INTERNATIONAL MONETARY FUND

FRANCE

Assessment of the Compliance by France with the Basel Core Principles

Prepared by the Monetary and Exchange Affairs Department

Approved by Hassanali Mehran

October 22, 2001

Executive Summary

This report was prepared by an MAE team on the basis of information provided by the French authorities during the mission's visit (November 6–14, 2000) and subsequently updated through a visit of a French delegation to Washington on July 3, 2001. The report takes into consideration the self-assessment prepared by the French authorities on France's compliance with the Basel Core Principles.

The assessment team was led by Alain Ize and included Mohammed El Qorchi (both MAE), Keith Bell (formerly Office of the Superintendent of Financial Institutions, Canada), and Fernand Naert (Commission Bancaire et Financière, Belgium). Peter Hayward (MAE) participated in the July 3 final discussions.

The overall degree of compliance of the French supervisory authorities with the Basel Core Principles was found to be very substantial, reflecting the overall high quality of bank supervision. With some minor caveats, the French supervisory system fulfills the necessary preconditions for effectiveness. The oversight capacity of the supervisory authorities is of a high quality, with special mentions due to the well-balanced organization of the supervisory process, the professionalism of the staff, the close consultations with the banking community in the discussion of issues and regulations, and the impressive information systems and analytical support tools. As regards the capacity of banks to manage risk, while the overall internal control procedures and risk management systems of French banks appear to be generally comparable to those in other industrial countries, some strengthening is needed on governance. In addition, the supervisory authorities need to expand their efforts aimed at ensuring that banks adequately recognize (and provision) the risks involved in lending to small and medium enterprises. In terms of the market's capacity to assess banks' exposure to risk, the mission concurred with a 1998 official report that found some lags in the transparency and disclosure practices of French banks relative to their counterparts in some industrial countries, although substantial progress has been made in the last few years.

Contents **Page**

Text Tables

GLOSSARY

ABFEI	Association des Banques Françaises et des Entreprises d'Investissement
AFECEI	Association Francaise des Etablissements de Crédit et des Entreprises d'Investissement
BA	Banking Act
BAFI	Base des agents financiers
BCP	Basel Core Principles for Effective Banking Supervision
BdeF	Banque de France
CAC	Commissaires aux Comptes
CACSF	Collège des Autorités de Contrôle du Secteur Financier
CAD	Basel's Capital Adequacy and Solvency Directives
CB	Commission Bancaire
CCA	Commission de Contrôle des Assurances
CCAC	Compagnie Nationale des Commissaires aux Comptes
CECEI	Comité des Etablissements de Credit et des Entreprises
CLAMEF	Comité de Liaison des Autorités Monétaires et Financières
CMF	Conseil des Marchés Financiers
CNC	Conseil National de la Comptabilité
COB	Commission des Opérations de Bourse
CRBF	Comité de la Réglementation Bancaire et Financière
CRC	Comité de la Réglementation Comptable
DC	Direction du Contrôle
DCP	Délégation au Contrôle sur Place
DS	Direction de la Surveillance
ESCB	European System of Central Banks
FAMA	The 1996 Financial Activity Modernization Act ("1996 FAMA")
FGD	Fonds de Garantie des Dépots
FIBEN	Fichier bancaire des entreprises
MEAFI	Ministére de l'Economie, des Finances et de l'Industrie
ORAP	Organisation et Renforcement de l'Action Preventive
ROSC	Report on the Observance of Standards and Codes
SAABA	Systeme d'Aide a l'Analyse Bancaire
SCR	Service Central des Risques
SFSA	The 1999 Savings and Financial Security Act ("1999 SFSA")
SGCB	Secrétariat Géneral de la Comision Bancaire
SIGAL	Systeme d'Information de l'Inspection Generale

I. INTRODUCTION

1. The following assessment of the Basel Core Principles for Effective Banking Supervision (BCP) is based on the Core Principles Methodology of the Basel Committee on Banking Supervision (October 1999) and takes into consideration both the essential and additional criteria for effective supervision. It takes into account the self-assessment prepared by the French authorities on France's compliance with the Basel Core Principles and the reforms of the legal and regulatory framework for bank supervision that have taken place after the mission's visit, up to June 2001. The overall degree of compliance of the French supervisory authorities with the BCP was found to be very substantial (Table 1), reflecting the overall high quality of bank supervision. The only core principles that were found to fall somewhat short of full compliance were Principles 5 (Acquisitions and Investments), 13 (Other Risks), 18 (Bank Reporting) and 21 (Accounting). Notable progress towards achieving full compliance was found for nearly all of these criteria.

Background

2. The French banking system is highly developed, highly concentrated, and well diversified. In 2000, there were 1,116 credit institutions established in France, of which 540 were banks and other savings institutions, 557 were finance companies and securities houses, and 19 were specialized financial institutions. The banking sector is dominated by five groups, which in 2000 represented about 69.2 percent of total deposits and 48.4 percent of credits. Commercial banks accounted in 2000 for 58 percent of total assets, followed by mutual and cooperative banks (18.1 percent) and the savings banks (9.8 percent). However, commercial banks accounted for a substantially smaller share (40 percent) of the system's deposits. In 1984, state-owned banks accounted for close to 90 percent of deposits. Since then, successive waves of privatization (including the recent privatization of Crédit Lyonnais) eliminated state ownership in the banking system, the only remaining state bank, the small Bank Hervé, having been acquired early in 2001 by Credit Commercial de France. However, in June 2001, the state-owned Caisse des Depots et Consignations and the Caisses d'Epargne announced that they would form a holding company for their insurance and banking activities, with the Caisse des Depots et Consignations holding majority ownership

Table 1. Compliance with the Basel Core Principles

Core Principle	Degree of Compliance				Remarks
	1	2	3	4	
1.1 Objectives	X				While appropriate at this time, interagency coordination arrangements may need further strengthening in the future.
1.2 Independence	X				It would be desirable that the heads of the bank supervision bodies be appointed for fixed terms.
1.3 Legal framework	X				
1.4 Enforcement powers	X				A further strengthening of the legal framework for bank resolution may be needed.
1.5 Legal protection	X				
1.6 Sharing of information	X				
2 Perm. activities	X				
3 Licensing criteria	X				
4 Ownership	X				
5 Investment criteria		X			Legal powers are needed to allow a prior review of the planned acquisition of a non-financial institution
6 Capital adequacy	X				
7 Credit policies	X				
8 Loan evaluation	X				Better matching of current provisioning requirements to forward-looking risks would be needed.
9 Large exposures	X				
10 Connected lending	X				
11 Country Risk	X				
12 Market risks	X				
13 Other risks		X			Measures to strengthen corporate governance are needed.
14 Internal control	X				
15 Money launder.	X				Customer protection issues need some attention.
16 On-site and off-site supervision	X				Strengthening of macro-systemic risk management capacity would be highly desirable.
17 Bank managmt	X				Sharing with banks of overall ORAP assessment would be desirable.
18 Reporting		X			Full compliance should be attained once the new regulation on consolidation of mutual institutions is implemented.
19 Information	X				A further strengthening of the supervisory mission of the CAC would be highly desirable.
20 Consolidated Supervision	X				See Principle 18
21 Accounting		X			Further strengthening of disclosure practices, including in times of market instability, is needed; progress is also needed as regards scope for inter-bank comparisons.
22 Remedial Meas.	X				See Principle 1.4
23 Consolidation	X				
24 Host country supervisors	X				
25 Foreign inst.	X				

Explanations: The columns marked 1-2-3-4 indicate the degree of compliance. 1=full compliance; 2=largely compliant; 3=materially non-compliant; 4=non-compliant. The columns refer to the Essential Criteria and Additional Criteria combined, that is an overall assessment of each Core Principle.

in the new corporation. By size of shareholders' equity, the latter will rank only behind BNP-Paribas and Credit Agricole. French banks have also experienced a rapid process of consolidation, which intensified in 1997-98 through a number of acquisitions and mergers, and continued in 1999 through the acquisition of Paribas by BNP, and in 2000 with the acquisition of Credit Commercial de France by HSBC.

3. The French banking system is also characterized by intense domestic competition and, until recently, mediocre profitability. After a period of declining margins (1993-95), banks' profitability increased during 1997-98, following an upward trend in the economic cycle. Total bank assets grew by 10.1 percent in 1999, owing to an appreciable increase in banks' securities portfolio and, to a lesser extent, loan portfolio. Nevertheless, the average return on equity (ROE) of French banks (9.1 percent in 1999) remained rather low by international standards, due in part to fierce domestic competition for market share. However, it improved markedly during 2000 (to around 15 percent, which is in line with international standards). Considerable discrepancies also exist between the generally less profitable mutualized and cooperative banks (particularly the savings and loans) and most commercial banks (the largest private banking group had an ROE in excess of 20 percent in 2000). The low yield of conventional banking operations has induced many French banks to diversify their activities and increase the share of service-originated fees in their total income (to nearly half of total income in the case of some large commercial banks). They also have increased their external exposure, with the assets of foreign branches and subsidiaries of French banks abroad growing by about 14 percent in 1999 and accounting for 18 percent of the total assets of credit institutions.

4. The mission did not conduct an independent assessment of the soundness of the banking system, its potential vulnerabilities and the main risks it faces. However, based on the evolution of some key prudential indicators, it appears that banking system conditions have strengthened notably over the last few years, mirroring the state of the economy and the privatization of state-owned banks. In addition to the already mentioned improvement in profitability, it is also worth noting that the ratio of non-performing loans to total loans declined to 5.8 percent at end-1999 (down from 9.2 percent at end-1994) and the coverage of non-performing loans by provisions rose to 64.4 percent at end-1999 (up from 47.9 percent at end-1994). Nonetheless, it is the view of the supervisory authorities that vigilance is needed as regards some important potential weaknesses and risks. In particular, notwithstanding efforts by the BdeF and the CB to raise awareness on this matter among banks (including the establishment of benchmark lending rates), profit margins on loans to small and medium enterprises have continued to be too thin to reflect underlying risks. Although lending to the construction and residential sectors (where asset prices have risen sharply in the last few years, particularly in the Paris area) and the leveraged purchases of shares (share prices have similarly risen sharply during the mid to late 1990s) also deserve attention, specific factors of the French economy and customers' behavior may mitigate these risks somewhat: in particular, the rather low stock of premises available to meet demand bolsters their current price level; in addition, the relatively modest proportion of shares in individuals' portfolios explains the equally modest level of loans granted to leverage their acquisition. The financing of the "new economy," particularly as regards loans to the telecommunication sector, also

merits close attention, although the percentage of total loans outstanding is in line with the relative importance of this sector in the economy (about 3 percent for telecom providers).

5. As a member of the European System of Central Banks (ESCB), the *Banque de France* (BdeF) no longer conducts independent monetary policy, but remains active in the area of bank supervision. The *Commission Bancaire* (CB), the *Comité de la Réglementation Bancaire et Financière* (CRBF), and the *Comité des Etablissements de Crédit et des Entreprises d'Investissement* (CECEI) play the leading role in supervising, regulating, and licensing, respectively, the banking system. Coordination between the three agencies is facilitated by the close involvement of the BdeF, which remains the pivotal institution in the general governance and day-to-day operations of the agencies. Unlike some countries outside the Euro area, France has maintained separate supervisory institutions with adequate coordination between the different authorities. In particular, the insurance and banking supervisory agencies are working closely together on issues of common interest, through dedicated working groups, joint on-site inspections and regular meetings. The general oversight of financial markets is shared by: (a) the *Commission des Opérations de Bourse* (COB), in charge of prudential regulation and supervision of portfolio management companies; (b) the *Conseil des Marchés Financiers* (CMF), which supervises investment service providers other than asset management companies; and (c) the BdeF, which retains a residual supervisory role in the negotiable debt instrument markets and monitors the unregulated money market. The oversight of the insurance sector is exercised by the *Ministère de l'Economie, des Finances et de l'Industrie* (MEAFI) through its Treasury Department (*Trésor*) and the *Commission de Contrôle des Assurances* (CCA). Their jurisdiction covers all insurance companies, except for a small mutual sector involved mainly in health insurance.

Pre-conditions for effective banking supervision

6. The French bank supervision system benefits from a clear, frequently updated legal framework (Principle 1(1)). The 1984 Banking Act (BA) created a common legal framework encompassing all credit institutions and subjected them to the same regulatory and supervisory authorities (except as regards deposit insurance). The Banking Act was amended in 1996 by the Financial Activity Modernization Act (FAMA), which placed investment firms under the aegis of the same authorities (with the exception of asset management for third parties, which is placed under the exclusive supervision of the COB). A further amendment was introduced in 1999 through the Savings and Financial Security Act (SFSA), which strengthened cooperation among supervisors through the *Collège des Autorités de Contrôle du Secteur Financier* (CACSF) (the latter comprises the chairmen of the CB, the CCA, the CMF and the COB; its mandate is to review the regulatory and supervisory issues of common interest to the four supervisory agencies, enhance the exchange of information and facilitate the supervision of conglomerates), reinforced the intervention powers of the CB, and tightened the scope for cooperation between the CB and external auditors. It also replaced the various existing deposit guarantee arrangements by a single, pre-funded deposit guarantee fund with individually assessed risk premia, and widened the scope of action of this fund in the prevention of banking crises. Further legal reforms that aim at merging the

COB and CMF and strengthening inter-agency cooperation are currently under discussion. While the increasingly blurred boundaries between traditional banking and other financial activities may require yet additional efforts at tightening coordination in the future, the current legal arrangements—including the collegial, interlocking nature of key decision-making bodies and the well-specified information sharing procedures (Principle 1(6))—appear to provide at this time sufficient scope for coordination between the different authorities.

7. The independence of the bank supervision authorities, based on autonomous boards, is generally adequate (Principle 1(2)), although the presence of the Director of the *Trésor* on the board of the CB is open to question. In addition, it would be desirable that its *Secrétaire Général* be appointed for a well specified term, and the rules and conditions for his/her dismissal be more clearly specified. The CB is clearly not independent from the BdeF, which controls its resources and whose Governor chairs its board. However, with the BdeF itself being independent and not exposed to obvious conflicts of interest with the CB's prudential objectives (particularly in view of the centralization of monetary policy decisions at the European Central Bank), the linkages between the BdeF and the CB do not appear to be a matter for serious concern. Instead, the CB appears to derive ample benefits—in terms of budget, information, and personnel—from its close cooperation with the BdeF. While the size of the CB's staff engaged in supervisory activities, particularly on-site, is still somewhat tight in view of the size of the French banking system, it has been steadily increasing. The professionalism of the CB's staff is well-recognized. The legal protection of supervisors (Principle 1(5)) is satisfactory.

Oversight capacity of the supervisory authorities

8. The framework and practices governing the entry of credit institutions (Principle 1(3)), and their licensing and structure (Principles 2–5) are satisfactory (with one minor caveat). A suitable legal framework exists for the authorization of credit institutions, the definition of credit institutions is clear, the CECEI has the authority and means to license banks and verify the fit-and-proper characteristics of their managers, and there are clear rules, adequate monitoring, and generally prompt supervisory response on changes of ownership and major acquisitions by banks. However, a legal reform is needed to ensure that the French supervisory authorities have the power to carry out a prior review of the planned acquisition of a non-financial services institution.

9. Prudential regulations are in line with established best practices and close consultation between the regulators and the banking community facilitates the smooth introduction of regulatory reforms. Capital requirements (Principle 6) fully comply with the current Basel Capital Accord, and the regulatory framework regarding the internal controls of credit institutions and the monitoring by the supervisory authorities of their implementation (Principle 7) is satisfactory. Prudential limits on large exposures and connected credits (Principles 9 and 10), the oversight of country risk and market risk (Principles 11 and 12), the supervision of cross-border banking activities (Principles 23–25), and the regulatory framework to control money laundering (Principle 15) are all adequate.

10. The main area where some regulatory strengthening might be needed is that of the framework to establish provisions (Principle 8). In particular, the potential future risks associated with loans to small and medium enterprises (particularly in the event of an economic downturn) do not appear to be always sufficiently recognized and provisioned against. The introduction of a dynamic provisioning system, such as the one currently under discussion, would be one way to ensure adequate provisioning with an anti-cyclical nature. However, the French banking community would prefer that the norms for such a system be established internationally prior to its introduction in France.

11. The information available to supervisors for carrying out their monitoring and control activities is generally abundant, of good quality and timely. Through its reporting requirements (Principle 18), well designed and effectively implemented program of on-site inspections, and close contacts with banks' managers and staff (Principle 17), the CB maintains itself well-informed about the financial conditions of banks and the quality of their management. However, in view of its limited resources (which result in a three to five-year on-site inspection cycle for banks that have not been identified as systemically relevant), the CB has under review the means by which it may derive greater benefit from the work of the external auditors in the execution of its own mandate (Principle 19). While important reforms have already been made in this regard, through close consultations between the CB, the COB and the *Conseil National de la Comptabilité* (CNC), further progress is needed. Moreover, for some of the mutual institutions, fully consolidated financial statements remain unavailable. While significant progress has also been made on this issue (and a draft regulation aimed at eliminating the problem has already been published) achievement of full, system-wide consolidated supervision remains impeded (Principles 18 and 20).

12. The good record of the French supervisory system for early detection of troubled institutions is based, in part, on effective analytical and micro-monitoring capabilities (Principle 16). Particularly impressive are the CB's early warning system (SAABA) and the CAMELS-type bank-by-bank assessment and rating system (ORAP), which make extensive use of available databases, including the BdeF's voluminous database on enterprises. However, as in most other industrial countries, there is room for improvement in the CB's grasp of macro-systemic vulnerabilities and for banks on non-traditional risks, such as operational risk (Principle 13).

13. The CB has an adequate enforcement capacity, derived from well designed coordination arrangements between on-site and off-site supervisors, a flexible and comprehensive set of notification and corrective action procedures, effective follow-up, and sound legal and other enforcement powers (Principles 1(4), (16), and 22). As regards bank exit policies, substantial progress has been achieved with the reform of the deposit insurance system in defining more effective bank resolution procedures. Nonetheless, the ability of bank creditors to stop (or reverse) the actions of public administrators could continue to limit the scope for prompt and effective closed-doors bank resolutions.

Risk management capacity of the credit institutions

14. French credit institutions, particularly the larger ones, appear to have generally adequate internal controls and risk management systems (Principle 14). Moreover, the quality of the dialogue on risk management issues between the banks and the supervisors is generally satisfactory (Principle 17). As indicated above, the French supervisory authorities have been discussing with banks the possible introduction of a system of dynamic provisioning for potential future losses. Additional measures to encourage banks to internalize risk more effectively could include the disclosure to (and discussion with) each credit institution of its overall ORAP assessment. Further efforts also appear to be needed to strengthen bank governance. Measures are needed to ensure that all boards of directors include the participation of external, properly qualified members and that the database on fit-and-proper characteristics of bank managers is continuously updated (Principle 13).

Transparency and market discipline

15. While the CRBF's and CNC's accounting rules and regulations may be considered to be generally appropriate and in line with European and international standards as regards the accounting treatment of operations and their monitoring, the rules on the reporting and publishing of financial statements need further strengthening (Principle 21). While important reforms have already been enacted through the 1999 SFSA and further improvements aiming at better disclosure in several key areas are under discussion, it is important that any remaining lags and weaknesses on transparency practices be corrected as soon as possible. To facilitate comparisons of risk exposure and management across banks, more disclosure on credit classification and provisioning would be desirable and the CB should find ways to make the output of banks' internal scoring and risk assessment models more comparable in the context of the new Basel proposal. The credit institutions also need sometimes to adopt more open and timely communication policies as regards significant difficulties or relevant external events that affect their risk exposure.

