

Q1: What was the culture of Societe Generale? How were they perceived by their peers? What is the significance of Soldier-Monks?

- Shift of focus from auditors and inspectors to the market
- Leading bank in equity derivatives trading in the world
- Most traders are graduates from their graduate classes
- The firm was known for being more willing than most of its peers to take proprietary trading risks
- The trader portfolio were engineers and mathematicians who first joined from top soldier-monks were determined to make Societe Generale the best derivatives player through their complex computer models

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Q2: What was Jerome Kerviel's background and his motivations for taking such risky bets?

- Child of a housewife and a vocational school teacher
- Undergraduate studies in Finance at the University of Nanterre (and top tier)
- Masters in organization and control of financial markets at University of Lyon (top tier)
- Middle office - product modelling and securities for new derivatives and improve record keeping
- Trading Assistant - record trader's deals
- First line on a trader and found the need to prove himself to his peers and superiors
- Bonus was too low given his performance

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Q3: Societe Generale is considered to be one of the best risk managers, what controls were in place? What were some of the weaknesses of these controls?

- Middle and back office - transaction handling, risk reporting and risk management
- The trading assistants who reported to the Middle and back Office, providing another layer of risk control
- The internal control included the mandatory two-week vacation for traders, which could be a way to detect suspicious trading activities
- Societe Generale also had external auditors like Deloitte to check its internal controls
- One of the weaknesses of these controls was that the traders still had the flexibility in risk limits have large discretionary exposures on a intraday basis. Another weakness was that traders could come up with many devices to nearly bypass regulations like the mandatory vacations

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SIDE A

SIDE B

Q4: How did Kerviel conceal his trades?

- He recorded fictitious trades that offsetted his positions and balanced their risk. In other words, he made it look as if his bets were hedged
- Entered pairs of fictitious trades - a buy and a sell - on the same asset, but at a different price. By doing so, he was able to net out the earnings from his bets, camouflaged losses as unreal losses, suspending the risk below the eyesight and keeping his play under the radar
- Kerviel has own proprietary flows, which were used to correct model bias to reflect the value of his positions
- This is trades with counterparties that had not been disclosed, or that parameters such as the dates of exercise, or that parameters which they were disclosed or misstated by the middle or back office
- Capital was hidden from the middle or back office, verified or misstated by the middle or back office, and reported there with new ones
- Used different counterparties to same top transactions, avoided dealing with the same control signals, swapped initials, and colluded with his trading assistants

Q5: How were Kerviel's trading activities finally detected?

- Under Basel II, the CDOs ratio for the counterparty of Kerviel was so high that it caught the attention of the regulatory issues
- The bank asked him to name his counterparties but Kerviel made up some fictitious counterparties and lied that the counterparty was Deutsche Bank, which was later uncovered to be a lie by a control agent after he contacted Deutsche Bank
- Then, Kerviel confessed what he did during the meeting with management

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Q6: As a risk manager, please discuss other risk management aspects of this case.

- Lack of a sophisticated system of detecting rogue activity at Societe Generale. For instance, he refused to take his mandatory vacations, used different counterparties in trading trades, and imagined various deal signals like credit limits for purchasing 1000 forward contracts in a two-hour interval
- Lack of a sophisticated regulatory that kept track of these suspicious behaviors. Although one or two could be due to general reasons or chance, consistent red flags by the same individual should have been monitored and reported to senior management for investigation
- Moving from Societe Generale to the back and loopholes of the back-end settlement, risk control systems
- Failure of proper supervision
- Back-office agent could not understand Kerviel's explanation about the suspicious counterparty issue and eventually gave up following the case
- Even more in the technology that would help him and detect improper trading such as automatically rejecting upon limit to position and sending alert messages directly to senior management

# Societe Generale (B): The Jerome Kerviel Affair

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**Q1: What was the culture of Societe Generale? How were they perceived by their peers? What is the significance of Soldier-Monks?**

- Shift of focus from traders and investors to traders
- Leading bank in equity derivatives trading in the world
- Most traders are graduates from the grandes écoles.
- The firm was known for being more willing than most of its peers to take proprietary trading risks.
- The Soldier-monks were sharpshooters and mathematicians the firm hired from top schools. These disciplined and competitive Soldier-monks were determined to make Societe Generale the best derivatives player through their complex computer models.

