, fraud on the markets such as the manipulation in agricultural commodities prices can create social unrest in certain regions of the globe, thereby increasing the chances of physical assaults or robberies. On the other hand, blue-collar crimes like smuggling of illegal items during the Prohibition era can lead to a large accumulation of liquidity which if transferred to markets can create or worsen a financial crisis.

Secondly, financial crime is no different from a psycho-emotional point of view from committing any other type of offense. There is a level of conscience where manipulating a stock or

creating a network for money laundering is no different from smuggling goods or holding up a bank. The psychological and emotional triggers have many similarities.

Over the past decades traditional organized crime migrated slowly toward more sophisticated areas of white-collar crime. Therefore the factors involved in the typology of financial crime are very heterogeneous and include various social backgrounds and psychological profiles. The common theory of a positive correlation between poor education, low income per capita and crime does not hold true in this scenario.

Thus the knowledge of criminal phenomena from a purely process-oriented perspective is absolutely necessary. When constructing a framework that explains the offense it is first necessary to understand the behavioral and psychological mechanisms that underlie an offender or a criminal enterprise.

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# Mr X Anonymous Interview

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May 2014

## BIOGRAPHY

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This interview took place in May 2014. Mr X is working for the investment banking division of a major global bank.

**Marius Christian Frunza (MCF):** *Has the business model of investment banks changed over the last decade, and what is the future of the investment bank in the current context?*

**X:** I think that the model has not changed, but it should change, that is to say that the regulatory constraints that are imposed on banks should lead to a greater simplification of business, with a significant reduction of market activities or activities involving the balance sheet, and in return, a move to simpler operations—I have given two interviews on the return to simplicity, to commercial sales models in which the banks sell, take deposits, lend, and confer very simple hedging tools. I think this is the kind of evolution that the sales models for finance and investment must undergo because the regulatory constraints will push them to simplify, on the one hand because the balance sheet will be more constrained, producing less ability to achieve leverage on operations, and on the other because the regulators are rightly increasing the working capital risk threshold. So, in my opinion, this trend toward simplicity and a return to traditional banking, as in the 1980s or 1970s, will take place in the next five to ten years.

**MCF:** *In this context, in terms of strategic products, should there be a reduction in complexity?*

**X:** We have to get back to the business of traditional commercial banking, taking deposits

and giving loans, transaction banking, that is to say, cash management and everything connected with credit, and then opening up to capital markets, through the offer of market capital in bonds or investments in bonds issued by companies or shares, and a small hedge of interest rate changes, something much simpler than what banks can do today. Very complex derivatives, etc., must disappear.

**MCF:** *In this context, is there room for innovation?*

**X:** No, but we do not expect banks to innovate. They are expected to provide credit to their clients, and to give investors the opportunity to invest their balance sheet items. Business clients need relatively simple banking services at the end of the day, and investor clients need to invest in simple products they understand. I think financial innovation will now become very marginal.

**MCF:** *Nevertheless, there are still a lot of changes in terms of market structure. Indeed, it is clear from the arrival of high-frequency trading, algorithmic trading, that the markets...*

**X:** Yes, but it will all go away again.

**MCF:** *So broadly speaking, we will see a return to fundamentals in the markets?*

**X:** Yes, and all these complex activities, which are proprietary activities, are going to disappear. Quite rightly, the regulators are restricting them. So it is normal for them to disappear. High frequency trading contributes nothing to the clients that we serve, whether corporate borrowers or investors actually investing. Maybe we will still have some hedge funds, but within clear



regulatory constraints so that they do not have a competitive advantage over other investors in terms of market access.

**MCF:** *In this context, the role of hedge funds will change. Will they resume what they were doing previously in the future...?*

**X:** No, they cannot really resume it, because they need leverage, and the banks will give them less of it. Indeed, if banks give leverage to hedge funds, it means that they are taking the leverage on their balance sheets, which will happen less and less. In addition, behind this, hedge funds will take risks, but not necessarily high-frequency, but rather straight credit risks or underwriting risks which the banks will not necessarily take: Guaranteeing subordinated loan tranches, positioning on specific capital investments that banks cannot take on their own accounts, or perhaps underwriting or co-underwriting transactions that banks cannot fully take on their lines.

