



# Global Derivative Debacles: From Theory to Malpractice: 2nd Edition

By Laurent L Jacque

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**Global Derivative Debacles: From Theory to Malpractice: 2nd Edition** By Laurent L Jacque

This book analyzes in depth all major derivatives debacles of the last half century including the multi-billion losses and/or bankruptcy of Metallgesellschaft (1994), Barings Bank (1995), Long Term Capital Management (1998), Amaranth (2006), Société Générale (2008), AIG (2008) and JP Morgan-Chase (2012). It unlocks the secrets of derivatives by telling the stories of institutions which played in the derivative market and lost big. For some of these unfortunate organizations it was daring but flawed financial engineering which brought them havoc. For others it was unbridled speculation perpetrated by rogue traders whose unchecked fraud brought their house down.

Should derivatives be feared "*as financial weapons of mass destruction*" or hailed as financial innovations which through efficient risk transfer are truly adding to the *Wealth of Nations*? By presenting a factual analysis of how the malpractice of derivatives played havoc with derivative end-user and dealer institutions, a case is made for vigilance not only to market and counter-party risk but also operational risk in their use for risk management and proprietary trading. Clear and recurring lessons across the different stories in this volume call not only for a tighter but also "smarter" control system of derivatives trading and should be of immediate interest to financial managers, bankers, traders, auditors and regulators who are directly or indirectly exposed to financial derivatives.

The book groups cases by derivative category, starting with the simplest and building up to the most complex — namely, Forwards, Futures, Options and Swaps in that order, with applications in commodities, foreign exchange, stock indices and interest rates. Each chapter deals with one derivative debacle, providing a rigorous and comprehensive but non-technical elucidation of what happened.

**What is new in the second edition?** A new chapter on JP Morgan-Chase's London Whale, an in-depth discussion of credit-default swaps, and an update of the revamped regulatory framework with Basel 2.5 and Basel III against the backdrop of the Euro crisis, along with a revised and expanded discussion of the AIG debacle.

Readership: Economists; undergraduates and graduates majoring in finance, economics and business administration; professionals, financial managers and CPAs in the financial service industry.

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## **Editorial Review**

Review

### ***Reviews of the First Edition:***

*"This timely and well-written book is a must read for anyone directly or indirectly involved in financial markets and instruments as well as risk management. By telling actual stories of how rogue traders and incompetent managers put their firms at risk, the author demystifies the complex world of financial derivatives. His incisive and in-depth analysis of all major derivatives debacles should help the reader understand what happened and avoid future disasters."-- Gabriel Hawawini, The Henry Grunfeld Professor of Investment Banking, INSEAD*

*"The author has written a book whose clarity makes it accessible to a wide range of practitioners and executives, and he brings the technical subject matter to life through the concrete examples of the highest profile failures in the use of derivatives B Craig Owens, Senior Vice President and Chief Financial Officer, Campbell Soup*

*"The book is a timely contribution to a subject that has been at the epicenter of the current financial crisis ... Learning from past mistakes and applying the lessons is what sets this book apart and should make it a useful guide for practitioners." -- Dr Oliver S Kratz, Head of Global Thematic Equities, Deutsche Bank*

### **From the Inside Flap**

This book analyzes in depth all major derivatives debacles of the last half century including the multi-billion losses and/or bankruptcy of Metallgesellschaft (1994), Barings Bank (1995), Long Term Capital Management (1998), Amaranth (2006), Soci t G n rale (2008), AIG (2008) and JP Morgan-Chase (2012). It unlocks the secrets of derivatives by telling the stories of institutions which played in the derivative market and lost big. For some of these unfortunate organizations it was daring but flawed financial engineering which brought them havoc. For others it was unbridled speculation perpetrated by rogue traders whose unchecked fraud brought their house down. Should derivatives be feared "as financial weapons of mass destruction" or hailed as financial innovations which through efficient risk transfer are truly adding to the Wealth of Nations? By presenting a factual analysis of how the malpractice of derivatives played havoc with derivative end-user and dealer institutions, a case is made for vigilance not only to market and counter-party risk but also operational risk in their use for risk management and proprietary trading. Clear and recurring lessons across the different stories in this volume call not only for a tighter but also "smarter" control system of derivatives trading and should be of immediate interest to financial managers, bankers, traders, auditors and regulators who are directly or indirectly exposed to financial derivatives. The book groups cases by derivative category, starting with the simplest and building up to the most complex namely, Forwards, Futures, Options and Swaps in that order, with applications in commodities, foreign exchange, stock indices and interest rates. Each chapter deals with one derivative debacle, providing a rigorous and comprehensive but non-technical elucidation of what happened.

### **About the Author**

**Laurent L Jacque** is the Walter B Wriston Professor of International Finance & Banking at the Fletcher School of Law and Diplomacy (Tufts University) and Director of its International Business Studies Program. He is the author of two books — *Management and Control of Foreign Exchange Risk* (Kluwer Academic Publishers, 1996), and *Management of Foreign Exchange Risk: Theory and Praxis* (Lexington Books, 1978)

— as well as many articles on International Risk Management, Multinational Control Systems and Capital Markets. He served as an advisor and consultant to the Foreign Exchange Rate Forecasting Service of Wharton Econometrics, Forecasting Associates (1982–1990) and as a member of Water Technologies Inc's board of directors (1991–1994). Jacques received the James L Paddock award for teaching excellence at The Fletcher School in 1996. He is a consultant to a number of firms in the area of corporate finance and risk management and has taught in many Management Development Programs, including Manufacturers Hanover Trust, Merck, Sharp & Dohme, Philadelphia National Bank, General Motors, Bunge and Born (Brazil), Rhone-Poulenc (France), Siam Commercial Bank (Thailand), Daewoo (South Korea), General Electric, Dupont de Nemours, Norwest Bank, Bangkok Bank (Thailand), INSEAD, Pechiney, Petrobras and the IFC (World Bank group).

## **Users Review**

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