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**Q2: What was Jerome Kerviel's background and his motivations for taking such risky bets?**

- CMU of a hardworker and a vocational school teacher
- Undergraduate studies in Finance at the prestigious University of Nantes (not top-tier)
- Masters in organization and control of financial markets in University of Lyon (not top-tier)
- Middle Office - products modelling and scenario submission, helping to test scenarios for new derivatives and improve record keeping
- Trading deskholder - record trader's deeds
- Took like an initiator and found the need to prove himself to his peers and superiors
- Kerviel was too low given his performance

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**Q3: Societe Generale is considered to be one of the best risk managers. What controls were in place? What were some of the weaknesses of these controls?**

- Middle and Back Office - transaction handling, risk reporting and risk management
- The trading deskholder also reported to the Middle and Back Office, providing another layer of risk control
- The robust control included the mandatory two-week vacation for traders, which could be a way to detect irregular trading activities
- Societe Generale also had external auditors the rights to check its internal controls
- One of the weaknesses of these controls was that the traders still had the flexibility in risk limits and position holdings. For example, they could have huge discretionary exposures on a Saturday basis. Another weakness was that traders could come up with many excuses to easily bypass regulations like the mandatory vacations.

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SIDE A

SIDE B

**Q4: How did Kerviel conceal his trades?**

- Kerviel used Soldier-monks that followed his profits and balanced their risk. In other words, he made it look as if his bets were hedged.
- Extensive series of hedged trades - a long and a short on the same asset, but at a different price. By doing so, he was able to net out the underlying loss but not, unhedged bets to show a virtual loss representing the loss before the hedge and keeping his play under the radar
- Updated the main position book, which was used to correct model bias to reflect the value of his positions
- Put in trades with counterparty that had not been disclosed, or that counterparties such as the CDOs of the trade had not been performed
- Carried the futures trades before they were verified or reported by the middle or back office, and reduced them with some cases
- Used different computers to enter his transactions, avoiding dealing with the same control agents (trading window, and confused with his trading partners)

**Q5: How were Kerviel's trading activities finally detected?**

- Under Basel II, the CDOs rule for the counterparty of Kerviel was so high that it caught the attention of the regulatory team.
- The team asked him to provide his counterparty but Kerviel made up some unclear statements and lied that the counterparty was Deutsche Bank, which was later uncovered to be a lie by a control agent after he contacted Deutsche Bank.
- Then, Kerviel confessed what he did during the meeting with management.

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**Q6: As a risk manager, please discuss other risk management aspects of this case.**

- Lack of a sophisticated system of detecting rogue activity at Societe Generale. For instance, he refused to take any mandatory vacations, used different computers in his mandatory vacations, used different signals like making profits, and triggered various alert signals like email from France for purchasing CDOs (however contracts in a few days margin)
- Lack of a centralized regulatory that kept track of these suspicious behaviors. Although one or two could be suspicious behaviors, although one or two could be suspicious behaviors or chance, consistent and large due to general reports or chance, consistent and large by the same individual should have been investigated and reported to senior management for investigation
- Missing from Societe Generale's Front Office - This position played an important role because the individual has very insights of the bias and loopholes of the back-end settlement, risk control system.
- Failure of senior supervision
- Back-office agent could not understand Kerviel's explanation about the suspicious counterparty issue and eventually gave up following the case.
- Most of the time the technology that serves help firms and detect improper trading such as automatically reflecting upper limits in positions and sending alert messages directly to senior management

# Societe Generale (B): The Jerome Kerviel Affair

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GENERALE**

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Q1: What was the culture of Societe Generale? How were they perceived by their peers? What is the significance of Soldier-Monks?