**MCF:** *The next subject for discussion concerns disputes and practices of mis-selling, rogue finance and rogue trading. I will start with structured products and then the complex products that have led since 2009 to numerous disputes in the markets between various entities about everything to do with rogue finance, mis-selling, etc., especially everything to do with interest rate derivatives, toxic loans, etc.: what is your view of that?*

**X:** I believe that the regulator is right to have a very disciplined approach to all these issues, first of all to ensure that products sold to clients are understandable for them—the product must be simple—and secondly to ensure that banks cannot possibly take advantage of market shifts on special fixings—as we have seen with commodities, FX and interest rates—which can create a disadvantage for the clients. So all in all, I think that a much more disciplined approach to a number of factors can only be beneficial to the market in the future, but anyway I think that this must all form part of a major simplification of the product range. Of course, these processes must be adjusted to be more in line with the

client's interest and to avoid special arbitration areas, but on the other hand I think that they will be resolved by themselves because the products will also become much simpler.

**MCF:** *But can we say that complexity created these problems? Are they the result of complexity? Are they a lever?*

**X:** No, they are partly due to the complexity of the entire product offering and to misunderstanding, since the products were complex, by the end clients of some of the mechanics. There was misunderstanding of some of the mechanics by the managers in the banks themselves. This is obvious from the Libor fixing problems, for example, for managers of banks, when you look at what has been said about the banks that are now in the spotlight of the courts or journalists, that management did not really understand what the traders were doing because neither the clients nor the management understood that there could be areas where there could be operations which were not in the client's interest but in the interest of the bank.

**MCF:** *If we look back to the 1980s, to the case of Michael Milken, and then back to today with the Libor case, can we say that there is a procyclicality factor in everything to do with rogue finance? Does it depend a little on the trend?*

**X:** I do not think that it is the fact that there is a bull market or a bear market that is important, but rather the fact that when there is a more active market—which is essentially the case when there is a bull market—with greater liquidity and volumes, this can lead to the development of more products, and possibly arbitrage that might not be done in the client's interest. But I think that the regulation has also evolved, that is to say, what today might be seen as an action that is not in the client's interest was not necessarily seen a few years ago as something that could perhaps be against the regulations. The regulations have rightly become stricter. I think that we are now in something that is simpler in terms of environment. I believe that bull markets often bring more liquidity and therefore

a more dynamic market: we meet new people who join banks and are perhaps not well supervised. There is more hiring, and so there may be a little less direct supervision, and the risks are certainly higher in bull markets than in bear markets where the banks rein in their activities more.

**MCF:** *What happens next depends on slightly controversial decisions of the courts, in particular the French traders Kerviel and Picano-Nacci, who went down last year and a few days ago. It is clear, indeed, that there is still a part of this business for which the banks are held liable; so, the liability is somewhat shared between the environment and the individual. Do you agree with that? And in this type of case, what is the role of the institution and the environment, and what is the role of the individual?*

**X:** If a burglar breaks into a house, is it the fault of the police or of the burglar? That is to say, is it the fault of the police because there were no policemen in front of the house? With the banks, it is the same thing. Depending on how you look at it, the liability is not just that of the individual committing the fraud, but further back, whatever the principles or the number of locks you put on a door, the burglar can get through the basement window. Depending on the culture of the country, you can take more or less immediate measures, or you can have a different approach. So I think it is very much a cultural matter.

