

**France: Financial Sector Assessment Program—Detailed Assessment of Observance of  
Basel Core Principles for Effective Banking Supervision**

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FINANCIAL SECTOR ASSESSMENT PROGRAM

FRANCE

BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

DETAILED ASSESSMENT OF  
OBSERVANCE

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**GLOSSARY**

AC	Additional criteria
AMA	Advanced measurement approach
AML/CTF	Anti-money laundering/counter terrorism financing
ACP	Autorité de Contrôle Prudentiel
AMF	Autorité des marchés financiers (Financial Market Authority)
BdF	Banque de France
BCP	Basel Core Principles for Effective Banking Supervision
CEBS	Committee of European Banking Supervisors
CCSF	Comité consultatif du secteur financier, (Financial Sector Consultative Committee)
CCLRF	Comité consultatif de la législation et de la réglementation financiers
COMOFI	Code Monétaire et Financier (Monetary and Financial Code)
COREFRIS	Conseil de Régulation Financière et du Risque Systémique
DGF	Deposit Guarantee Fund
EBA	European Banking Authority
EC	European Community
EEA	European Economic Area
EU	European Union
FSB	Financial Stability Board
FATF	Financial Action Task Force
GDP	Gross Domestic Product
H3C	Haut Conseil du Commissariat aux comptes
IFRS	International Financial Reporting Standards
MINEFI	Minister of the Economy and Finance
MoU	Memorandum of Understanding
RRP	Recovery and Resolution Plan
SIFI	Systemically important financial institution

## I. EXECUTIVE SUMMARY, KEY FINDINGS, AND RECOMMENDATIONS

1. **France has a high level of compliance with the Basel Core Principles for Effective Banking Supervision (BCPs).** The French banking system weathered the 2007-2009 crisis relatively better than a number of other countries, in part due to the benefits of a diversified banking model and an undoubted material contribution from a well-developed regulatory and supervisory structure. More recently, developments in the eurozone and in funding markets, as well as in markets for sovereign debt, have exposed vulnerabilities that are being dealt with by banks and the authorities. Certain weaknesses in risk management practices were revealed. And the supervisory and regulatory system has been under strain, as have banks, in part from these developments coming at the same time as major changes in international rules are being implemented and markets are putting pressure on banks as to how they will respond to the new rules on capital and liquidity.

2. **The assessors saw many examples of high-quality initiatives and practices in the supervisory authority (ACP), but there are several areas where weaknesses in legislation and regulation need to be addressed to give supervisors the full range of tools, and supervisors need to enhance their practices in a few areas in order to take advantage of these tools and increase their effectiveness.** The recent merger of supervisory agencies for prudential regulation of banking and insurance into the Autorité de Contrôle Prudentiel (ACP), as part of the Banque de France, should be an important contributor to this enhanced effectiveness, given the prevalence of the banc-assurance model in France.

### A. Introduction

3. **This assessment of the current state of the implementation of the BCPs in France has been completed as part of a Financial Sector Assessment Program (FSAP) undertaken by the International Monetary Fund (IMF) during 2012.** It reflects the regulatory and supervisory framework in place as of the date of the completion of the assessment. Importantly, it is not intended to assess the merits of the important policy and implementation issue regarding several aspects of the international regulatory framework that are yet to be decided in international fora, the European Union (EU), and in France. An assessment of the effectiveness of banking supervision requires a review of the legal framework, both generally and as specifically related to the financial sector, and detailed examination of the policies and practices of the institutions responsible for banking regulation and supervision. In line with the BCP methodology, the assessment focused on the major banks and banking groups, and their regulation and supervision, given their importance to the system.

### B. Information and Methodology Used for Assessment

4. **The French authorities agreed to be assessed according to the Core Principles (CP) Methodology issued by the Basel Committee on Banking Supervision (Basel Committee) in October 2006.** The current assessment was thus performed according

to a revised content and methodological basis as compared with the previous BCP assessment carried out in 2005. The assessment of compliance with each CP is made on a qualitative basis to allow a judgment on whether the criteria are fulfilled in practice. Effective application of relevant laws and regulations is essential to provide indication that the criteria are met.