- Shift of focus from auditors and inspectors to traders
- Leading bank in equity derivatives trading in the world.
- Most traders are graduates from the grandes écoles.
- The firm was known for being more willing than some of its peers to take proprietary trading risks.
- The Soldier-monks were engineers and mathematicians the firm hired from top schools. These disciplined and competitive soldier monks were determined to make Societe Generale the best derivatives player through their complex computer models.

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## Q2: What was Jerome Kerviel's background and his motivations for taking rush risky bets?

- Child of a hairdresser and a vocational school teacher
- Undergraduate studies in finance at the provincial University of Nantes (not top-tier)
- Masters in organization and control of financial markets at University of Lyon (not top-tier)
- Middle office - products modelling and process automation, helping to test scenarios for new derivations and improve record-keeping
- Trading Assistant - record trader's deals
- Felt like an outsider and found the need to prove himself to his peers and superiors
- Bonus was too low given his performance

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Q3: Societe Generale is considered to be one of the best risk managers, what controls were in place? What were some of the weaknesses of these control?

- Middle and Back Office - transaction handling, risk reporting and risk management.
- The trading assistants also reported to the Middle and Back Office, providing another layer of risk control.
- The indirect control included the mandatory two-week vacation for traders, which could be a way to detect suspicious trading activities.
- Societe Generale also hired external auditors like Deloitte to check its internal controls.
- One of the weaknesses of these controls was that the traders still had the flexibility in risk limits and position holdings. For example, they could have large directional exposures on an intraday basis. Another weakness was that traders could come up with many excuses to easily bypass regulations like the mandatory vacations.

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## Q4: How did Kerviel conceal his trades?

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- Recorded fictitious trades that offsetted his positions and balanced their risk. In other words, he made it look as if his bets were hedged.
- Entered pairs of fictitious trades - a buy and a sell - on the same asset, but at a different price. By doing so, he was able to net out the earnings from his real, unhedged bets to show a virtual loss, suppressing the risk below the threshold and keeping his play under the radar.
- Updated his own provision flows, which were used to correct model bias to reflect the value of his positions.
- Put in trades with counterparties that had not been classified, or that parameters such as the dates of the trade had not been determined.
- Cancel his fictitious trades before they were verified or monitored by the middle or back offices, and replaced them with new ones.
- Used different computers to enter his transactions, avoided dealing with the same control agents, forged e-mails, and colluded with his trading assistants.

Q5: How were his activities...

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## Q5: How were Kerviel's trading activities finally detected?

- Under Basel II, the Cooke ratio for the counterparty of Kerviel was so high that it caught the attention of the regulation team.
- The team asked him to name his counterparties but Kerviel made up some unclear statements and lied that the counterparty was Deutsche Bank, which was later uncovered to be a lie by a control agent after he contacted Deutsche Bank.
- Then, Kerviel confessed what he did during the meeting with management.

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Q6: As a risk manager, please discuss other risk management aspects of this case.

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- Lack of a sophisticated system of detecting rogue activity at Societe Generale. For instance, he refused to take this mandatory vacations, used different computers in making trades, and triggered various alert signals like emails from Eurex for purchasing 6000 forward contracts in a two-hour intervals.
- Lack of a centralized repository that kept track of these suspicious behaviors. Although one or twice could be due to personal reasons or chance, consistent red flags by the same individual should have been monitored and reported to senior management for investigation.
- Moving from Back/Middle Office to Front Office. This situation posed an operational risk because the individual has key insights of the bugs and loopholes of the back-end settlement, risk control systems.
- Failure of proper supervision
- Back-office agent could not understand Kerviel's explanation about the suspicious counterparty issue and eventually gave up following the case.
- Invest more in the technology that would help limit and detect improper trading such as automatically adjusting upper limits to positions and sending alert messages directly to senior management.