

## Société Générale Trading Loss

### Context

In the 2000s, it became common banking practice to devise complicated financial instruments in order to score substantial profits. Following the deregulation of the banking industry in the 1980s, and with low interest rates, bankers used high leverage strategies to give their shareholders and clients the investment returns they sought. Successful traders were able to make massive gains for their employers and secure huge cash bonuses for themselves. Jérôme Kerviel, who worked for Société Générale in Paris, was one such trader.

### All Aboard

Jérôme Kerviel began working for Société Générale in the summer of 2000. Five years later he was promoted and joined the bank's Delta One products team. Kerviel was responsible for plain vanilla futures hedging on European equity market indices. He traded profitably throughout 2007 and posted a €2 billion profit in December of that year.

### On The Wrong Track

But the next month - January 2008 - Kerviel engaged in unauthorised trades on European stock index futures totalling around €50 billion. In making these transactions, he personally exceeded Société Générale's total market capitalisation. He was working alone and his bosses were not aware of his actions. The bank turned a blind eye as he was generating large profits, part of the ethos at the time. Through using arbitrage discrepancies, he expected to make a €2 billion profit for the bank and rewarded with a €300,000 bonus.

## Into The Gap

Towards the end of the month - between 21 and 23 January - Société Générale shut down Kerviel's positions, resulting in a €4.9 billion loss. This caused stock markets around the world to fall by 6%. It was the largest fraud in banking history. Two days later Kerviel was taken into police custody.

## Down The Line

Kerviel admitted to exceeding his credit limits and was prosecuted on minor charges. He was brought to trial on 8 June 2010 and found guilty of abuse of confidence and illegally accessing computers. He was sentenced to five years in prison with two years suspended and banned from working in the financial services industry. He was ordered to pay €4.9 billion in damages to the bank. Senior traders who were supposed to have managed Kerviel also lost their jobs. Société Générale presented its Ambition SG 2015 programme to investors in June the same year. Its aim was to “deliver growth with lower risk” by 2015 using lessons learned from the crisis. During 2011, the company's share price lost over 57% of its value.

## Further On Down the Line

Following the 2008 crash, the public blamed the greed of traders like Kerviel for the near-catastrophe. Many thought the problem could be solved by getting rid of corrupt individuals - to blame the crooks, not the system. Nowadays banks beyond a certain size are taxed and must finance a larger part of their risks with equity rather than borrowed money. It is now possible to prosecute bankers for reckless behaviour.

## Pop Analysis

### LOAD

Jérôme Kerviel was one of many traders who created complicated financial instruments to provide substantial profit for his bank and significant bonuses for himself. His trading was unsupervised so he was able to take out highly leveraged positions that put the bank at risk. His case is representative of how traders across the financial markets behaved at the time.

### NOVELTY

As long as the positions are not closed out prematurely, a profit will be made. In a world of low interest rates risks have to be taken in order to make profits. I am doing well for my company. I make them a decent profit and they give me a decent bonus. That's fair.

### EQUITY

It's easy to use individual bankers as scapegoats for systemic problems. I'm only doing what everyone else is doing.

### DREAD

Either I make a profit for the company or someone else will. I'm not doing anything that's illegal as I'm not using the bank's money to profit personally. If I am not making a profit for the company, the guy on the next desk will be. Take a risk, or risk being fired.

### SOCIAL ACCEPTABILITY

It's unfortunate that the bank suddenly turned against me and I've been used as a scapegoat for the kind of trading that goes on at the moment. They called my trades fraudulent, but there is no regulation in place that could have prevented what I was doing. I have been the victim in all of this. My superiors at the bank have just tried to save their skins. At least some of them

lost their jobs too. You can't say, "I'm going to be paid €7 million a year," and then when there's a problem you say: 'It's not my fault.'"

### Governance Analysis

#### LOAD

Société Générale is the third largest bank in France based on total assets. The bank has been expanding through a combination of organic growth and acquisitions. The year 2007 had been difficult for the bank as its market capitalisation was reduced by 23% during the second half of the year because of exposure to the U.S. subprime crisis. On the Delta One desk, traders usually posted sums well under €1 million and their combined risk cannot exceed €125 million. In the first three weeks of January, Kerviel bet €49 billion, equivalent to 181% of Société Générale's total capital. The bank would not survive the bet if the markets opposed it.

#### NOVELTY

Trades of €1.5 billion are an anomaly in this market and deserve investigating. It looks like these trades may be unhedged and Delta One traders are not supposed to make unhedged trades. If a security rises the trader must also bet that a similar security will fall, making his profit on the small difference in the price between the two securities. If there is no hedging there may be total exposure should stock fail. It becomes clear that Kerviel has been making such unauthorised trades for months, making significant profits for the company.

#### EQUITY

We can unwind Kerviel's positions at a loss, but we must secure new capital to cover it. This means we will be able to regain

profitable growth quickly. We are the victims of a master criminal.

#### DREAD

How can we convince our shareholders, business partners and the world that this is not our fault and will never happen again? Traders, who go off on their own without authorisation, threaten the entire banking system. We are losing our image as a reliable French bank. There are fewer accounts being opened with us than have been in the past.

#### SOCIAL ACCEPTABILITY

Shareholders did not accept Kerviel's total responsibility for the disaster, "Who is responsible for the madness of risk-taking that overtook the markets, if it isn't the banks and their bosses?"

#### Cognitive and Behavioural Analysis

#### LOAD

Jérôme Kerviel had been providing consistent profits for Société Générale prior to the investigation into his actions. He was considered a "star" trader, making extraordinary profits considering the strict trading limits of the Delta One desk. "Who is responsible for the madness of risk-taking that overtook the markets, if it isn't the banks and their bosses?"

#### NOVELTY

In 2007, Kerviel generated almost 27% of the total earnings of Delta One. This made him the 15<sup>th</sup> best among the 143 traders working on arbitrage. With these results he was trusted to continue trading.

#### EQUITY

If you don't properly monitor the actions of your employees, you expose yourself to risk.

#### DREAD

Unregulated activity allows individuals to bet with other people's money and expose the entire financial system to risk. When multiple bad choices (U.S. subprime mortgages) are joined with dodgy trading there is the danger that the entire financial system could collapse. This cannot be allowed to happen.

#### SOCIAL

Kerviel's actions were fraudulent because he had not set up his trades appropriately. But no one was watching.

There are not enough checks in place to prevent rogue traders and their breach of trust.

The banks permit rogue traders to continue their activities whilst profitable, but use them as scapegoats when it goes wrong.

Shareholders demand the bank and its leaders take responsibility.