SOCIETE GENERALE

<u>**Explanatory note about the exceptional fraud**</u>

Paris, January 27th 2008

The present document describes the arbitrage activities, the method behind the fraud, the conditions in which the fraud was uncovered, the unwinding of the fraudulent position and the measures taken with immediate effect, as revealed by Société Générale's investigations at January 26th 2008. On January 29th, the Audit Committee will take a decision on an additional external audit.

1. The arbitrage activities and an explanation of the size of the nominal amounts used in the fraud.

It is not the role of Société Générale's Equities businesses to take directional positions on the equity markets (i.e. to speculate on rises or falls). The division where the trader worked is assigned to arbitrate financial instruments on European stock markets. This is a proprietary trading business which is completely independent of the Equities activity's client businesses.

For example, this arbitrage business involves purchasing a portfolio of financial instruments A and selling at the same time a portfolio of financial instruments B with extremely similar characteristics, but with a slightly different value. The arbitrage business generates its profits or losses from these differences in value.

Because these differences are both small and temporary, the arbitrage activities rely on a very large amount of operations involving very high total nominal amounts.

The fact that portfolios A and B have very similar characteristics and that they offset each other, means that these activities generate very little market risk.

However, these risks do exist and, as part of the development of its arbitrage activities, Société Générale has put in place a large number of controls designed to monitor the risks involved: control of operations and control of market risk linked to the changes in the prices of portfolios of financial instruments.

The exceptional fraud which we have suffered consisted of avoiding these controls or making them inoperable: the trader inserted fictitious operations into portfolio B in order to give the impression that this portfolio genuinely offset portfolio A which he had purchased, when this was not the case.

These fictitious operations, were registered in Société Générale's systems but did not actually correspond to any economic reality.

2. The method behind the fraud

- The trader involved had been employed at the Group since 2000. He first spent five years working in different middle-offices (one of the departments which controls traders). Consequently, he had a very good understanding of all of Société Générale's processing and control procedures. In 2005 he became a trader in the arbitrage department.

In the course of his arbitrage activity, the trader developed an initial portfolio A comprising genuine operations using financial instruments (futures) which reproduced changes in the main European stock market indices (Eurostoxx, the Dax, the FTSE, etc.).

The financial instruments in the portfolio, which were genuine and consistent with the volumes traded by a large investment bank, were subject to daily controls and in particular margin calls with the main clearing houses. Insofar as these instruments were actually purchased and considered as such by Société Générale, the margin calls were checked and settled by or paid to the bank.

- The risks generated from commitments made by the bank are managed and controlled on a daily basis. With regard to this fraud, the financial instruments in portfolio A were in appearance offset by the fictitious operations housed in portfolio B, which meant that the only visible risk was very low residual risk.

  As a result, the trader was able to hide a very sizeable speculative position, which was neither consistent with nor related to his normal business activity for the bank.

  In order to ensure that these fictitious operations were not immediately identified, the trader used his years of experience in processing and controlling market operations to successively circumvent all the controls which allow the bank to check the characteristics of the operations carried out by its traders, and consequently their real existence.

  In practice, the trader combined several fraudulent methods to avoid the controls in place:
  - firstly, he ensured that the characteristics of the fictitious operations limited the chances of a control: for example he chose very specific operations with no cash movements or margin call and which did not require immediate confirmation;
  - he misappropriated the IT access codes belonging to operators in order to cancel certain operations;
  - he falsified documents allowing him to justify the entry of fictitious operations.
  - he ensured that the fictitious operations involved a different financial instrument to the one he had just cancelled, in order to increase his chances of not being controlled.

3. The conditions in which the fraud was uncovered

- **Friday January 18th**

  - ✓ Abnormal counterparty risk on a broker is detected several days earlier. The explanations provided by the trader result in additional controls.
  - ✓ On January 18th, the trader's superiors are informed and in turn they alert the management of the division.
  - ✓ In the afternoon of January 18th, it appears that the counterparty for the recorded operations is in fact a large bank, but the confirmation e-mail raises suspicions.
  - ✓ A team is immediately created to start investigating the situation.

