
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 a 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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SIDE A
SOCIETE GENERALE
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SIDE B
Q4: How did Kerviel conceal his trades?
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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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Societe Generale (B): The Jerome Kerviel Affair
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Q4: How did Kerviel conceal his trades?

- 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.

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

- Lack of a sophiscated 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.