

# Unauthorised Trading - Slipping through the net

In light of the recent Societe Generale unauthorised trading loss, many risk managers are being asked by their board to confirm that existing insurances would cover such an event. Unfortunately, in nearly all cases, the answer will be no. As with Societe Generale, Barings and Sumitomo, most publicised rogue trading losses have typically been against a company's own proprietary trading accounts. Consequently Professional Indemnity (PI) cover does not provide protection, whilst standard Financial Institution Bond (FIB) only covers acts of dishonesty by an employee that are intended to cause a loss or lead to Improper Personal Gain (IPG). Furthermore, FIB terms and conditions are often so strict that IPG does not include salaries or bonuses, which means that there is no cover unless the employee has stolen funds from the insured.

As it would appear with Mr. Kerviel (the Societe Generale unauthorised trader) the motives of rogue traders may not include intent for IPG or any deliberate intent to financially disadvantage their employer and therefore, cover is not available through an FIB. Cover under any PI policy is not relevant as third parties have not suffered a loss. In contrast to traditional FIB, Unauthorised Trading (UT) insurance does not require evidence of the motivation of the trader, but focuses on objective tests, such as what the trader did and what the outcome of the activity was. The policy covers direct financial loss to the insured caused by concealed or falsely reported unauthorised trading. This is defined as trading with a counter-party which at the time of the trade is:

- in excess of permitted financial limits
- outside of permitted product lines
- not with a designated counterparty.

If an unauthorised trading position is discovered, underwriters recognise that not only is confidentiality important, but also that prompt corrective action to begin dealing with that position may be necessary. The traditional process of notification to underwriters followed by investigation is deemed too slow and cumbersome to meet this need. Therefore, the UT policy explicitly permits the assured to take immediate discretionary action to mitigate, contain, reduce or otherwise prevent a loss.

These actions can include liquidating the positions or purchasing financial instruments. The costs, fees and other expenses incurred by the assured in taking steps to mitigate a loss will be covered by the policy. The actions must, however, be considered to be reasonable and necessary for loss mitigation purposes.



Given the above, risk managers are now able to purchase a cover which protects their employer against the consequences of an unauthorised trade.

Complementing risk management systems and traditional FIB and PI policies, unauthorised trading cover acts as a backstop to protect the insured against the risks of an unauthorised trade.

JLT are able to access over \$150m of unauthorised trading capacity, which is best purchased as an extension to a traditional FIB or commercial crime placement.

Reinsurance markets dictate that stand alone unauthorised trading insurance is expensive. Underwriters are able to achieve more efficient pricing when unauthorised trading cover is coupled with tradition FIB or crime insurance.

Therefore, we recommend that UT coverage is purchased by way of endorsement to an FIB or crime policy rather than as a stand alone cover. JLT are able to assist with this by ensuring cohesive FIB and UT cover, avoiding demarcation problems in the event of a claim.

**If you have any questions regarding unauthorised trading cover, please contact:**

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