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Rogue trader costs French bank billions

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PARIS — The biggest rogue trader scandal in history hit Société Générale on Thursday as the French bank accused a junior employee of a fraud costing $7.1-billion (U.S.).

France's central bank and government scrambled to shore up confidence in the banking system after France's second-biggest bank, known as SocGen, told investors already battered by the credit crisis that it had been the victim of massive and "exceptional" fraud.

Trading losses spiralled to €4.9-billion as the bank tried to close out the rogue positions in Monday's sliding market.

Some investors wondered whether the bank's manoeuvres had contributed to that day's market fall, and to the U.S. Federal Reserve's decision to cut interest rates. A Fed source said the central bank had not been aware of SocGen's problems ahead of the emergency 75 basis point cut.

The country's top banker dubbed the trader "a genius of fraud." SocGen declined to give a name, but three sources at the bank named him as Jerome Kerviel, 31, a trader on the bank's award-winning equity derivatives desk earning less than €100,000 a year.

Mr. Kerviel could not be reached for comment. A headshot of him cut from a trading Website showed an earnest-looking young man. At the start of the afternoon, when his identity was revealed, he had 11 friends listed on the facebook.com social website. That number later dropped to four.

If fraud is proved, the loss will be the biggest caused by a single trader, dwarfing the $1.4-billion loss by trader Nick Leeson that broke British bank Barings, and the $2.6-billion Sumitomo Corp. lost in rogue copper trades in the 1990s.

It also eclipses a $6-billion-plus loss racked up by hedge fund Amaranth trader Brian Hunter and his team ahead of the fund's collapse in 2006.

Lehman Brothers chief executive officer and chairman Richard Fuld called the debacle "everyone's worst nightmare" and investors, wary of recent financial turmoil, were incredulous.

"We get the feeling that the financial markets have become a big casino which has lost control. It seems incredible that the Société Générale can lose 5-billion through one operator," said Alain Crouzat, a portfolio manager at Montsegur Finance.

SocGen chairman Daniel Bouton offered to resign, but was asked to stay on by the board.

Shares in SocGen, which has a market capitalization of about €36-billion, fell more than 4 per cent to €75.81.

Traders said the shares were cushioned from further falls after the French financial establishment moved quickly to shore up SocGen's shattered capital.

One of France's oldest banks but a world leader in free-wheeling modern financial derivatives, SocGen said the losses came to light at the weekend when it found that a junior trader had tried to cover up bad bets on the stock market.

Instead of beating a path to cash-rich sovereign wealth funds, as some U.S. banks have done during the recent credit slump, SocGen announced a capital increase of €5.5-billion and said this had already been underwritten by other banks.

France's Prime Minister reassured investors that SocGen's woes were isolated from the malaise sweeping global financial markets after a meltdown in U.S. subprime credit markets.

"It is a serious case, but at the same time it has nothing to do with the situation on the financial markets," said François Fillon, speaking in Davos, Switzerland.

In addition to the fraud, however, SocGen unveiled a further writedown of €2.05-billion related to the credit crunch.

The Bank of France launched an investigation into the trades. The central bank's Governor, Christian Noyer, said SocGen had been able to overcome the crisis because it was solid.

"Today we have seen that there was a glitch in the system that was exploited by someone who I think got round five successive risk control systems, so who was without doubt a genius of fraud," Mr. Noyer said.

The announcement sent a shiver through the world banking industry, which is suffering from the credit crunch as high-risk U.S. mortgage borrowers default on their loans.

SocGen accused the trader of taking "massive fraudulent" positions in 2007 and 2008 on European equity market indexes, meaning he was gambling on broad movements in share prices.

When the bank discovered the hidden trades on Jan. 19 and 20, it decided to close the positions in the market quickly.

But this coincided with a market rout, and the bank ended up nursing losses of €4.9-billion — close to its net 2006 profit. SocGen said it expected a 2007 net profit of just €600-million to €800-million.

The trader has been suspended and faces a formal sacking and a legal complaint from Société Générale, which is in turn already being sued by a group of 100 angry shareholders.

French police announced a criminal probe.

Like Mr. Leeson before him, the trader apparently benefited from knowledge of the bank's control systems after working in the back office of its trading rooms, according to SocGen.

It said he had used a "scheme of elaborate fictitious transactions" to try to cover up his mistakes, but did not accuse him of profiting personally from his actions.

"He was not one of our stars," said a senior board member.

Others said the crisis at SocGen, one of the top 10 banks in the eurozone by market value, could spell trouble elsewhere.

"The most serious thing is that this puts into doubt the risk-management systems at some banks," said Fortis analyst Carlos Garcia.

Analysts said the episode would have a major impact on the reputation of SocGen, which was founded in 1864.

Several said the bank, which has for years been coveted by larger French rival BNP Paribas SA, could face a battle to remain independent. Shares in BNP rose 7 per cent.