**MCF:** *There has been discussion of whether it is the fault of the police or the burglar, but it is true that the recent crisis is something that recurs in financial services and that there is an asymmetry between risk managers and operators. Sometimes public opinion thinks that the capacity of risk managers has been reduced...in terms of organization, process, resources, training, etc. Is that something which...?*

**X:** I do not believe that. I think we should go back to the analogy of the burglar and the police: if you put a policeman in front of every house, it will be less likely they are burgled. They might still be, but at some point, it is not the amount of resources that proves that the establishment of whatever kind (a bank, an insurance fund, etc.) is more or less protected. I think

that, behind that, it is much more the nature of the risks that will dictate the resources and processes that need to be implemented. In banking, front office activities have decreased a lot in terms of resources and number of operators, whereas control activities have increased quite a bit. So we have had contrasting developments in terms of resources. The fact that today we have more investment in everything connected with risks versus a reduced front office means that the initial situation was too unbalanced, there were not enough resources for the number of operators. I think it all depends on the level of refinement of those involved. Major risks for banks are IT risks, for example, in which you can have computer attacks from hackers: these risks were much less likely a few years ago; today many more resources are deployed because hacking techniques have improved, and the exposure of banks is much greater. So I am sure the marginal action in risk resources will definitely decrease after a certain time, and today what is more important is to decide not to do a range of things rather than to do something and then need additional risk resources. There are a number of segments where either the bank has no particular competitive advantage, or there is no local presence; so it is better for the bank to stay away, rather than expand, with all the additional costs that involves. Take the example of European banks that are growing in Asia: there are lots of banks that have strategic visions, but the competitive advantage of European banks in Asia is very limited—no local presence of domestic banks, no in-depth knowledge of the markets, no hiring of networks of locals, etc. All in all, I think that this development can only lead to a number of operational market, credit and regulatory risks. I think that rather than saying, “We will expand in Asia, we will invest heavily in the Middle East,” the best thing is to say, “We are not going to expand in Asia, we will just stick with the markets we know.” When we look at the problems of credit risk, which is a very common issue, a European bank that is

expanding in Asia today, in order to take credit decisions on clients, will have a very limited reading of the credit risk of Asian clients and the movements in credits. It will have a much more limited sense of them, since the bank's management structures are in Europe, and when you do not have that sense then, inevitably, mistakes will be made which local banks will not make. Do you have to have several local credit analysts to try to compensate for this, so that ultimately credit functions or investment strategies will be taken over by management? If management has a poor understanding of the case, I do not think that hiring additional credit analysts will compensate for this lack. All in all, I think the best way to manage these risks is to decide on the one hand to simplify your business and on the other to be positioned in sectors that you understand—when I say that you understand them well that means that you have a particular competitive advantage.

**MCF:** *When it comes to bank losses due to unauthorized trading problems or anything that revolves around what may be called financial crimes, it is clear that the focus is still on the pretty big losses at the heart of distribution or on the profits that can occur due to bad decisions.*

**X:** I think that the greatest losses of banks still relate to the provisions that are part of their traditional business. Of course, when you lend money to clients, there is a certain probability of default, so that banks have to make provisions. But then, what are the loss levels compared to the initial expected loss, and what is the offset, positive or negative? There is less focus or analysis on what has happened than on the more dramatic losses. When we look at the huge bank losses, it is still about the provisions and their relationship to the expected loss, that is, the projected loss. I think the key factors today are to simplify the models so as to limit the probability of distribution losses alone due to unauthorized actions on an operator account, but I think a very big focus should also be the use of credit portfolios, the targets that are given to the bankers who grant credits, and how

these bankers are assessed and evaluated so as to be sure that there is consistency between the targets and the behavior in order to optimize and better manage the loan portfolios. These days, we too readily forget that banks must first of all lend money, and that it is in terms of credit that they lose market share. I am not sure that researchers or journalists are focusing much on that, but it is the heart of the business.

**MCF:** *You talk a lot about credit as an activity. Should we expect that the classical players on Wall Street or the big Anglo-Saxon investment banks will change course at some point?*

**X:** If the Anglo-Saxon investment banks remain pure investment banks, they will not make loans, but will certainly offer consultancy. As for the European banks, which are banks with a global offering, that is, retail as well as business, you must remember that each of the largest European banks lends between 250 and 300 billion euros in Europe to European clients. That is still a lot of loans, and an error of credit assessment can lead to significant losses compared to the average expected loss. I think the first thing to do is to clean and regularize the management of these loan portfolios: that is the first task of a bank; market activity, etc. is a secondary activity.

