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Busted!

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HIGHLIGHT: How could a 28-year-old lose a billion dollars and take down the investment firm that financed the Louisiana Purchase? Greed, chutzpah and bosses willing to look the other way.

HEY SAY THAT THE MARKETS GET into your blood, that the daily rhythms of capitalism's purest forum become addictive. Young Nicholas William **Leeson** evidently knew it. Since he got out of high school he had been like a kid pressing his nose against a window, watching a party to which he wasn't invited. He had toiled in the back rooms of brokerages for what must have seemed like forever, watching traders out on the floor have all the fun. Until, in 1992, he moved to Singapore for **Baring PLC**, and finally got to live the life for himself.

It seemed to come naturally. By day, he worked making bets on the Japanese stock market, and he got better at it as he went along. By night, he and his wife, Lisa, like thousands of other newly affluent Yuppies, flitted along Singapore's lovely riverfront, partying nightly at places like Harry's Quayside and the 5 Bar. At 28, half a world away from his working-class neighborhood north of London, Nick **Leeson** was living the life of the modern-day colonialist, working for the storied British firm that had financed the real thing. The **Leesons** had a fashionable, if not flashy, apartment; a regular maid; the occasional vacation through Southeast Asia. All that, and about \$ 150,000 a year, plus bonus.

It is not yet clear when, over the last few months, Nick **Leeson** came to know that the world he had worked so hard to create was collapsing. But Jan. 23 is probably as good a guess as any. How cruelly clear it must have been then that the fates were arrayed against him. From his position as the chief trader at the Singapore office of **Baring** Futures arm of the 233-year-old British bank **Baring Brothers** -- **Leeson** dealt mainly in contracts tied to the fluctuations of Japan's stock exchange. He started conservatively. There was nothing too risky in the trades he executed for **Barings's** clients. But in late 1994, the sophistication of **Leeson's** trading increased. He began betting on the assumption that the Nikkei would not move sharply higher or lower. He used a technique of financial exotica known as straddles to turn that belief into a position in the market.

On Jan. 17, a massive earthquake had devastated the port city of Kobe. At first, **Barings** and other investment firms had downplayed the impact of the quake on the Japanese economy. Firms that were bullish-and **Barings** was -- for the most part remained so. After the quake the Nikkei dipped, but not too badly-no doubt to **Leeson's** great relief. But on the 23d, the markets came to a different conclusion entirely. The Nikkei cracked, plunging more than 1,000 points. For **Barings**, and for the young, relatively inexperienced trader to whom it had entrusted its Singapore operation, this was a disaster-an act of God translated into financial calamity.

What happened next, and on whose authority, is still not entirely clear. This much, though, is: **Barings**, in the person of Nick **Leeson**, began laying huge bets on a subsequent rebound in the Nikkei. They were, moreover, bets that appeared to be "naked"; that is, not hedged against the possibility that the Nikkei might not go up. In Tokyo and in Singapore, traders watched in mounting puzzlement. Why, after the Jan. 28 debacle, would **Barings** come back for more? Usually, "you try to cut your losses and lick your wounds," says one futures specialist. "Sometimes your year is destroyed in three days, but that's the way it is. I can't think of a professional trader who hasn't gone through something like this."

But after the 23d **Leeson** did not cut **Barings's** losses. Quite the opposite. His bets on the long side of the market doubled by Jan. 27, and like the shirts he would later leave flapping on a clothesline strung across his balcony after fleeing Singapore, they were out there for all to see. Other firms simply assumed the bets had to be offset by hedged positions

somewhere else. Nothing else made sense. But Nick **Leeson's** positions, it's now clear, were not hedged. This, it seems, was gambling, pure and simple. **Leeson, and Barings**, were in trouble. "There's a classic strategy in roulette," says one Hong Kong trader. "You bet on red and you lose. You double your bet on red and you lose again. But as long as you keep doubling your bet, you will never lose in the end -- if you have limitless capital."

