How to lose a billion

Nick Leeson - lost $1billion: Peter Young - lost $600milllion: Toshihide Iguchi lost $1.1billion: John Rusnak lost - $691million: In January, John Rusnak was found to have lost his bank hundreds of millions of dollars. He now awaits trial. Like other rogue traders before him, he had fallen into a crazy web of deceit, covering up his losses while losing yet more in a desperate effort to recoup debts. Why take the risk?

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At some point in the late 1990s, something changed inside John Rusnak's head. A switch flipped. Before the switch flipped, he was a trader, working for Allfirst Bank in Baltimore, a subsidiary of the Allied Irish Bank. Afterwards, he was a rogue trader. Before the switch flipped, Rusnak was supposed to be an expert at making money. Afterwards, he became an expert at throwing money away. In a period of just over four years, Rusnak threw away hundreds of millions of dollars. Which makes you want to ask some very simple questions. Why did he throw all this money away? And why, when he was in the process of throwing this money away, did nobody notice?

By late January 2002, Rusnak was running out of moves. He had started losing large amounts of money in 1997 by making bad trades on the foreign exchange market. The trades were straightforward; he bought yen in a falling market, and lost money, and then bought more yen, and lost more money. He was the top foreign exchange trader at Allfirst - or, rather, he was the senior trader of two; it was a small office. In Baltimore, Rusnak was Mr Wall Street; he'd worked as a trader in two New York banks, but he hadn't been a star. Hardly Gordon Gekko. So when he was offered a job in Baltimore, he saw it as a chance to shine in the provinces. Things didn't work out that way. On February 8, 2002, Rusnak's trading accounts reportedly showed a deficit of $691.2m.

Amazingly, he'd managed to hide this fact from his bosses. This was, no doubt, part of the reason that the Allied Irish Bank commissioned Eugene Ludwig, a banking specialist who had worked for the Clinton administration, to make a thorough report into Rusnak and his huge losses. And, even though Rusnak himself did not give evidence to Ludwig, that report provides fascinating insights into the mind of the rogue trader - underneath the dry prose is a terrifying story about money and the accountability of those who handle it, about the frailty of our financial structures, and, perhaps most fascinating of all, about the effects of fear on the mind of the gambler.

When Rusnak arrived at Allfirst, he had promoted himself as a trader who could make wildly complicated deals in the foreign exchange and options markets; he claimed to be able to make bets on currency movements and offset those bets with a complex hedging system, so exposing himself to very little risk. But in fact, as a trader, he was one-paced; he bought yen, and yen kept falling. Then he bought more yen.

But if the 37-year-old Rusnak was an uninspired trader, he was a star when it came to covering up his losses. In the grip of rogue trading fever, he'd burned through millions of dollars over a period of 1,500 working days - and nobody had noticed. That's how good he was. If his trading was suicidal, his ability to cover up his losses was miraculous. Not only that, but he had even persuaded the bank that he'd been making money; his annual bonuses, which were calculated to give him 30% of his trading profits in excess of his $110,000 salary, had been $102,000 in 1999 and $78,000 in 2000. Rusnak's next bonus, based on his system of false accounting, was to be $220,000. It was payable on February 8. But by now the authorities were closing in; Rusnak knew he might not survive that long.

On the morning of Thursday, January 31, according to Ludwig, the supervisor of Allfirst's back office (where the trades are accounted for, as opposed to the front office, where the trades are made) called Rusnak with a problem. The previous day, this supervisor had spoken to a back-office employee about two "deal tickets" (records of trades supposedly made by Rusnak) that had not been confirmed. In other words, the employee had not checked to see if the deals had actually been made. Why not? Because, said the employee, Rusnak had designed the deals in such a way that they offset each other; no cash had actually changed hands. It was part of his clever hedging scheme. Also, the purported counterparties were Asian banks, and Rusnak had told back-office employees not to bother confirming deals in the Asian time zone - it meant getting up in the middle of the night.

The supervisor didn't like the sound of this. His suspicion was part of a general unease felt by several senior employees of this small bank; they had a niggling feeling that something might be wrong, but nobody was quite sure what it was. So this supervisor instigated further checks and found, in all, 12 unconfirmed deal tickets referring to recent trades with Asian banks. All 12 led back to Rusnak. These were trades that, had they been genuine, would have been right on the money - they appeared to show that Rusnak's real losses had been offset. But when the Asian banks were called, they knew nothing about the trades. It was as if Rusnak, having made a large bet on a losing horse, had produced betting slips on which were written the names of winning horses. On the phone to Rusnak, the supervisor said, "We're having trouble confirming these trades."