- **Saturday January 19th**

  - ✓ Management cannot obtain a clear explanation from the trader.
  - ✓ The large bank in question does not recognise the operations.
  - ✓ The trader finally acknowledges committing unauthorised acts and, in particular, creating fictitious operations.
  - ✓ The investigation team starts piecing together his real position.

- **Sunday January 20th**

  - ✓ During the morning, all of the positions are identified.
  - ✓ In the early afternoon, the extent of the total exposure is known.
  - ✓ Daniel Bouton immediately informs the Governor of the Banque de France.
  - ✓ A meeting of the Audit Committee has been convened in the afternoon of Sunday January 20th to examine the estimated results for 2007 and the write-downs related to US residential mortgage assets (in particular CDOs), prior to the meeting of the Board of Directors at 18:30 on the same day.

    The Chairman informs the members of the Committee of the trader's position which has just been uncovered. He indicates that he has decided to close the position as quickly as possible and, in accordance with market regulations, to postpone all communication on this issue and on the estimated results until said position has been closed.
  - ✓ Daniel Bouton then informs the general secretary of the AMF.
  - ✓ At the Board meeting, the Chairman explains that it is impossible to communicate on the estimated results for 2007 on account of the discovery of problems in certain market activities, which could result in substantial losses.

- **Monday January 21st**

- ✓ The unwinding of the fraudulent position begins in particularly unfavourable market conditions.

- **Wednesday January 23rd**

  - ✓ The unwinding of the fraudulent position is completed.
  - ✓ Another Board meeting is convened on Wednesday January 23rd, the day when the position is closed, and its members are fully briefed on the facts and their repercussions.

- **Thursday January 24th**

  - ✓ Before the markets open, the existence of the fraud and its repercussions are relayed to the markets. Société Générale asks for trading in its shares to be suspended.

Investigations are under way by Société Générale's General Inspection division and the Banque de France and will confirm the exact circumstances of the fraud. The police have begun an inquiry.

4. The unwinding of the fraudulent position

The equivalent nominal amount of the fraudulent position uncovered on Sunday January 20th was approximately 50 billion euros.

The priority was to unwind the fraudulent position as quickly as practicable, given the risk generated by its size.

The unwinding could only start on Monday January 21st and in a measured fashion so as keep volume levels under 10%, in order to respect the markets' integrity.

Conditions in the market were very unfavourable. In the afternoon of Friday January 18th, there had been a sharp downturn in the European markets. In the night of January 20th to January 21st, there was a significant drop in the Asian markets (Hang Seng down –5.4%) before the European markets opened.

The position was unwound over three days in a controlled fashion, thus ensuring that Société Générale did not exceed around 8% of volumes traded on the relevant futures indices (EUROSTOXX, the DAX and the FTSE).

volumes of positions unwound on the Futures Indices markets (as a %)	Eurostoxx	DAX	FTSE
21 January 2008	8.1%	7.8%	1.7%
22 January 2008	6.8%	5.7%	3.1%
23 January 2008	5.9%	6.1%	0%

The position was finally fully closed or hedged on the evening of January 23rd. Overall, movements in the market triggered by the sharp fall in the Asian markets during the night of January 20th to January 21st resulted in a final total loss of 4.9 billion euros.

Our statutory auditors and the relevant regulatory authorities were informed of the details of the initial positions and of the unwinding operations.

On January 26th 2008, the regulatory authorities were informed of the analysis of the methods used to perpetrate the fraud and the corrective measures taken.

5. Measures taken with immediate effect

Over the last week, teams at Société Générale have reviewed all the operations which took place from the trader's workstation and any transactions bearing a possible resemblance to the fraudulent operations discovered. Moreover, the futures position has been checked against our counterparty (clearer). This review has strengthened our conviction that all the fictitious operations had been identified as of January 20th.

Specific control procedures have been implemented so that the techniques devised by the trader to avoid controls can no longer be applied. The regulators have been informed of these changes and of the dates of their deployment.

Lastly, beyond these specific measures, additional controls will be launched. Significant human resources will be mobilized for this project, with the support of external specialists in fraud techniques. It will be supervised by the Audit Committee.