5. **To assess compliance, the BCP Methodology uses a set of essential and additional assessment criteria for each principle.** The essential criteria (EC) are the only elements on which to gauge full compliance with a core principle. The additional criteria (AC) are suggested best practices against which the French authorities have agreed to be assessed. The AC are commented on but are not reflected in the grading. The assessment of compliance with each principle is made on a qualitative basis. A four-part grading system is used: compliant; largely compliant; materially noncompliant; and noncompliant. This is explained below in the detailed assessment section.

6. **The assessment team reviewed the framework of laws, rules, and guidance, and held extensive meetings with officials of the ACP, and additional meetings with the Banque de France (BdF), the Minister of the Economy and Finance (MINEFI), and banking sector participants.** The team met the industry association representing banks in addition to a number of domestic and nondomestic institutions.

7. **The team appreciated the very high quality of cooperation received from the authorities.** The team extends its thanks to staff of the authorities, who provided excellent cooperation, including extensive provision of documentation, at a time when many other initiatives related to domestic, European, and global regulatory initiatives were in progress.

8. **The standards were evaluated in the context of the French financial system's sophistication and complexity.** It is important to note that France has been assessed against the BCPs as revised in 2006. This is significant for two reasons: (i) the revised BCPs have a heightened focus on risk management, its practice by supervised institutions, and its assessment by the supervisory authority; and (ii) the standards are evaluated in the context of a financial system's sophistication and complexity.

9. **An assessment of compliance with the BCPs is not, and is not intended to be, an exact science.** Reaching conclusions required judgments by the assessment team.<sup>1</sup> Banking systems differ from one country to another, as do their domestic circumstances. Furthermore, banking activities are undergoing rapid change after the crisis, prompting the evolution of thinking on, and practices for, supervision. Nevertheless, by adhering to a common, agreed methodology, the assessment should provide the French authorities with an internationally

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<sup>1</sup> The assessment team comprised Nick Le Pan and Katharine Seal.

consistent measure of the quality of its banking supervision in relation to the revised Core Principles, which are internationally acknowledged as minimum standards.

10. **To determine the observation of each principle, the assessment has made use of five categories: compliant; largely compliant, materially noncompliant, noncompliant, and non-applicable.** An assessment of “compliant” is given when all essential criteria are met without any significant deficiencies, including instances where the principle has been achieved by other means. A “largely compliant” assessment is given when there are only minor shortcomings, which do not raise serious concerns about the authority’s ability to achieve the objective of the principle, and there is clear intent to achieve full compliance with the principle within a prescribed period of time. A principle is considered to be “materially noncompliant” in case of severe shortcomings, despite the existence of formal rules and procedures, and there is evidence that supervision has clearly not been effective, the practical implementation is weak, or that the shortcomings are sufficient to raise doubts about the authority’s ability to achieve compliance. A principle is assessed “noncompliant” if it is not substantially implemented, several essential criteria are not complied with, or supervision is manifestly ineffective. Finally, a category of “non applicable” is reserved (though not used) for those cases that the criteria would not relate to the French authorities.

11. **For completeness’ sake, it should be noted that the ratings assigned during this assessment are not directly comparable to the ones assigned in terms of an FSAP performed using the pre-2006 BCP Methodology.** Differences may stem from the fact that the bar to measure the effectiveness of a supervisory framework was raised by the 2006 update of the BCP Methodology, as well as by lessons drawn from the financial crisis that may have a bearing on supervisory practices.

### **C. Institutional and Macroeconomic Setting and Market Structure—Overview<sup>2</sup>**

12. **French banks are large with an aggregate balance sheet amounting to five times GDP.** Four of the top five French banks are on the Financial Stability Board (FSB) list of global systemically important financial institutions (SIFIs). The sector is relatively concentrated with the top five banks accounting for 88 percent of banking system assets. The structure of the French banking system has long been based on universal banking; so most major banking groups, while headed by a bank, have a material insurance operation. The French banking system is also characterized by a substantial presence of mutual banks among the largest entities. These are structured with regional/local mutual banks that control a central body responsible for funding and group-wide risk management, and various subsidiary operations in France and abroad. Credit support usually exists in some fashion within the group. For several (but not all) of the mutual groups the central body or another

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<sup>2</sup>In FSAP/FSSA reports, this information will be contained in other parts of the FSAP report. Salient details, however, may be briefly restated for convenience.

material body in the group is a listed entity. These groups serve the traditional retail and small- and medium-size business clients. During the last decade, a number of them expanded significantly outside of France and acquired material corporate and investment banking operations. Several major French banks have a global presence, as well as material operations in investment banking, though the size of these has been reduced as a response to the crisis and to the advent of more stringent capital and liquidity rules. There is also an important bank attached to the postal system, 100 percent owned by the government, with limited funding from markets.

