CHAPTER I

INTRODUCTION

How could a 28-year-old trader in Singapore bankrupt 233-year-old England's oldest bank ? This is the question asked around the world following news of $1 billion in trading losses by Barings.

Nick Leeson may have been a 'rogue dealer', as the Governor of the Bank of England called him, but how could a young trader run up such losses without anyone stopping him ? Banks do have compliance departments, internal auditors and lawyers to make sure traders stick to approved trading techniques. But these safeguards depend on rigorous internal enforcement. So what weakened self-regulation ?

1.1 GLOSSARY

Term	*Definition*
Arbitrage	The capturing of profits from temporary price differences between two markets by near simultaneous buying of a specified item in the lower priced market and selling it or its equivalent in the higher priced market.
Back Office	The department in a futures firm which is responsible for the settlement of trades.
Call Option	A contract which gives one party the right but not the obligation to buy a specified product from the other party at a pre-determined price within a specified time period.
Derivative	An asset or security whose value is related to or derived from the value of some under-lying base product(e.g. stocks, bonds etc)..
Hedge	A portfolio manager may anticipate that a stock market is bearish in the near future. Anticipating of the bearish market, he can sell his portfolio by hedging his risk of the bearish market sentiment through an equity derivative product such as stock index futures or option or stock option.

Term	***Definition***
Initial Margin	The minimum amount required to be deposited by customer with a member for each contract opened.
JGB	The futures contract is an agreement to buy or sell, on maturity, a notional long term 10-year Japanese Government Bond of face value Y50 million with a coupon of 6%.
Long Position	An outstanding position that is established by the purchase of a futures contract or option contract.
Margin Call	The stock exchange requires everyone showing a loss on their position to lodge margin payments covering the loss at the end of each day.
Nikkei 225 Stock Average Index	A stock index based on a basket of 225 stocks traded on the Tokyo Stock Exchange.
Nikkei 225 Futures	A futures contract based on the Nikkei 225 stock index.
Nikkei 225 Option	A contract giving the purchaser the right but not the oblibation to buy or sell a Nikkei 225 futures contract at a pre-determined price within a specified period.
Short Position	The position created by the sale of a futures or option contract with no off-setting position.

Short Straddle

An option position achieved by selling similar numbers of put and call options at the same strike price. For the short straddle strategy to succeed, the market must remain stagnant and prices must not fluctuate outside a given band. The futures contracts had to be settled at a price that was equal to the strike price in order to gain maximum profit from the sale of these options. Nevertheless, its profit potential is only limited to the premium collected. But there is no limit to the loss potential. The more the settlement price fell short of the strike price, the greater would be the losses inccured on the call options. On the reverse, the more the settlement price exceeds the strike price, the greater is the loss incurred on the put options. (Please refer Chart 1(a)).

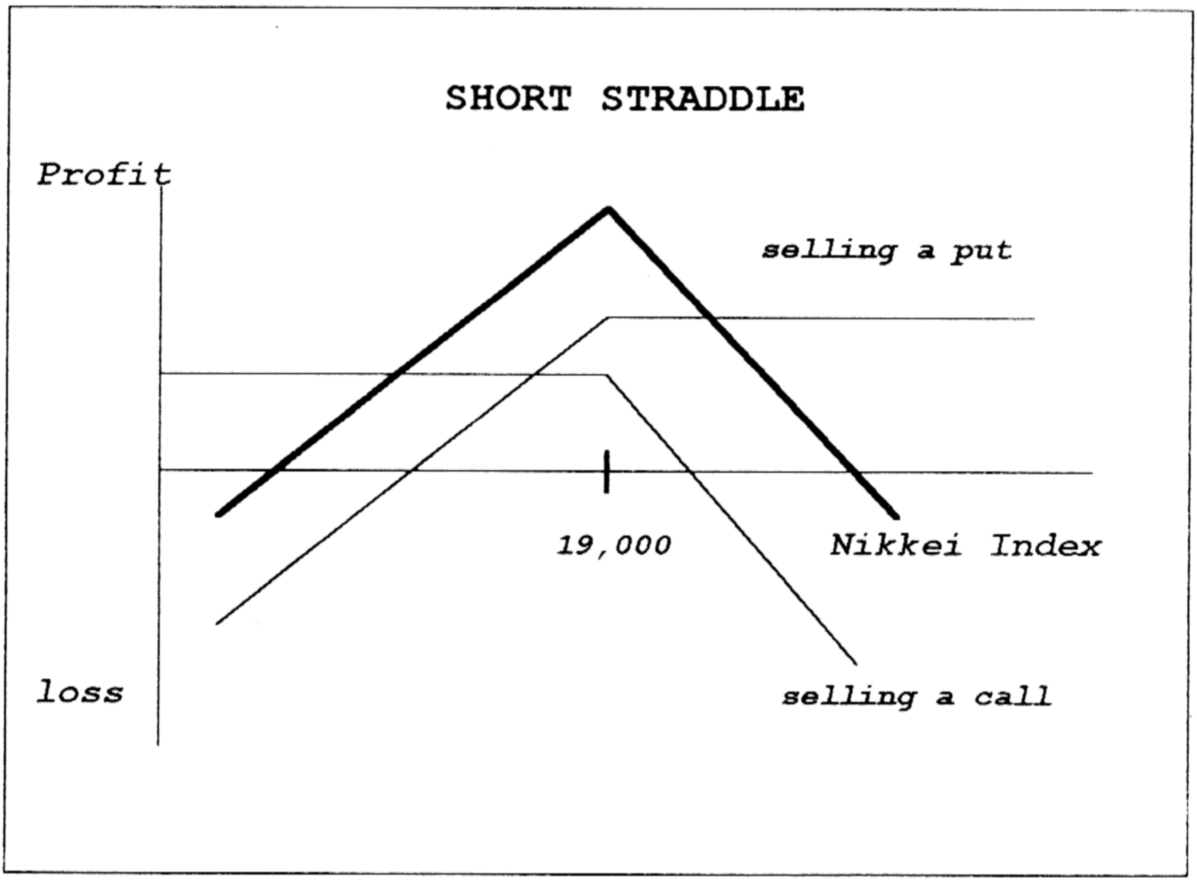
SHORT STRADDLE
Profit
selling a put
19,000
Nikkei Index
loss
selling a call

Chart 1 (a)

1.2 ORGANISATION OF THE STUDY

The study comprises 4 Chapters.

Chapter I is the introduction which includes the terminology used, purpose of study, methodology and the organization of the study itself.

Chapter II portray the case : actual events, person involved and the background of the Bank.

Chapter III chart the selected stock markets movements before and after the event and analyse factors contributed to the negative response.

Chapter IV concludes the study with a summary.

1.3 PURPOSE OF THE STUDY

The case saw the collapse of 233-year-old England's oldest bank by a 28-year-old trader in Singapore. The author is trying to analyse events leading to the collapse, how it could happen and to examine selected global stock market response in relation to the events.

1.4 METHODOLOGY

This study uses secondary datas, library research and book readings. A series of informal interviews were conducted with KLOFFE and MME officers and seminars were attended.