Barings did not. In fact, in a game where size is important, it was among the most thinly capitalized players in the market. Whether senior management in London knew how dire the situation was will now be among the most contentious issues in the debacle's wake. But Nick **Leeson** surely knew, and so, at some level in the corporate hierarchy, did London. **Leeson** had, as is common, bought many of his positions with borrowed funds, a practice known as buying on margin. If the bets subsequently are underwater, the investor has to ante up more cash. According to monetary authorities in Singapore, **Barings** in London funneled nearly \$ 900 million to its Singapore operation in January and February to meet margin calls, an amount slightly larger than the firm's entire capital base.

By late February, the Nikkei had not moved much, and Nick Leeson's recklessness had turned, inevitably, to desperation. On Thursday, Feb. 23, the **Leesons'** maid saw the young couple in their apartment for the last time. Sometime that evening, they packed up some of their belongings, jumped into a rented Mercedes and got across the Malaysian border just 12 miles to the north. **Leeson's** wife, Lisa, late last week would tell a London tabloid that they were merely going to celebrate Nick's 28th birthday. More likely, **Leeson** had considered how much Singapore had invested in its reputation as East Asia's most rapidly growing financial center -- and how the authorities would not take kindly to the black eye **Barings** was about to deliver. Leaving Singapore wasn't a bad idea.

They drove the three hours to leafy Kuala Lumpur and checked into the elegant Regent Hotel. Trader's chutzpah intact, **Leeson** used his **Barings** corporate credit card to pay so he could get the standard company discount. The next day they moved to Kota Kinabalu on the island of Borneo. If Nick **Leeson** was going down, at least it was going to be in style. He and Lisa checked into the Tanjung Aru Resort, a sprawling complex of suites, guest rooms, pools and tennis courts set among 25 acres of seafront gardens.

In an interview Lisa **Leeson** gave last weekend to a London tabloid, she claimed she and her husband had no idea what was happening at **Barings**. They were in Borneo to relax, and didn't hear about the firm's collapse until the evening of the 27th. But if the couple had just turned on CNN in their hotel room, they could have watched the reports of **Barings's** final meltdown. And of the desperate -- and unsuccessful -- effort by the Bank of England to fashion a rescue. As a last gasp, the bank even solicited the Sultan of Brunei, reputedly the world's richest man, to have a look, but even he balked. **Leeson** would have heard Britain's chancellor of the exchequer pin the blame for the **Barings** collapse squarely on his shoulders, calling him a "rogue trader."

By that point Interpol, the international intelligence agency, had sent an alert to every government in the region. Nick **Leeson**, evidently, decided either that it was no use hiding or that it was time to tell his story. Or both. On Feb. 28, wearing dark glasses and a hat, he went to the Royal Brunei Airlines office in Kota Kinabalu and bought two economy-class tickets, paying cash, for a flight from Kota Kinabalu to Frankfurt, with stops in the Brunei capital of Bandar Seri Begawan, Bangkok and Dubai. The tickets were bought in the **Leesons'** own name, and the airline agent tipped off a local newspaper editor. When he finally walked off the plane and into the arms of police at Germany's Frankfurt airport last Thursday, **Leeson** hardly looked like a hunted man. With his wife trailing a few steps behind, the world's most celebrated financial fugitive had a book tucked under his arm and a backpack slung over his shoulder. He looked for all the world like just another European Yuppie, back from a jaunt through Southeast Asia.

A Rogue Trader?

The collapse of **Barings**, and Nick **Leeson's** role in it, is one of the most spectacular debacles in modern financial history. Markets have always been cruel, but rarely have they been so cruel so swiftly and on so grand a scale. The **Barings** collapse came after trading losses that exceeded \$ 1 billion. Markets weakened in its wake, but not catastrophically. No other firm seemed to be at risk from the **Barings** implosion, and by the end of last week a few companies were actually poking at the charred remains--a giant Dutch financial firm called the ING Group even offered to absorb the **Barings** liabilities and throw in one British pound. Smith Barney also expressed interest. It appeared, as the Bank of England's deputy governor, Rupert Pennant-Rea, put it, that no "plague" was spreading throughout the financial system. "It was much more like a meteor striking one bank down."