13. **The crisis during 2007–2009 did not affect French banks as much as banks in a number of other markets.** However, more recently, they have been impacted by uncertainty about resolution of European issues, exposure to peripheral Europe, which is especially important for certain of the banks (sovereign and corporate and household debt), and ongoing market and regulatory pressures to buttress liquidity and capital. French banks' diversified earnings mix and relatively lower exposure to various structured products meant that their losses were manageable in the period of 2007–09 (although one French bank that was a subsidiary of a Belgian bank, failed, and continues to be restructured). Furthermore, the recession was mild in France and banks benefited from the mortgage market and housing finance, which is conservative.

14. **On the other hand, French banks have had higher wholesale funding than average for some time, and more reliance on short-term funding.** The year 2011 saw downgrades of a number of major banks, widening CDS spreads and reductions in short term U.S. dollar funding. This, together with the pressure to attain Basel III capital ratios well ahead of the original target, has led them to aggressively plan to deleverage focusing on credit extension and wholesale banking products that use the most funding. French banks did not raise capital since 2009 and had capital ratios close to the average of other European banks. They are now building core capital through reducing earnings' distribution on top of strong retail and commercial earnings power. Banks face large funding needs in the first half of 2012. In addition to future funding pressures and the outcome of the resolution of European issues, the other short-term risk relates to the severity of the slowdown in the European and French economy that appears to be underway. While authorities have identified the mortgage sector as a potential concern, there do not appear to be clearly higher imbedded losses in that sector that would lead to concerns about banks. This is because of the prudent way the mortgage market and bank mortgage granting policies work in France.

15. **The regulatory and supervisory structure in France has recently changed.** The ACP (part of the Banque de France) was created in 2010 through a merger of the former banking and insurance authorities, with a new additional mandate for consumer protection. At the same time, a Financial Stability Committee was created and is functioning. The authorities, as in other European countries, are dealing with the evolution of regulations and supervisory practices at the EU level and the implications those have for France and for French banks. The emergence of additional EU rules will, however, alter the operations of



the ACP and some emerging rules have major implications for banks, as they do in other markets. The recent interim capital raising exercise conducted by the European Banking Authority (EBA) showed that French banks needed relatively modest amounts of additional capital to meet the mid-year 2012 targets. French authorities and banks have indicated they saw this as eminently achievable without going to markets or requiring state support.

#### **D. Preconditions for Effective Banking Supervision**

16. **France has a well-developed public infrastructure supporting effective banking supervision.** France has a complete system of business laws, consistently enforced. Accounting standards for listed companies and other consolidated accounts have been prepared to International Financial Reporting Standards (IFRS) standards, as adopted by the European Union, for some time. Auditing standards are generally consistent with international auditing standards, and there is a French audit oversight body (H3C) that inspects audit firms. Rules to limit potential auditor independence issues, such as restrictions on non-audit services, an audit firm may offer are tougher in France than in other jurisdictions. H3C has only recently revised its approach to inspections, so that the body itself now inspects audit firms to determine that audits are being conducted consistent with accounting standards applicable in France and French audit standards. Previously, these inspections were done by the professional body under H3C's oversight. It will need to continue to enhance its coverage, build its resources, and develop its oversight of audit firms.

17. **French banks, and listed companies more generally, make extensive public financial disclosures under IFRS, and as a result of bank regulations (Pillar III of Basel II).** Market analysts that the assessors talked to indicated general satisfaction with disclosure. But they, and the assessment team also noted a few areas of potential improvement or areas where there was inconsistent treatment among banks that made peer comparison difficult. Recent EBA reviews of banks' Pillar III disclosures indicate a similar result. It was also noted that financial literacy in France was lower than in some other major jurisdictions, and that might have some implications for consumer protection regulation going forward.