Coordination with other European supervisors

16. At present, the activities of French banks in other EEA countries are generally small as compared to their domestic activities (by contrast, operations in the United States and in several Asian countries account for a significant part of the consolidated balance sheets of the largest banking groups). Thus, the coordination of France's supervisory activity with that of its EEA counterparts appears to be sufficient, based on bilateral Memoranda of Understanding (MOUs) and discretionary exchanges of information. However, further efforts at expanding coordination with other European supervisory agencies may be needed in the future as the unified currency and rising trade and financial integration increase the scope for the cross-border activities of both lenders and borrowers.

II. Preconditions for Effective Banking Supervision

Principle 1. Framework and coordination

An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks. Each such agency should possess operational independence and adequate resources. A suitable legal framework for banking supervision is also necessary, including powers relating to authorization of banking establishments and their ongoing supervision; powers to address compliance with laws as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for the sharing of information between supervisors and protecting the confidentiality of such information should be in place.

1 (1): An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks.

Description

17. The French system of banking supervision is to be seen within the context of the overall supervisory framework of the financial services sector. While this framework is based on specialized, autonomous oversight agencies, the necessary checks and balances and the overall cohesiveness of the framework are provided through collegial arrangements with interlocking membership and the active involvement in overall coordination of both the *Banque de France* (BdeF) and the Department of the Treasury (*Trésor*) of the Ministry of Economic Affairs, Finance and Industry (MEAFI). The framework is organized around three pillars: (a) one for the banking sector, with the BdeF and the *Commission Bancaire* (CB) having the key roles; (b) one for the insurance sector, where the *Trésor* and the *Commission de Controle des Assurances* (CCA) predominate; and (c) one for the financial markets, where the *Commission des Opérations de Bourse* (COB) and the *Conseil des Marchés Financiers* (CMF) are the main agencies.

18. Broad objectives and responsibilities of the agencies involved in the supervision of credit institutions (including "banks") and investment firms are set out in a legislative scheme comprising (a) the 1984 Banking Act ("1984 BA"); (b) the 1996 amendment to the 1984 BA, i.e., the Financial Activity Modernization Act ("1996 FAMA"); and (c) the 1999 Savings and Financial Security Act ("1999 SFSA").

19. The 1984 BA, which—inter alia—addresses "activities and supervision of credit institutions," identifies the three agencies separately responsible for the distinct functions of: (a) regulation (*Comité de la Réglementation Bancaire et Financière*—CRBF); (b) authorization (*Comité des Etablissements de Credit et des Entreprises d'Investissements*—CECEI); and (c) supervision (CB). All three agencies are closely connected to the BdeF, as more fully described in the discussion of Principle 1(2). Indeed, it is the practice in official reporting (e.g., Annual Report to the President of the Republic and

Parliament by the Governor of the BdeF) to refer to the four (i.e., the BdeF, the CB, the CRBF and the CECEI) as "the market authorities."

20. The CB, an "independent administrative authority," is responsible for the supervision of the financial condition and operating practices of individual credit institutions and ensures their compliance (as well as that of individual investment firms) with applicable laws and regulations issued by the CRBF (1984 BA Arts. 37 and 37-1). The CB has administrative and legal powers to issue reprimands and impose sanctions for non-compliance.

21. The CRBF is responsible for establishing the general regulations applicable to credit institutions and investment firms, most notably those concerning internal control procedures, minimum capital requirements and management standards. The latter, particularly in respect to credit institutions, include prudential ratios for solvency, liquidity, and large exposures (1984 BA Arts.30 and 33 to 36). However, the CRBF is subject to the authority of the *Comité de la Reglementation Comptable* (CRC) as regards accounting regulations. The CRC, which was created through the Act 98-261, is in charge of laying down the accounting rules with which all companies, including credit institutions, investment firms and financial holding companies must comply. Nonetheless, the CRBF gives its opinion prior to the issue of accounting rules relating to such entities. In regards to investment firms and to the granting of investment services by credit institutions, the CRBF issues regulations only after first consulting the CMF, and provided that it does not infringe on the jurisdiction of the COB (see below). A regulation of the CRBF may be appealed in an administrative court (1984 BA, Art. 32).

22. According to the 1984 BA (Art. 31), the CECEI is responsible for taking the decisions and granting the individual authorizations or exemptions provided by laws and regulations applicable to credit institutions and investment firms (except asset management firms), with the exception of those within the competence of the CB (for example, the revoking of authorizations for disciplinary reasons). Specifically, the CECEI is responsible for issuing the authorizations, which credit institutions and investment firms must obtain prior to commencing operations and, thereafter, those required by any significant change in such operations (1984 BA, Art. 31). In this latter regard, the CECEI is responsible for authorizing certain changes such as a fundamental restructuring of the institution's shareholder base or a change in corporate legal form, and for approving the appointment of senior managers. Those firms wishing to provide investment services must obtain approval of their business plans by the CMF and/or the COB prior to seeking authorization from the CECEI. A single format and content for the information required from credit institutions and investment firms has been agreed between the CECEI, the COB and the CMF. The CECEI operates as a one-stop window for the receipt of this information.

23. Insofar as financial services are concerned, the CECEI is responsible for the implementation in France of the principles of the "right of establishment" and the "freedom to provide services" applicable to Member States of the European Economic Area (EEA). Together, the CMF and the CECEI issue the "European Passport" that allows French companies to offer services in other Member States of the EEA.

24. While certain authorizations may be revoked by the CECEI, only the CB may revoke authorizations by way of sanction. The reasons for a decision of the CECEI must be disclosed and any such decision may be appealed to the *Conseil d'Etat* (the supreme administrative court).

25. Oversight of the insurance sector is the responsibility of the *Trésor* and the CCA. Their jurisdiction covers all insurance companies, except for a small mutual segment involved mainly in health insurance. The *Trésor* drafts applicable regulations and is responsible for granting licenses and authorizing transfers of portfolios among insurance companies or changes in their ownership structure. The CCA supervises the sector. It assesses the compliance of the insurance companies with the Insurance Code and can impose sanctions on companies that have infringed regulations or put their solvency at risk. The CCA is an "independent administrative authority" of five members, all appointed by the Minister of Finance (MoF). It depends on the MEAFI for its staffing complement.

26. Overall surveillance of the financial markets in which credit institutions and investment firms operate is shared by the COB, the CMF and the BdeF. The COB (an independent administrative authority) and the CMF (a professional body) have broad powers to regulate, authorize and supervise the financial market activities of the institutions whose operations come within their respective jurisdictions. The BdeF has a residual supervisory role in the negotiable debt instrument markets and monitors the unregulated money market.

27. Established by Executive Order in 1967, the COB's mission is to ensure the protection of investors, the adequacy of information given to them and the proper operation of the markets in financial instruments. Its key functions are: (a) verifying information published by companies; (b) authorizing the creation of unit trusts and mutual funds; (c) licensing credit institutions and investment firms as investment service providers to act as asset management companies; and (d) supervising compliance with French law, which imposes penalties on insider trading and market manipulation.

28. In accordance with the 1996 FAMA, the COB supervises investment firms carrying on asset management for third parties and has sole jurisdiction to define the rules of sound practice applicable to such businesses. The COB is made up of a Chairman and nine members (two of whom are designated by the BdeF and the CMF, respectively). A representative of the MoF is entitled to be heard by the COB and to submit any proposal for consideration, provided that it does not concern any particular individual.

29. The CMF was created by the 1996 FAMA, which transposed into French law the 1993 European Union directive on investment services. Broadly, the CMF regulations set out: (a) rules of conduct applicable to investment services as provided by credit institutions and investment firms, with the exception of asset management for third parties (which comes under the jurisdiction of the COB); (b) the general principles for the organization and operation of the regulated markets; (c) the rules on the execution, reporting and publicizing of transactions on such markets; and (d) the rules governing the acceptance and administration of public offerings and takeover bids.

30. The CMF's General Regulations (which were approved by the MEAFI, after consultation with the BdeF and the COB) apply to all investment service providers, including credit institutions and investment firms, as well as to market undertakings (i.e., exchanges) and clearing houses. The CMF's 16 members are appointed by the MEAFI for a four-year term (a government commissioner and a representative of the BdeF attend CMF meetings, but do not vote). The CMF has powers of supervision and sanction that enable it to enforce compliance with the rules for which it is responsible. These sanctions are exercised by specially formed disciplinary committees and are subject to appeal to the *Conseil d'Etat*.

31. The 1999 SFSA provided for the establishment of four pre-funded guarantee schemes for bank deposits, investment firms, securities, and insurance companies respectively. The deposit insurance fund (*Fonds de Garantie des Dépots*—FGD) is financed by credit institutions according to rules laid down by the CRBF (Regulations 99-05 to 99-08). It covers commercial, mutual and cooperative banks. To limit moral hazard, the fund is managed by representatives of credit institutions. The FGD intervenes upon the request of the CB when a member credit institution is not able to meet (or will not be able to meet) its obligations as they fall due. It may also deal with a bank in distress in a preventive fashion, by lending to, or taking a stake in it.

32. Coordination among the three agencies involved in the regulation, authorization and supervision of banks is primarily achieved through the "interlocking" character of their membership and, equally, through the sourcing of their respective staffing complements. In addition, cooperation has been strengthened by virtue of the 1996 FAMA (Art. 68), which authorized exchanges of information between the agencies responsible for supervising investment service providers. It was strengthened further by the 1999 SFSA, which widened the scope for exchanges of information to other oversight agencies, including the CCA and the FGD. It also (Art. 60) established the *Collège des Autorités de Contrôle du Secteur Financier* (CACSF), wherein the chairmen of the CB, the COB, the CMF, and the CCA gather regularly to exchange information regarding the exercise of their respective responsibilities on cross-sector issues, to prepare regulatory proposals for improving cross-sector supervision, and to facilitate exchanges of staff to enhance cross-sector analysis. The CACSF replaced the *Comité de Liaison des Autorités Monétaires et Financières* (CLAMEF), which comprised representatives of the MEAFI, the BdF, the COB, and the CMF. The CACSF must meet at least three times a year under a revolving chairmanship and always with the MoF or his/her representative present. The CACSF, like the CLAMEF, has no supervisory responsibilities and is not endowed with staff or logistic support.

33. At the time of the mission's visit to Paris, two legal reform bills were under discussion or awaiting parliamentary approval. The first aimed at increasing the transparency of the stock market, clarifying the operations of the CECEI, enhancing the sanctioning capacity of the CCA and the COB, and strengthening the regulatory framework against money laundering. The second provided for the merging of the COB and the CMF and the creation, by end-2001, of a single supervisory entity for capital markets (the *Autorité des Marchés Financiers*). While the first bill was passed during the first half of 2001, the second bill is not expected to be approved before 2002.

Assessment of Principle 1(1): Compliant

34. The 1984 BA and its enabling regulations have been amended as necessary to reflect changes in the financial services sector and to transpose applicable European legislation. This body of legislation and regulations clearly sets out the responsibilities and objectives of the three agencies involved in the regulation, authorization and supervision of banks and provides a well-defined framework of minimum prudential standards that banks must meet. Smoothly operating coordination arrangements are obtained through: (a) the collegial, interlocking nature of key decision making bodies; (b) detailed information sharing agreements between oversight agencies; (c) the establishment of the CACSF as a central clearinghouse for sharing information and discussing regulatory or supervisory initiatives involving the rest of the financial sector; and (d) the active involvement of the BdeF and the *Trésor* in general coordination issues.

35. A further strengthening of coordination arrangements between the different oversight agencies appears to be desirable, both to reduce duplication (e.g., for derivatives, banks report that supervision is conducted both the CB and the CMF) and to respond to the further evolution of the financial services sector (e.g., the growth of conglomerates, particularly banc assurance groupings, whose supervision does not pose major supervisory difficulties at this time, but may require in the longer term the development of a fully consolidated supervisory approach, as envisaged in the EU draft directive on financial conglomerates). The legislation to be enacted in 2002 should ensure a greater coordination among the agencies and facilitate the required response.

1(2) Each agency should possess operational independence and adequate resources

Description

36. Operating as an independent administrative authority, the CB is a "college" of six members, namely the Governor of the BdeF, who acts as ex-officio Chairman, the Director of the *Trésor* (or the Director's representative), and four members (or their alternates) being, respectively, a member of the *Conseil d'Etat*, a judge at the *Cour de Cassation* (the commercial supreme court) and two members who are experts in the disciplines of banking and finance. As an "independent administrative authority" the CB is placed outside France's traditional administrative structures, possesses strong guarantees of operational independence and has powers of regulation and intervention in the banking sector.

37. The CECEI is chaired ex-officio by the Governor of the BdeF (as Chairman of the CB), and comprises the Director of the *Trésor* at the MEAFI, the Chairman or Chairmen of the authorities that have approved the program of operations of an investment services provider (CMF or COB), the Chairman of the Managing Board of the FGD and six members (or their alternates) comprising a member of the *Conseil d'Etat*, a senior manager of a credit institution, a senior manager of an investment firm, a trade union official representing the staff of credit institutions, and two experts.

38. The CRBF is a "college" of seven or ten members, according to the issue at hand. Two members (or their respective representatives) are ex officio, namely its Chairman, the Minister of Finance , and the Governor of the BdeF (as Chairman of the CB). The other five full members comprise a member of the *Conseil d'Etat*, a representative of the *Association Francaise des Etablissements de Credit et des Entreprises d'Investissment* (AFECEI), a trade union official representing the staff of credit institutions, and two experts. Three additional voting members are called upon for general regulatory matters applicable to investment service providers, namely the Chairmen of the COB and the CMF and a representative of investment firms.

39. As shown in Table 2, the BdeF plays a pivotal role in the overall governance and day-to-day operations of the three "collegial" agencies involved in regulation, the granting of authorizations and the supervision of credit institutions and investment firms. Its Governor chairs the CB and the CECEI, and also has a seat on the CRBF. These three agencies rely heavily on the BdeF for staffing and logistical support, including access to various databases. The CRBF and the CECEI rely on departments of the BdeF and of the CB for the preparatory work for—and implementation of—their decisions. The CB's General Secretariat's staff is almost totally seconded from the BdeF.

Table 2. Composition of the Three Collegial Agencies

Agency	CRBF	CECEI	CB
Responsibility	regulation	licensing	supervision
Chair	MoF 1/	Governor BdeF	Governor BdeF
Members:	Governor BdeF	Dir. of Treasury 2/ Chair FGD	Dir. of Treasury
	MoF appointees (5) Conseil d'Etat rep. Expert Expert AFECEI Trade Unionist	MoF appointees (6) Conseil d'Etat rep. Expert Expert AFECEI (credit inst) AFECEI (invest. firm) Trade Unionist	MoF appointees (4) Conseil d'Etat rep. Judge Cour de Cassation Expert Expert
Additional members as required:	Chair COB Chair CMF Self-regulatory organization rep.	Chair COB or Chair CMF	

1/ Must approve all regulations
2/ May request postponement of any decision

40. The BdeF's capital is entirely owned by the State (Art. 6 Act no. 93-980 Statute of the BdeF). Its Governor and two Deputy Governors are appointed by decree of the Council of Ministers for a six-year, irrevocable term, which is renewable once. The BdeF's Governing Council—which is responsible for administering the BdeF, including the allocation of the BdeF's own funds—comprises (in addition to the Governor and the two Deputy Governors) the remaining six members of the Monetary Policy Committee who are also appointed by the Council of Ministers for a nine-year, irrevocable, non-renewable term, plus a BdeF staff representative (a censor, or his/her alternate, appointed by the MoF also attends the Governing Council's meetings and may submit proposals to it and oppose its decisions).

41. Article 08 of the Constitution of 1958 provides that the President of the Republic appoints the MoF (who also serves as Chairman of the CRBF and must approve its regulations, 1984 BA Art. 36). The Director of the *Trésor* (who represents the MoF as a member of the CB and the CECEI and may request that any matter for decision by the latter be postponed for further consideration) is appointed to his/her primary function by decree of the Council of Ministers. Article 13 of the Statute of the BdeF provides that the Governor of the BdeF, who is also Chairman of the CECEI and the CB and a member of the CRBF for his/her term of office (i.e., six years irrevocable, which may be renewed once) is to be appointed to his/her primary function by similar decree of the Council of Ministers. The remaining appointments to the "collegial" agencies are by decree of the MoF (1984 BA, Arts. 30, 31, and 38) and are irrevocable. All members of the CB appointed by decree of the MoF have a mandate of six years, while those of the CRBF and the CECEI have mandates of three years. The Public Service appointees (i.e., the Governor of the BdeF, Director of the *Trésor*, the members from the *Conseil d'Etat* and the *Cour de Cassation*) may be removed from their functions for high treason or serious professional misconduct. Decisions of the three "collegial" agencies are by majority, with the relevant Chairman having a casting vote.

42. At the operational level, the BdeF's Credit Institutions and Investment Firms Division functions as the Secretariat for both the CECEI and the CRBF (where it works in conjunction with the CB's General Secretariat, appropriate department(s) of the MEAFI and, where applicable, the CMF). The CB has its own General Secretariat whose budget for resources and staff is provided entirely by the BdeF, pursuant to the requirement of the 1984 BA (Art. 39) and under the terms of a formal agreement. Each Secretariat is headed by a Secretary General appointed for an unspecified period of time by the MoF on a proposal from the Governor of the BdeF. While the 1984 BA does not specify it explicitly, it is understood that each Secretary General is subject to removal from his/her functions for just cause by the same process, without the grounds for removal being disclosed.

43. The CB's General Secretariat's Budget (which is part of the global BdeF budget) has allocations for salaries, staff training programs, inspections (including travel expenses for those inspections conducted overseas), equipment and the recruitment of outside experts with specialized skills where the occasion demands. The CB's General Secretariat's supervisory staff primarily consists of graduates in all applicable disciplines and is equipped with effective information technology (IT) systems for monitoring on an institution-by-institution basis as well as in aggregate. The staff of the Credit Institutions and Investment Firms

Division has similar attributes. Overall, the salary levels and employment conditions at the CB General Secretariat have enabled it to attract and retain qualified professional staff and to withstand competition from the private sector. Moreover, the CB has been able to attract, on temporary or permanent assignments, top-level personnel from the commercial banking sector or academic institutions to help develop its expertise on specific issues. Available human resources have increased significantly from the period immediately prior to enactment of the 1996 FAMA, which widened the responsibilities of the CB to include the supervision of investment firms (Table 3).

Table 3. Human Resources of the CB and CECEI

	Dec 1995	Oct 2000
Supervision (full-time equivalent)		
Off-site	231	294
On-site	119	163
Authorizations	56	63
Branch Networks	27	45
Total	433	565

Source: CB's General Secretariat

44. Currently, there are approximately 1,300 credit institutions and investment firms in France, excluding all branches established by institutions incorporated elsewhere in the EEA (Table 4), which are supervised by the CB (except for liquidity issues) by virtue of the Second European Banking Directive. This relatively large number of participants obscures the high level of asset concentration in the system, which has led the supervisory agency to commit significant resources to the development of a sophisticated off-site monitoring capability (see Principle 16) and the maintenance of a frequent presence in the largest institutions judged critical to the system's functioning. Conduct of on-site inspections of institutions judged less critical to the system—and without significant weaknesses—proceeds on a three-to-five year cycle. The current disposition of the supervisory agency's resources is also influenced by the large networks of mutual credit institutions and the prudential supervisory efforts undertaken by the "central bodies" of those networks in the discharge of the responsibilities conferred upon them by the 1984 BA, as amended (Arts. 21 and 22).

