

As Big Losses Grew, Trader's Solution Backfired

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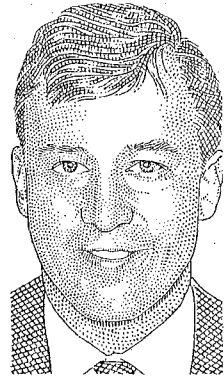
The currency trader blamed for \$750 million in losses at the U.S. unit of Allied Irish Banks PLC says he engaged in a series of

By Wall Street Journal staff reporters Gary Fields in Washington, Erik Portanger in London, Jathon Sapsford in New York and Craig Karmin in Baltimore.

trades that escalated as he tried to make up for his losses, according to law-enforcement officials involved in the case.

Ireland's largest bank stunned the global banking community on Wednesday by announcing that a foreign-exchange dealer in its U.S. banking unit in Baltimore, Allfirst Financial Inc., incurred huge losses through the trading of Japanese yen before the bank discovered them. The news forced Allied to take a one-time charge of 596 million euros (\$519.1 million), and prompted speculation that the bank could become a takeover target.

In interviews with federal agents, the trader, 37-year-old John Rusnak, ex-



John Rusnak

plained that he made a series of bad investments on behalf of the bank and then tried to develop a secret strategy to recover the losses, Federal Bureau of Investigation and other law-enforcement officials said.

Those efforts backfired when financial markets turned down, making it impossible for him to recoup his losses. "He said he was investing in various enterprises and the stock market dropped on him, so he tried to recoup the losses and he just got deeper," a law-enforcement official said. "Whether he was authorized to make those investments is one of the questions now."

The FBI said it is too early to tell if the unauthorized investments would be considered criminal violations. No criminal charges have been filed.

An FBI official said that although the investigation is in its preliminary stages and authorities are still looking at Mr. Rusnak's assets to make sure he doesn't have hidden assets somewhere, his behavior hasn't been that of an embezzler. "He hung around Baltimore," even though he didn't come to work after bank officials discovered his actions, this FBI official said. "It isn't looking like he embezzled \$750 million and has an island in the Caribbean."

Allied officials, speaking to reporters last night after an all-day board meeting in Dublin, said Mr. Rusnak's actions, which occurred between early 2001 and last month, weren't authorized by the bank.

Allied Irish Banks: Some History

Stock: Trades in Dublin and London, and on the New York Stock Exchange in the form of American depositary shares (symbol: AIB)

1966: Formed by combining three Irish banks:

- The Provincial Bank, founded in 1825, which pioneered branch banking in Ireland
- The Royal Bank, established in 1836, a mercantile bank.
- The Munster and Leinster, formed in 1885, the largest of the three, with the

most extensive branch network.

1980s: AIB invests in the U.S. Allfirst—where currency trader John Rusnak, currently accused of losing \$750 million, was employed—is formed in the merger of First Maryland Bancorp, a 1983 AIB investment and Dauphin Deposit, which AIB acquired in July 1997.



July 1991: The merger of AIB Group's interests in Northern Ireland with those of TSB Northern Ireland creates First Trust Bank.

December 1995: AIB Capital Markets acquires the investment management company John Govett, based in the United Kingdom.

February 2002: Currency-trading scandal breaks.

Source: the company

The bank's chief executive, Michael Buckley, said Mr. Rusnak allegedly created fake entities, or counterparties, with which he recorded trades. "There is no doubt that John Rusnak was involved in fraudulent activity," he said. "Whether or not he benefited from that is still the question."

David Irwin, an attorney for Mr. Rus-

nak, said he couldn't comment in detail about the bank's claims. But, he said, "I'm pretty sure the investigation will show that there's no theft of the bank by my client."

Neighbors of Mr. Rusnak in Baltimore's Mount Washington neighborhood continued to express amazement that he

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Trader Says His Losses Escalated

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was the subject of such a large, and complex, controversy. Barbara Sattler, who lives across the street from Mr. Rusnak, said the Rusnaks for the most part lived modestly, with Mr. Rusnak mowing his own lawn and his wife taking him to work each morning in the family car. "They would be the last sort of people to be involved in something like that," Ms. Sattler said.

Mr. Rusnak was involved in the local church, served on the board of a ceramics and pottery center near his home, and campaigned for Baltimore Mayor Martin O'Malley, Ms. Sattler says. (The mayor's office said it was unaware of any involvement by Mr. Rusnak in the campaign.)