Rusnak was trying to keep calm. For several weeks now, he had had trouble sleeping. Neighbours had noticed that he looked stressed. He must have known that the positions he held on the foreign exchange markets represented enormous losses. He still hadn't told his wife. Soon, there would be nothing he could do but make a run for it, like the British trader Nick Leeson had famously done in 1995 when his rogue trading went belly-up in Singapore.

Ludwig's report presents more fascinating details about Rusnak and his alleged cover-up. On the phone in his office, Rusnak told the supervisor, "I'll call the broker who handled the trades for me. You'll get your confirmations in the morning." But he hadn't made the trades. According to reports, later that day, Rusnak opened a file in his own computer. The file was called "fake docs". Here, Rusnak had copied the letterheads of Asian banks. He apparently typed bogus confirmations of his 12 trades, signed them, placed them on the desk in the back office, and went home to his wife, his two daughters, and Barney, his labrador.

The next day, when Rusnak arrived at work, the back-office supervisor was waiting for him. He didn't like the look of Rusnak's documents. Rusnak lost his temper. He'd been losing it a lot lately - back-office staff had complained of his "bullying" behaviour. This time, he snapped, "I'm the guy who makes the money around here." He also said that, if the questioning did not stop, he would quit his job. Then he stormed out and went for a walk. After 10 minutes, he came back. He was calmer; he apologised for storming out and said he'd do his best to help confirm the trades. It was a Friday - by now the Asian markets were closed and would not reopen until Sunday night, Eastern Seaboard Time. Rusnak said that he would call the Allfirst office on Sunday with the number of a broker who could confirm his trades. He never called. He didn't turn up for work on Monday. His career as a rogue trader was over.

What had happened to him? Between late 1997 and early 2002, he was in the grip of the same rogue trader madness, the same anti-talent for banking, that had done for Leeson of Barings, who threw away a reported $1bn, and Peter Young of Morgan Grenfell, who flushed around $600m, and Toshihide Iguchi of Daiwa Bank, who parted with $1.1bn. As traders - people who are expected to understand the art of making money - none of them had a normal relationship with money in the first place. And then, in each case, a switch flipped inside their heads and their relationship with money entered the realm of the pathological.

How did these traders, men who had spent years studying the nature of investment and risk, get into this state? The answer, at least partly, is that they were the kind of people who wanted to become traders in the first place. Traders are money-artists. In the banking environment, they are revered, in the same way that, say, quarterbacks are revered in American football, or pilots in the air force. In his book The Bonfire Of The Vanities, Tom Wolfe identifies traders as "Masters of the Universe". According to Michael Lewis, who worked for Salomon Brothers in New York in the 1980s, successful traders were known as "big swinging dicks". Traders often have short, intense careers, like sportsmen. While trading, they tend to exhibit obsessive behavioural traits. Losing is not an option. The rate of burnout is high.

What do traders do? They make investments on behalf of their employers, the banks, and the banks' customers. They watch screens all day, looking for fluctuations in prices, and then try to buy things when they are cheap and sell them when they are expensive. So what they are really trading in is opinions. They are like bookies once removed - they make bets on how other people will bet. Traders, in other words, are pure capitalists - they understand that something is worth exactly what people say it's worth.

To spend time - up to 12 junk food-scoffing, nail-biting hours a day - in this world of pure capitalism is both terrifying and exhilarating. As the cultural commentator PJ O'Rourke puts it, "Traders spend their day in that eerie, perfect state the rest of us achieve only sometimes when we're playing sports, having sex, gambling or driving fast." For this, they get a salary and a yearly profit-related bonus. So they are encouraged to take risks with the bank's money with little financial downside - if they lose, the bank pays.

A rogue trader is not a crook in the normal sense of the word. He is someone who loses money and, in trying to pretend that he hasn't lost money, loses more. It's like a classic farce. For the trader, as Leeson says, it feels like being carried away by a hot-air balloon; if you don't jump off immediately, you can't jump off at all. Most people, finding themselves in this position, would jump off immediately. But rogue traders stay where they are; they try to trade their way out of trouble. As the trades get worse, the cover-ups get more complex. And, paradoxically, as the losses get bigger, the harder they get to spot - a loss of several hundred million is, in the eyes of a bank executive, much more likely to be a misprint.

What do rogue traders have in common? Quite a lot, it seems. Like Leeson, Rusnak came from a relatively humble background - he was a steel worker's son who grew up in a suburb of Philadelphia; Leeson's father was a plasterer from Watford. Both Leeson and Rusnak found themselves making more money than they had ever dreamed of. Both had something to prove; Rusnak had swaggered into his Baltimore bank with grand Wall Street ideas and a licence to take risks. Then, humiliatingly, he started to lose money. Leeson was employed as the back office supervisor of Barings' operation in Singapore; he was never officially a trader, although he behaved like one. Then, humiliatingly, he started to lose money. Peter Young, meanwhile, had a maths degree from Oxford and styled himself as a market wizard. Then, humiliatingly, he started to lose money.