18. **The establishment of the ACP in early 2010 was complemented by the creation of a Systemic Risk Board, *Conseil de Régulation Financière et du Risque Systémique* (COREFRIS).** It is chaired by the Minister of Finance and presidents of the ACP (Governor of the Banque de France), Financial Markets Authority, and Accounting Rules Authority are members. The COREFRIS provides a national framework for cooperation and coordination between authorities, including in crisis time, but it is not a decision making body as each individual authority retains the responsibility to act in its own right. No domestic Memorandum of Understanding (MoU) specific to crisis management has been agreed, but the COMOFI provides gateways for information sharing and cooperation between the relevant authorities. In addition, coordination in crisis times is likely to be facilitated by the fact that there are structural relationships among a number of these

authorities. For example, the governor of the BdF is the chairman of the ACP and the Director of the treasury is represented on the college of the ACP. Hence, the functions of central banking (lender of last resort) and prudential supervision are separate at staff level but coordinated at decisional level, and the treasury will be fully informed throughout.

19. **In line with the FSB SIFI Recommendations, the ACP has asked large banking groups to start preparing recovery and resolution plans (RRPs).** These issues have been discussed, since 2009, in the core supervisory colleges, as well as among French authorities, and continue in the context of Crisis Management Groups (associating central banks and supervisors) set up in 2011. Firms have been requested to have group-wide RRP, capturing all key dimensions, available by mid-2012. Practical implementation of the plans will extend until end 2012.

20. **France has a deposit guarantee scheme, distinct from the Prudential Supervision Authority, with two complementary objectives:**

- Paybox: According to EU Directive (94/19/EC of the European Parliament and of the Council of May 30, 1994 on deposit-guarantee schemes, as amended) depositors are guaranteed up to a limit of €100,000 per credit institution.
- Preventive action: The French Deposit Guarantee Fund (DGF) can intervene in a credit institution facing difficulties only at the ACP's request.

21. **The deposit guarantee scheme is funded on a risk-based approach in order to mitigate against moral hazard.** The pay box function is automatic to protect depositors and protect confidence in the financial system, but the preventive action remains discretionary to avoid moral hazard. The ACP and the DGF are contemplating whether to draw up an MOU.

## E. Main Findings

### *Objectives independence, powers, transparency, and cooperation (CPI)*

22. **As a newly-created integrated regulator, ACP is starting to benefit from synergies in the supervision of banks and insurers, but has more to do to fully realize these benefits.** One of its predecessor organizations, the Commission Bancaire, already benefitted from being part of the BdF, and those benefits are likely to become more important as many countries add systemic considerations into micro-prudential supervision. There is room for more day-to-day cooperation on these issues, but the ACP and the BdF are well placed to achieve that. At the same time, a consumer protection mandate has been added to the legislative mission of the new organization, and it has used material additional resources in starting up this task. It will be important going forward not to let consumer protection crowd out the essential micro-prudential contribution of ACP to financial stability.

23. **Certain aspects of the new structure raise concerns about potential independence, sound governance, and access to adequate resources for the supervisor, though there is no evidence of problems to date.** The issues concern the role of the MINEFI in the College (decision making body) of the ACP and in controlling resourcing for the ACP, legislative limits on ACP headcount, and the fact that ACP cannot independently set any prudential rules or its own assessments on industry. It is important that MINEFI have information on individual institution issues that are potentially important for financial stability, and information on market developments. It is also important that they have a major role in decisions that affect financial stability. However, there are ways to achieve these aims without the ministry having a right to attend and attending *all* of the ACP College discussions and decisions, and having a right to force reconsideration of any issue, even those that do not raise potentially systemic concerns or possible risk to public funds. Also, the ACP could be given a more formalized role in recommending prudential rules.