**MCF:** *In terms of risk management, it is true that the classical framework tends to focus on rare events. Do you think that today it is necessary to understand rather the entire P&L of activity, the structure, the drivers...?*

**X:** You have to look at how business leaders manage their work. If I start with market activities, it is necessary to ensure the robustness of the processes, because they are defined, but then applied by people who, inevitably, can make mistakes—the person who has never made mistakes does not exist. So it is necessary to have different levels of control and to ensure that they are effective. This is a process approach that is relatively conventional and the various events of the past mean that the levels of control and sensitivity are well developed in banks, although the process requires a commitment

which must never stop: when processes are set up, it is crucial to ensure that they are applied, which is difficult but necessary. When you do this, you avoid losses on credits, but you do not avoid market losses in an adverse market—that depends on sound activity, management costs, and other factors, and that is a matter of limits or risk appetite. On credit, it is something else: it involves the need for approaches that can be to very granular credits, rather more statistical approaches—anything that has to do with the financing of consumer credit, for example, or credit to individuals, etc.—or much more specific approaches—when granting credit to corporations, you are perhaps a bit between the two extremes in terms of approach: there, credit analysis, risk allocation and concentration risk must be the focus. In addition to these credit risks, you have everything to do with the targets and nature of the targets given to the bankers, the traders: if you set a credit volume target to bankers, like the classical target given in banks about 15 years ago, the rational banker will lend to riskier clients because he can charge them higher finance fees. If the target volume is risk-adjusted, that is to say, if you look at the amount of interest less the loss from client defaults, you then have an approach on which the operators try rather to achieve a distribution of their risk such that the actual loss will be very close to the expected loss, and prevent the actual loss being well above the expected loss, which is the task of true credit portfolio management: converging on the expected loss and not going over it. I think that credit approaches and targets depend on the understanding of the latter but also on the development principles of the assessments and targets defined, and in my opinion that is still not well understood, either by the managers of banks or by the regulators.

**MCF:** *If I can digress for a moment on credit, before introducing a measure such as volume adjusted by risk, you need a credit risk modeling system that is marginal, that can be...*

**X:** As regard risk-adjusted volume, or risk-adjusted revenue, every client should have a rating in a bank that is basic. A rating indicates the expected loss. Is the rating model of a bank correct? There may be differences between the various banks, when they have an advanced rating model which they define themselves, but they all more or less converge on the same models. So I think that rating clients on the one hand is not very complicated to do and on the other is relatively standard between banks, and it will become even more so with the review that the European Central Bank is currently carrying out, to ensure that there is comparability of banks between European clients. The European Central Bank is in the process of taking over supervision. So I think it really depends on the targets: you set credit risk-adjusted targets for your banking teams—I know this is not necessarily the case in other banks; on the other hand, there must be other ways to manage risk, and simply setting a risk-adjusted target will not in itself achieve that. Afterwards, you have to look at how the credits are clustered, how you are going to manage concentrations. I can set a risk-adjusted target for a banker who has one credit in his portfolio that will meet my target; if another has a thousand credits in his portfolio for the same nominal amount, he is more likely to hit his expected loss because his exposure is much more granular, while the one who has only one credit will be either very good or very bad. So, a risk-adjusted target alone is not sufficient; on top of that, you have to look at the concentration target, the distribution of exposures, etc. This is what is most important today, in my opinion.

**MCF:** *In that context, if you generalize this to all activities, does the modeling risk play a more important role than before?*

**X:** I think the modeling risk plays a more important role than before because banks have more models. In the past, they had no modeling risks because there were no models, but that does not mean they had no risk—this approach is perhaps a little too unsophisticated. Today,