Table 4. France: Supervised Credit Institutions and Investments Firms

	Dec 1995	Dec 2000
Credit Institutions		
Banks	406	365
Mutual and cooperative banks	132	119
Savings & Provident Institutions	35	34
Municipal credit banks	20	22
Financial companies	821	557
Specialized financial institutions	31	19
	1,445	1,116
Investment Firms (under CB supervision)	--	182
Total	1,445	1,298

Source: CECEI—Annual Report 1996 and CB draft report 2000.

Assessment of Principle 1(2): Compliant

45. In view of the important role played by the Governor of the BdeF in the collegiums of the three agencies involved in banking system oversight and regulation and the reliance of these agencies on BdeF staff and financial resources, they are clearly not independent from the BdeF. Moreover, it is worth noting that the BdeF's Charter does not explicitly define its independence as regards financial system issues. Instead, it only states that "The *Banque de France*, represented by its Governor, Deputy Governors or any other member of the Monetary Policy Council, shall neither seek nor accept instructions from the Government or any other body in the performance *of the tasks arising from its participation in the European System of Central Banks.*" However, the fact that all the members of the BdeF's Governing Council are appointed for fixed, irrevocable terms is an important guarantee of its own independence. Moreover, there are no obvious conflicts of interest between the objectives of the BdeF and those of the banking oversight agencies. Instead, the agencies perceive clear benefits from their proximity to the BdeF, notably in terms of resource availability and access to information. Thus, on balance, the dependence of the supervisory agencies on the BdeF does not seem to be a matter for concern. Nonetheless, it would be desirable that the two Secretaries-General be appointed for fixed, irrevocable (possibly renewable) terms.

46. Given the three "collegial" agencies' statutory membership, in particular that of the Director of the *Trésor* at two of the oversight agencies (i.e., the CECEI and the CB) and that of the MoF at the CRBF, it is difficult to assert that the determination of supervisory policies, plans and processes is entirely independent from the government and that the latter is not involved in operational supervisory and regulatory activities. In fact, in the latter case, the requirement for the MoF to approve regulations brought before the CRBF for approval is provided for in the French Constitution, which does not contemplate the delegation of that function. However, the recent privatization of government-owned banks (excluding from

consideration the financial holding company to be established by the *Caisse des Dépots et Consignations*, as referenced above) has substantially reduced the scope for conflicts of interest between the government's role as an owner of financial institutions and that of a direct participant in their supervision and regulation. Further, there is no clear evidence that the *Trésor*'s direct participation in the supervision and regulation of financial institutions has been a substantial issue in the past, although such participation contrasts with the recent trend in many industrial countries towards enhancing the independence of supervisory agencies.

47. Those credit institutions canvassed in the course of the mission's on-site work reported that the CB's General Secretariat's supervisory staff demonstrate a high level of integrity and professionalism in their dealings with them, as well as a clear and comprehensive understanding of the institutions' operations. The recognition earned by the staff of the French supervisory system is illustrated by the CB's very active involvement in the setting of international standards at the Bank for International Settlements and the Basel Committee.

48. The staff resources engaged in supervisory activities, particularly on-site, appear to be somewhat limited as regards the size of the French banking system. However, senior management of the CB's General Secretariat, as well as that of the CRBF/CECEI, is firmly of the view that current budgets for human resources are adequate for the present and that an excessively rapid expansion would likely lead to problems of absorption.

1(3): A suitable legal framework for banking supervision is also necessary, including powers relating to authorization of banking establishments and their ongoing supervision

Description

49. The 1984 BA, as amended (Art. 15), reserves to the CECEI the power to grant to a credit institution or investment firm (except asset management firms) an authorization to conduct business. Whenever needed, the CECEI has the discretionary power to impose requirements on specific institutions that may exceed the minimum prudential requirements. The 1984 BA, as amended (Art.19), also empowers the CECEI to withdraw an authorization from an institution, either at the behest of the institution itself (e.g., due to cessation of business or merger) or at the CECEI's own initiative in those instances where the institution no longer meets the terms and conditions of the original authorization. However, the CECEI is not empowered to withdraw an authorization in the event of non-compliance with the banking regulations. It remains the responsibility of the CB to impose disciplinary sanctions, including the withdrawal of an institution's authorization to conduct business (see Principle 1(4)).

50. The 1984 BA, as amended (Art. 15), also provides that prior to its granting an authorization to an institution to conduct business, the CECEI "shall take into account the program of operations of the undertaking, its proposed technical and financial resources and the suitability of the persons investing capital and, where applicable, their guarantors."

Where there is substantive change contemplated in any of these particulars, the prior approval of the CECEI must be sought in order that it may be satisfied that the proposed change(s) are not at variance with the authorization under which the institution currently conducts its affairs. The types of substantive change contemplated are set out in the CRBF's Regulation 96-16. In broad terms, that Regulation requires that the CECEI's prior authorization be obtained for changes in the distribution of the share capital beyond a given threshold (acquisition or loss of the effective power to control the management of the enterprise, or of a third, a fifth, or a tenth of the voting rights), changes in the legal form and name, and the redefinition of the scope of operations authorized, be they in banking or investment services.

51. The 1996 FAMA (Art.11) makes the CECEI responsible for the issue of authorizations to credit institutions and investment firms intending to provide investment services (other than those instances where asset management on behalf of third parties is the prime object of the business, in which case the COB is the responsible authority). As in the case of credit institutions carrying on "banking business," the CECEI's responsibilities also extend to the withdrawal of authorizations from investment firms in non-disciplinary situations. In the discharge of its responsibilities with respect to investment firms (and credit institutions offering investment services), the CECEI coordinates its activities with those of the CMF and the COB. Before deciding to issue an authorization, the CECEI must officially notify the CMF and/or the COB, as appropriate, in order that it may approve the program of operations where the provision of investment services is contemplated. Coordination is also required where the investment services provider wishes to make any changes to the characteristics of the program of operations as originally authorized.

52. The legislative scheme also provides that the CECEI is to be notified: (a) in advance (e.g., whenever credit institutions or investment firms with registered offices outside France wish to open information, liaison or representative offices within France); (b) immediately (e.g., on appointment of a person with power to determine an institution's business strategy) or; (c) after the event (e.g., whenever changes are made to the institution's capital structure, the rules for calculating voting rights, or to the composition of the Board of Directors or the Managing Board).

53. The CECEI authorizes and licenses non-European banks planning to operate in France and controls the new authorizations for credit institutions and investment firms wishing to establish themselves in Monaco. As regards transactions within the European Community, the CECEI is responsible for implementing the twin principles of "right of establishment" and "freedom to provide services" introduced by the Single European Market. It vets French credit institutions' plans to establish branches in the EEA and must be notified if such institutions wish to provide services in EEA countries. Since implementation of the Single Market, credit institutions with headquarters in other EEA Member States no longer need the authorization of the CECEI to set up branches in France. This represents a distinct reduction in the CECEI's "power of authorization." The number of actions taken by CECEI in its implementation of the "European Passport" has grown fairly rapidly (Table 5).

54. The CECEI is equally responsible for implementation of the same two principles in respect to investment service providers, except those whose main business is asset management for third parties, and without prejudice to the role assigned to the authorities responsible for approving programs of operations (i.e., the CMF and the COB). Under the European procedures applicable to investment service providers (i.e., credit institutions or investment firms other than third party asset management companies) the authorities responsible for approving programs of operations must similarly be consulted.

Table 5. Actions Undertaken by the CECEI under the European Passport Program, 1996-99

Number of Actions	1999	1998	1997	1996
EEA credit institutions				
Establishment	4	3	7	4
Provision of service	39	35	32	54
EEA investment firms				
Establishment	8	5	5	2
Provision of service	114	95	285	2
French credit institutions				
Establishment	5	10	12	13
Provision of service	48	30	28	6
French investment firms				
Establishment	5	7	-	-
Provision of service	11	14	11	1

Sources: Annual Reports of Banque de France

55. The CECEI is currently reviewing the feasibility of (and modalities for) authorizing and monitoring Internet-based banking operations. In coordination with the banking profession, the BdeF and the CB issued in mid-2000 a "*Livre Blanc*" that discusses some of the challenges associated with Internet banking and also prepared a preliminary code of best practices on such activities. The CB also actively participates in the Basel committee working on this issue.

56. The regulatory scheme provided by the 1984 BA, as amended (Art. 30), gives to the CRBF extensive regulation-making powers. However, such regulations are set administratively and require, as per the French constitution, the MoF's approval before they become applicable.

57. The CB is granted broad powers to require the delivery to it by credit institutions and investment firms of all information that it considers necessary, in the format and with the frequency that it deems appropriate (Art. 40), and to conduct on-site inspections both within and beyond the statutory corporate perimeter of the credit institution or investment firm concerned (Arts.39, 41, and 73).

Assessment of Principle 1(3): Compliant

58. The 1984 BA, as amended, creates a suitable legal framework for the authorization and ongoing supervision of credit institutions. In particular, the legislative scheme clearly identifies the CECEI as the body responsible for the granting of individual licenses and authorizations to credit institutions and investment firms and the removal of authorizations of institutions that no longer fulfill the conditions to which the authorization is subject. The CECEI is also the authority in charge of monitoring the European Passport procedures for all credit institutions and investment firms except those providing third party asset management services. Equally clearly, the law empowers the CRBF (the defined regulatory agency) to establish the general regulations applicable to credit institutions and investment firms, including prudential regulations. As these regulations are generally prepared in close consultation with the banking community, their implementation is usually very smooth. The law also empowers the CB (the defined supervisory agency) to exact such information from the supervised institutions as it deems warranted and to conduct on-site as well as off-site programs of supervision.

1(4): A suitable legal framework for banking supervision is also necessary, including. powers to address compliance with laws as well as safety and soundness concerns.

Description

59. The legislation provides the CB with three tasks to accomplish. It is responsible for verifying compliance by credit institutions (and investment firms) with the laws and regulations applicable to them and for imposing sanctions for breaches thereof. It examines how these institutions conduct their business and ensures, to the extent possible, that their financial condition remains sound. It also ensures that the standards of sound business and financial practice are followed. Supervision is applied at three levels: (a) continuous supervision by data analysis ("off-site" control); (b) supervision by inspection visits ("on-site" control); and (c) general oversight of the banking system.

60. The 1984 BA, as amended (Art. 37), provides the CB broad supervisory powers to require appropriate control of the risks assumed by credit institutions and investment firms and to provide timely assessment of their financial soundness. Techniques designed and implemented through both off-site and on-site supervision pursuant to those powers enable the CB to assess institutions' compliance with the applicable statute and regulations, as well as prudential and safety and soundness concerns.

61. Insofar as prudential supervision is concerned, the CB has the right of unrestricted access to all aspects of an institution's operations (including those of its subsidiaries as well as those of its direct and indirect controlling shareholder(s) (Arts. 40 and 41) and to require corrective action in those instances where inspection indicates that this is necessary (Arts. 42 and 43). Failure to implement the necessary remedies exposes the institution concerned to a

progressively harsher regime of sanctions (the nature of which may be made public at the CB's discretion [Art.45]).

62. Under the powers available to the CB, it may: (a) warn any credit institution failing to follow standards of sound business and financial practice (1984 BA; Art. 42); (b) issue an injunction to a credit institution whose situation merits it, calling upon that institution to "take all necessary measures within a given period to restore or strengthen its financial equilibrium or to rectify its management methods" (1984 BA; Art. 43); (c) appoint a provisional administrator "to whom will be transferred all the powers for administering, managing and representing" the credit institution (1984 BA; Art.44); or (d) appoint a liquidator (1984 BA; Art. 46) where an institution's authorization is withdrawn.

63. The 1984 BA, as amended (Art. 45), provides that where a credit institution has contravened a law or regulation relating to its business (including failing to respect commitments given at the time of the granting of an authorization by the CECEI), has not complied with an injunction or has not heeded a warning, the CB (acting in its capacity of an administrative court for the purpose) may impose a disciplinary sanction (i.e., caution; reprimand; prohibition on the execution of certain operations and any other limitations on the carrying on of business; temporary or permanent removal of senior executives responsible for the institution's direction—with or without the appointment of a provisional administrator; withdrawal of the institution's authorization—with or without the appointment of a liquidator). These disciplinary sanctions may be appealed to the *Conseil d'Etat.*

64. The amendments to the 1984 BA by the 1999 SFSA sought, inter alia, to enhance financial security, with provisions on the supervision of credit institutions and investment firms and on the protection of depositors and investors. The provisions devoted to the strengthening of financial security radically reformed depositor and investor protection arrangements. Thus, "the FGD shall intervene at the request of the CB as soon as it (the CB) finds that one of the institutions (i.e. a member institution of the FGD) is no longer able to repay funds received…" (1984 BA, as amended [Art. 52-2]) and "On a proposal from the CB, the FGD may also intervene in a preventive capacity vis-à-vis a credit institution whose situation gives rise to fears that deposits... may become unavailable at some time in the future…." (1984 BA, as amended [Art. 52-2]). Further, the 1984 BA, as amended (Art 38-1), provides that "The CB shall hear the Chairman of the managing board of the FGD for any matter concerning an institution in respect of which it envisages seeking the intervention of the FGD or proposing to the FGD that it should take preventive action. The CB shall also hear the Chairman of the managing board at his request." The immediate closure of a troubled credit institution can be achieved once a temporary administrator has been appointed by the CB, the administrator himself having the capacity (and responsibility) for declaring the closure.

Assessment of Principle 1(4): Compliant

65. The legislation enables the CB to enforce compliance with the legal and regulatory framework, and address those safety and soundness concerns that, in the CB's professional

judgment, exist at a particular institution. In coming to its assessment on such issues, the CB has access to all records of the supervised institutions and has at its disposal a wide set of analytical tools (see Principle 16). For cases of non-compliance with the law and regulations and also for instances where an institution is failing to follow standards of sound business and financial practice (or about to fail to do so), the CB has available a range of disciplinary actions to achieve a remedy. The capacity to impose disciplinary action is not totally unfettered, however, as decisions of the CB to penalize an institution may be appealed to the *Conseil d'Etat*, which provides a suitable safeguard against abusive practices.

66. With the 1999 SFSA, substantial progress has been achieved in firming up the framework for facilitating the orderly and transparent exit of troubled banks. In particular, the law enhanced the CB's ability to enforce prompt corrective actions (such as the removal of management) with minimum interference of the courts, and allowed the FGD to commit resources into a potentially insolvent institution. The latter should facilitate the rapid transfer of a troubled bank's deposits to sound banks, thereby limiting risks of contagion, and more transparent management of its assets.

67. However, as also noted under Principle 22, some residual weaknesses in bank exit policies may need to be addressed. In particular, under the current legal framework, banks' creditors can block (or reverse) steps taken by the CB-appointed administrator towards the resolution of a troubled bank, which may discourage prompt and resolute action by the administrator. In addition, progress could be made in the application of the legal procedures for asset recovery and general bankruptcy proceedings. A reform of such procedures is under preparation.

1(5): A suitable legal framework for banking supervision is also necessary, including. legal protection for supervisors.

Description

68. As an independent administrative authority (and thereby an institution of the State) and also as an administrative court when exercising its disciplinary powers, the CB benefits from principles of French administrative law. First, as it is not a legal person, the CB cannot incur liability in its own right and any monetary liability attributed to the CB's performance of its duties is the responsibility of the State. Second, the conditions upon which the State may incur liability by the CB's exercise of its jurisdictional powers are severely limited. Lastly, in respect to the CB's performance of its administrative duties, the current *Conseil d'Etat* case law indicates that the State may incur liability only for the CB's gross negligence.

69. Insofar as senior officials and employees of the CB's General Secretariat and the BdeF Credit Institutions and Investment Firms Division are concerned, they have the benefit of the Statute protecting Public Servants. A Public Servant may not incur liability for an administrative error committed in the exercise of his public office. In those instances where such senior officials and employees are pursued for actions taken in the course of their duties, they are entitled to claim their costs from their employer.

70. Where there is personal fault (e.g., abuse of a client) or criminality involved, then the Public Servant may incur liability. Nonetheless, should he be able to argue convincingly with his/her employer that the case against him is biased (i.e., that no personal fault is involved), he/she may request his/her employer to cover his legal expenses.

Assessment of Principle 1(5): Compliant

71. French administrative law provides adequate legal protection to the CB and to the staff of its General Secretariat for actions taken in good faith in the performance of their duties. The collegial nature of the CB's decision-making provides a further layer of protection against suits aimed at any one of its members. Moreover, both the CB and the staff of its General Secretariat are adequately protected against the legal costs of defending legitimate actions. Thus, legal protection for supervisors is satisfactory at present. Nonetheless, it appears that a trend is emerging that may see the State held liable for simple negligence. Were this trend to continue, the legal protection afforded the CB could be reduced.

1(6): Arrangements for the sharing of information between supervisors and protecting the confidentiality of such information should be in place.

Description

72. As noted in Principle 1(1), the 1999 SFSA (Art. 60) strengthened the cooperation between domestic supervisory authorities by creating a collegium, the CACSF, comprising the Chairmen of the CB, the COB, the CMF and the CCA. The MoF—or his representative—is in attendance at any meeting of the CACSF. The CACSF must meet at least three times per year and its mission is to enhance exchanges of information between supervisors of conglomerates involved in banking, insurance and investment activities, and to deal with all questions related to the coordination of the supervision of such conglomerates. It has no supervisory responsibilities and is not endowed with staff and logistical support.

73. The 1999 SFSA (Art.59) modified the Act 92-665 (Art. 45) to permit the CECEI, the BdeF, the CB, the CCA, the COB, the CMF and the FDG to exchange information for the achievement of their respective objectives. The information exchanged is covered by the professional secrecy obligation in effect at each of the transmitting and receiving organizations. The 1984 BA, as amended (Art. 52-2), contemplates the CB bringing information concerning a credit institution or investment firm to the attention of the FGD. These modes of information sharing between supervisors have been developed, notwithstanding the requirement for professional secrecy imposed by Art. 31-1 (CECEI) and Art. 49 (CB) of the 1984 BA, as amended.

74. The 1984 BA, as amended (Art. 41-1), provides for the exchange of all information relevant to the exercise of their duties between the CB and the authorities of a Member State of the EEA responsible for supervising credit institutions, investment firms and other financial institutions, including insurance companies. Specifically, where the authorities of a

Member State wish to verify information concerning a "legal person" controlling a credit institution or investment firm with a registered office in France, the CB is required to either effect the verification itself on behalf of the Member State or allow representatives of the latter's supervisory authorities to do so. Equally, where the "legal person" has its registered office in a Member State, on-site supervision may be effected by the CB by requesting the Member State's authorities to act on its behalf or, with their consent, by appointing its own representatives. So as to ensure the supervision of an institution subject to its control, the CB may require branches in a Member State to disclose all information relevant to that supervision and, after informing the Member State's relevant supervisory authorities, cause its representatives to effect on-site supervision at the institution concerned.

