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10 POINTS TO BETTER UNDERSTAND

THE JÉRÔME KERVIEL AFFAIR

1. SOCIETE GENERALE DISCOVERED THE FRAUD IN JANUARY 2008.

On 18 January 2008, after being alerted by its control systems, Societe Generale conducted an internal investigation and discovered that one of its traders, Jérôme Kerviel, had created fictitious trades to conceal one of his transactions. Societe Generale immediately put together a team of 20 people to carry out systematic searches over the weekend. On 19 and 20 January 2008, a number of massive positions totalling some €50 billion were discovered, which Jérôme Kerviel had carefully hidden through fictitious transactions.

The Bank found itself at risk of collapse. The positions taken by Jérôme Kerviel represented more than the Bank's total capital. It was therefore impossible to maintain them, for both regulatory and financial reasons. After consultation with the Governor of the Bank of France and the AMF's Secretary General, the decision was taken to close out these positions as soon as possible to secure the Bank's survival and the stability of the global financial system, which would have been threatened if the Bank had collapsed. Societe Generale thus proceeded to liquidate the fraudulent positions on Monday 21 January 2008 and the three days that followed, in the greatest of secrecy, while complying with the rules governing market operations.

Once this process had been completed, on 24 January 2008, Societe Generale made a public announcement of the massive fraud to which it had fallen victim, and the final loss of €4.9 billion. At the same time, the Bank announced that it had secured a capital increase enabling it to absorb this loss.

2. WHY DIDN'T THE BANK KNOW?

All those who claim that the Bank knew, or couldn't have 'not know', were not directly involved in the events. Regardless of their expertise, these external commentators very likely have not read or followed the numerous legal cases brought over the past eight years! From the initial investigation by judge Renaud van Ruymbecke in 2008-2009 up to the Court of Cassation's decision in 2014, all the rulings have unanimously and unequivocally found Jérôme Kerviel guilty of forgery and use of forged documents, breach of trust and fraudulent entry of data into an automatic processing system. These rulings mean that the Bank was the victim of fraud committed without its knowledge. Societe Generale was betrayed by Jérôme Kerviel. The transactions were concealed, hidden and justified by lies or forgery; they were fraudulent acts.

At the time of the investigation, Jérôme Kerviel himself acknowledged that his managers were not aware of his activities (before changing his defence): "I hid my positions by entering fictitious trades". "I covered up the exposure. Therefore, Societe Generale did not know about my positions"[1], he said. Consequently, the Bank as not aware of his risk taking, or his gains or losses, until the fraud was discovered on 20 January 2008!

If he evaded, bypassed the Bank's controls, lied and created fictitious trades to hide his positions and results, then clearly that was because **he knew that the Bank would not permit such actions**.

No one could imagine for a single moment that the Bank would have taken on commitments totalling the enormous sum of nearly €50 billion, which represented one and a half times its entire capital, contravening prudential regulations and exposing the Bank to a very high risk of insolvency!

The events of the weekend in January 2008 when the fraud was discovered (without Jérôme Kerviel's cooperation, as he did not reveal the positions at risk even though he had been caught doing wrong) demonstrates the shock caused by this discovery, which put the Bank and its employees in danger.

[1] *Page 28 of the Order to refer the case to the first-level criminal court (Tribunal correctionnel)*

3. THE LOSS OF €4.9 BILLION WAS AUDITED.

The €4.9 billion loss is the result of the €1.4 billion profit on unauthorised positions that was concealed by Jérôme Kerviel in 2007, less the €6.3 billion loss on the unwinding of positions totalling nearly €50 billion set up in the first weeks of January 2008.

It was necessary to unwind these positions as the Bank could not hold positions that exceeded the amount of its capital, and they had to be unwound in secret to avoid causing panic on the markets. The outcome of the closure of these positions was not important. The Bank had no choice. This decision was in accordance with market regulations, and was taken in liaison with the supervisory authorities.

We began to unwind the positions on Monday 21 January 2008, despite extremely unfavourable trading conditions. We settled all the positions over three days, in a very controlled manner, remaining within the limit of 10% of market volumes to respect market integrity. The process was very closely monitored, and has been examined during the different legal proceedings. Auditors from the French Banking Commission informed the AMF that “the positions were unwound very professionally”.