Even so, in the wake of Mexico, Orange County and last year's trading disaster at Kidder, Peabody & Co., the destruction raised doubts about a global financial system that can wreak such havoc so quickly. And inevitably, it again focused attention on the trading of so-called derivatives contracts, which are now staples of institutional and corporate portfolios all over the world. Derivatives are contracts pegged to the value of an underlying asset, like a stock or a commodity. They can be relatively simple, like the bets **Leeson** placed on contracts that reflect the direction of the Japanese

stock market, or maddeningly complex, like the so-called swaps that Procter & Gamble lost \$ 102 million on last spring (page 50). Did firms allegedly sophisticated about such things really know what they were doing? Hadn't Peter **Baring** himself, in a speech in 1998, said, "Derivatives need to be well controlled and understood, but we believe we do that well here"? And if that were the ease, how could one "rogue trader" burn down the house?

By the weekend, the answer was becoming dear: **Leeson** couldn't, at least not without staggering sins of commission, omission or both in **Barings's** headquarters. Though critical details will not be known until investigators from Singapore or Britain pore over the firm's books, it is already clear that the tale of **Barings's** collapse is not a story about a lone rogue trader. It is about a deeply divided firm that allowed itself to get blindsided in a business it didn't understand-even though it got warnings just a few months ago as to precisely how that might happen.

The Singapore Story

To understand how it happened, consider the odyssey of Nick **Leeson** himself. He is a product of what in Britain has come to be known as the Thatcher revolution. To him, as to former prime minister Margaret Thatcher, getting rich was glorious -- and it mattered not a whit what your class background was. **Leeson's** father, Harry, is a workaday plasterer, and he raised his family in a public-housing project north of London. Nick never went to college. Instead, he hooked on as a clerk in one of the stuffiest private banks in the U.K. -- Coutts & Co. -- then spent a couple of years in the back office at Morgan Stanley's London office. In 1989 he jumped to **Barings**, processing trades in anonymity for three years. In 1992, he met and married a bright, attractive woman named Lisa Sims, who had been a clerk to a **Barings** stockbroker. That same year, **Leeson** accepted a transfer to Singapore, where the firm was gradually expanding a small trading operation.

Away from headquarters, in a place that evokes images of empire -- from the massive cricket ground in front of the city square to old colonial homes in Bukit Timah behind Orchard Road -- Nick **Leeson** saw his opportunity. He managed to gain control both of the back office-where he had been working-and of the futuretrading operation. Once on the floor, he took to the new culture immediately. In those days at **Barings** the operation, by trading standards, was a rather staid affair. But **Leeson**, friends say, had found a calling. On behalf of **Barings's** customers, he was executing a rather simple strategy called index arbitrage. It is the financial equivalent of waiting for a door to blow open, slamming it shut when it does, and getting paid for the privilege. The contracts **Leeson** bought and sold-futures on the Nikkei 225, Japan's version of the Dow Jones index -- traded both in Singapore and in Osaka. In theory, there should never be much of a discrepancy between the two markets, but in practice there are. Arbitrageurs watch for those openings and then trade them away.

It was easy money. And in time, **Leeson** was the one making it for the firm. It was also an intoxicating life. He and his wife lived in an apartment just off Orchard Road, a kind of neocolonial version of Beverly Hills' Rodeo Drive, full of designer boutiques. Their building was nice but not overly splashy, furnished with less-than-elegant bamboo furniture. It is an image of a young man from a working-class background living well, but not extravagantly. **Barings** traders in the Far East back then made around \$ 140,000. They also received bonuses based on performance. But with housing paid for, "all we had to spend money on was drinking," says one former employee.

Like most of the other young financiers who rioeked to Singapore in the early '90s, the **Leesons** cruised the waterfront in Singapore. There was, in truth, not much else to do in a place where failure to flush a public toilet is a misdemeanor and spraying graffiti can get you three lashes. But unlike many traders, **Leeson** was not the mouthy, macho type. While he often drank with Bends after work, **Leeson** was "just like any other suit who comes in here, very nondescript," says Jim Gelper, owner of Harry's Quayside bar. **Leeson** played soccer on a reasonably good club team, arriving for practice not in a fancy car-as many did -- but in a taxi.