75. Exchange of information with the supervisory authorities of the EEA Member States is facilitated by the existence of a common frame of reference. French law and regulations relating to credit institutions and investment firms have been made consistent with European legislation, such as the Second Banking Coordination Directive, the Directive on the Solvency Ratio for Credit Institutions, the Directive on the Supervision of Credit Institutions on a Consolidated Basis and the Directive on Investment Services in the securities field. Further, the Secretary General of the CB is a member of the European Banking Advisory Committee and of the European Central Bank's Banking Supervision Committee. The General Secretariat of the Banking Commission (SGCB) itself takes part in the activities of the technical working parties set up by both bodies.

76. Bilateral arrangements for information exchanges between the CB and supervisory authorities of States outside the EEA may now be agreed where those supervisory authorities observe the principles of reciprocity and are subject to a professional secrecy obligation comparable to that in France (Art. 41-2). There are three objectives. The first is to extend on-site inspections to branches or subsidiaries in a foreign country of a credit institution, investment firm or financial holding company governed by French law. The second purpose is the CB's conduct, at the foreign supervisory authorities' request, of on-site inspections of institutions subject to supervision in France that are branches or subsidiaries of institutions subject to the foreign authorities' supervision (such inspections may be carried out jointly). The third purpose is to define conditions under which the CB may transmit, receive or exchange information relevant to exercise of its powers and those of foreign supervisory authorities.

77. Any inspections carried out by foreign supervisory authorities' representatives may only concern compliance with the prudent management standards of the State concerned so as to permit assessment of the financial situation of a banking or financial group. A report thereon must be made to the CB, which alone may impose sanctions with regard to the branch or subsidiary inspected in France.

78. The 1984 BA, as amended (Art. 41-3), requires that the CB refuse any request for assistance from a foreign supervisory authority where the result is likely to be prejudicial to French sovereignty, security, economic interests, or public policy or when criminal proceedings have been initiated on the matter at issue.

Assessment of Principle 1(6): Compliant

79. The 1984 BA, as amended, provides a suitable framework for the sharing of information with domestic and foreign supervisory agencies. It does so under controlled circumstances so as to safeguard confidentiality and appropriate use of information transmitted. The legislation also provides a means for the supervisor to deny access to information within its control. In general—and subject to the disclosure mechanisms described above—the staff of French supervisory authorities are bound by a professional secrecy obligation (overridden by the necessity to disclose information relevant to a criminal proceeding). The 1984 BA, as amended (Arts. 31 and 49), provides that breaches of that obligation may be subject to criminal prosecution.

80. The 1999 SFSA also facilitates the exchange of information with countries outside the EEA through bilateral agreements whenever principles of reciprocity are respected and these countries have professional secrecy obligations comparable to those in France. Some of these agreements have already been signed and others are under preparation (see Principles 23 and 24).

III. Licensing and Structure

Principle 2. Permissible activities

The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined, and the use of the word "bank" in names should be controlled as far as possible.

Description

81. Compared to other European countries, France has a broader definition of "credit institution." The 1984 BA, as amended (Art. 1), defines "credit institutions" as "legal persons carrying out banking operations as their usual business." "Banking operations" are then defined as the "receipt of funds from the public, credit operations, and making available to customers or managing means of payment." Article 18 further refines the definition of "credit institutions," setting out the various types of banking operations in which each category (i.e., "banks, mutual or cooperative banks, savings and provident institutions, municipal credit banks, financial companies or specialized financial institutions") is permitted to engage. The 1996 FAMA uses a similar procedure in defining activities constituting "investment services" and the authorizations relating to those various activities. The definition of credit institutions includes institutions that provide credits but do not collect deposits, which contributes to explain the rather high number of institutions supervised by the CB and licensed by the CECEI.

82. The 1984 BA, as amended (Art.10) states that "it shall be prohibited for any person other than a credit institution to carry out banking operations on a regular basis." The 1996

FAMA (Art. 21) provides that "no one other than an investment service provider may provide investment services to third parties as its usual business." Both the 1984 BA (Art. 14) and the 1996 FAMA (Art. 23) prohibit the use of business names, advertising or any expression implying that an institution is authorized (when such is not the case) or that is likely to cause confusion. Criminal penalties may be imposed for breach of these prohibitions, according to the 1984 BA (Art. 75), and the 1996 FAMA (Art. 82).

83. By virtue of the CECEI's power to impose terms and conditions on an institution's authorization at the time of its granting (1984 BA, Art.15) and that of the CB to impose sanctions on an institution where such terms and conditions are not respected (1984 BA, Art. 45), the legislative scheme provides considerable scope for exerting control over the business activities carried on by a credit institution.

Assessment of Principle 2: Compliant

84. While the term "bank" is not expressly defined, the definitions of "credit institutions" and "banking operations" are clear and the permitted activities of "banks" (which comprise the carrying out of all "banking operations") are clearly set out in the 1984 BA, as amended. By inference, use of the words "bank"/"banking" is limited to licensed and supervised institutions and, by virtue of the prohibition incorporated in the 1984 BA, as amended (Art.10), the receipt of funds on deposit is reserved to "credit institutions." Enforcement of this principle is adequate.

Principle 3. Scope of licensing

The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the banking organization's ownership structure, directors and senior management, its operating plan and internal controls, and its projected financial condition, including its capital base: where the proposed owner or parent organization is a foreign bank, the prior consent of the home country supervisor should be obtained.

Description

85. The CECEI reviews 600 to 700 applications per year, including those for new licensing, changes of license and changes in ownership. The 1984 BA, as amended, (Arts. 15-18), provides that when considering the authorization of an institution, the CECEI must: (a) ensure that the institution meets the minimum capital requirement (Art.16); (b) ensure that there are two senior managers of integrity and experience responsible for the overall direction of the institution's business policy (Art.17); (c) review the business plan and the technical and financial resources available; (d) assess the suitability of the investors (or their guarantors); and (e) "assess the applicant undertaking's capacity to achieve its development objectives in a manner compatible with the smooth working of the banking system and which offers sufficient safety for its customers." The 1984 BA, as amended

(Art.15), further provides that the CECEI "may withhold authorization when it is likely to be hindered in the exercise of its supervision of the applicant undertaking either by the existence of equity links, or links of direct or indirect control between the undertaking and other natural or legal persons, or by the existence of laws or regulations of a state that is not a party to the agreement on the EEA when one or more of the above-mentioned persons are governed by such laws or regulations."

86. Although there is no legal requirement to do so, the CECEI consults the CB on license applications, a practice underpinned by the fact that the Governor of the BdeF is the Chairman of both the CECEI and the CB. Similarly, an institution's adherence in practice to a business plan submitted to the CECEI is determined by the CB during its ongoing supervisory activities. In the case of an intending investment service provider, the CECEI must first seek the view of the CMF and/or COB on the business plan. Where the authorization concerns an investment firm, the 1996 FAMA (Arts.12-16) sets out the verifications to be made. These procedures closely replicate those for credit institutions. Licenses obtained by fraud are subject to revocation.

87. The CECEI's current model application form for an authorization ("Authorization Dossier") seeks specific information on: (a) the institution's management; (b) the proposed management and control procedures; (c) the development objectives; and (d) the origin of the initial capital. The minimum capital requirement (Art.1 CRBF Regulation 92-14) is FF 35 million, FF 15 million or FF 7.5 million, depending on the type and characteristics of the credit institution. The CECEI may insist on increased initial capital in light of the business plan. Part IV of the Authorization Dossier, entitled "Declarations to be forwarded by the Contributors of Capital" requires that it be accompanied by attestations of the intending capital contributors to the effect that each is aware of the import of the 1984 BA, as amended (Art.52), which allows the Governor of the BdeF, in his capacity as Chairman of the CB, to call upon shareholders to contribute further capital, should the financial condition of a credit institution so dictate. Responses sought from intending contributors of capital in the "Declarations" enable the CECEI to question the provenance of the capital to be contributed, and hence its quality.

Assessment of Principle 3: Compliant

88. The CECEI clearly has the authority to set criteria for the licensing of banks and may reject applications for just cause. The Authorization Dossier requires information sufficient to enable the CECEI to make a determination on the proposed institution's scheme of ownership (including inter-corporate linkages), capacities and experience of senior management, the origin and sufficiency of its original capital, its business plan and its proposed management structure and control processes. A centralized database on "fit and proper" characteristics of bank managers is under preparation. While, as a matter of course, the CECEI requests that evidence of the home supervisor's prior consent be obtained to establish a subsidiary of a non-EEA bank in France, the introduction of a formal regulation on this matter would be desirable.

Principle 4. Ownership pattern

Banking supervisors must have the authority to review and reject any proposals to transfer significant ownership or controlling interests in existing banks to other parties.

Description

89. The CRBF Regulation 96-16, which relates to changes in the situation of credit institutions and investment firms (other than asset management firms), provides (Art.2.1) that the CECEI's prior authorization must be obtained whenever the result of the intended actions of a person, or a group acting in concert would be: (a) to acquire or relinquish effective control over the management of the institution or firm; or (b) to acquire or relinquish 33.3 percent, 20 percent or 10 percent of the voting rights of the institution's (or firm's) outstanding capital stock (this requirement is omitted in the case of an internal restructuring by French or other EEA groups).

90. To facilitate the ongoing control of the shareholders of credit institutions, CRBF Regulation 96-16 also requires that each credit institution and investment firm subject to its provisions files with the CB information on each holder of at least 10 percent of its outstanding capital stock and gives to the CB the right to exact all necessary information on holders of between 0.5 percent and 10 percent of such outstanding capital stock. In addition, any transaction where the effect is for one person or group acting in concert to acquire 5 percent or more of the institution's (or firm's) voting rights must be immediately reported to the CECEI. The latter may also require that an institution (or firm) identify those shareholders declaring holdings of between 0.5 percent and 5 percent of an institution's (or firm's) voting rights (Art. 3).

91. A transaction effected outside France which changes the allocation of an indirect equity interest in an institution or firm subject to CRBF Regulation 96-16 (Art. 2.1) must be reported immediately to the CECEI, which may decide that the effect of the transaction is sufficient to warrant the re-examination of the regulatory position of the institution (or firm) (Art. 2.2).

92. Where formal authorization from the CECEI is required, it is given by default if the CECEI does not render its decision within a period of three months (for entities supervised by the COB or the CMF, the default period is two months). Where a transaction is completed without first obtaining the required authorization from the CECEI, the 1984 BA, as amended (Art. 33), provides that the CECEI may apply to the courts to have the voting rights applicable to the shares in the transaction suspended.

Assessment of Principle 4: Compliant

93. CRBF Regulation 96-16 requires that the prior approval of the licensing agency (the CECEI) be obtained (or that it be notified) in the case of proposed changes that would result in a change of ownership or the exercise of voting rights over threshold levels or a change in

controlling interest. Given the "collegiality" of the French system of banking supervision, there is close collaboration between the CECEI and the CB on any such proposed changes. The CECEI has the capacity to reject any request submitted for its approval in respect to ownership changes, subject to its providing reasons therefore.

94. While there are well-defined thresholds for submitting ownership transfers to the CECEI's prior authorization, it would be desirable that a clearer definition be given of what constitutes "significant ownership." Moreover, although reporting delays are generally short, some practical difficulties occur when large transactions take place through the stock market. The legislation to which reference is made in paragraphs 33 and 35, above, aims at ensuring that the Governor of BdeF, and the presidents of the CECEI and CB be informed at least eight business days before a takeover offer is transmitted to the CMF.

Principle 5. Acquisitions and investments

Banking supervisors must have the authority to establish criteria for reviewing major acquisitions or investments by a bank and ensuring that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.

Description

95. Subject to conditions laid down by the CRBF, credit institutions may make investments in the equity of all types of entities (1984 BA, Art. 6). In this regard, the CRBF Regulation 90-06 (Art. 1) defines an "equity interest" as being at least 10 percent of the outstanding capital stock or voting rights in question and limits acquisition of such interests (except for interests in financial institutions ["*Entreprises a caractere financier*"] and insurance companies licensed in the EEA (Art. 3)) to: (a) 15 percent of the credit institution's own funds for each separate interest; and (b) 60 percent of the amount of the credit institution's own funds for all such interests in aggregate (the same limits and exceptions apply for investment firms in CRBF Regulation 98-04). CRBF Regulation 90-06 (Art. 5) permits the CB to authorize a credit institution to hold a particular equity interest that exceeds one of the limits set out in Art. 2. Such excess is to be recognized as a deduction in computing the credit institution's "own funds."

96. The CRBF Regulation 96-16, inter alia, governs acquisition of equity interests in French credit institutions and the CECEI must therefore be notified of the transaction or its authorization first obtained (Art. 2). The CECEI must authorize acquisition of equity interests in French credit institutions in the circumstances given in Principle 4. For equity interests taken up in a credit institution in another EEA country, the host country must first seek the French supervisory authorities' view, as required by the Second Banking Directive (see Principle 1(6) and the provisions of the 1984 BA, as amended [Art.41-1], concerning permitted exchange of information between EEA supervisors). There is no requirement under current French law and regulations to obtain approval from the French supervisory authorities to acquire interests in banking businesses in non-EEA countries. The CB relies on an annual survey of banking establishments outside France to identify any such transactions.

97. The 1984 BA, as amended, (Art.7), limits in the most general terms the extent of non-banking activities that may be carried on by a credit institution. CRBF Regulation 86-21 further limits total revenues from non-banking activities to 10 percent of net banking income.

98. Although CRBF Regulation 90-06 sets quantitative limits on the acquisition of non-financial sector equity interests, *it does not empower the supervisor to review a planned acquisition beforehand.* Where a transaction is viewed as unsound, the 1984 BA, as amended (Art. 43), empowers the CB to "issue an injunction calling upon (the credit institution) to take all necessary measures within a given period to restore or strengthen its financial equilibrium, improve its management methods or ensure the adequacy of its organization to its activities."

99. As to the matter of corporate structures that present the potential for undue risk to the credit institution or an impediment to effective supervision by the CB, the latter is aided by CRBF Regulation 96-16 (and the latter's requirement for notification to—or prior approval by—the CECEI of acquisition of equity interests in supervised credit institutions), by CRBF Regulation 90-06 (and the quantitative limits set out in the latter in respect to non-financial sector equity interests), and by the 1984 BA, as amended (Art.15), which permits the licensing authority (the CECEI) to withhold an authorization "where it is likely that it would be hindered in its supervision of the applicant undertaking...by the existence of equity links or links of direct or indirect control between the undertaking and other natural or legal persons...." In addition, the CB has available recourse to the 1984 BA (Art. 43), referred to above.

Assessment of Principle 5: Largely compliant

100. The 1984 BA, as amended, and CRBF Regulations 90-06 and 96-16 describe the types and amounts of acquisitions and investments requiring supervisory approval and clearly set out the criteria to determine whether particular investments are permitted. The licensing agency (the CECEI)—in close cooperation with the supervisor (the CB)—assesses whether new acquisitions or investments will hinder effective supervision or pose unwarranted risks for the supervised institution's financial soundness.

101. To become fully compliant with this principle, the French supervisory (and licensing) authorities should acquire the legislated power to carry out a prior review of the planned acquisition of a non-financial services entity and require prior approval from the supervisory authorities for the acquisition of a banking business in non-EEA countries.

IV. Prudential Regulations and Requirements

Principle 6. Capital requirements

Banking supervisors must set minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. For internationally active banks, these

requirements must not be less than those established in the Basel Capital Accord and its amendments.

Description

102. Laws and regulations consistently require credit institutions to maintain both an absolute level of minimum capital and an adequate amount of own funds. Art. 16 of the 1984 Banking Act states that all credit institutions must be in a position at any time to prove that their assets effectively exceed their liabilities to third parties by an amount at least equal to the minimum capital. Moreover, according to CRBF Regulations 91-05 and 95-02, credit institutions shall observe at any time a solvency ratio of their own funds to their aggregate credit and market risk exposure of not less than 8 percent. Solvency requirements apply consistently on a consolidated basis, whenever the credit institution is part of a group. The capital adequacy requirements apply to all types of credit institutions, whatever their legal form or their structure. Capital regulations fully apply to investment firms in accordance to the Basel's Capital Adequacy and Solvency Directives (CAD). Financial holding companies are also subject to the same capital requirements. In addition, the CB can require (an) institution(s) to meet requirements on a solo or sub-consolidated basis, when allocation of capital within the group is perceived to be unbalanced or inadequate (see Principles 18 and 20) and it may refuse to include certain resources in the calculation of own funds when certain conditions are not met.

103. Components of capital and own funds and the method for their calculation are defined in CRBF Regulation 90-02 and further detailed in the CB Instructions 90-01and 96-01. Tier 1 capital is restricted to core capital and general reserves. Provided they meet strict requirements with regard of stability and capacity of absorbing losses, certain subordinated debt instruments (Tier 2) are taken into account but are limited in importance. Tier 3 instruments are strictly limited to the coverage of market risks (transposition of the CAD-amendment of 1993).

104. French requirements on capital adequacy are fully in line with the Basel Capital Accord and European legislation. The latter includes both balance sheet and off balance sheet commitments, weighted according to the Basel capital Accord rules. The Banking Law of 1984, moreover, enables the CB to take disciplinary action against institutions that fail to meet minimum requirements. It may also require higher solvency ratios than this legal minimum whenever it deems this justified by specific risk characteristics of a credit institution. This power can be exercised in full discretion, no binding policy or line of conduct having been published by the CB in this respect. Moreover, whenever overall weaknesses or negative trends should appear in the financial system or with regard to significant types of activity, the Governor of the BdeF can issue a formal warning to the profession (as happened for real estate financing).

105. A specific requirement is stated for banks having trading activities, to which risks the standard method is generally applied (CRBF Regulation 95-02). While most French banks use standard methods to measure these risks and determine the associated capital charges,

major banks use their own internal models. The adequacy and effectiveness of these models must be assessed and approved by the CB, which has a specialist team for assessing their adequacy and effectiveness (see Principle 16).

106. Semi-annual comprehensive reporting on solvency to the CB is mandatory. In case a credit institution fails to meet the requirements, and whenever the evolution of ratios puts it at risk of shortfalls, the CB is enabled to induce or impose, to its own discretion, a flexible range of corrective measures.

Assessment of Principle 6: Compliant

107. Capital requirements are fully in line with the Basel Capital Accord and the CAD. Moreover, France participates actively in the on-going discussions held in Basel (and Brussels) aiming at a comprehensive review of the 1988 Capital accord and the CAD.

Principle 7. Loan and investment policy

An essential part of any supervisory system is the independent evaluation of a bank's policies, practices and procedures related to the granting of loans and making of investments and the ongoing management of the loan and investment portfolios.

Description

108. CRBF Regulation 97-02 sets standards for the internal control structure of credit institutions. It indicates that it is a key responsibility for the bank's management and board to provide for proper credit administration, risk measurement and monitoring, and to supervise the effectiveness of the policies and procedures established for this purpose. Internal controls should include a control system for operations and internal procedures, the organization of accounting and information processing systems, risk and result measurement systems, risk monitoring and supervision systems, and a documentation and information system. Each credit institution must set up a consolidated system adapted to the nature and volume of its activities, its size, its establishments and the various types of risk to which it is exposed.

