SocGen: the lessons for London

Edward Fennell on the themes to emerge from the biggest fraud case in banking history

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At the centre of things: Christian Charrière-Bournazel, one of Jérôme Kerviel's two lawyers, talks to reporters

The fog that still surrounds so much of the Société Générale affair and the murkiness of Jérôme Kerviel's activities mean that it is still too early to be sure about what happened or the lessons that might be learnt.

Nonetheless, from a legal perspective, observers are already picking out the themes that might be worth following up — from the most fundamental regulatory matters through to simple issues of employment contracts.

Already it seems that the initial analysis — that this was a rogue trader, acting in isolation and in deep secrecy so that there was no way he could be stopped — was naively wide of the mark, especially given that M Kerviel's giant trades had been going on for months (often quite profitably) and that Eurex, the international derivatives exchange, had signalled its concerns to SocGen last year.

So what factors might help to focus management's attention on these kind of irregularities? And, in particular, what about the penalties on management if it turns a blind eye to such improper behaviour?

Well, it's mixed. Put into a London context, lawyers refer back to the J P Morgan case in November 1997 when two traders succeeded, through virtuoso computer manipulation, in creating a wave of sales in the final six seconds of trading on a Friday that resulted in a number of financial products paid out to JPM's advantage.

The bank was fined in the subsequent disciplinary action, but by considerably less than it had earned. So while the individuals got the sack, the bank pocketed a nice little windfall.

And as Anthony Speaight, QC, of 4 Pump Court, who acted for one of the J P Morgan traders in the Court of Appeal, commented last week: "If the SocGen events happened in London, past experience suggests that individuals at the bank would have more to fear from disciplinary proceedings than the institution itself [would have to fear from them]."

Meanwhile, more recently (in May last year) the Financial Services Authority fined BNP Paribas Private Bank a relatively small £350,000 for weak anti-fraud controls that allowed a senior employee fraudulently to transfer £1.4 million out of clients' accounts without permission.

Ronnie Fox, doyen of employment lawyers, suggests that nothing in the employment contract of a risk-taker such as Mr Kerviel would be likely to deter him from his adventures and deceptions.

Nonetheless, he says that there is an argument for managers' contracts to spell out in more detail their obligations to supervise their staff and to keep track of their activities. "For example, if a member of staff regularly fails to take their holidays — as I believe was the case with Mr Kerviel — then that is a warning sign that something odd is going on and needs to be investigated."

Of course, once the authorities in France got wind of what was happening, they had the benefit of a three-day period of grace before they had to reveal to the world what was happening. This gave them an opportunity to establish some stability and so forestall a run on the bank.

How unlike, you might think, our own dear Northern Rock. And as Stephen Rosen, head of the financial dispute group at Collyer Bristow, points out, there could have been no better casebook example of the superiority of the French approach over our own.

At least the Government has quickly taken this on board and there was approval all round last week when Alistair Darling, the Chancellor, proposed that failing banks should be able to receive help in secret from the Bank of England. Under the plans, it would also be relieved of the obligation to publish weekly accounts setting out how much money it had lent as emergency funding.

Just as significantly, however, it was revealed that Bank of England staff would be immune from prosecution by shareholders fed up with the way it had dealt with any particular bank or situation. (What incentives there, then, for effective action?)

Talk of prosecution, however, brings us back to the Kerviel affair and the possible response of those businesses and individuals who have suffered losses. As the fraud specialist, Steven Philippsohn, of PCB Litigation, says, while the first instinct may be to turn to the French courts, his experience of them "has not been great".

He recommends that those affected adversely should "look very carefully" at other available jurisdictions. "Banks can find themselves liable not only to penalties by the regulator but also to substantial claims by disgruntled investors," he says. "We would advise investors bring class actions in jurisdictions where greater levels of damages can be awarded. France has a much less developed system for class actions, while the English system is developing, with the increasing availability of third-party funding."

The obvious place to look for redress, perhaps, is America where the courts take a dim view of rule-breaking that results in losses for their nationals.

And as Mr Philippsohn points out, there must be a strong likelihood of a US dimension to the Kerviel affair — even if only in terms of SocGen marketing its services there. Could there be a "SocGen Three"? We shall have to see.

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