In their different ways, these were personality types who found it impossible to admit that they were losers. Iguchi, who was Daiwa bank's top trader in New York until it came to light that he had lost the company more than a billion dollars, might have been speaking for every one of them when he said, "I think all traders have a tendency to fall into the same trap. You either admit your loss, and lose face, or you wait a little: one month, two months, or however long it takes."

Of course, for Iguchi, Rusnak, Leeson and Young, it took longer than a month or two months, and they found themselves unable to trade their way out of their losses. Iguchi says that he suffered from a sense of unreality - he felt that there was no difference between $100m and ¥5. Money lost its meaning. Young began to believe that rats were living inside his stomach, gnawing away at him. Leeson obsessively munched packets of wine gums, sometimes sneaking away to vomit. He also began to eat deal tickets, enjoying "the clean, bleached taste of the paper". And towards the end, Leeson says that he felt a strange sense of elation as he lost money - elation that soon he would be caught and the nightmare would be over.

For the rogue trader, it all starts the moment you make a bad trade and try to cover it up. You tap false figures into your computer and hope that you'll be able to make good the loss from a future trade. Several traders told me that this is common practice - you make a mistake and, believing you won't make the same mistake again, you gamble.

And, of course, you often win. Nobody is the wiser. As a trader, a money alchemist, you have the trust of your superiors. So long as the bank's executives believe that you are making money, they don't want to look too closely into your practices. Perhaps more importantly, they probably don't even understand those practices in the first place. Bank executives, often men in their 50s and 60s, are people who grew up in the markets of the 1970s and 1980s - in other words, they are dinosaurs. As Leeson continued to lose money, he says Barings' executives "never dared ask me any basic questions, since they were afraid of looking stupid about not understanding futures and options".

When Rusnak started losing large amounts of money on his yen trades in 1997, something strange and unprecedented was happening in the foreign exchange markets. The sheer volume of trade was increasing at a dangerous rate. A decade earlier, the world's foreign exchange dealers traded $50bn or $60bn on a typical day. By 1997, this had jumped to around $15 trillion a day. Money is information; there had been an information revolution. The markets were now globally integrated. With such a huge volume of trade, smaller economies, such as those in south-east Asia, were more vulnerable. What Rusnak failed to predict was the vulnerability of the yen.

His strategy, as he explained it, was to buy yen contracts for future delivery, hoping the yen would rise in value, then to hedge, or offset, those trades by buying and selling options. An option is a contract that gives you the right, but not the obligation, to buy or sell something on or before a specified date at a specified price. It's like making a virtual deal. Manipulated cleverly, combinations of options can be a brilliant investment tool. Rusnak thought he was a master of "exotic" options, such as "bear spreads", in which the investor buys and sells a combination of options to take advantage of a falling market. As it turned out, he was not - he was more like a desperate loser at the roulette table, doubling his bets.

For Rusnak, the situation must have been terrifying. The losses were beginning to take on a life of their own. In the same situation, Leeson said, "It had started off so small, but had rapidly seized hold and was now all across me like a cancer." (Later, when Leeson was serving his jail sentence in Singapore's Changi jail, he was diagnosed with cancer of the colon.) As the yen continued its nose dive, Rusnak was faced with an immediate problem. When a trader holds a large position in a falling currency, he is obliged to make "margin payments" every month; it's like paying interest on a loan. The more the yen fell, the more Rusnak needed to find each month. According to Ludwig, instead of buying options that would hedge his losses, he developed his system of bogus options - he pretended to make trades that he had not made, thus appearing to balance Allfirst's books, and then used the money he saved to make his margin payments. He was exposing Allfirst to liabilities of which it was not aware. But, as long as he met his margin payments, he was in with a chance.

Imagine how lonely you must feel. As your losses mount, from the millions to the tens of millions, from the tens of millions to the hundreds of millions, you realise that nobody else knows. Nobody else understands. You don't know if you'll be caught in an hour, a day, a month or a year - or even whether you'll be caught at all. You begin to think of the losses as nothing more than electronic blips inside computer chips. "My products were notionally called Japanese government bonds, or futures, or options, but nobody cared what the hell they were," said Leeson. "They were just numbers to be bought and sold. It was like trading ether." And ether, or numbers, or electronic blips, are the most valuable thing in today's economic world. Naturally, electronic blips are easier to hide than the things that people used to trade in earlier societies: cows, gold, even coins. Just look at the recent Enron and Worldcom accounting fiascos. In the old days, you could lose a cow or two, and your carelessness might go unnoticed. But a million cows? Seven hundred million cows?