there is a modeling risk which, because of the greater use of models, means that the sensitivity to modeling error is larger. That is tautological in a way. Then, the key point for me is not so much the modeling risk, but knowing what the reins are for a commonsense approach. To try to illustrate this point, the major ongoing debate is about the bank leverage ratio versus capital consumption, the latter being calculated by the banks on the basis of models, so that you can have a capital adequacy ratio of 9% or 8%. Some regulators say that beyond the capital amounts required for a bank to seem to be safe, there must also be a ratio to the leverage ratio, that is, the capital size to the balance sheet size, the size of the balance sheet not adjusted for risk under Basel, better known as Basel III. I think that that is not at all stupid because the calculation of capital under Basel III is done by models, and models can create inconsistencies or very high risk concentrations: there are some models that have virtually no risk when working with AAA, that is, very high, ratings. So, you can build up huge risk concentrations for very low capital commitments. This can be on sovereign debt and, behind that, if you do not have the rein of common sense, which is the nominal exposure or leverage ratio, the balance sheet size in capital against the specific balance sheet size, you will not know the adequacy of the situation. I give you an example: the largest German bank has a capital adequacy ratio of 8% or 9%, so beyond the regulatory constraints, and capital to balance sheet size ratio of 3%: is a balance sheet protected by 3% of the capital reassuring? Probably not, and being protected by 4% of capital will probably not be much more reassuring. What is the right exposure in terms of leverage that a bank must have? That is for everyone to judge. And I think that a "mark to model" approach, without returning to a nominal approach, that is, the nominal concentration of risk after assessment on a particular asset against the balance sheet total, for a sector: this does not enable you to manage these risks. So simply trusting the model

is actually to make the bank very exposed, and you always have to have a return to the nominal exposure. If there is one lesson to learn from the crisis it is that.

**MCF:** *You are talking about credits. Do you think the role of the major rating agencies will change?*

**X:** No, I do not think so, because banks do not use the rating agencies. You do not give out credit on the basis of the agency rating. You do your own credit analysis, and the rating given is not used for your own analysis or in the rating used for defining regulatory capital. I think that in the crisis the rating agencies showed that they were far behind the evolution of credit, not that they do a bad job, but that they are a lag indicator rather than a lead indicator, which is understandable for reasons of structures or indeed the calculations of potential risks they can make. Today you have three major rating agencies, not that many. Should you have more? Do the rating agencies give fairly transparent information to users, etc.? I do not know, but I think that investors should rely less on credit rating agencies. A good investor must take credit decisions on his own assessment of the credit, not on something that he has been given by a rating agency.

**MCF:** *Going back to market risks, two terms that are making a lot of noise today—even if you say that they are likely to become rather less used—are high-frequency trading and dark pools. Aside from the flash crash, which happened a few years ago, could there be a wave of rogue finance in this context?*

**X:** Finance being based on the concentration of financial markets on large amounts invested, I think there will always be risks of rogue finance or incorrect behavior, but certainly not where you expect it. High-frequency trading is basically an operational risk—for example, a computer that you can no longer control, or poorly defined price because of a badly reassessed parameter—rather than a matter of market risks, since, by their nature, positions are closed every night. So I think the risks are more operational than anything else. Future fraud risks in banks will come from places that are not being scrutinized



enough today. Huge amounts of controls have now been put in place for market activities after certain events that may have taken place. On the other hand, as I mentioned earlier, the real risk is in fact at the IT level. We have not yet seen a major fraud because hackers have broken into a bank and transferred billions of euros by converting the second decimal place to cents on all transfers, or making transfers below sensitivity thresholds. It is possible to transfer billions without people necessarily noticing. For me, the real risk is there rather than in market activity risks, to which considerable attention is devoted *a priori*, even if frauds have recently occurred in major Swiss banks, etc. This is something that will continue to happen, but I think it will decline because of control methods. The risks will come from elsewhere, and I am thinking in particular of IT.

**MCF:** *If you are talking about the IT side, is this where the term Big Data comes in?*

**X:** That is a different subject. Banks have access by their nature to a huge amount of information about clients, because we know everything they buy and everything they sell, and we know all of their financial flows. This information could certainly be used better by banks to understand the behavior of their clients better, and possibly offer them product deals, if the clients agree of course—there is a notion of confidentiality about client transactions. This could certainly be very useful, like what Amazon or eBay are doing already, by analyzing what their clients are buying, given that a bank holds much more data because it knows everything that the client spends. However, banks are not exploiting this information. So I do not see any link between this information and rogue trading, etc.