In light of the losses at Allfirst, Mr. Buckley said Allied will centralize in Dublin the management and control of all of its treasury activities. In a statement, the bank's board also said it plans to prepare an internal report within 30 days that will analyze the controls that were in place and look at how they might have failed.

Allied's stock, which fell 17% in Europe on Wednesday on news of the losses, made a modest rebound yesterday, rising 3.5% to 11.75 euros. The bank's American depository shares on the New York Stock Exchange made similar moves Wednesday and yesterday.

The bank has said it is at least partially insured against fraud but won't know for some time how much of a payout, if any, it will receive in this case. Allied also might have a legal claim against other banks if they are found to have colluded with Mr. Rusnak.

A Federal Reserve spokesman in Washington said members of the agency's supervisory staff are at the bank and are working closely with both the Irish central bank and the FBI but declined to comment further.

Mary Louise Preis, Maryland's commissioner of financial regulation, an office that shares regulatory responsibility for the bank with the Fed, said the last regulatory examination of Allfirst took place in May 2001, but declined to say whether the exam identified any problems that could be related to this week's revelations.

Ms. Preis said the loss won't affect the soundness of Allfirst or its customers' deposits. As to whether the internal controls at the bank worked, Ms. Preis said it was too early to tell. "No control is going to be foolproof," she said. "The controls were there. The policies and procedures I believe were adequate."

Meanwhile, currency traders and professionals in other financial markets are mystified by how a single trader at a relatively small Baltimore subsidiary of an Irish bank could circumvent controls and rack up such huge in losses. Mr. Rusnak was one of only two foreign-currency traders at the bank. Other employees who work on Allfirst's foreign-currency unit wouldn't respond to questions about Allfirst's foreign-currency operations.

One thread tying this week's incident to other recent trading scandals is the element of distance. Just as Mr. Rusnak allegedly racked up enormous losses working for a distant satellite of Allied, a look back at a number of other high-profile trading scandals shows that they, too, were operating at a distance from the central office and its risk-control policies.

Toshihide Iguchi, a trader who confessed in 1995 to losing \$1.1 billion in the U.S. bond market, was a local hire in the New York market for Japan's Daiwa Bank Ltd., while Nick Leeson, that same year, bet wrong on the Japanese stock market from his perch as a derivatives trader in Singapore. That move resulted in \$1.4 billion in losses for Barings Bank, based a half a world away in London.

"Geographic distance is an element in many of these things," says Jim Wiener, director of the risk management practice

at Oliver Wyman & Co., a consultancy. "It complicates the ability to control, complicates the ability to report, complicates the process of managing risk."

To guard against wild trades or fraud, banks typically use networks of checks and balances, including a separation of powers and responsibilities between people who perform different functions.

To begin with, well-managed banks enforce a rigorous process of approving—or disapproving—entities with which traders are allowed to conduct business. "It's the first line of defense," says the head of risk-management and trading at a British bank. A trader "can't just make up counterparties," or institutions and companies at the other side of a trade.

Some analysts say Allfirst should have raised some red flags. Market-research firm Gimme Credit notes that according to documents filed with U.S. regulators, Allfirst had foreign-exchange contracts of \$4.9 billion, equal to 28% of its total assets. By contrast, Allfirst's peer group had contracts representing only about 11% of total assets, the report said.

Currency traders and other bank executives say Mr. Rusnak may have evaded controls by working with others in the bank who should have been checking his work to make sure it was in line with the rules. Alternatively, they said, he might have been responsible for many of the functions that in other banks are handled by different people.

After the collapse of Barings, for instance, investigators found that Mr. Leeson had been responsible for back-office functions that normally would have been handled by others.

"This whole thing would be impossible if there weren't complicity with some people in the back-office control element, or unless he was also his own back office," said an executive at the British bank. "It has all the earmarks of [the Leeson case]: It was a small office, a satellite, outside of a major financial center," the executive noted. Allied officials declined to comment on the bank's internal controls.

If a trader was generating inordinately profitable trades—which for big international banks would generally be a \$250,000 or larger profit on a trade—that would normally be detected by a group that monitors big transactions.

"You want all that control there—in the extreme for cases like this—but also because the process isn't infallible," one bank executive said.

—Alessandra Galloni in Dublin,
Michael R. Sesit in London
and Greg Ip in Washington
contributed to this article.

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