109. The system must be designed to ensure compliance with major organizing principles and to permit the application of specific rules, especially for monitoring credit risk (Articles 18 to 24). Specifically, the regulation requires clear criteria to be set for the granting of loans according to their nature and importance (Article 18), and to conduct a comprehensive forecast analysis of credit risk and posterior analysis of the profitability of credit operations (Article 20). All operations must be analyzed by a unit that is independent of the operational entity, and lending or commitment decisions must be taken by two persons. For transactions of a certain nature or size, the two persons must occupy senior positions. Commitments must subsequently be subject to strict and frequent monitoring and analysis. The broad thrust of these regulations also applies to investment firms under the terms of CRBF Regulation 97-04.

110. The responsibilities of the main bodies concerned (decision-making body, executive body, internal and external auditors) are clearly defined. Lending criteria should be set by top management and the respect thereof controlled by the internal auditors. The regulation lays particular emphasis on the need to involve the decision-making body, with the optional assistance of an audit committee, in setting lending and loss limits, and to inform it of the extent of exposure, the main characteristics and concentration of risks, doubtful debts, and the results of the internal auditor's work. Each year, credit institutions must draw up and furnish to the supervisory authorities a twin report on the conditions in which internal control is conducted and the measurement and monitoring of their exposure.

111. The assessment of the credit process and risk management is conducted in large part through off-site supervision (including through a study of the annual report credit institutions must submit to the SGCB on the conditions under which they conduct their internal controls and set up risks limits, through the analysis of credit portfolios using the ratings produced by rating agencies and the BdeF, and through regular talks with bank managers). It is also a main area of attention in regular on-site supervision. As described below under Principle 16, several external sources (national credit register, ratings by the BdeF and by rating agencies, access to a national register of published annual accounting statements) allow CB inspectors to confront the banks' systems and procedures, as well as the result of their credit risk assessment, with a composite benchmark. The procedure for on-site inspections also ensures that adequate attention is given to the total exposure of debtors and to large exposures.

Assessment of Principle 7: Compliant

112. The CRBF Regulation 97-02 strengthened in an important way the regulatory framework regarding internal controls of credit institutions. The CB, having full access to the credit data of banks, ensures on a periodical basis that standards in credit granting and administration are maintained and evaluates the adequacy of the risk-assessment and risk-management procedures of banks. Mandatory annual comprehensive reporting on internal control structure and procedures, on the basis of an analysis scale, allows the supervisor to assess strengths and weaknesses of the credit institutions and to induce corrective actions whenever indicated or required.

113. A further strengthening of the supervisory framework will be achieved as the CB will be able to rely more systematically on the work done in the area of internal controls by the external auditors (*Commissaires aux Comptes*-CAC). Although the CB systematically and closely examines the CAC's reports and sometimes ask for a special opinion or auditing, it is unable at this time to assess credit risk in banks solely on the basis of the work undertaken by the CAC and needs instead to rely on its own assessments, as conducted through off-site or on-site analyses. However, the frequency of the latter is constrained by the CB's limited inspection staff resources, particularly in the case of banks that are not deemed to be systemically important. This issue is reviewed further under Principle 19.

114. For large segments of the credit market, especially for consumer loans and credit to small and medium enterprises, the toughness of competition between banks appears to have

often impaired banks' capacity to secure margins that adequately reflect the credit risk involved, particularly in the event of an economic downturn. While the BdeF and the CB have repeatedly stressed such risks (including through the publication of a *"Livre Blanc"* on this matter), and have instituted a procedure for notifying all credits with abnormal margins to the CB, only limited results have been obtained so far. This issue is revisited under Principle 8.

Principle 8. Asset quality

Banking supervisors must be satisfied that banks establish and adhere to adequate policies, practices and procedures for evaluating the quality of assets and the adequacy of loan loss provisions and reserves.

Description

115. CRBF Regulation 97-02 requires banks to provide for an adequate system for assessing the quality of the loans, in particular through the classifications of loans into buckets according to their internal rating system. There is no harmonization as to the number of buckets or the standards for internal ratings, nor specific requirements for impaired or restructured debts. In particular, accounting rules do not require a detailed break-up of impaired debt (according to standards such as substandard, doubtful and loss), nor do they require that performing loans be broken down into normal loans and special mention loans. The only norm (imposed by instruction CB 94-09) is that a debt must be classified as doubtful when: (a) it has accumulated three months of unpaid due amounts (6 or 9 months respectively for property loans or loans to local authorities); or (b) it is likely or certain that it will not be recovered in whole or in part; or (c) legal proceedings against the debtor exist.

116. Thus, credit institutions must mainly use judgment, on a case-by-case basis (except for small customers loans with well-defined characteristics) for assessing their risk profile and determining the level of provisions. This approach is meant to induce banks to make their own assessments and seeks to avoid the potential pitfalls of excessive "mechanistic," "by-the-book" loan classification and provisioning procedures. Scrutiny of the bank rating classifications is conducted by the CB on a regular basis, both on-site and off-site. An effort by the CB to assess the consistency of the ratings (and rating systems) across banks is currently under way.

117. Banks are required to have adequate policies and procedures for periodically reviewing and assessing loans, collateral and provisioning and for recovering and collecting overdue amounts. In particular, ratings must be reviewed on a quarterly basis. Article 24 of CRBF Regulation 97-02 states that credit institutions must analyze developments in the quality of their commitments so that they can make the necessary reclassifications and provisions. To do this, credit institutions must seek to obtain recent and reliable information on the financial situation of their customers. In particular, they have access to a detailed Credit Register at the BdeF (see Principle 16), which they also have the obligation to update.

France also has a well-developed rating industry, which is generally well used by the banks in their credit decisions and assessments.

118. Provisioning is required on the basis of individual reviews of credit files or a statistical analysis of past losses. The level of provisions must take account of prudently valued collateral and the costs and likelihood associated with its recovery. Provisions must be constituted as soon as a risk of non-recovery arises. Full provision must be made for unpaid income.

119. The main responsibility for regularly reviewing and assessing asset valuation and risk provisioning lies with the external auditor, the CAC, who, if he/she does not agree with the accounts as presented, may issue an adverse opinion or refuse to certify the accounts. However, the CACs are not required to certify the loan classification. During regular on-site inspections, loan classification and provisioning are reviewed by CB inspectors (thoroughly or through sampling), making use of information obtained from the Credit Register, the rating agencies and various BdeF sources. These inspections often result in recommendations for re-classifications and additional provisions. The board of directors, in liaison with the auditor(s), is empowered to revise the accounts. Where relevant, the CB may refuse to account resources corresponding to unrecorded provisions as regulatory capital or, if it deeply disagrees with the accounts as presented, demand the publication of rectified accounting statements.

120. Article 24 of the CRBF Regulation 97-02 requires loan classification and provisioning to be performed on loan-specific assessments. Additional provisioning is sometimes recommended, but only required upon the effective identification of more general risk features (sector-specific or regional deterioration factors). As the CB strives to encourage prudent provisioning, including for statistical future losses, general provisions have been built up by some banks, notwithstanding a dissuasive fiscal regime that does not allow for their tax deductibility (deductibility of provisioning is reserved to well-identified losses). However, the built up of general provisions ("provision pour risques généraux") is not systematic, nor uniform.

121. A system of general forward-looking (dynamic) provisioning for the more massive types of credits, based on historical and statistical analysis of large credit portfolios, is under discussion with the banking sector and the MEAFI. Indeed, France has been somewhat of a precursor in this area with discussions on this issue starting as early as mid-1998. However, acceptance of the project has been delayed out of concerns, by the MEAFI, for its fiscal implications, and by the banking community, for its impact on banks' profitability and the pricing of their stock market shares in a framework where no requirement of that sort exist in G10 countries. In the absence of a Basel-type agreement for the uniform application of dynamic provisioning rules in other G-10 countries, French banks are concerned that their competitiveness and funding costs may be negatively affected.

Assessment of Principle 8: Compliant

122. The decision to grant a loan must be taken on the basis of an objective assessment of the customer's capacity to repay it and an analysis of profitability that includes all operational and financing costs. The banking supervisor ensures that loan portfolios and provisions are systematically reviewed at regular intervals and that individual credit files are regularly updated. The procedures in use are examined as part of the review of internal control systems (see Principle 7). The quality of loan portfolios and the value of other categories of assets are also examined in the context of ongoing supervision. To help them assess debtors' credit worthiness, credit institutions have access to elaborate databases, including the very detailed databases provided by the BdeF (see Principle 16).

123. The system for classifying assets and provisioning losses on impaired and bad debts is adequate and properly supervised. However, some improvements to the system might enhance its effectiveness. In particular, although banks are required to declare their impaired credits to the BdeF on a monthly basis, continued vigilance by the CB and the active cooperation of the CACs are needed to ensure full discipline in the timely reporting of these credits. In addition, more comprehensive asset classification and provisioning benchmarks might allow for better comparability across banks and facilitate the tasks of the CACs and the CB's inspectors in reviewing loan portfolios. The limited incentives or requirements for general provisioning may partly explain the abnormally low lending margins observed on loans to small and medium enterprises, that were mentioned under Principle 7. Should banks be induced to raise their provisions against possible future risks on such loans, this problem would likely disappear as margins on the loans would need to rise. Thus, a better matching of provisioning to effective, forward-looking credit risks, based on solid evidence of proper risk assessment and loan classification, and without taxation punishment, would appear to be desirable. A dynamic provisioning system, such as the one being currently contemplated, would be one way to address this issue, particularly for the most common types of credit.

Principle 9. Management information systems and prudential limits

Banking supervisors must be satisfied that banks have management information systems that enable management to identify concentration within the portfolio, and supervisors must set prudential limits to restrict banks' exposures to single borrowers or groups of related borrowers.

Description

124. The notion of "single beneficiary," serving as the basis for grouping related risk-exposures of credit institutions, is referenced in CRBF Regulation 93-05 (as amended by Regulations 94-03 and 99-03) as "persons connected in such a way that, were one of them to encounter financial problems, the others would probably experience payment problems." It defines also the nature of exposures to be taken into account as group exposures and sets precise limits on such exposures in relation to the capital of the bank. While this limit generally is 25 percent per beneficiary, small banks benefit temporarily until 2004 (as

provided for in the EU Directive) from an exception allowing them to raise the limit up to 40 percent per beneficiary. This transitional regime has been tightened since January 1, 1999 to progressively reduce the ceiling to 25 percent. The total of large exposures may not exceed 800 percent of own funds.

125. The CRBF Regulation 97-02 requires banks to put in place adequate monitoring procedures for large exposures, actively involving top-management in the assessment process. Notwithstanding these precise prescriptions, the CB has large discretion in assessing and adapting the notion of closely related exposures to deal with the complexity of relations between companies, groups and individuals acting as managers or directors. Moreover, while institutions are required to comply with the rules on a consolidated basis, the CB may require compliance on an individual or sub-consolidated basis, especially when it considers that the distribution of own funds within a group is unsatisfactory with regard to the exposure of the institutions concerned.

126. The regulation also imposes the monitoring of group exposures to be backed by a sector-wide and geographical analysis of the portfolio. Moreover, a quarterly reporting is mandatory bearing on all exposures in excess of 10 percent of the banks' own funds (5 percent in the case of exposure to a shareholder or manager) and more recently, credit institutions must declare their principal risks on a gross basis.

127. As part of the quarterly reporting, the CB obtains detailed information on the loan portfolio of each credit institution. To assist in checking the risk concentration features of the portfolio, the CB has access to comprehensive databases at the BdeF, which cover, inter alia, capital links between companies, management and board functions, and outstanding loan balances. Moreover, the staff of local BdeF agencies can provide more detailed information about companies and individuals whenever required. At present, the CB is building an information system that aims at a flexible exploitation of these databases. This system will be used in preparing and performing local on-site inspections.

Assessment of Principle 9: Compliant

128. Precise rules exist concerning the assessment and limitation of exposure due to a concentration of risk, which are closely monitored and enforced by the supervisory authorities. The standardized computerized reporting system currently being implemented will further strengthen the quality and detail of the CB's monitoring of large exposures.

Principle 10. Connected lending

In order to prevent abuses arising from connected lending, banking supervisors must have in place requirements that banks lend to related companies and individuals on an arms-length basis, that such extensions of credit are effectively monitored, and that other appropriate steps are taken to control or mitigate the risks.

Description

129. The company law (the 1966 Commercial Companies Act) regulates all transactions with related parties for all corporations and fully applies to all credit institutions. It requires full board authorization (and reporting to the annual General Assembly of shareholders) of those transactions between the company and a director or senior manager (including their close relatives) not in the line of a company's day-to-day business or not entered into under normal market conditions. Related parties, as defined by banking regulations (CRBF Regulation 93-05), are persons that have capital links such as one of them exercises, directly or indirectly, exclusive or joint control or that are subject to common management.

130. The CRBF Regulation 97-02 provides that credit institutions set up adequate internal control in view of monitoring and controlling risks, including for connected lending. Lending to related parties and to their parent companies, subsidiaries, significant shareholders (or their partners) must be reported under the same regulations and procedures as that for reporting large exposures whenever they exceed 5 percent of the banks' own funds. Under the discretionary powers available to them, supervisors may also require that exposure to borrowers between whom there is no apparent link be aggregated.

131. To tighten up these regulations, the authorities recently introduced measures (CRBF Regulation 2000-09), which impose a deduction from the bank's regulatory own funds of all commitments to shareholders or linked staff exceeding 3 percent of own funds. This regulation lays down a transitional period (until October 2002). Some exceptions, essentially for investment grade commitments to related parties, are allowed.

Assessment of Principle 10: Compliant

132. Adequate attention is paid to exposure to connected borrowers and to the conditions under which such loans are granted and monitored. The returns, which must be filed quarterly and are carefully scrutinized, are computerized (see Principle 9). The CB is also attentive to the conditions in which auditors review agreements between an institution and its managers (or shareholders).

Principle 11. Country and transfer risk

Banking supervisors must be satisfied that banks have adequate policies and procedures for identifying, monitoring and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining appropriate reserves against such risks.

Description

133. Country risk is defined on the basis of methodological note 94-09, which applies to all balance sheet and off-balance sheet commitments with regard to private or public borrowers residing in countries that have obtained or asked for a rescheduling of their debt in

a multilateral framework or that have suspended debt repayment, or whose financial situation justifies the constitution of provisions. Loans denominated and financed in local currency are not regarded as country risk, nor are non-defaulting commercial loans with an initial maturity (except in exceptional cases) of less than 12 months. Moreover, through the CRBF Regulation 97-02, banks are required to have information and management systems that allow for proper identification, monitoring and controlling of country risk. These policies and procedures are reviewed during the regular on-site inspections.

134. Annual (quarterly for the share held by large or internationally active banks) comprehensive surveys on country risk exposure are undertaken by the CB, which closely monitors exposure to all countries except the G10 and EEA countries. Exposures are split up by type of borrower and type of credit. Quarterly individual reporting by each bank, in an annex to the normal prudential returns, is confronted to the result of these surveys.

135. While credit institutions are allowed to constitute general provisions for country risk, provisioning for country-risk is, as a general rule, not mandatory. Although each credit institution is entirely responsible for the level of its reserves, the CB has strongly recommended, on a case-by-case basis and if the economic situation of a given country deteriorates, to constitute what it considers to be a minimum rate of cover. Special attention is given to country risk provisioning by both the external auditors and the CB in the audit of financial reports. The CB also pays particular attention to large international groups' internal control systems for country risk, especially as regards procedures for setting limits and channels for issuing authorizations and centralizing loans.

Assessment of Principle 11: Compliant

136. The CB pays adequate attention to the analysis and coverage of country risk.

Principle 12. Market risk

Banking supervisors must be satisfied that banks have in place systems that accurately measure, monitor and adequately control market risks; supervisors should have powers to impose specific limits and/or specific capital charge on market exposures, if warranted.

Description

137. For institutions with limited exposure to market risk, an adequate general provision on capital coverage is applicable by force of CRBF Regulation 91-05. For those with significant market activity, specific requirements are laid down (CRBF Regulation 95-02) regarding own funds coverage. The regulations also set criteria for risk measurement and prudential limits. Market risks are covered by appropriate own funds, namely residual own funds after the solvency ratio has been covered, and own funds specifically earmarked for coverage of market risks.

138. Semi-annual reporting to the CB is imposed by its Instruction 96-01. Regulation 97-02 (for credit institutions) and Regulation 97-04 (for investment firms) on internal control define strict organizational internal control requirements and set strict conditions for the recording of information on market exposure, for the measurement and monitoring of market risk and for its supervision by top management and the board of directors. Internal control systems should record trading book and foreign exchange operations on a daily basis, contain all information for assessing the related risk, and assess the capital adequacy to cover these risks daily.

139. Systems accepted by the CB can be both fully fledged models, specifically agreed to by the CB, and appropriate management information systems for banks with more limited market activities. Formal agreements on model validation rely on an extensive expert report from a specialist team at the CB. Model validation is based on state of the art statistical and mathematical analysis, using VAR approaches, Monte Carlo models and other techniques. Each agreement procedure also contains extensive stress-testing of the models. Consideration must be given to maximum potential loss and maximum limits must be set for each category of risk. The systems must also be able to aggregate positions in different products and markets, at both individual and group level.

140. During on-site supervision, substantial attention is given to the adequacy of systems and controls (including at times renewed testing of models), to that of limits and segmentation and to the validity of assumptions for both day-to-day measurement and stress-testing. The model validation specialists are actively involved during such on-site inspections. As a result of such reviews, the CB often makes comments or asks for changes to be made. Similarly, bi-annual returns relating to the calculation of prudential ratios are carefully scrutinized, and disciplinary action may be taken in the event of an infringement.

Assessment of Principle 12: Compliant

141. Supervision, especially for large banks and trading banks, is based on the analysis of specific returns relating to compliance with prudential requirements and on verification of control systems. On-site inspectors verify these aspects within the framework of general assignments or assignments focusing specifically on trading activities. Credit institutions may use the standard method for calculating own funds requirements or their own internal models. In the latter case, the CB must give its explicit approval after the model has been validated by a specially assembled team of experts. Institutions using their own models must also apply a multiplier, which has hitherto consistently been set at a higher level than the regulatory minimum.

Principle 13. Risk management process

Banking supervisors must be satisfied that banks have in place a comprehensive risk management process (including appropriate board and senior management oversight) to identify, measure and control all other material risks and, where appropriate, to hold capital against these risks.

Description

142. Article 11 of CRBF Regulation 97-02 lays down precise rules for organizing the assessment and monitoring of all risks to which a credit institution is subjected and relates these rules to the size and the nature of its operations. It makes explicit mention to the need for a consolidated approach. Under the terms of Articles 32 to 37 of the regulation, the systems in place must also be based on the measurement and monitoring of internal limits, both overall and operational. These must be reviewed at regular intervals, based on well-defined conditions for compliance with these limits. Developments in the quality of assets must be analyzed rigorously and at regular intervals, in particular with a view to making any necessary reclassifications and determining the appropriate levels of provisions (see Principle 8). The analysis of banks' profitability, which must be a criterion for selecting credit operations, should include all forecasted costs relating to such operations, including operational costs and the cost of remunerating capital (Article 20).