Still, off the trading floor, **Leeson** had his moments. Once he dropped his pants in front of a group of young women, then offered them his cellular phone so they could call the police. They exercised their option, and he ended up with a \$ 140 fine and a sex offense on the books. No one was particularly surprised. The traders at **Barings** in Asia, said one of **Leeson's** former colleagues last week, were more like "Animal House than a trading house."

The Queen's Banker

There was a time when **Leeson's** bosses in London would not have been amused. **Baring** Brothers is the original blue-blooded investment house, a bank to the House of Windsor, no less. It is the sort of place where off portraits hang from the walls, and they bear uncanny resemblances to the guys in the corner offices. Peter **Baring** is the current chairman, and was going to be the last family member to run the firm. It was one of his ancestors who, in 1803, financed the Louisiana Purchase for a fledgling United States. **Barings** cash had helped keep Britain's armies in the field during the Napoleonic Wars. The family had run the firm for 233 years, and Nick **Leeson** had about as much in common with Peter **Baring** as he did with the Queen Mum.

But markets in the '90s are powerful things. They can, in their own way, level social hierarchies as quickly as they can lighten wallets. At **Barings**, pedigree no longer counts for much, because it's an affectation it cannot afford. American investment banks have for a decade now dominated their industry's increasingly profitable -- and increasingly sophisticated-trading business. The fabled British houses have flagged. What mattered to Peter **Baring** is that Nick **Leeson** -- for a while, anyway-did what counted. He made lots of money for the firm in a field that its senior management knew precious little about: trading futures on exchanges in Tokyo and Singapore. In return, the firm rewarded him with money and power at an age when one senior adviser to British Prime Minister John Major says, "I was still riding a bicycle." Adds one of his former colleagues at **Barings**: "Nick had become a star."

But it wasn't that unusual. If the traders in Singapore and Tokyo were young, it was because there wasn't anybody older in the firm who knew anything about the exploding derivatives business. The whole field seemed alien to them. That's why, in 1992, **Barings** was barely a factor in the derivatives business. In booming Asian markets in particular, bigger American companies like Morgan Stanley and Goldman, Sachs were raking in enormous profits trading, both for customers and for their own accounts. Stocks, bonds and currencies and, more important, the derivative products spun off from them were becoming key profit centers for the American banks. But at hoary British firms like **Barings**, that wasn't the case. Tradition dies hard, and it clung stubbornly to its investment-banking role: brokerage, research and raising money for corporate customers. As far as the rest of the industry was concerned, this was tacking against the wind. In Asia in particular, the brokerage business had stalled, and maintaining research staffs was increasingly burdensome in expensive places like Tokyo and Hong Kong. Meanwhile, says one former **Barings** trader, "we derivatives guys were thriving."

Nick **Leeson** more than most. The Singapore office was a relatively small operation (Masters of the Universe they were not), but the group surprised London with the money it made in 1993. **Barings** Futures accounted for 20 percent of the firm's overall profit, and **Leeson** took advantage. "As Nick grew in power and he accounted for more and more profit, management control shifted from Tokyo to [the trading group's managers in] London," says one former **Barings** trader.

By all accounts, the investment bankers in London -- who still dominated the firm -- liked the money it was producing. But those bankers weren't particularly interested in the details of the growing derivatives business. Nor, apparently, did they view it as a key part of the firm's future. In 1993 Christopher Heath, the department head overseeing the derivatives operations in Asia, argued strenuously in London for more resources; in particular, he wanted much more capital to expand the business. That's because in trading, size can be an advantage. For a firm to be able to trade on its account -- not just on behalf of customers-it must be able to withstand occasional setbacks in the market, and that takes money. But to the traditional bankers who held sway at **Barings**, the idea of risking the firm's capital on something as capricious as the animal spirits was heretical. According to a **Barings** insider, a senior manager, Andrew Tuckey, said, "We don't use our balance sheet, and the last thing we are going to do is to go into risk management."

That diffidence led to a dangerous lack of sophistication among senior managers about the derivatives business, particularly after Heath quit in frustration in 1993. At that point the cold war between the two sides of the house intensified. It was an off-and-water split that has plagued other investment banks -- most famously at Lehman Brothers in the mid-'80s -- but sources say that at **Barings** it was particularly bitter: "[The blue bloods] were too aristocratic to be involved," says a former **Barings** employee.