**MCF:** *Yes, but there could be IT fraud, etc.*

**X:** IT fraud is mainly about access to client accounts and making transfers. There, on the other hand, the risks are huge. I think the next really big problem could be, for example, just the computer system of a bank that crashes because of the actions of hackers or even States.

It seems that a particular State may have introduced viruses into the nuclear processing plant of another State, in the Middle East. If you can do that in a closed system, you can certainly introduce viruses which reduce the system of a bank. If the system of a bank crashes, it is a real problem both for itself and its clients. What keeps me awake at night these days is basically that, because there are very major risks involved. Anyone can put a USB key in a PC, or click on a false document attached to an email, and expose the system to viruses, despite the safety systems in place.

**MCF:** *So at the moment there are no real defenses against that risk at the regulatory level?*

**X:** No, and I think that at the moment the regulators are tending to focus on market risk and distribution risk rather than on IT risks, but that is just my opinion, I could be wrong. And I think that IT risks are now greater than the distribution risk, in terms of consequences.

I gave a presentation to the finance graduates at a reputed university. They work part time in banks, so I asked them what they were doing. They said: "I am working in the structured derivatives department of big banks etc." I told them they had made a bad choice by working in derivatives because derivatives are on the way out. They said, "Yes, but it is important. Can you create, have creativity in derivatives, innovation?" I explained to them that it has been clear for a long time that innovation is useless. And I think when you look basically at the medium term, the overdevelopment of financial products or derivatives or too complex products is on the way out. I said that the "new derivatives" are cash management and trade finance, which are quite important sectors where, by being a little smarter, the bank can be quite profitable, with a very good risk profile. And when you lend money and perform cash management, you cover your cost of capital in general. The market values the activity at a multiple of book value, which is not the case for trading or derivatives activities. So when you look at where you want

to put the capital in a bank, you put it into loans for cash management rather than derivative activities. That is why I think that there are quite profound changes going on, but I am not sure they are well understood today, and in any case it takes time for universities to adjust their programs because they are still working on the capital markets and derivatives. As I said earlier, the model is one thing, but getting back

to reality is another. All the nonsense that has happened in banks or regulators has happened because they have the right model, whereas in fact people were looking back to the nominal—to avoid problems, you have to follow the nominal. When I say follow the nominal I mean follow the nominal in the balance sheet. It is not very exciting when you put it like that, but I think it is part of the way things are going.

# Nick Leeson: Interview

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London, United Kingdom, February, 2014

## BIOGRAPHY

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In the early 1980s, Nick Leeson landed a job as a clerk with royal bank Coutts, followed by a string of jobs with other banks, before moving to Barings, where he quickly made an impression and was promoted to the trading floor.

Before long, he was appointed manager of a new operation in futures markets on the Singapore Monetary Exchange (SIMEX) and was soon making millions for Barings by betting on the future direction of the Nikkei Index. His bosses back in London, who viewed with glee his large profits, trusted the whizzkid. Leeson and his wife Lisa seemed to have everything: a salary of £50,000 with bonuses of up to £150,000, weekends in exotic places, a smart apartment and frequent parties, and to top it all they even seemed to be very much in love.

Barings believed that it wasn't exposed to any losses because Leeson claimed that he was executing purchase orders on behalf of a client. What the company did not realize is that it was responsible for error account 88888 where Leeson hid his losses. This account had been set up to cover up a mistake made by an inexperienced team member, which led to a loss of £20,000. Leeson now used this account to cover his own mounting losses.

As the losses grew, Leeson requested extra funds to continue trading, hoping to extricate himself from the mess by doing more deals. Over three months he bought more than 20,000 futures contracts worth about \$180,000 each in a vain attempt to move the market. Some three quarters

of the \$1.3 billion he lost Barings resulted from these trades. When Barings executives discovered what had happened, they informed the Bank of England that Barings was effectively bankrupt. In his wake Nick Leeson had wiped out the 233-year-old Baring Investment Bank, who proudly counted HM The Queen as a client. The \$1.3 billion dollars of liabilities he had run up exceeded the entire capital and reserves of the bank.

