France's second-largest bank blames "rogue" trader for $7.2 billion loss

Bill Van Auken
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A 31-year-old equity futures trader was blamed Tuesday for inflicting $7.2 billion in losses on France's second-largest bank, Societe Generale.

The massive losses allegedly stemmed from the biggest single instance of trading fraud in history. Together with nearly $3 billion more the bank was forced to write off because of exposure to the crisis-stricken US mortgage markets and bond insurers, the losses virtually wiped out Societe Generale's profits for the year.

Bank officials announced that they would seek to raise more than $7 billion by offering new shares. Societe Generale (SocGen) shares were already down by nearly 50 percent over the past six months, largely due to concerns over its exposure to the US subprime crisis.

Just last November, the bank was compelled to write down more than $300 million for its structured-credit product positions exposed to the US mortgage sector.

In a press release issued Thursday, Societe Generale said that the trader, later identified as Jerome Kerviel, had engaged in a "scheme of elaborate fictitious transactions" between 2007 and 2008. Kerviel was said to be responsible for "plain vanilla futures hedging," industry jargon for the most basic futures purchases on European equity markets. According to the company, he "had taken massive fraudulent directional positions in 2007 and 2008 far beyond his limited authority."

Societe Generale executives insisted that he had acted alone—though several supervisors have been forced to resign—and claimed to have discovered the transactions only last weekend. The bank also said that the trader—who earned $142,000 a year, including his bonus—did not personally profit off the fraudulent trades.

"He made no money out of things, nothing, not a cent," said Philippe Collas, from the bank's global investment management division. "In December things were going very well for him, then he panicked, he gambled against the market, he started deliberately losing to try and hide it, to reduce the possibility he'd be caught. He didn't make a cent, this wasn't done to get rich. What was his motive? I don't know, maybe he wanted to prove himself."

"He was polite and good to deal with but never made the breakthrough into the big-money league," one of his colleagues told the press, "He is not a member of the Paris-educated elite who get all the best jobs in banking and finance."

Union officials at the French bank said that the trader had been "suffering from family problems" and "might have lost his mind a bit."

The financial fiasco recalled a similar episode in 1995, when another so-called "rogue trader," Nick Leeson, racked up $1.38 billion worth of losses on the Asian futures markets, precipitating the collapse of the British Barings Bank.

Like Leeson, Kerviel was employed in a "back office" job before being promoted to a job on the trading floor. As a result, he was familiar with the bank's computer system and able to cover up his fraudulent trades, according to the bank.

"Aided by his in-depth knowledge of the control procedures resulting from his former employment in the middle-office, he managed to conceal these positions through a scheme of elaborate fictitious transactions," the bank said in its statement.

That the losses resulting from Kerviel's trades are nearly six times greater than the ones that brought down Barings is indicative of the massive amounts of speculative capital invested by the banks in a process that is increasingly divorced from the actual production

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of goods and services.

The amount lost by the one junior French trader is roughly equivalent to the gross domestic product of Honduras, a country of over 7 million people.

French government officials rushed to issue declarations dismissing the significance of the massive trading fraud and insisting that the underlying economic and financial system remains sound.

Speaking from the World Economic Forum in Davos, French Prime Minister François Fillon sought to reassure the markets. “Societe Generale has had to deal with a very major case of fraud,” he said. “It is a serious case, but at the same time it has nothing to do with the situation on the financial markets.”

This is patently absurd. The massive trading scandal—if that is indeed what it was—is entirely bound up with the rampant speculation, parasitism and outright fraud that predominates in every sector of the financial markets and which has come to a head with the subprime mortgage meltdown in the US.

Moreover, the bank moved to close the trader’s positions on Monday, as share prices plunged from India to London, in the worst day for the world markets since September 11, 2001. It is still not clear to what degree Societe Generale’s transactions contributed to the downslide in Europe.

Finally, the news of the fraud has further destabilized the European and international banking system, calling into even greater question the credibility of financial institutions beset by a global credit crisis.

On the eve of Societe Generale announcing its losses, the US investment bank Merrill Lynch warned of the international character of the credit crisis and the relative inability of the central banks to stop it. “Many investors believe that the credit crisis is purely a US subprime problem,” said Merrill’s chief investment strategist Richard Bernstein. “Nothing could be further from the truth. There appears to be a growing global credit pandemic.”

Both the bank’s claims and the French government’s denial that the massive fraud had any broader significance were met with open skepticism in financial circles. Suspicion has been heightened by Societe Generale’s concealment of the massive trading fraud for five days and its failure to criminally charge Kerviel after interrogating him about his transactions.

Elie Cohen, a right-wing economics professor who has played a major role in the French government’s Economic Analysis Council, told the daily *Le Figaro* that it’s “rather hard to swallow that one could hide such losses for an entire year.” He suggested that SocGen has decided to “blame it all on some poor sucker” to pass off losses which “had accumulated” during the subprime crisis. He went on to say, “The feeling in the market trading rooms is that a single individual could not have done all that. Societe Generale presumably piled everything on a fraud story to get beyond several bad market transactions.” The paper also quoted an anonymous Paris management analyst, who said that it is “peculiar that someone who apparently didn’t have particularly major responsibilities” could have single-handedly provoked such large losses.

Similarly, Arnaud Riverain, who heads share research for Arkeon Finance in Paris, voiced doubt that Kerviel could have brought about such a “catastrophe” on his own. “If a dealer acts for a client, at least three people are involved—to give the order, transmit it and carry it out,” he said. “He’s just a link in the chain. And this chain has precise rules.”

Meanwhile, a Paris-based analyst quoted by the Dow Jones news agency warned, “It’s quite possible that SocGen isn’t an isolated case and that other losses are lurking out there.”

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