Societe Generale’s accounts were audited independently by the statutory auditors and approved by the French Banking Commission.

The amount of the losses on Jérôme Kerviel’s unauthorised positions was **€4.9 billion**. The Court of Cassation definitively confirmed this in its decision of March 2014.

4. JÉRÔME KERVIEL KNEW THAT HE HAD TO OBSERVE TRADING LIMITS; THE BANK DIDN’T ENCOURAGE HIM.

Jérôme Kerviel and his team (Delta One, which had eight traders) had a global exposure limit of €125 million that could not be breached at the end of the day; he clearly acknowledged this during the investigation.

Compliance with this limit was monitored by the Bank’s risk department on a daily basis. Collective limits were sometimes overrun at the end of the day due to technical adjustments between the products bought and their hedges. Any such limit breaches must systematically be reversed immediately.

Jérôme Kerviel’s comments and behaviour during the various legal proceedings show that he was fully aware that he was in breach of the limits and that the Bank would not permit this, as demonstrated by his repeated concealment of the positions, fictitious trades, lies and forgery.

The unauthorised positions totalling €30 billion that he set up in 2007, and the €50 billion in January 2008, were concealed and their exorbitant amounts threatened the Bank’s solvency.

Jérôme Kerviel did not receive any special treatment in terms of the objectives and limits he was set. Jérôme Kerviel alleged that his limits were increased from €1 million to €5 million as a result of the Allianz affair. This is false. The increase in the risk limit depended on experience, when the trader moved from junior trader limits to standard limits. The objectives for the current year are set based on the results achieved the previous year and are not increased in relation to the amount actually achieved the previous year. This is intended to ensure that a trader can reproduce their annual results, reflecting an increase in expertise and experience (and not the winnings from forbidden bets). In 2007, Jérôme Kerviel posted a profit of €55 million, which, according to his line managers, seemed consistent with his activities, especially in view of the bullish environment for these activities.

The Bank did not encourage Jérôme Kerviel. He was caught up in a downward spiral caused by his own fraud, as seen in other cases of rogue trading. Unfortunately the Bank did not detect the fraud and was only able to stop it belatedly. Fortunately it was a rare and isolated case.

5. WHAT MOTIVATED JÉRÔME KERVIEL’S ACTIONS?

It is hard to understand the ultimate aim of such large-scale fraud. The investigating judges’ order nonetheless reveals that “his attitude shows that he was not disinterested in the outcome”. Jérôme Kerviel’s fixed annual salary was €48,500 in 2007. He claimed a bonus of €600,000 for that year, following a bonus of €60,000 received in 2006, based on his “official” profits of €55 million in 2007 (and not the €1.4 billion that was hidden). He could have been motivated by a desire for professional and material recognition.

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6. WE CHEAT TO WIN, NOT TO LOSE...

Wrong! The investigation confirmed that Kerviel's fraudulent exposures first generated unrealised losses amounting to colossal sums. If the Bank had known about this, it would have immediately put a stop to it, as it did when it detected a forbidden directional trade in 2005. In this case, Jérôme Kerviel was given a verbal warning during a special meeting with his line managers. On the day the forbidden trade was discovered, another meeting was held with the whole team to make it clear that what Jérôme Kerviel had done was unacceptable and that it must not be repeated. In this regard, it is essential to note that Jérôme Kerviel's line managers were not aware of the trade as he had concealed the directional position with a fictitious transaction. The gigantic positions that Jérôme Kerviel had taken represented an unrealised loss of €2.5 billion in June 2007 but ended the year with an unrealised profit of €1.4 billion. **The €1.4 billion profit at the end of 2007 was concealed by fictitious transactions, and was therefore invisible. Jérôme Kerviel admitted and acknowledged that he concealed this profit from his employer.**

Jérôme Kerviel systematically concealed his positions and his profits or losses because he was fully aware that - regardless of the outcome - the Bank did not permit such practices, which were outside his assigned mandate and generated a risk liable to put the Bank under threat.

7. THE TERMS OF DEPARTURE OF JÉRÔME KERVIEL'S LINE MANAGERS.

Most of Jérôme Kerviel's line managers are no longer with the Bank. Some resigned and others were dismissed for failing to perform the controls that would have identified the fraud sooner, not because they knew about it.