143. The development of new activities requires notification to the CB, which in turn imposes prior implementation of adequate procedures and tools for measuring and monitoring the activities and risks concerned. Next to the detailed attention to credit risk and market risk, special attention is given to large exposures (see Principle 9), transformation risk (interest rate risk), foreign exchange risk and liquidity risk. With respect to liquidity and interest rate risks, precise and comprehensive guidelines and limits have been established by the CB. In the case of liquidity risk, institutions are required to maintain a minimum ratio between current liabilities and liquidity, determined according to precise rules that take account of the potential risk of withdrawal or immobilization of resources and exposures. As mentioned under Principle 6, the CB is fully enabled to require additional capital coverage in relation to the individual risk profile of a bank and do so on the basis of mismatch criteria for more than one year operations.

144. While regular corporate law provides for general rules regarding the responsibility of the board of directors and individual directors, there are no specific requirements for a bank to ensure that the composition of its board is such as to enable it to have effective control over every aspect of the bank's activity and risk management.

Assessment of Principle 13: Largely Compliant—improvement under way

145. The measures introduced in 1997 with CRBF Regulation 97-02, which updated the existing rules introduced in 1990, cover all the main recommendations relating to risk management issued by the Basel Committee in recent years. Based on a mandatory and comprehensive annual reporting on internal control systems of banks, on auditors reports and on off-site and on-site inspections, regular demands are made by the CB for amending and improving systems and ensuring that top management is able to take full control and responsibility for the business. However, in line with the Basel proposals, there is a need for banks to develop a more formalized approach to the various aspects of operational risk.

146. However, risk awareness appears to be weaker in some smaller or cooperative banks, mainly for historic reasons. Even where the latter have developed sophisticated risk-management systems at the operational level, it is questionable whether their boards are fully ensuring their corporate role as regards the overall supervision of risk management.

147. Further efforts also appear to be needed to strengthen bank governance, particularly to ensure that the composition of the board of directors allows for a full understanding and assessment of all activities undertaken by a bank and the risks it assumes. Indeed, in a recent report, the *Rapport Viennot*, special attention has been drawn on the importance for financial institutions to conform to the principles and rules of corporate governance and French performance in this respect need to be enhanced. This stems in part from historic grounds, in part linked with the preponderance, until recently, of large government-owned banks. At the core, a strengthening of governance may require a significant evolution of the French corporate culture. Important steps can be taken in this direction at the level of banks, such as requiring that all boards include the participation of external, properly qualified members. The establishment of a continuously updated database on "fit and proper" characteristics of bank managers, currently being prepared by the CECEI (see Principle 3), should help in this process.

Principle 14. Internal controls

Banking supervisors must determine that banks have in place internal controls that are adequate for the nature and scale of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding its assets, and appropriate independent internal or external audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.

Description

148. The guidelines regarding the role and responsibility of corporate managers are covered by the Commercial Companies Act of July 24, 1966, supplemented by its implementing decrees and the recommendations of collegiate professional bodies. The rules applicable to credit institutions are defined even more strictly, in both legislation and regulations, than those for commercial companies. Senior managers (Article 17 of the Banking Act) must fulfill certain conditions of competence. The CECEI is in charge of ensuring the respect thereof in licensing procedures and in acceptance of bank managers' designation. The Banking Act also empowers the CB, as a disciplinary measure, to temporarily suspend or require the resignation of one or more senior managers (Article 45), and to appoint a provisional administrator if the situation so warrants.

149. Proper and comprehensive rules regarding internal controls and the appointment of internal auditors are also in place and are monitored by the CB by means of specific annual reporting and regular verification. All classical principles, such as segregation of duties,

checks and balances, delegation of functions and responsibilities, reconciliation of accounts and information of senior management are properly provided for in all areas of banking activities. The CRBF Regulations 97-04 and 97-02 give a very comprehensive set of instructions, requirements and criteria to define, monitor, and evaluate the overall internal control structure of banks and investment firms.

150. The internal audit office is required to have unfettered access throughout the bank and its adequate staffing, independence and functioning are periodically reviewed during on-site inspections. Significant progress towards enhancing the responsibility and awareness of the boards of directors has been made by major banks by establishing incipient audit committees, as explicitly referred to by the said regulation.

Assessment of Principle 14: Compliant

151. The CB pays close attention, both during on-site inspections and through the off-site analysis of internal control reports, to the procedures for making decisions and delegating powers, the quality of internal control and the resources made available for it, and the practical procedures for informing the decision-making body. Supervisors may call for the reporting hierarchy to be changed or for additional staff so that internal controllers are more independent of operational departments and can regularly review all areas of activity in a timely manner. Similar recommendations may also be made with regard to specific departments, such as accounts or information technology. These on-going measures have helped to focus the attention of managers on the importance of rigorous internal control. Systems to limit exposure are steadily being introduced and credit risk is being monitoring more closely. Further efforts may be needed to generalize the use of internal audit committees.

Principle 15. Know your customer

Banking supervisors must determine that banks have adequate policies, practices and procedures in place, including strict "know-your-customer" rules, that promote high ethical and professional standards in the financial sector and prevent the bank being used, intentionally or unintentionally, by criminal elements.

Description

152. French law 90-614 with respect to the role of financial intermediaries in the repression of money laundering, Decree 91-160, and the CRBF Regulation 91-160, lay down strict principles and rules regarding the prevention of money laundering through the financial system. The mandatory signaling of dubious transactions, or attempts to perform them, to the "Department for the Processing of information and Action against Clandestine Financial Circuits" (TRACFIN), the government agency in charge of repressing such transactions, is key to the system.

153. Under current money laundering laws and regulations, credit institutions have an obligation of vigilance and are required to implement internal procedures and rules that

enable them to ascertain the identity of the account holder when an account is opened or of occasional customers for transactions in excess of FF 50,000. Staff are also required to note down in writing information about transactions in excess of FF 1 million that are unusually complex and seem to have no economic justification or lawful purpose.

154. An extension of the legislation, aimed at the mandatory signaling of all transactions with certain designated offshore centers, is presently being examined by the French Parliament. A peer review within the framework of the Financial Action Task Force, in which France takes an active part, has shown France to be fully in line with rules and recommendations of the said international body.

155. During regular on-site inspections of general nature and by means of specific missions, CB inspectors periodically ensure that the procedures for detection and signaling are not only adequate, but that they are strictly adhered to by the banks and their staff. A specific section of their work program, dealing with this issue, has been developed and is regularly reviewed.

156. Furthermore, thematic surveys of the whole sector are periodically conducted by the CB, aiming both at the overall compliance function and specific aspects of prevention. The CB also meets with French judiciary authorities to examine coordinated action against financial crime (in 1999, for instance, five cases were brought to court). As of January 2001, the CB has distributed extensive questionnaires on money laundering to all credit institutions. These questionnaires will provide additional inputs for assessing the status of anti-money laundering practices and guidance for adjusting the scope and location of specialized on-site visits. In addition, the questionnaires, which are to be signed by the top management of the institutions, will enhance the commitment of the banking community in the fight against money laundering.

157. Finally, in a recent instruction with regard to Internet banking, the CB has explicitly stated that the principles and regulations on compliance also fully apply to this innovative practice. As a result, some precise instructions have been formulated on how to translate these principles and rules in this environment.

158. With regard to other codes of conduct, the responsibility fully rests with the *Association des Banques Françaises et des Entreprises d'Investissement* (ABFEI), which recommends best practices in several fields, mainly regarding consumer and investor protection. The formal enforcement hereof is however not organized. Most cases are handled either through an Ombudsman-service of the ABFEI or in court. Although the CB and the CRBF have been consulted by the ABFEI before the issuing of such codes, it bears no responsibility, neither for their adequate character nor for the monitoring of their observance or their enforcement.

159. The CB and the CECEI are both competent authorities also for banking supervision in the Principality of Monaco. However, the French money laundering regulations do not apply to Monaco.

Assessment of Principle 15: Compliant

160. The rules in place on money laundering are comprehensive and adequate. Supervisors verify that the right procedures are in place and are properly applied. These aspects are systematically reviewed as part of more broadly based prudential investigations. In certain cases, supervisors specifically verify compliance with money laundering legislation and implementing regulations. The CB may take disciplinary measures if a financial institution fails to report a suspicious transaction following a serious failure of vigilance or a flaw in the organization of its internal control procedures. The CB is required to advise the public prosecutor of such cases. The bill on new economic regulations currently before parliament is expected to include a section on combating money laundering, which would make it compulsory to report particular transactions (especially with certain off-shore zones) to TRACFIN.

161. Reflecting the growing importance of customer protection issues and ethical standards, a joint effort by the ABFEI and the authorities could be envisaged to reinforce the adherence to codes of best practices in various such areas, such as in client-bank relations.

V. Methods of Ongoing Banking Supervision

Principle 16. Banking supervision system

An effective banking supervisory system should consist of some form of both on-site and off-site supervision.

Description

162. The 1984 BA, as amended (Art.39), states that "the General Secretariat of the CB ("SGCB") shall carry out supervisory off-site monitoring and on-site supervision." The SGCB is organized in three departments, namely: the *Direction du Contrôle* (DC), which numbers approximately 140 persons and conducts off-site prudential supervision of both the system as a whole, and for each individual institution; the *Délégation au Contrôle sur Place* (DCP), which numbers approximately 180 persons and conducts on-site inspections at the supervised institutions, and, lastly, the *Direction de la Surveillance* (DS) which numbers approximately 128 persons and is in charge of international relations, juridical and accounting matters and IT and research projects. For purposes of supervision, there are four groups of credit institutions, aggregating thirteen sections. The four groups are: (a) "General" Credit Institutions; (b) "Specialized" Credit Institutions; (c) Provincial Banks; and (d) Investment Firms and Market Operators.

163. The SGCB's off-site supervision is primarily carried out through systematic, continual analysis of prescribed quantitative and prudential data filed by each credit institution (e.g., periodic reports derived from the management accounting and financial accounting systems, periodic reports showing the credit institution's performance against

statutory or regulatory norms, and annual reports on the institution's system of internal control) together with its analysis of publicly available documents (e.g., the credit institution's annual report and accounts). An important adjunct to this activity is the SGCB's consultation of databases maintained by the BdeF. The off-site supervision process also encompasses regular direct contact with the credit institution's management, either by telephone or in meetings, where the results of the systematic analysis referred to above form the subjects of discussion. Further, it is off-site supervision that is particularly involved with "distressed" institutions. Off-site supervision also places great reliance on the capacity of pre-emptive tools (e.g., SAABA and ORAP, see below) to signal the requirement for corrective action at a particular institution or for the conduct of an on-site inspection.

164. On-site supervision, in effect, covers those areas that cannot be addressed through the normal methods of off-site supervision where, for example, it is critical to determine the exact state of the credit institution's loan portfolio or its system of internal controls. The DCP's inspections can follow various forms, such as: (a) a general, periodic inspection or one limited to a specific sector (such as at the largest banks); (b) an inspection necessitated by the credit institution's perceived financial condition; or (c) "thematic" inspections (such as the state of preparedness for the "Y2K" date change).

165. Comprehensive on-site inspections of institutions considered not to represent a systemic risk, and where off-site supervision has not revealed significant weakness, are conducted on a three-to-five year cycle. For the "Big Five" institutions, on-site inspection is almost continuous, focusing on key areas of risk, as assessed by SGCB staff. Inspections are conducted on a consolidated basis, including foreign branches and subsidiaries where deemed necessary by the inspection plan. Other on-site inspections outside the "Big Five" may also have a specific focus (e.g., rapid growth in assets, marked deterioration in observance of prudential norms or, on a general basis, a specific activity, such as lending to particular segments of the economy).

166. The 1984 BA, as amended (Arts. 21 and 22), indicates that "Central bodies of mutual credit institutions shall ensure that the laws and regulations applying to these institutions are implemented and exercise administrative, technical and financial supervision over their organization and management. On-site supervision may be extended to their direct and indirect subsidiaries and to those of affiliated institutions. Within the scope of these powers, they may take disciplinary action as provided for under the laws and regulations applying to them. Without prejudice to the powers conferred on the CB to exercise supervision by off-site monitoring and on-site supervision of their member institutions, the central bodies shall assist in implementing the laws and regulations governing the credit institutions. As part of these responsibilities, they shall bring any infringements of such provisions to the notice of the CB."

167. Both the comprehensive and specially focused on-site inspections (which the on-site supervision unit plans with the assistance of its off-site homologue) are conducted using standardized, written procedures specifically developed for this purpose by the methodology unit. The initial draft program of inspections is drawn up by the DC with the input of the

DCP inspectors, given the latter's "on-the-spot" experience. The program may be modified in light of current findings of both the DC and the DCP. The final determination of the annual program of on-site inspections is made by the CB itself. It is the practice to conduct approximately 240 on-site inspections per year.

168. A wide spectrum of risks (credit risk, liquidity risk, operational risk, etc.) may be addressed in the course of on-site inspections, with particular attention being paid to the evaluation of internal control systems, adequacy of regulatory and management reporting, internal and external audit and management capabilities. This approach also permits evaluation, as required, of the institution's capital adequacy, asset quality, management, earnings, liquidity and sensitivity to market risk, as well as compliance with the law and regulations.

169. On-site inspection "teams" are led by a Chief Inspector, assisted by two to four Inspection Officers, with the same "team members" remaining as a unit for several inspections. The "teams" are supported, as needed, by two groups of specialists, namely Information Technology and Market Risk Analysis, and have available to them several important databases. Notable among the latter are: (a) the *Base des agents financiers* (BAFI), which is drawn from accounting and prudential returns filed by supervised institutions with the SGCB; (b) the *Service Central des Risques* (SCR), which contains all loans of more than FF 500,000 to non-bank entities reported to the BdeF by credit institutions; and (c) the *Fichier bancaire des entreprises* (FIBEN), which contains accounting and financial data reported to the BdeF on all non-bank enterprises in France with annual gross revenues exceeding FF 5,000,000.

170. A total of 200,000 firms are covered by the FIBEN database, accounting for 90 percent of total banking credit to enterprises in France. Thus, FIBEN provides a regularly updated rating system for most French enterprises, that goes substantially beyond the capacity of the private rating agencies, and thereby plays a fundamental role in bank lending to small and medium enterprises.

171. Using a portable computer, a team uses the *Systeme d'Information de l'Inspection Generale* (SIGAL) to retrieve financial information. SIGAL analyzes accounting statements and prudential reports, extracts statistical information concerning the structure and quality of a credit institution's loan book and scans for connected borrowers.

172. Inspectors also have access to specially developed tools such as the *Systeme d'Aide a l'Analyse Bancaire* (SAABA), an automated early warning system for rapid detection of weakness in the financial condition of credit institutions and the *Organisation et Renforcement de l'Action Preventive* (ORAP), a CAMELS-type comprehensive methodology carried out by the DC to study, compare, and combine the components of risks associated with the activity and environment of each institution. Using data from twenty-five databases, SAABA produces a detailed loan quality analysis on each credit institution, a partial analysis of the principal aspects of banking risk, or a summary analysis of credit institutions in aggregate. It can also be adapted to simulate the effects of various events, e.g., sector-specific

economic shocks. Besides using the BdeF's databases, SAABA also uses the product of special surveys (e.g., real estate risk, country risk) and external sources, such as rating agencies. In ORAP, each credit institution is assessed on a series of indicators (15 in all, plus a global synthetic grade) covering its current activities; its observance of prudential ratios and the strength of its capital base; the current risk profile of each of its portfolios; the quality of its earnings; its internal procedures for evaluating and managing risk; the appropriateness of its organizational structure, its internal control system, and the professional capacities of its senior management. This assessment process leads to an overall rating of the institution, a rating for each major category of risk and, where applicable, the identification of weaknesses for remedy. The DC provides its recommendations or requirements for action in writing to every credit institution accorded a "substandard" or "poor" rating.

173. On-site inspections are characterized by regular, two-way communication between the Chief Inspector and the DC. As the latter is responsible for off-site supervision, care is taken to ensure that, in the course of an inspection, it does not take any action or decision that could prejudice the outcome of the inspection or disrupt its progress. During major inspections (or inspections of credit institutions in distress) the team leader files progress reports to the SGCB.

174. To minimize misunderstandings and disagreements on matters of fact, a draft inspection report is first discussed with senior management of the credit institution who are free to append formal written comments on its content. Where the inspection report contains matters of serious importance (e.g., the requirement to establish substantial provisions for loss, the capacities of senior management, interpretation of the statute or regulations) the Chief Inspector discusses its content in detail with the DC. The revised report is then signed by the Chief Inspector and forwarded to the DCP. The latter is responsible for the report's delivery (pursuant to the 1984 BA, as amended, Art. 41) to the institution's Board of Directors or the managing or supervisory board (or other similar decision-making body) and to the external auditors. Those matters raised by the inspection as requiring attention are the subject of a *lettre de suite*, composed by the DC—with the aid of the Chief Inspector—and signed by the CB's Secretary General or, in certain instances, by the Chairman of the CB (i.e., the Governor of the BdeF). Implementation of systematic follow-up on the actions required by the *lettre de suite* is the responsibility of the DC, with the Chief Inspector being kept informed.

175. Members of the DC and the DCP have the opportunity to exchange views in working groups convened as required in the course of the year (particularly in respect to drafting of regulations or reviews of emerging risks). More formally, a monthly meeting between the senior management of the DC and the Chief Inspectors permits current issues to be discussed in detail. To foster collaboration between the DC and the DCP, the two units exchange personnel from time to time. Recruits to the DC are regularly attached to DCP inspection teams so that they can see banking "from the inside" and appreciate the problems that their colleagues in the inspection teams must confront, while conversely inspectors are seconded to positions in the DC.

176. Staffing levels have considerably increased since 1995 in order to cope with the growing demands of banking supervision. In addition, in response to the growing complexity of certain aspects of banking activity, the SGCB has recruited various specialists, in areas such as derivatives trading, for example.

177. The SGCB is currently strengthening its capacity to assess macro-prudential risks and to take early action to limit the risks of systemic financial crises. In particular, it is developing a module in the SAABA system to perform simulations based on changes in sector-specific conditions (e.g., a deterioration of conditions in the housing and construction sectors) or changes in macroeconomic variables such as the interest rate, the exchange rate, or the level of economic activity. Indeed, one of the main responsibilities of the DS is precisely to conduct such activities.

Assessment of Principle 16: Compliant

178. The SGCB has in place a well-conceived process for the execution of both on-site and off-site supervision and for the coordination of the two. On-site inspections permit verification of the standard of corporate governance in place, the quality of the data submitted in the prudential returns, and the institution's current financial condition. Inspection reports are comprehensive, well organized, and clearly show that the inspection process incorporates the SGCB's prudential policies and standards. Key issues, as well as matters requiring special attention, are given appropriate treatment, and follow-up procedures are timely and appropriate. Off-site supervisory processes permit continuous monitoring and analysis of reported performance both by institution and for the industry in aggregate.

179. The databases and analytical support tools (SAABA, SIGAL, ORAP) are broad ranging and of a high quality. They allow the CB's inspectors and its off-site staff to have rapid access to a wealth of information on each credit institution and its portfolio of debtors and to use this information flexibly as a guide to assess the soundness of credit institutions and the potential risks they may face in the immediate future or in the longer term.