24. **There are two serious legislative deficiencies that affect full compliance with a number of the core principles and hamper supervisory effectiveness.** One is lack of a complete legislative framework related to regulating the responsibilities of the Board of Directors (as distinct from senior management), including inability to apply a fit and proper test to Board members, coupled with ACP practice that has only a limited direct interaction with the decision making body in banks (i.e., the Board). This has consequences for several areas from the integrity of the fit and proper process on changes of ownership in banks, the inability to suspend or dismiss Board members (individually or collectively), to ACPs ability to set separate requirements for Board responsibilities in oversight and risk governance, to the inability of ACP to meet with the nonexecutive members of the Board together to present their supervisory findings and ensure the Board is overseeing the necessary improvements by management. As a result the possibility of effective early intervention by the ACP is impaired on more major prudential concerns affecting an individual bank's strategy that *would* normally have to be dealt with at this level. Furthermore, the ability of ACP to assess whether the Board of Directors of an institution has sound knowledge of the business and risks of a bank is impaired. There is considerable room to enhance assessments of Board oversight of risk issues, which is relevant for a number of CPs. The second legislative issue is the fact that the ACP does not have the formal power to approve acquisitions by French banks, either in the European Economic Area (EEA) or abroad. The ACP would be highly likely to react to an unacceptably-risky acquisition by a French bank, after the fact, with additional restrictions and required capital buffers. However, that is not as effective as having approval authority in the first place, as exists in most other jurisdictions. The legislative deficiencies mentioned in this paragraph are covered in the text below, according to the relevant core principle under consideration.

25. **Mechanisms are in place for information sharing and cooperation among the authorities.** France benefits in this regards from close links between officials from various authorities.

*Licensing and structure (CPs 2–5)*

26. **In the main, licensing and structure are given appropriate treatment under France’s regulatory regime.** The ACP process and procedures surrounding the licensing function are detailed thorough and diligent. There remain, however, some important areas within the legal framework where adjustments are recommended. Please note that some of the issues considered in CPs 2–5 are touched on in the preceding section on CP1.

27. **The ACP should be granted powers to assess, individually and severally, the suitability of Board members, as well as the associated powers to suspend or dismiss such individuals (CP23).** Further, the ACP should make more use of direct contact with the Board in order to ensure that the governance of the authorized institution is appropriate, as well as to ensure that critical supervisory messages that the ACP may need to deliver as the situation warrants can be as directly and clearly communicated as possible. International experience indicates that the suite of powers to approve, dismiss, and communicate without restriction with the Board of Directors is core to supervisory effectiveness.

28. **Acquisitions by banks are not subject to approval by ACP unless the target institution is also authorized by the ACP.** Therefore, the ACP does not have the systematic power to review major acquisitions by a bank; in particular, it does not have the power to review the establishment of cross-border operations. While the ACP would act, and has acted assertively, in response to such situations, for example, through the application of higher capital requirements, reinforcement of internal controls, or de-consolidation or ring fencing of such problematic entities, such tools are themselves limited and are a second best option. Consequently, it would not be possible to prevent or impose necessary conditions on a major cross-border acquisition. Such a situation may result in adverse systemic issues, or have possible consequences for supervisory effectiveness. The ACP should have formal approval powers or powers to ensure that, at least, it receives prior notification and is thus able to consider ex ante whether the acquisition (or establishment of new branch or subsidiary) is compatible with its effective oversight of the group. Given the significance of the acquisition issue for the practice of effective consolidated supervision, the ACP should also be granted the complementary power to insist on divestment of a cross-border entity where such an entity impedes the effective consolidated supervision of the group.

29. **The change of control of a credit institution is clearly specified in French law, and subject to appropriate notification to, and approval by, the supervisory authorities.** However, the French regulatory approach provides an exemption for internal group restructuring requiring only a post-notification to the supervisors where the control of the authorized institutions remains within the EEA. This option creates the potential for significant challenges to the effective supervisory process, given that internal management and control issues may arise in the restructured group. A pre-notification process should be

put in place to ensure that the ACP is not put in the position of having to identify remedial supervisory practices after the fact. Notification requirements should also be placed on institutions to notify the ACP in situations where the institution becomes aware of material information, which may negatively affect the suitability of a major shareholder.

30. **The ACP does not have the power to withdraw an authorization that was granted on the basis of false information.** The ACP has powers that are likely to lead to an equivalent outcome, but launching a revocation process would absorb greater supervisory resources than a direct power to withdraw an authorization that was falsely obtained. It is therefore recommended that the ACP is granted this power, which is in conformity with provisions in existing EU legislation.