So the rogue trader presses on, living in his parallel universe, his world of private madness. For 11 years, between 1984 and 1995, Iguchi, at the Manhattan branch of Daiwa bank, made bad trades in the bond market and covered them up simply by selling bonds from Daiwa's own accounts and entering forged documentation into the bank's files. Like Leeson and Rusnak, he was in a small, understaffed branch thousands of miles from the bank's HQ; like Leeson and Rusnak, he had control over the front and back offices. He was known as "Tosh", and lived quietly in New Jersey with his two children.

When he could take no more, he sat down and wrote to his superiors, admitting everything; an act of professional hara-kiri. His reasons for doing what he had done were, he said, simple - he hadn't wanted to let anybody down. "The New York branch depended on me so heavily for profits. They wanted to keep their eyes closed and they didn't want to know anything." He was not trying to siphon off profits for himself. He was fined $2.6m and sentenced to four years at the Allenwood Federal Prison in Pennsylvania.

Young was different - he did go mad, and not so quietly. In 1995, as the head of Morgan Grenfell's European Growth Unit Trust, a fund worth £788m, he became interested in buying shares in a company called Solv-Ex, a US company whose directors claimed that they had found a cheap way of extracting oil from sand. Young began to sink large chunks of his bank's money into Solv-Ex. He set up "shell" companies in Luxembourg so that he could buy more Solv-Ex shares secretly and illegally. "People thought that he was the most brilliant fund manager they had ever seen," an investment banker who knew Young, but did not want to be identified, told me. By the summer of 1996, Solv-Ex was facing a US federal investigation. Yet Young had ploughed £400m of Morgan Grenfell's money into it.

Young began to behave eccentrically. He spent hours at his computer, developing a mathematical model of the burrowing of termites. He refused to eat because by eating, he believed, he would be feeding the rats that lived inside his stomach. One day, his wife sent him to the shops, but he couldn't think what to buy and returned with 30 jars of gherkins. Young was beginning to lose contact with reality. A voice inside his head told him he was really a woman. Young's wife, Harmanna, began to suspect that something was wrong when he "started dressing in pink dresses". He waxed his body hair. When he was arrested, Harmanna told the press, "He needs help." At his trial in November 1998, he declared himself mentally unfit. He appeared in court wearing a skirt and high heels, and holding a pink handbag.

Why were Leeson, Iguchi and Young allowed to continue trading for so long, after their losses had become so vast, while they gradually became more bonkers? One reason is that they became more and more adept at cooking the books. Rusnak, according to the Ludwig report, had developed a system of "price manipulation" - juggling information on the bank's database so that bank treasury executives would believe that his bad trades were not as bad as they were. Both Rusnak and Leeson allegedly forged documents to give the impression that bogus trades were real. Young's labyrinthine scam, meanwhile, was so complicated that nobody understands it even now.

Driven by a poisonous cocktail of ambition and fear, with fear in the ascendant, the rogue trader becomes more and more devious. But he's not the only one to blame. Bank executives do not want to believe that they have allowed hundreds of millions of dollars to slip through the net; if they have, they might lose their jobs. So the rogue trader's bosses, like the rogue trader himself, become distanced from reality. A loss of $10,000 is easy to spot; when it grows into a loss of $100m, it almost begins to disappear. It is like the elephant in the middle of a room that nobody wants to talk about because nobody can believe it actually exists. And senior bank executives don't always understand what's going on in the trading office. They are like dads asking their sons to explain the new generation of computer games.

Towards the end, John Rusnak began to make more and more desperate trades. When he failed to turn up for work on February 4, bank executives found an email in his computer, addressed to a trader at another bank. The email read, "I have come to you with a problem, we need to outsource our balance sheet funding." He had done what a trader should never do - he had shown his weakness to another player in the market.

What will happen to Rusnak? As with Leeson, Iguchi and Young, a case is being mounted against him for fraud. He faces up to 30 years in prison and a large fine on each of seven charges of bank fraud and making false entries. Like Leeson and Iguchi, he might serve jail time. Like Leeson and Young, who spends his time at a daycare centre in Guildford, making tea for patients, he might have trouble with his marriage. Like Leeson, who also made substantial amounts of bonus money based on false accounting (Leeson took a £135,000 bonus in 1994), this was not Rusnak's primary motivation. It was something much more atavistic. He was frightened. He didn't know what to do. He just wanted to keep on trading. It is unlikely that he will ever trade again.

Rusnak's trial has been set for February 10, 2003. His lawyer, David Irwin, says that he will be pleading not guilty to all charges, and that he has requested a jury trial. Rusnak has denied stealing or benefiting personally from his activities, but he may have a difficult task convincing a jury - several of whose members will be poor - that he was motivated not by greed, but by fear. He's going to have to explain what it feels like when the switch flips inside your head, and you start to lose, and all you can do is throw away money, hundreds of millions of dollars, until the black hole becomes so big that it can no longer be ignored, and the nightmare is finally over