180. While the increasing attention (exerted through the DS) to macro-systemic risk assessment and management is to be commended, much work remains to develop and strengthen this activity. As with most supervisory agencies across the world, the bulk of supervision remains focused at present on microeconomic, bank-by-bank, debtor-by-debtor monitoring, with limited incorporation of macro-systemic aspects. The work already done on macro-prudential issues within the Banking Supervisory Committee (a committee at the European Central Bank comprising the 15 banking supervisory authorities and national central banks) is of great interest in this context.

Principle 17. Supervisory contact

Banking supervisors must have regular contact with bank management and a thorough understanding of the institution's operations.

Description

181. As noted in Principle 16, the SGCB's supervisory activities are based upon a combination of on-site and off-site inspection techniques to establish the safety and soundness of an institution, which are underpinned by a range of sophisticated technical monitoring systems and tools. An essential element of this process is that representatives of the SGCB (mainly of the DC but also of the DS for regulatory, accounting and juridical issues, and including the periodic contacts made by the Secretary-General and his Deputy) maintain regular contacts and meet with the institution's key officers and senior management to discuss issues of importance. The extent of these meetings depends on the size and risk profile of the institution and may include interviews with such key executives as the chief financial officer, the head of internal audit, the external auditors and the senior officers responsible for the critical risk areas, as established by the SGCB's risk-based approach to supervision. Discussions include amendments to corporate strategy, operational performance, changes in asset quality and any other significant issues that have arisen in the period under review.

182. On-site inspections also afford the opportunity to meet with management and the external auditors, to convey the ongoing findings of the inspection, receive explanations and, where required, resolve matters of interpretation. Management is kept informed of the progress of the assignment in parallel to inspectors' regular contacts with the staff of the departments concerned. On completion of their assignment, the inspectors present a draft report for discussion before the final report is officially forwarded to the CB and the institution's chairman. The inspection process helps to shape the SGCB's assessments of senior managers, especially their ability to define and implement a strategy for the institution, and of the quality of the management team. Their views are incorporated into the ORAP criteria for analyzing institutions. In cases where serious operational deficiencies or statutory infractions are encountered, the CB may take disciplinary action against the senior managers responsible.

183. In maintaining an understanding of an institution's operations, the supervisory authority is assisted by the provisions of CRBF Regulation 96-16, relating to the changes in the situation of credit institutions and of investment firms (other than portfolio management firms). It requires that institutions notify the CECEI of any significant changes in their circumstances (Arts. 9-11), including the appointment of senior managers. While keeping the licensing agency (the CECEI)—and thereby the supervisory agency (the CB)—informed of key developments at an institution, the opportunity is afforded for either the institution's authorization to be modified in light of the proposed changes, or for the institution to be informed that a proposed appointment is incompatible with the terms of the institution's authorization to conduct operations.

Assessment of Principle 17: Compliant

184. Through regular contacts with the managers and staff of credit institutions and constant monitoring of databases built from prudential reporting and other sources, the

SGCB maintains a thorough understanding of their operations and management. It uses meetings with senior management as an integral part of the supervisory process. In the context of on-site supervision, there are working meetings with senior management and external auditors, permitting the supervisory authority to convey its impression of the standard of performance achieved by both. Off-site supervisors also hold regular contacts with banks' senior management and are kept well-informed by on-site supervisors (in those instances where there has been a recently completed inspection) and by the on-site unit's own analysis of prudential returns--including the outputs of the SGCB's proprietary analytical tools.

185. In particular, the SGCB discusses with the bank's management the performance of the bank according to the main risk dimensions identified in the ORAP system. However, they do not share with them the overall ORAP assessment of the bank. To enhance the quality of the feedback process, it is important that such assessments be discussed with each credit institution as soon as possible.

Principle 18. Reports and returns

Banking supervisors must have a means of collecting, reviewing and analyzing prudential reports and statistical returns from banks on a solo and consolidated basis.

Description

186. The CRBF Regulations on Management Standards for Credit Institutions and Investment Firms specify the bulk of the statistical and prudential reporting requirements by banks. The latter include: Own Funds (Regulation 90-02); Solvency (Regulations 91-05); Large Exposures (Regulation 93-05); Capital Adequacy (Regulations 95-02 and 97-04); Liquidity (Regulation 88-01); Own Funds and Permanent Capital Ratio (Regulation 86-17).

187. In accordance with the 1984 BA, as amended (Art. 40), "the CB shall draw up a list of the documents and data to be submitted to it and determine their form and the deadlines for filing. In addition, it may require the credit institutions and investment firms to provide any information, clarification or proof necessary to the exercise of its functions. It may ask to be sent the auditors' reports and, in general, all accounting documents (and, when necessary, for them to be certified), as well as all relevant information and data." Accordingly, the CB's database is compiled from documents that include off-balance sheet transactions, doubtful loans and the corresponding provisions for loss. Large institutions file monthly reports on their activities and situation in France, and they must, like other institutions, file quarterly reports, which include their foreign branches. Profit and loss accounts must be filed twice a year. Consolidated accounts must be filed annually (see above), but the larger institutions now publish consolidated data on a quarterly or semi-annual basis, as expected by the market. Filings made to the CB that are repeatedly found to be in error or late may subject the bank to sanction.

188. Most of the CRBF Regulations and most of the CB's instructions require institutions to provide reports or statistical returns on both a solo and a consolidated basis. In particular, credit institutions must comply on a consolidated basis with Management Standards on Solvency, Large Exposures and Internal Control. Further, should the CB consider that the distribution of an institution's own funds within a financial group is unsatisfactory from the standpoint of safety and soundness, it may require that the institution complies with certain regulatory standards on an individual or sub-consolidated basis.

189. The CRC's Regulation 99-07 applies consolidation rules according to the nature of the activity carried out by the consolidated entity and the level of control. Thus, institutions constituting an economic group must prepare and publish audited consolidated annual accounts, a copy of which must be filed with the SGCB. In accordance with the 1984 BA, as amended (Art.55), the CB ensures that such publication is regularly made. CRBF Regulation 00-03 on consolidated supervision reflects the new accounting rules introduced by CRC Regulation 99-07. Given the particular three-tier structure of mutual groups –in which, typically, local banks hold the capital stock (and elect the Board of Directors) of regional banks and the latter, in turn, hold the capital stock of the central institution, it was initially the practice for a partial consolidation to be carried out, through an aggregation of the group's financial results and a cancellation of intra-group transactions. Currently, nearly all mutual groups prepare a form of consolidated accounts (e.g., financial statements following consistent accounting norms within the group). However, two mutual groups are not yet capable to provide fully consolidated accounts.

190. Sophisticated analytical tools (such as SAABA and ORAP, see Principle 16) have been developed to assist in the review and analysis of the SGCB's database as well as those of the BdeF. Further, the SGCB has developed a cross-industry methodology for "homogenous line(s) of business groups" enabling it to analyze profitability and capital structures of credit institutions with closely comparable line(s) of business profiles and thus to compare an institution's performance with that of its peers.

Assessment of Principle 18: Largely Compliant—improvement under way

191. The 1984 BA, as amended (Art.40), and applicable Regulations, give the CB capacity to require all the information that it deems necessary to perform its supervisory duties. The CB may enforce timely delivery of such information, on both a solo and consolidated basis, and specify the frequency, formats and accounting treatments to be used. Further, the CB has authority to request and receive any relevant information from credit institutions—as well as from all of their related companies—where it is of the view that such information is important for the assessment of the institution's financial condition or its risk profile. It has at its disposal powerful analytical tools to facilitate the continual monitoring of the financial condition and operating performance of supervised institutions.

192. However, to fully comply with this principle, the SGCB should be able to receive fully consolidated accounting statements from all the mutual credit institutions. Following the conclusion of the mission's visit to Paris, a draft document was published by the French

authorities entitled: *"Avant-projet de réglement relatif a la surveillance prudentielle sur base consolidée des etablissements affiliés a un organe central modifiant le réglement No 2000-03 de septembre 2000."* The proposed regulation, which would make mandatory the preparation of consolidated accounts by all mutual and cooperative groups, is to come into force on December 31, 2001 (see Principle 20). Thus, full compliance will be achieved once this regulation is effectively implemented.

Principle 19. External audit

Banking supervisors must have a means of independent validation of supervisory information, either through on-site examination or use of external auditors.

Description

193. The supervisor has the right to have access to all information concerning the supervised institution's affairs and, where necessary, to have access to its Board of Directors, senior management and staff. The 1984 BA, as amended (Art.40), provides the CB full authority to require supervised institutions to deliver to it all information that it considers necessary, and in the format and with the frequency that it deems appropriate. Included in this broad power is the CB's capacity to require delivery to it of "the official auditors' reports and, in general, all accounting documents (and, when necessary, for them to be certified)."

194. As noted in the discussions of Principles 16 and 17, the SGCB operates a highly developed system of off-site and on-site supervision, the latter providing—as part of its mandate—a verification of much of the information provided to the former. Integral to the supervision process is the practice that the SGCB inspectors hold two meetings with the external auditors (CAC) in the course of an on-site inspection.

195. The external audit is entrusted to the CAC, who belong to an external audit profession that is properly organized and structured. While the CB must provide its opinion as to any proposal by a bank to designate a CAC (in most cases, an external audit firm, rather than a particular auditor), it is however not involved in the evaluation of the quality of the work of the auditor (or of the firm to which he/she belongs), nor in the definition of his/her mission. Regular consultation between the CB and the COB (the public authority in charge of ensuring the quality of information published by listed companies) allows for some indirect influence in assessing the scope and quality of banks' external auditors. However, while the COB is directly involved in the assessment of audit quality, formal responsibility rests with the professional body, the *Compagnie Nationale des Commissaires aux Comptes* (CCAC). As for the scope of the CAC's mission, it is strictly limited to that of commercial and industrial companies. No formal special missions are entrusted to the CAC in relation to the specific nature and risk characteristics of banking activities.

196. The 1984 BA, as amended (Art. 53-1), provides that the CB may request an institution's external auditors to supply to it "all information on the activity and financial situation of the institution being audited and on the controls which they have carried out in

the conduct of their auditing assignment." The CB may also forward written observations to the auditors, who must reply in like form. Article 53-1 further provides that: (a) the CB may provide the external auditors with information for them to accomplish their assignment; (b) the external auditors have a duty to advise the supervisory authority of certain facts or decisions that come to their attention in the conduct of their assignment at the credit institution, its parent, subsidiary or "financial holding company" (e.g., statutory or regulatory infractions which could have a significant effect on the financial condition of the entity, and actions or decisions which could hamper its continued functioning); (c) in such cases the auditors are relieved of the obligation of professional secrecy as regards the CB; and (d) the CB may appoint an additional auditor. The CB has automatic access to the official report of the CAC, but the BA (Art. 40) now entitles the authorities to ask for all other documents necessary for the discharge of their functions.

197. Decree 84–709, as modified by decree 93-305, provides (Art. 29) that a credit institution must advise the CB of the external auditors that it proposes to nominate, and that the CB has two months to give its opinion on such nomination. This opinion has to be brought to the attention of the institution's shareholders meeting. Article 53-2 also provides that the CB may ask the Court to relieve a CAC of its function and/or inform the CAC's professional governing body of any infraction of the 1984 BA, as amended, or where the external auditors appear to be in a situation of non-independence from the client.

Assessment of Principle 19: Compliant

198. The SGCB's legislated right of access to all information concerning the supervised institution's affairs is comprehensive, as is its access, by long-held practice, to the Board of Directors, senior management and staff. As previously noted, the SGCB has in place a well-conceived process for the execution of on-site supervision. On-site inspections permit the verification of the standard of corporate governance in place, the quality of the data submitted in the prudential returns, and the institution's current financial condition. In the course of an inspection, CB inspectors have working meetings with senior management and external auditors, permitting the supervisory authority to convey its impression of the standard of performance achieved by both.

199. Given its resources, and the related factor of its 3 to 5-year examination cycle, the CB has under review the means by which it may derive greater benefit from the work of the the external auditors in the execution of its own mandate. While important reforms have already been made in this regard, through close consultations between the CB, the COB and the CNC, further progress is needed. Certainly, there is room for placing more accountability on external auditors so as to enhance the accuracy of information transmitted to the supervisory agency. The recently granted capacity for the CB to nominate an additional external auditor should be used as a means to pursue this objective.

200. Following the adoption of the 1999 SFSA, France has acquired a corpus of legislation that should enable external auditors and supervisors to develop more effective relations within the framework of their respective legal responsibilities. The implementing decrees are

being drafted and discussions have taken place with the CCAC with a view to establishing a code of conduct that standardizes the conditions of application of the new rules. Since the CB has to give an opinion on the designation of the CAC for all credit institutions and is enabled, if deemed necessary, to designate an additional CAC, it has some influence in ensuring the quality of their work and of the published accounts for credit institutions. Furthermore, it can ask the courts or professional bodies to take disciplinary action against a deficient auditor.

201. The issue at hand is probably one of gradually changing the prevalent work culture, rather than taking extreme disciplinary action against gross negligence or unprofessional behaviour by the CAC. Thus, through further close consultations with the COB and the CCAC and especially with the CACs themselves, the CB is seeking ways to derive greater benefit from the work of the external auditors. While the CB remains strongly of the view that it is necessary to pursue its own investigations in order to achieve the best possible assessment of credit risks, it foresees an increasing role for the CACs in this regard. Furthermore, on a case by case basis, the CB has already had the opportunity to require an audit firm, other than that nominated by the credit institution to perform its statutory annual audit, or to conduct a specific mission at that credit institution.

Principle 20. Consolidated supervision

An essential element of banking supervision is the ability of the supervisors to supervise the banking organization on a consolidated basis.

Description

202. The SGCB reviews the corporate structure of a credit institution as an integral part of the planning phase of its supervisory activities and its monitoring of the institution's risk profile. Where necessary, particularly when corporate entities are regarded as significant in relation to the risk profile of a consolidated group, the SGCB extends its supervisory processes (including the conduct of on-site inspections if warranted) to those entities.

203. The SGCB's risk-based approach to supervision encompasses the evaluation of all significant activities of the institution, whether or not these constitute "banking operations" within the meaning of the term given by the 1984 BA, as amended (Art. 1) (see Principle 2). As discussed above, the SGCB has access to all the records of a credit institution or investment firm. In addition, the 1984 BA (Art. 41) requires that the CB has on-site access to the business and records of the corporate entities controlled by the institution, including subsidiaries or affiliated companies, as well as to the business and records of "the legal persons directly or indirectly controlling it (i.e. the institution) and to their subsidiaries." For corporate entities located outside France, the SGCB has all powers necessary to collect data and information from the group's corporate headquarters in France and to extend its supervisory activities (including on-site inspections) to those entities when necessary. When those entities are located outside the EEA, on-site inspections may also be carried out, provided that the permission of the host country is obtained and the activity involved is significant in relation to the whole. In addition, the SGCB monitors the relationships of credit

institutions with regulatory bodies in other jurisdictions to ensure that the credit institution complies with all regulatory requirements, on a globally consolidated basis. In that regard, it has already signed MOUs with several other supervisory bodies.

204. As noted in Principle 18, the applicable CRBF Regulations and CB instructions require that institutions provide to the supervisory authority their reports or statistical returns on both a solo and consolidated basis. Prudential standards are primarily imposed on a consolidated basis, particularly those covering such areas as capital adequacy, large exposures and lending limits. After the establishment of the rules set out in CRBF Regulation 00-03, banking regulations taken as a whole (see below) now require regulatory filings to be prepared on a consolidated basis. CRBF Regulation 98-03 (Art.6) provides that the CB may insist that an entity be excluded from the scope of consolidation where there exist obstacles to the transfer of information necessary to determine accurately the level of exposure, or in those cases where consolidation would be misleading or inappropriate from the standpoint of prudential supervision.

205. CRC Regulation 99-07 contains new rules for the drawing up of consolidated accounts for both credit institutions and investment firms. It changes the definition of exclusive control and introduces consolidation criteria for special-purpose entities, including the possibility for networks affiliated with a "central body" (as defined in 1984 BA, as amended, Arts. 21 and 22) to draw up consolidated accounts comparable to those of other credit institution groups. As indicated under Principle 18, while two mutual groups do not as yet report fully consolidated accounts, nearly all mutual groups prepare a form of consolidated accounts (i.e., financial statements following consistent accounting norms within the group).

206. The 1984 BA, as amended, and applicable Regulations, serve to limit the activities in which a "banking organization or group" (i.e., a credit institution and its subsidiaries) may engage. If an institution carries out non-banking activities, they must remain of limited importance and must not hinder, restrict or distort competition on the market concerned (BA Article 7). This general rule is completed by Regulation 86-21, which limits total revenues from non-banking activities to 10 percent of net banking income. As discussed in Principle 5, however, there is presently no requirement that a prior authorization be obtained from the French supervisor for the acquisition by a credit institution of interests in banking businesses in non-EEA countries.

207. Where corporate ownership of a credit institution is concerned, the means for the supervisor to review the activities of a credit institution's direct or indirect parent companies and the latter's subsidiary affiliated companies are available in the 1984 BA, as amended (Arts. 41). Protection of the credit institution against adverse developments (which could impact its soundness) at the parent or non-bank affiliate companies would be achieved through the provisions of the 1984 BA, as amended (Arts. 42, 43, and 45) which provide for the CB to warn against—or to recommend—a course of action, with graduated sanctions for failure to heed the CB's observations.

208. In respect of owners of parent companies, the CRBF Regulation 96-16 requires the prior authorization—by the CECEI—of the acquisition (by acquirers domiciled in France) of defined levels of direct—or indirect—equity interests in credit institutions. Acquisitions by acquirers domiciled outside France requires immediate notification to the CECEI, which may find reason that the credit institution's authorization be modified. Given the close "collegial" links between the CECEI and the CB, the supervisor thereby has a means of establishing and enforcing "fit and proper" standards for owners.

209. For senior managers, the 1984 BA, as amended (Art.73), makes "financial holding companies" subject—inter alia—to Article 17 of the 1984 BA, under conditions set out in Regulation. The CRBF Regulation 96-16 (Art. 9) requires notification of changes in senior management to the CECEI, affording the latter the opportunity to state whether an appointment is seen as compatible with the credit institution's authorization. This provides an oblique means of establishing and enforcing "fit and proper" standards for senior managers of parent companies of credit institutions.

Assessment of Principle 20: Compliant

210. Prudential rules are extensively applied on a consolidated basis and supervisors make a point of verifying the scope of consolidation. The SGCB is well aware of the overall structure of banking organizations or groups (i.e., the credit institution and its subsidiaries) and has an understanding of the operations conducted therein. The 1984 BA, as amended, empowers it to supervise the entire activities of a credit institution, whether those activities are carried on directly (including branch operations located outside France), or by means of subsidiaries and/or affiliates. Regulations provide for supervised credit institutions to observe prudential standards on a consolidated basis, particularly those relating to capital adequacy, large exposures and lending limits. At the same time, the SGCB's supervisory processes enable it to evaluate the risks that non-banking activities conducted by a credit institution or the other elements of the banking group may pose for the institution or group as a whole.

211. Information exchange mechanisms with other domestic and foreign regulators allow the SGCB to adequately access information on the financial condition and the risk management practices and controls of business vehicles within a banking group. In non-EEA countries, bilateral agreements are strengthening this aspect of supervision, though the scope of competence is a frequent stumbling block in certain countries with a tradition of opacity (see Principle 24).

