Financial Market Losses

Jérôme Kerviel at SocGen: Fake it till you Make it

Facts

Loss

4.9 bn €

Parties concerned

SOCIETE GENERALE

> “Much time is spent on protecting the external threat, but the internal threat can be even larger in terms of risk to the company. – J.R. Reagan, BearingPoint”

Story

- Jérôme Kerviel joined SocGen in 2000 and moved to Delta One in 2005.
- Kerviel was supposed to be making arbitrage trades, but faked transactions to hide his speculation. His knowledge of the back office and IT systems allowed him to avoid detection.
- The faked transactions became larger and more frequent, as many of his bets paid off and yielded millions in profit. Over the course of less than three years, Kerviel faked about 1,000 transactions.
- Internal control systems raised 75 alerts on Kerviel’s positions, but none of these were properly investigated.
- In January, superiors became aware of an email fabricated by Kerviel, and an investigation was launched.
- In the end, Kerviel’s positions were worth 50 bn € while the company's market capitalization was 36 bn €. This long position amid a falling marked led to a 4.9 bn € loss.
- Kerviel was arrested, sentenced, and ultimately served a period of only five months in prison. He claims that his superiors had been aware of the position size.

Timeline

2005

- Kerviel joins Delta One at SocGen
- Kerviel begins faking transactions to cover up his speculations.
- Profit of 500k€ from Allianz after London terrorist attack.

2006

- Short worth several billion taken on the DAX

2007

- February: Profit of 20 MM € from the DAX short.
- By September, 75 alerts raised by internal controls.

2008

- January: Superiors alerted by a fake email from Kerviel and launch an investigation
- The next day, Kerviel admitted to his fraud.

Instruments/positions: Mainly equity index futures on Eurostoxx 50, DAX and FTSE

Facts

Transparency of actual position	Criminal action involved
Transparency of risk	Risk management issue
Transparency of P&L	Compliance issue

Takeaways

- Effective risk management setups include proper procedures for trade / position monitoring. Early warning signs should be taken seriously and followed up by management.
- Conduct in-depth-analysis of trading strategies and their P&L impacts to assess the plausibility of results. Compensation rewarding of sustainable profits can disincentivize gambling.

+49 6221 6479171

mailbox@forrs.de

FORRS