*Prudential regulation and requirements (CPs 6–18)*

31. **French banks have materially increased their capital, and the proportion of this that is high quality Core Tier 1, in anticipation of the introduction of the Basel 3/CRD4 regulations.** Most major banks have announced their intention to be fully compliant with the new rules (without regard for transition measures), by the beginning of 2013. In addition, there are targets for the middle of 2012 resulting from the EBA interim capital strengthening exercise. There are several areas where current capital regulations in France, pursuant to the EU capital rules, fall materially short of the current Basel standard (Basel 2.5, which was in place at the time and is the basis for the assessment). These involve issues of how cross-holdings of banks within mutual groups, and cross-holdings of banks and insurance companies, within corporate and mutual groups, are treated for capital purposes. It is a material issue for some, but not all banking groups. The treatment of insurance investments of bank-insurance conglomerates affects the consolidated Tier1 capital position, and results in overstatement of this ratio compared to Basel requirements (however, total capital ratios are calculated appropriately, but the issue can also affect pro-forma current disclosures of Core Tier 1 ratios by banks)). The bank cross-holdings issue affects the publically-reported capital of some material internationally-active subsidiaries in the affected groups, but does not affect the consolidated capital position of the groups. The result can be double counting of capital in the relevant banking part of the group or counting as capital amounts that may not be available, thus leading to market and investor misunderstanding. This can be exacerbated because of the complexity of the intra-group relations and opacity in disclosures about how the group operates (which may already be harder for markets to understand in the case of financial support arrangements in mutual bancassurance groups), although quality of disclosure has been improving since the assessment. The ACP rightly focuses its attention on the consolidated group capital position, on various sub-measures, and on financial relations between the various parts of these groups, and shows an excellent understanding of the situation. Regardless of how the current policy discussion is resolved about these issues in

CRD 4, France should require clearer and full disclosure of the capital treatment in place, and the related financial interactions within complex groups.

32. **France's approach to Pillar 2 has been well developed, formally linked to ACP risk rating of banks, and a part of its system to intervene to reinforce incentives for banks to respond to supervisory interventions.** The current enhanced focus by banks on new capital measures (Core Tier 1) has rendered the existing Pillar 2 measures, based on old capital targets, less effective. The move to Basel 3/CRD4 necessitates changes in this regime which the authorities recognize. They are right to keep the basic principles of their regime, but adapt it to the new technicalities as soon as possible.

33. **Globally, shortcomings in enterprise-wide bank risk measurement and risk management practices have been revealed in the crisis and in recent market, sovereign, and liquidity pressures, and supervisory oversight has not always been as effective as desired in identifying those weaknesses and having them remedied.** Major causes have been identified by the global senior supervisors group in which France participates. That is also true in French banks, despite the fact that the extent and impact of these issues has been less than in some other markets. Given the systemic importance, size, and complexity of the French banking system, bank risk management practices, and the French authorities' ability to assess them, must be held to a very high standard. Banks in France are on the right track and are being pushed by recent changes in regulation, and by supervisory intervention to strengthen enterprise-wide risk measurement and risk management. Risk governance oversight also needs to be enhanced, as does the ability of ACP to assess risk governance. This would be assisted by the legislative changes noted above, allowing regulation and supervisory intervention at the level of banks' Boards, as is takes place in other leading countries. French banks also need to enhance their internal capital adequacy assessment process and related enterprise-wide stress testing, and ACP should find ways to make its expectations clear in this regard. ACP has an excellent understanding of the major banks it supervises and the strengths and weaknesses in their business models and practices, and possible events that might cause them stress. When ACP is exercising supervisory early intervention in areas where banks may actively resist, it needs to use all channels of influence in order to get prompt action by banks to support financial stability.

34. **Credit risk management, large exposure limits, and processes to deal with problem loans and provisioning are well developed in France.** The ACP methodology for credit risk supervision appears sound. ACP decided, as a result of discussion in COREFRIS, to add more-frequent monitoring of the potential risks in this market, and to perform on-site examinations of a variety of smaller and larger banks' residential mortgage portfolios in 2012. ACP needs to make sure banks are identifying the sectors likely to experience most credit stress in the forecasted economic slowdown (which may not be the mortgage sector),

and are focusing their resources on ensuring that risk rating and provisioning is adequate for those credit exposures.