212. As yet, a limited number of mutual institutions have not drawn up fully consolidated financial statements. The fact that these institutions are not yet able to do so largely reflects their structure, and the fact that heretofore consolidation has not been legally compulsory for them. It should be noted, however, that most mutual institutions do in fact publish a form of consolidated financial statements of their own volition. Moreover, the CB has been able, through requiring the reporting of aggregate figures in several key areas of banking risk, to achieve its supervisory objectives in regard to the mutual institutions. In addition, as already

noted under Principle 18, the new regulation on consolidated accounts, which was issued in June 2001, should fully resolve this issue once it becomes implemented.

VI. Information Requirements and Corrective Actions

Principle 21. Adequate and true records

Banking supervisors must be satisfied that each bank maintains adequate records, drawn up in accordance with consistent accounting policies and practices that enable the supervisor to obtain a true and fair view of the financial condition of the bank and the profitability of its business, and that the bank publishes on a regular basis financial statements that fairly reflect its condition.

Description

213. The Banking Law, in its articles 54 and 55, refers to the CRC the competence and responsibility to issue accounting regulation for banks, after formal consultation with the CRBF. Formerly the CRBF was the only body enabled to regulate accounting matters for banks.

214. Most of the current regulations were defined by the CRBF before the CRC was created. The CRBF (in particular, Regulation 91-01) has elaborated extensive accounting and valuation rules for the financial sector, thus providing for a framework specifically adapted for keeping bank records and for publishing statutory accounts for financial institutions. In particular, French regulations allow for "marked to market" valuation under the double condition that it concerns assets that are likely to be traded (trading book concept) and that appropriate management and control procedures are in place. Moreover, CRBF regulation 97-02 on internal control issues strict rules regarding internal control procedures in accounting aiming specifically at ensuring the "auditability" of accounts (audit trail). CRC Regulations 99-07 and 99-03 (for investment firms) further specify the modalities for the preparation of consolidated accounts.

215. As explained under Principle 19, the CAC play a fundamental role in certifying banks' accounts and the 1999 FSFA has strengthened the CB's capacity to request the assistance of the CAC in monitoring the activities of the credit institutions and investment firms and ensuring the reliability of their reports.

216. A joint report ("*Livre Blanc*") issued by the COB and the CB in December 1988 noted that much remained to be done towards strengthening the transparency of reporting by French banks and making it comparable to practices prevailing in many other G-7 countries. In particular, the report stressed the more limited and less standardized disclosure by French banks on credit risk, including information on non-performing or non-accrual loans, provisioning, write-offs, and interest income on doubtful loans. The report also noted some weaknesses as regard the reporting of market risks, including disclosure on derivative activities and counter-party risks. It also noted that the reporting of income from

commissions was often spread out throughout the accounts and difficult to trace, and that the quality of the qualitative information (methodological and analytical notes) in the accounting reports of French banks was often below that encountered in U.S. or other G-7 banks. Moreover, the substantial heterogeneity in the presentation of accounts across banks hampered in an important way the comparability of these accounts. While some deficiencies in disclosure remain, the major weaknesses have been addressed and banks' disclosure practices have steadily improved.

Assessment of Principle 21: Largely compliant—improvement under way

217. While the CRBF's and CNC's accounting rules and regulations may be considered to be generally appropriate and in line with European and international standards as regards the accounting treatment of operations and their monitoring, the rules on the reporting and publishing of financial statements need further strengthening. Although most French banks have made substantial progress in the last few years in giving more detail on the various elements of their profit and loss accounts (especially on the relative importance of sources of income), there still appears to be a lack of comparability between banks and, in some cases, of inter-temporal consistency. The notable privatization and liberalization efforts undertaken by the French authorities during the last decade need to be followed by resolute efforts to strengthen the accountability and transparency of banks, in accordance with the increasing emphasis on market discipline made through the third pillar of the revised Basel Capital Accord. The issue of regulations that ensure broader disclosure *on a uniform and internationally comparable basis* should allay the concerns of banks about the potentially negative impacts of disclosure.

218. As a result of the report on financial transparency, important reforms have already been enacted through the 1999 FSFA. Further improvements aiming at better disclosure in several key areas are under discussion at the CNC and will be progressively introduced. In particular, more comprehensive and consistent information shall be given, including in the annexes to the accounting statements, on elements of market risk, exposure to derivatives, counter-party risk concentration, provisioning charges, the net result of banking activities, general expenses, and the return on equity. The CB and the COB are also discussing ways to provide more detailed and consistent disclosure relating to some elements of credit risk, including the coverage ratio of doubtful debt by provisions and variations over time in the structure of impaired debt. It is important that any remaining lags and weaknesses as regards disclosure and transparency practices of French banks be corrected as soon as possible.

219. At the same time, following the remarks made under Principle 8, it would be desirable, especially for facilitating inter-bank comparisons, that banking groups make further progress in providing more detailed criteria on their credit classification and provisioning. In addition, it would be of great interest if this could be done under the supervision of the CB (and the COB), and if the CB could develop its present efforts to make the output of banks' internal scoring and risk assessment models comparable, especially by working closely with the national (and international) banking community. In this context, further work appears to be needed (in line with the work underway in the Basel Committee)

towards identifying the key aggregates and ratios that all banks should provide to facilitate the assessment and comparison of their performance.

220. The most delicate matter concerns crisis communication. Notwithstanding clear evidence, as noted in the report on financial transparency, of the beneficial effects of timely crisis communication, most bankers remain reluctant to accept regulations or to make firm commitments in this respect. While the CB and the COB have encouraged banks to adopt a policy of open and timely communication on any significant difficulties and on relevant external events that affect their risk-exposure, results so far have been mixed.

Principle 22. Corrective action

Banking supervisors must have at their disposal adequate supervisory measures to bring about timely corrective action when banks fail to meet prudential requirements (such as minimum capital adequacy ratios), when there are regulatory violations, or where depositors are threatened in any other way. In extreme circumstances, this should include the ability to revoke the banking license or recommend its revocation.

Description

221. As noted in Principle 1(4), the 1984 BA confers a large range of enforcement and sanctioning powers of the CB, which have been considerably strengthened by the law of June 1999. It has at its disposal a wide range of measures, to which it is enabled to have recourse to its full discretion. Measures range from a recommendation or an injunction (both aiming at making the credit institution take appropriate corrective action within a given period of time in order to improve its financial situation, enhance its management methods or insure the adecuation of its organization to its activities or development targets) up to the designation by the CB of provisional administrator who takes over all of the powers of the existing management (including the eventual closure of the bank). The most common and effective corrective measures are the *lettres de suite* following an on-site inspection. They call on the responsibility of both management and Board of Directors for ensuring the corrections and improvements recommended by the CB. In the case of serious deficiencies or infringements, the *lettre de suite* can take the form of a firm injunction, having a more coercive power than the recommendation. Article 45 provides diverse disciplinary sanctions among which the suspension of certain activities, the temporary suspension or compulsory resignation of the responsible directors and the withdrawal of the banking license. Pecuniary sanctions may also be imposed in addition to these measures. Moreover, the CB may impose the withdrawal of the voting rights of certain or all shares, the prohibition to pay dividends or other form of remunerations to shareholders and the obligation for the credit institution to disclose, at its own expenses, the disciplinary sanctions. Should it estimates convenient, the CB mentions infringements or criminal offenses to the Public Prosecutor's Office.

222. Sanctions may vary from penalties and fines to the removal of directors or managers, the withdrawal of the voting rights of certain or all shares, the prohibition to pay dividends or other forms of remuneration to shareholders and the obligation for the credit institution to

publish, at its own expenses, the said sanctions. In certain cases the CB considers it necessary to make mention of infringements or criminal offences to the Public Prosecutor's Office.

223. Whenever a bank is deemed to be at risk of not being able to meet its commitments towards its customers, the CB can resort to the Deposit Guarantee Fund. Given that the primary concern in such case is the optimal protection of the interest of private customers covered by the Deposit Guarantee Scheme, the CB and the Fund are expected to cooperate closely both in the decision-making and the implementation of the measures. The functioning of the Scheme and the Fund are both strictly regulated in accordance with the EEA Directive on Deposit Guarantees.

224. The CB being an administrative authority, its decisions and sanctions can only be challenged in an administrative court. In particular, bank customers and/or management and directors can go to court to contest the appointment of special directors or administrators by the CB. They can also contest the decisions and actions of such directors. Appeal against CB decisions taken in application of BA article 45 have to be made to the Conseil d'Etat. These legal resources are not suspending the effect of the initial decisions.

Assessment of Principle 22: Compliant

225. The CB appears to have taken a firm but prudent stand in using its sanctioning and injunctive powers. The panoply of measures and discretionary powers it has at its disposal fully enable prompt and effective action, both in the remedial and the sanctioning area. The supervisory authorities make effective use of the various options available to them by law to sanction institutions that do not comply with regulations. At the same time, adequate rights for defense are granted to protect against abusive disciplinary actions.

226. Although some of the measures introduced by the 1999 legislation are too recent to allow a proper assessment of their effectiveness (e.g., the publication of penalties imposed by the CB or the suspension of dividend payments), the creation of a deposit guarantee fund considerably changed the environment in which the CB operates. The CB has made, so far, a limited use of its ability to close financial institutions (less than twenty institutions have been closed in the last ten years, mainly reflecting the increasing use of forward-looking and early corrective actions, as well as many "voluntary" applications for closing down institutions in an orderly manner). As already noted in Principle 1(4), the new intervention procedures of the deposit guarantee fund should allow for more timely, flexible, and less disruptive actions, thereby strengthening the credibility and effectiveness of the CB's requests for prompt corrective actions. However, some residual weaknesses may need to be addressed. In particular, under the current legal framework, banks' creditors can block (or reverse) steps taken by the CB-appointed administrator towards the resolution of a troubled bank, which may discourage prompt and resolute action by this administrator.

Principle 23. Overseas supervision

Banking supervisors must practice global consolidated supervision over their internationally active banking organizations, adequately monitoring and applying appropriate prudential norms to all aspects of the business conducted by these banking organizations worldwide, primarily at their foreign branches, joint ventures and subsidiaries.

Description

227. The law explicitly enables the CB to extend its on-site supervision on a credit institution to all its foreign subsidiaries and branches, to its controlling entity and to the subsidiaries of the latter. One of the key-features of Regulation 97-02 on internal control is that each institution must ensure that its organization and procedures are adequate for its activities and that of the group it belongs to. This covers the inclusion of foreign branches and subsidiaries in management information, the internal control structure of the organization and the daily oversight responsibility of management. During on-site inspections on internationally active banks, the CB ascertains that the organization and internal control of the French parent fully meet this requirement. Part of the on-site inspection is in many cases carried out at the premises of foreign branches (and in some cases even jointly with the local supervisor) of French banks. Even when rules, regulations and requirements are not fully equivalent to those for the parent bank, the CB requires fully consolidated prudential information on all entities of a group, both purely national groups and those also operating abroad, on the basis of the groups' internal accounting and external prudential norms.

228. The French regulations make a distinction between EEA branches and other entities. In the case of EEA branches, which have to be notified to the CECEI prior to their constitution, the "home" supervisory authority retains all its sanctioning powers and can withdraw the authorization to run a branch that is deemed to be unsound or in violation of the home regulations. The "home" authority should only advise (and consult with) the "host" authority. In the other cases, if it does not comply with the "host country's" regulations, only the host supervisor can directly sanction it. However, as "home" supervisor, the CB could sanction the parent bank or require it to stop or limit its activities, making use of the powers specified by BA Article 45.

229. The CB and CECEI have elaborated an extensive network of Memorandum of Understanding (MOU) agreements with its peers to enable it to fully supervise French banking groups that are also active abroad. Negotiations are under way to extend this network of agreements further. These agreements have been broadened, since 1999, to encompass new cooperating countries and extend the scope of such cooperation, which now comprises also the possibility of bilateral on-site inspections. Apart from this formal aspect, the CB has already been carrying out a very close cooperation with all the main G10 or industrialized countries' supervisory agencies. In this framework, regular individual sharing of information is carried out between the CB and non-EEA supervisors, periodic meetings take place and stand alone or joined on-site inspections of French branches and subsidiaries

are usual, especially in North America and Asia where most French foreign operations are located.

230. Within the EEA, specific directives require the supervisory authorities to cooperate by mutually allowing each other to properly exert consolidated supervision. Thus, France has a wide range of MOUs in place to implement these directives. Wherever a significant presence of French banks abroad (or vice versa for foreign banks) exists, these MOUs give rise to regular consultations, both formal and informal. For a limited number of international financial conglomerates, involving French banks, these consultations are frequent and intense and are covered by special, sometimes multi-party MOU agreements. For some other non-EEA countries, similar bilateral agreements have been established. However, for countries for which the scope for cooperation is limited by the opacity of local rules on establishment, supervision and professional secrecy, the CB asks the institutions themselves, on a case by case basis, to provide the information it requires in order to carry out its supervisory duties on a consolidated basis.

Assessment of Principle 23: Compliant

231. In reviewing and assessing the financial situation and the organization of banks, the CB appears to take account of all relevant national and international ramifications of the banking groups concerned and, the case being, of their controlling entity (regardless of its nature). In practice, this enables the CB to realize a proper consolidated supervision on all French banks having affiliates or branches abroad, even when due and proper consolidation is not yet fully ensured, as in the case of some mutual groups (see Principles 18 and 20). Thus, France fully complies with the requirements needed for an adequate supervision of the overseas activities of French banking groups.

Principle 24. International coordination

A key component of consolidated supervision is establishing contact and information exchange with the various other supervisors involved, primarily host country supervisory authorities.

Description

232. French laws and regulations provide a comprehensive framework for cooperation with foreign authorities. As already mentioned in principle 1 (6), the 1999 SFSA has extended the power of the CB, which may now conclude bilateral agreements with the authorities of a country that is not an EEA Member State, in order to: (a) perform on-site inspections on entities in the jurisdiction of the signing authorities; (b) allow the national authorities to perform on-site inspections, upon request of the co-signing authority or jointly with them, on subsidiaries or branches of institutions under the supervision of the said foreign authority; and (c) lay down conditions and modalities for the exchange of information.

233. As explained under Principle 23, the CB and CECEI have in place a number of MOU agreements covering nearly all jurisdictions where French banks have established subsidiaries or branches. For most of these MOUs, in particular those with other EEA Member states, a practice of regular consultation and cooperation has been established. The main conditions for such agreements is that the counterpart authority be subject to the same professional secrecy regulations as the CB, that regulation and supervision in the country concerned be reasonably equivalent to those in France, and that the reciprocity principle be fully respected. For some countries, where the elaboration of a formal agreement is still under negotiation, pragmatic arrangements for informal information sharing are in place and appear to function reasonably well. Whenever French banks have the intention to branch out to a country or acquire or establish a banking activity there, the CB must approve the project and negotiate the cooperation on supervisory matters of the authority concerned. For EEA or OECD member countries, the CB is authorized to rely on these counterparts having truly and faithfully implemented EEA legislation or OECD recommendations and, thus, fulfilling all the requirements and conditions set by the French laws. The CB establishes with the competent authority the practical means and ways of cooperation. For other countries, the CB investigates whether acceptable cooperation terms can be agreed on. In case of unsatisfactory supervision or unacceptable conditions for supervisory cooperation, the CB can oppose a project to branch out.

234. For a heterogeneous financial conglomerate, a more elaborate three-party MOU has been prepared, which allows for far-reaching cooperation and for a clear sharing of responsibilities and information between the supervisors concerned. For heterogeneous international financial conglomerates the CB has in place arrangements for cooperation and exchange of information with other domestic supervisors, such as the COB (see above), the CMF, and the CCA.

Assessment of Principle 24: Compliant

235. For all foreign establishments of French banks and vice versa, satisfactory agreements for supervisory cooperation are in place and operational. Furthermore, informal exchanges of information have been taking place for several years now with other supervisors of the world's leading financial markets. Other formal bilateral agreements are under preparation. However, the CB wishes to limit the formal bilateral agreements to countries which share the same concern for transparency in the communication of information, professional secrecy and, more generally, compliance with and effective application of the criteria developed by the Basel Committee.

236. At present, the activities of French banks in other EEA countries are generally small as compared to their domestic activities (by contrast, operations in the United States and in several Asian countries account for a significant part of the consolidated balance sheet of the largest banking groups). Thus, the coordination of France's supervisory activity with that of its EEA counterparts appears to be sufficient, based on bilateral memorandums of understanding (MOUs) and discretionary exchanges of information. However, further efforts at expanding coordination with other European supervisory agencies may be needed in the

future as the unified currency and rising trade and financial integration increase the scope for the cross-border activities of both lenders and borrowers. The French authorities duly recognize the need for further intensifying their contacts with their colleague supervisors, both in the EEA and with other countries. Their active participation in both European and international consultation forums on these matters should allow them to remain in the forefront of international cooperation.

Principle 25. National treatment

Banking supervisors must require the local operations of foreign banks to be conducted to the same high standards as are required the domestic institutions and must have powers to share information needed by the home country supervisors for those banks for the purpose of carrying out consolidated supervision.

Description

237. As stated under Principle 24, the CB has full power to enter into any agreement or arrangement to mutually share information with its peers abroad concerning internationally active banks. For branches of EEA banks, European regulation entrusts full supervisory responsibility to the home-country supervisor, with the exception of liquidity supervision. Branches of non-EEA banks are subject to the same rules and regulations as are French banks. The CB may, however, accept that these branches meet different requirements (e.g., with regard to solvency and large exposures) provided that: (a) the home-country regulations require full consolidation of the risks taken abroad by the mother-bank; (b) the latter commits itself to supervise the operations and the situation of its branch on the same basis and principles as for a home-based institution and this under the supervision of its national supervisory authority; and (c) an equivalent treatment is granted to the branches of French banks in the country concerned.

238. For subsidiaries, France, as the host-country, must provide for the full respect of its rules and regulations, as such institutions are incorporated under French law, hence are subject to full CB supervision, with both on-site and off-site examinations, on the same basis as French banks. The CB also has the same sanctioning powers over such subsidiaries as over French banks, inclusive of the right to close their operations. Unlike branches of foreign banks, French subsidiaries of foreign banks are also covered by the French Deposit Guarantee Scheme. Since branches of EEA banks are covered by the deposit guarantee scheme of their home country, in accordance with EEA directives on deposit guarantees, the coverage of their customers is equivalent to that under the French regime.

239. Cooperation with the home-country supervisor ensures that the latter is enabled to perform fully consolidated supervision and that it can be called upon to sustain supervisory action whenever serious problems might occur. In addition, for licensing, the CECEI, before making any decision, may seek the advice from the home-country supervisory authority and its assessment of the project.

Assessment of Principle 25: Compliant

240. Overall, the prudential norms applied to foreign banks are as stringent as those applied to French banks. Within the EEA, prudential rules are harmonized. Nevertheless, the CB may accord exceptions provided that branches from countries whose regulations are at least as stringent as French regulations comply with certain prudential rules. Furthermore, the SGCB does not rule out the possibility of asking such branches to increase their own funds if they appear insufficient in relation to their exposure. Off-site supervisors regularly verify the rules that apply to foreign institutions. Likewise, the CB frequently organizes on-site supervision of the branches of foreign banks, like their French counterparts. In the event of a serious anomaly, the matter may be referred to the home country authorities, a practice which is likely to become more widespread with the possibilities now offered by the 1999 FSFA.