Allied Irish Banks
Allfirst Bank: recap

What happened

- Made mostly directional trades (not hedge positions).
- Covered up losses by fictitious trades (sell options deep in money), falsifying financial statements.
- Eventually falsified documents to confirm trades (fake docs folder on computer contained logos of firms confirming the trades.)
- Trades made no sense: options with different expiration dates reported as having same premiums. Deep in money options would expire unexercised.

Fraudulent activities included:

- Back office spreadsheet programmed to obtain prices from Rusnak’s computer / not Reuters.
- Sold real “deep in money” options to raise money. These were liabilities of Allfirst, but were removed from the books by claims of offsetting, fictitious options.
- Manipulated VAR by taking fictitious positions that appeared to hedge his directional trades.

Why didn’t back office confirm trades?

- Would have to work at 1 or 2 AM to contact Asian traders to confirm.
- Jobs threatened by Ray if Rusnak quit.

Fraud is discovered

- Jan/Feb 2002

What could be done differently for Allfirst?

- Flawed trading philosophy: How could a single trader profit, competing with largest, most complex hedge-fund firms?
- Transactions not consistent with bank’s core business.
- Failure to audit activities/independently verify transactions. Flawed control practices in back office.
- “lone wolf trader” is risky.
- Bully to those who questioned him...advantaged by Mr. Ray’s strong defense of him & tolerance of his friction with back office.
 Ways to minimize operational risk re: Derivatives

• Confirm trades
• > 1 employee should understand transactions
• Enforce VaR limits
• Force employee to take a vacation where s/he does not trade (true for non-traders as well)
• Do not structure compensation to provide risk-taking incentives when employee is in a risk-management or hedging function.