35. **On country and transfer risk management, recent experiences revealed that these systems were not as robust as banks desired.** However, banks have revamped and extended their risk management and risk governance, including limit setting and taking account of this risk in their capital models. The ACP has been actively involved in both off-site supervision and monitoring of the limits and exposures. On-site verification of the robustness of bank's systems will occur in 2012.

36. **The ACP is operating a high quality and proportionate liquidity regime.** Consistent with the evolving demands of the international market place, the ACP continues to extend and refine its approach. This has encompassed an intensifying of the supervisory relationship with the systemic banks and on site review by specialists. Severe stress testing requirements are already applied to the core firms and will be extended to a wider sample. Data requirements are also being refined to ensure greater scope for comparability between firms. The ACP should review its existing liquidity regime, with respect to the non-advanced banks, to ensure that the general requirements and principles of liquidity risk management apply to all banks and not only the advanced firms, as specified in the current Order of May 2009 on liquidity regulation.

37. **French requirements for internal control in banks are longstanding and extensive, and the ACP program to assess implementation of them is robust.** France's approach to AML/CTF requirements received a positive recent Financial Action Task Force (FATF) assessment, and the improvements recommended, primarily dealing with French overseas territories and departments, are underway. France makes excellent use of supervisory reporting and benefits from the existence of a well-developed credit register run by the Banque de France.

*Methods of ongoing banking supervision (CPs 19–21)*

38. **ACP has a thorough understanding of the operation of individual banks and the banking system, focusing on safety and soundness.** They operate an extensive, detailed, and in-depth program of on-site inspections and a high-quality off-site supervisory process that monitors individual major bank's financial situation and risk management and control practices. As in other countries, the ACP methodologies for risk rating banks are not very responsive to changes in bank conditions and are not very forward looking. There is room to better define the rating criteria to assist supervisors in forming a judgment of the quality of risk management. The ACP is at an early stage in assessing the quality of risk governance and feeding it into overall assessments, in part hampered by their inability to interact directly with Boards. While progress has been made, there is room to more systematically and

formally bring together the insurance and banking risk assessments to obtain an enhanced overall view of the banking groups.

39. **While off-site and on-site supervisory processes are of high quality, there is room for improvement.** There appear to have been examples where the comprehensiveness of the on-site process has meant it took a long time to reach conclusion and for supervisory recommendations to be communicated to the firms, which appeared to reduce the effectiveness of ACP intervention. In part, this was due to the need for the inspection process to have a formal ‘contradictory’ part, allowing a right of challenge and reply from the bank before the reports and findings are finalized. While this is understandable when the inspection is to be the basis of formal enforcement, this can stand in the way of effective timely intervention. ACP needs to build on recent developments to put in place a more flexible, timely, focused, on-site capability as a complement to the existing process.

40. **The ACP could reinforce its intervention on material issues at senior levels of the banks, including intervening more at the Board level.** This will necessitate more focus in the process of synthesizing and distilling the details from inspections, off-site work, and ratings into crisp overall findings and priority recommendations. Lastly, the ACP should publish aggregate results from theme reviews as a way of informing and reminding banks, not just the largest, about its expectations and required practices.

#### *Accounting and disclosure (CP 22)*

41. **Audit independence rules, such as restrictions on non-audit services, are more restrictive in France than in many other countries.** ACP uses its authority to approve auditors’ appointment effectively. ACP does not generally use auditors in its supervisory or prudential practices, preferring, understandably, to use its own staff and resources. ACP has productive relations with auditors when it needs to ensure that auditors better take into account issues like extra focus on valuations.

#### *Corrective and remedial powers of supervisors (CP 23)*

42. **The ACP has a wide range of tools for remedial and corrective measures, and the assessors saw evidence that such tools were used in practice.** The powers and sanctions process granted to the ACP are broader than for its predecessor the Commission Bancaire, and the ACP is consequently, still at early stages of becoming familiar with a very different approach to the one used formerly. The ACP fully recognizes that it is in the process of distilling practical lessons from its first experiences of the sanctions process, and has a concrete plan to analyze recent cases and adapt its practices in order to be as streamlined and as effective as possible. The readiness to be willing to move to a sanctions process is an important dimension in the new ACP culture which they are encouraged to



build upon, bearing in mind the importance of being able to achieve a timely, effective, and conclusive process.