During the legal analysis of the case brought before the Labour Court against Societe Generale by Jérôme Kerviel's line manager, the Bank decided it would be appropriate to settle with the employee in question to avoid another legal procedure that could have led to a conviction. The damages paid correspond to the amount the Bank could have been ordered to pay by the Labour Court.

8. HOW DO YOU EXPLAIN WHY THE FRAUD WAS NOT DETECTED DESPITE THE 75 WARNINGS?

It was Jérôme Kerviel's fraudulent actions that caused the Bank's control systems to fail. The effectiveness and the variety of techniques used by Jérôme Kerviel breached the Bank's trust. He was able to bypass the Bank's control systems by taking every opportunity to avoid controls and any inter-departmental cross-checks.

Jérôme Kerviel took advantage of his detailed knowledge of the control systems. He was an assistant trader for over two years and had forged personal relationships with many members of the middle and back offices.

When his fictitious trades triggered alerts, he did not hesitate to lie, fabricate and produce forgeries (seven false e-mails), to provide the control departments with erroneous explanations and false evidence to ensure that his fictitious trades were accepted and to neutralise the alert.

9. SOCIETE GENERALE WAS SANCTIONED BY THE FRENCH BANKING COMMISSION FOR SHORTCOMINGS IN ITS CONTROLS

We had controls in place, but they were evaded by the lies and forgeries perpetrated by Jérôme Kerviel and, unfortunately, we had been unable to detect the fraud before the weekend of 19-20 January 2008. They were clearly insufficient, and operated within several different departments, so there was no picture across the Bank as a whole. We have acknowledged this and have been fined by the Banking Commission.

Jérôme Kerviel took advantage of his detailed knowledge of the control systems to bypass them. He entered several hundred false trades that he deleted and then replaced to conceal his positions and gains/losses. When there were alerts, he gave false explanations, lied or created forgeries. These fraudulent actions enabled him to meticulously cover up each of the alerts that arose in various places, until the alert on 18 January that led to the fraud being discovered.

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Jérôme Kerviel admitted to the allegations before the police and judges in the presence of his lawyers, but is now suggesting that the weaknesses in the Bank's controls made his managers complicit in his actions, or even that they encouraged him in his activities. Any fraud exploits the weaknesses of control and security systems but, this does not in any way lessen the seriousness of fraudulent actions.

Negligence and human failure and the existence of technical shortcomings in the Bank’s control systems that were exploited by Jérôme Kerviel in no way justify fraudulent actions by an individual that put the future of a bank and the professional safety of its employees at risk.

Among the Bank’s 2,000 traders, only Jérôme Kerviel has committed fraud on this scale.

The Bank has of course learnt the lessons and immediately put in place a wide-ranging plan to improve its control system under the name 'Fighting Back'. Remedial measures were taken to make certain operational controls and access to computer systems more secure (e.g. risk monitoring of nominal amounts, monitoring of deletions, monitoring of holiday taken). The Bank has also implemented more structural measures, notably the creation of a cross-functional supervisory and operational security department (SAFE), which acts as a formidable control tower.

10. WHAT LESSONS HAS THE BANK LEARNT FROM THE FRAUD?

Beyond the immediate actions taken to save the Bank, Societe Generale has embarked on an extensive transformation programme, in addition, drawing more generally on the lessons of the financial crisis.

It has reviewed its risk policy and stepped up controls at all levels, spending more than €200 million since 2008 on strengthening the security of its market activities and improving operational efficiency. The various risk, compliance, audit and monitoring functions have also been strengthened across all the Bank's activities.

The Group has enhanced its business model and strategy by refocusing on activities for customers that contribute to financing the economy.

The Bank has changed its remuneration policies, which are now much more stringent: bonuses are now capped, deferred and subject to performance conditions over several years, with clawback clauses in case of any problems. It no longer rewards only financial performance, but also the methods and conduct by which this is achieved, and the risk management put in place to attain these goals.

It has also taken steps to change the Bank's culture by strengthening its "risk culture", with a significant campaign to raise the awareness of all the Group's employees in relation to fraud risk. It has also strengthened its values – team spirit and innovation, as well as responsibility and commitment. It is very important to the Bank that these values are integrated and reflected in exemplary conduct across its human resources policy, from recruitment to training, evaluation, job mobility and promotion.