The headquarters of Société Générale in La Défense, outside Paris. The bank reported an 82 percent decline in net profit for the year. (Judith White/Bloomberg News)

Société Générale posts record loss on trading scandal, subprime exposure

By Nicola Clark

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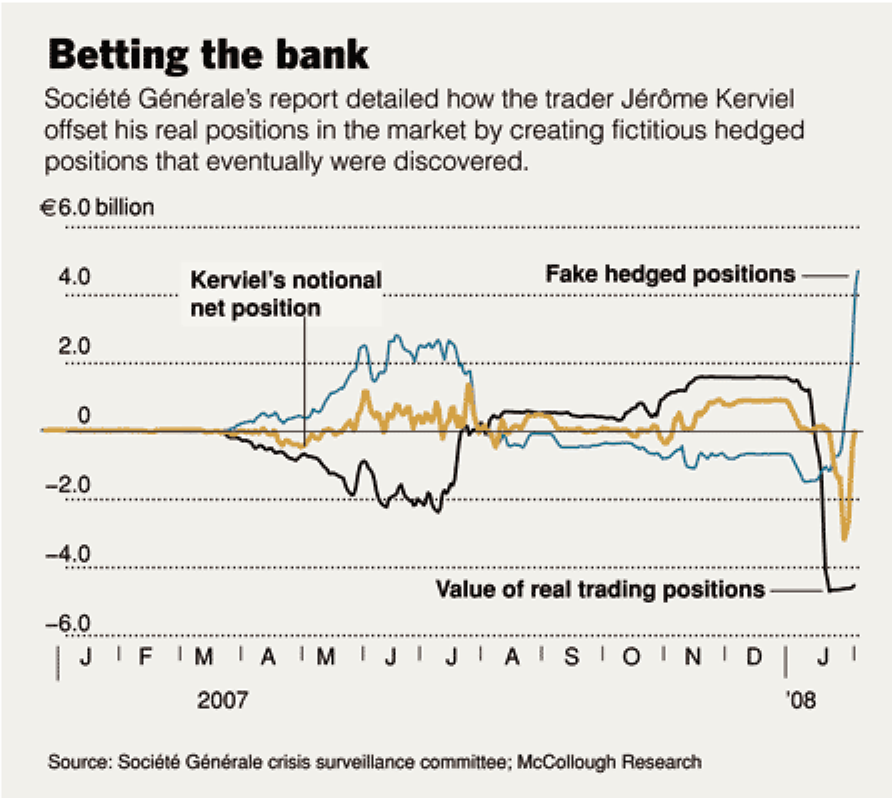
PARIS: Société Générale said Thursday that the rogue trading scandal uncovered last month, combined with significant write-offs of U.S. subprime mortgage investments, had pushed it to a record quarterly loss.

The French bank declared a €3.35 billion, or $4.95 billion, net loss for the fourth quarter of 2007, compared with a gain of €1.18 billion a year earlier.

Société Générale - which has blamed the bulk of its troubles on an "exceptional fraud" by a 31-year-old junior trader, Jérôme Kerviel - reported an 82 percent plunge in net profit for the year, to €947 million. The bank also said it had booked write-downs and provisions worth €2.6 billion linked to its holdings of collateralized debt obligations and mortgage-backed securities.

The results followed the publication late Wednesday of an independent report that found that Société Générale had failed to follow up on at least 75 alerts raised by its risk control officers, compliance officers and accountants over the course of two years.

The bank disclosed in January that it had lost a net €4.9 billion in the process of closing out €50 billion of unauthorized bets that Kerviel hid through a series of fictitious transactions. The revelation of the scandal has raised serious questions about the quality of risk-management and oversight at Société Générale and prompted intense speculation about a possible takeover bid for the 144-year old lender.



Betting the bank

Société Générale's report detailed how the trader Jérôme Kerviel offset his real positions in the market by creating fictitious hedged positions that eventually were discovered.

Source: Société Générale crisis surveillance committee; McCollough Research

Daniel Bouton, Société Générale's chairman and chief executive, reiterated Thursday that he would fight to protect the bank's independence.

"I am completely determined to continue with our strategy because, even taking into account our very bad year in 2007 due to the financial crisis and this fraud, it's this strategy which creates and will create the most value for shareholders," Bouton told Reuters in an interview. "This is my opinion, and it's one that's backed by the board."

Bouton has already offered twice to resign to take responsibility for the trading scandal. Bankers said they continued to believe that Bouton - who has led the bank for a decade - would eventually step down, though the board is unlikely to seek his departure before completion of the €5.5 billion offer of new shares to investors that is aimed partly at warding off a takeover.

Thursday marked the start of an eight-day window during which Société Générale shareholders can trade their preferential rights to discounted shares that the bank offered last week.

The independent panel concluded that Kerviel began making unauthorized transactions in 2005, but lapses in the bank's internal controls allowed the trades to go undiscovered until January.

It identified no fewer than 75 red flags - including transactions that appeared to settle on a Saturday or trades where the counterparty was either not named or listed as "pending" - between June 2006 and January 2008 that the report said should have alerted managers to Kerviel's activities.

Controllers duly followed the bank's procedures but rarely went beyond required checks, the report said, even when the size of Kerviel's bets was abnormally large for a trader of his experience and standing at the bank.

Kerviel "was routinely taking huge positions for an arbitrageur, even when you count in his fictitious positions," said Robert McCullough, a consultant based Portland, Oregon, with expertise in analyzing fraudulent trading at Enron and other companies. Noting that Kerviel's reported positions yielded a virtual gain of €1.5 billion in mid-June, McCullough said: "This should have rung every bell in the place."

In one case, on Jan. 8, a compliance officer identified as "Agent 3" asked Kerviel to explain eight forward transactions with an unnamed bank that implied an unusually high level of counterparty risk.

"That materializes give-ups of the futures that were made late," Kerviel replied in an electronic message. A "give-up" is a trade executed by one broker for the client of another. "I owe money to the counterparty. We'll rebook asap." The report said Agent 3 later confessed to auditors that he did not understand Kerviel's explanation.

Kerviel later told controllers the trades were entered in error and that he had canceled them. But the following week, the same eight transactions raised questions in Société Générale's accounting department, which was busy calculating the 2007 year-end ratio between its capital reserves and its overall counterparty risk exposure - information that the bank was obliged to publish to show that it was meeting minimum capital-adequacy requirements set by the Switzerland-based Bank for International Settlements, which tracks international money flows.

On Jan. 16, a compliance officer identified as "Agent 12" again raised questions about the same eight trades. "We still have very high valuations on these deals," Agent 12 wrote to two other colleagues. "Please investigate," he added, apologizing for his "excessive zeal."