For that they would pay the ultimate price, In Singapore, the apparent lack of supervision had set the stage for disaster. London allowed **Leeson** to take control of both the trading desk and the backroom settlement operation in Singapore. It is a mix that can be -- and in this case was toxic. In any firm serious about preventing fraud in its own operations, the arrangement is inconceivable. For a trader to keep his own books is like a schoolboy getting to grade his own tests; the temptation to cheat can be overwhelming, particularly if the stakes are high enough. It's easy, for example, to hide poor trades, hoping to make up for losses later, a phenomenon known as the ticket-in-the-drawer problem. "You should never have had the same person making and settling the trades," says a former **Barings** employee. "You should have had someone running **Leeson** in Singapore. Who guards the guards?"

Pointing Fingers

That is the question of the moment. In an interview with The Financial Times last week, Peter **Baring** insisted it was not until the Bank of England called him on Friday, Feb. 24, that he knew anything about the depth of the problems that Singapore had kicked up. Given that the firm that bears his name sent nearly \$ 900 million to Singapore in just two months -- much of it no doubt borrowed -- that's an extraordinary statement. Moreover, an internal audit last August warned senior management that the conflict of interest in Singapore was intolerable. "Very clearly," said Bank of England Governor Eddie George, "what we have here is a control problem."

That was putting it mildly. Last Saturday, at a press conference in Singapore, monetary authorities asserted that on Feb.

8, **Barings** group treasurer Anthony Hawes had assured the Singapore exchange that the firm was aware of its financial responsibilities and was taking steps to meet them. But the extent of the control problem was not obvious, and Nick **Leeson** has yet to be heard from. As of late last week, Singapore was still seeking his extradition. The government alleges that he forged a document from a U.S. company confirming payment of the yen equivalent of \$ 81 million into a **Baring** Futures bank account in Singapore. But his lawyer in Germany, Eberhard Kempf, confirmed that his client prefers to to England rather than Singapore. "The courts there would be too incalculable." In London, the Serious Fraud Office had just begun its own investigation into the collapse. But already, the general outlines of **Leeson's** defense (should it come to that) were clear. When and if he returns, **Leeson** will say that the idea he was a "rogue trader" who brought down **Barings** by himself is absurd. The London tabloids were competing to buy **Leeson's** story, and Max Clifford, a PR man brokering the potential deal, quoted **Leeson** as saying: "People far higher up in the organization of the bank knew everything that was going on" -- a charge **Barings** has repeatedly denied.

Somerset Maugham, who chronicled the foibles of British expatriates in Asia in another era, once wrote that "The type of person who did leave Great Britain for faraway posts had no particular tradition to uphold, as did the landed gentry. He was most times an incompetent, a rank opportunist, or a troublemaker." It is an uncharitable view, no doubt shared now by Peter **Baring**, among others. Late last week, when the crippled firm got an unexpected rescue offer from the Dutch ING Group, one **Barings** insider said it was the first glimmer of hope since the debacle unfolded. The sentiment may be premature. Though he may never trade again, Nick **Leeson** will at least have his day in court, and in the press. For **Barings's** management, the trouble may have just begun.

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GRAPHIC: Cover Photograph, THE BOY WHO LOST A BILLION, Nicholas **Leeson**, the 28-year-old trader who bankrupted England's oldest investment firm, by Express-Futures & Optic World-Kevin Phillips -- Archive Newsphotos, Inset Photograph by Pool -- SABA; Picture 1, Bad guy: **Leeson** arrested in Frankfurt, TIM OCKENDENG -- PA; Picture 2, A **Barings** employee in London squeezes past reporters last week, KEVIN COOMBS -- REUTER; Pictures 3 and 4, Party! Like thousands of other newly affluent Yuppies, **Leeson** and his wife, Lisa, flitted along Singapore's lovely riverfront, partying at places like Harry's Quayside and the 5 Bar, NEWS OF THE WORLD, EXPRESS NEWSPAPERS -- ARCHIVE NEWSPHOTOS

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