Eventually arrested in Frankfurt, Germany, Nick spent a few fraught months trying to escape extradition to Singapore. He failed and in December 1995 a court in Singapore sentenced him to six and a half years in prison. His wife Lisa got a job as an airhostess to be able to visit him regularly. At first, their marriage survived the strain of being apart, but she eventually divorced him. Within months, Leeson was diagnosed as suffering from cancer of the colon. His weight plummeted and most of his hair fell out from chemotherapy.

Finally released in 1999, and despite his return to the UK bringing the realization that the high life had been swept away—he was effectively homeless and without a job—Nick enjoyed a fairly hedonistic first year seeing friends and family but also continuing his cancer treatment.

Nick Leeson has proved his resilience and has been able to capitalize on his experiences. He was paid a substantial fee for the newspaper serialization of his book in the *Daily Mail*. The story was then turned into a film, *Rogue Trader*, starring Ewan McGregor. In 2001, he completed a psychology degree and Nick now spends much of his time presenting talks to companies on Risk



Management and making after-dinner and conference speeches based on his life experiences.

With a psychology degree and a second marriage to Irish beautician Leona Tormay (with her own children Kirsty and Alex) after trying for a baby they were delighted when, in 2004, Leona gave birth to a baby boy. Nick comments: "I'm of the mindset that cancer must not take you over and control your life. I do believe that the more positive you are, the greater your chance of survival." His advice to others is never to bottle up stress as he himself did: "You need to talk and express yourself as I now do to Leona. With cancer as with other problems, it's amazing how adaptable human beings are, and you will be able to cope provided you keep a strong frame of mind."

In April 2005, Nick was appointed Commercial Manager of Galway United Football Club, rising to the position of General Manager in late November 2005. The same year Nick published his second book *Back from the Brink, Coping with Stress* co-written with psychologist Ivan Tyrell. July 2007 saw him appointed as CEO of the football club and he remained in this position until his resignation in February 2011.

**Marius Christian Frunza (MCF):** *Hello Mr Leeson. It is a great honor to finally meet you. Many people I know in the financial industry that I know read your first book so I think it is probably more popular than a lot of classic financial books.*

**Nick Leeson (NL):** It should be a cautionary tale for anybody.

**MCF:** *The financial world had passed through some major events and crises over the past 20 years. From your perspective has the banking (investment banking) industry kept its elitist "culture" or has it evolved into something different?*

**NL:** I think what you see is wherever risk is, there are different ways people deal with it. Where there is risk, there is always opportunity for something to go wrong, be that by deliberate fraud, be that unintentionally or by mistake in the beginning. If you look at the large number of scandals that happened over the

last number of year, I think at their embryonic stage if you like a lot of them were characterized by people bending the rules as much as they could. And I think this is a culture that always existed in investment banking. It is a culture which is extremely competitive as you know. There is competition between individuals, there is competition between desks, there is competition between firms and there is competition even between financial markets, all trying to do better than the others.

Ultimately it is presented more so in volume and in profit and I think they are the main metrics people are looking for to measure success. I do not think that has changed materially over the years, I think that is still the same if you speak to any investment broker, salesman, or trader they are still measuring themselves by how much profit they make, that's what the financial markets understand and if you work for a French equity trading desk or if you work for a South East Asian trading desk again it is the amount of profit that has been made by that desk that is the metric that is measured. It is not about how ethical you are or how compliant you are or how safe your business is, the measurement is still how much money you are making. And I think that adds to the competition. For me I often described it as a modern day amphitheater, where the gladiators go into battle and the best, the strongest, the most successful survive and the rest of the people don't. And I think within that sort of environment you are looking for people that are very disciplined and follow the rules in order for the risk you take to be qualified and to be safe and you are looking for certain type of individuals and I wasn't that during that period; I wasn't particularly risk averse and I was particularly quite stubborn and undisciplined in terms of the trading that I was doing and that from a psychological perspective is not the type of person you want exhibiting that risk for you.

But if you look at how the culture changed over the years some people would suggest that with the LIBOR rate fixing the culture is getting