***Consolidated and cross-border banking supervision (CPs 24–25)***

43. **The ACP has a strong legal and regulatory framework, based on the EU legislative framework.** Importantly, this model is applied in practice, both in terms of ensuring the application of prudential standards at consolidated and (as appropriate) sub-consolidated level, to ensure adequate distribution of capital across-the group. Nonetheless, and as noted in the context of CP 5, the ACP’s ability to ensure effective global oversight groups, including all nondomestic establishments and locations, is seriously impeded by its lack of powers to prevent the establishment or acquisition of foreign interests or to require the divestment of such establishments, even in cases where there are obstacles, to the supervisor and/or the group’s management obtaining sufficient information for their tasks.

44. **The ACP has a broad network of MoUs and arrangements with other home or host supervisors supported by a gateways for information exchange and confidentiality provisions.** France is the home jurisdiction to four globally systemically significant banking groups, so there is a premium on the quality of home/host relationships to support home state oversight. Although the practices of supervisory colleges are presently in a major phase of development in order to achieve an ever more meaningful and substantive group wide perspective on the activities of such global groups for all firms, there is clear evidence that the ACP has devoted attention to this aspect of supervision and will continue to do so.

Table 1 offers a principle-by-principle summary of the assessment results.

**Table 1. France: Summary Compliance with the Basel Core Principles—  
Detailed Assessments**

Core Principle	Grading	Comments
1. Objectives, independence, powers, transparency, and cooperation		
1.1 Responsibilities and objectives	C	New financial stability and consumer protection mandate risks lack of clarity but the ACP is well placed to ensure priority on safety and soundness of institutions. Disclosure by the BdF and the ACP of financial system and financial institutions conditions and risks could be markedly enhanced.
1.2 Independence, accountability and transparency	LC	The clear intention is to create an independent authority, soundly governed and adequately resourced. Several aspects of the arrangements including the role of the MINEFI in the ACP college and in financing arrangements, and parliamentary limit on the ACP headcount, have the potential to undermine this objective, though there is no evidence of problems to date. The benefits of coordination and information sharing could be achieved with lower risks of perceived (or actual) future independence issues.
1.3 Legal framework	LC	The ACP does not have the ability to publish binding rules without changing laws. Consultative processes lack transparency.
1.4 Legal powers	MNC	There is room for improvement in legislative requirements related to Boards of Directors' responsibilities and ACP powers over Boards, and improvement in the way the ACP establishes direct contact with the Board and in its assessments of Board oversight. There is no ability to apply the fit and proper test to Directors; there is a lack of assessment of suitability of the Board as a whole, lack of formal specific requirements about Board composition and duties re risk management and governance and lack of an ability to suspend or dismiss Board members, jointly or severally.
1.5 Legal protection	C	
1.6 Cooperation	C	
2. Permissible activities	C	

Core Principle	Grading	Comments
3. Licensing criteria	LC	French legislation does not permit the supervisor to withdraw a banking authorization immediately should it become aware that the authorization was granted on the basis of false information.
4. Transfer of significant ownership	LC	There is no provision for the ACP to be notified in advance of an internal group restructuring where the control of the group remains within the EU/EEA. Inability to review changes in control of banking groups that do not change ultimate control could pose problems.
5. Major acquisitions	MNC	French legislation does not permit the supervisor to review acquisitions by banks. Acquisitions of EU financial institutions would require approval from the national supervisor of the target entity, as prescribed by EU law, and the ACP has other powers it could use, however, these elements are not a full or adequate substitute for formal approval.
6. Capital adequacy	MNC	<p>While capital requirements are in many ways prudent and appropriate, there are material weaknesses in the definition of capital, and related public reporting at the time of the mission vis a vis current Basel 2/2.5 requirements, especially for banc-assurance groups and cross-holdings of banks by certain major internationally-active publically traded entities within some major mutual bank groups. The identified banc assurance issues produce reported Tier 1 capital ratios that are less than the applicable Basel requirement and can produce reported measures that involve recognizing capital that may not be available to the banking part of the group, or double counting of capital. For mutual bank groups the overall consolidated group capital calculation is compliant.</p> <p>The assessors do not take a position on the desirability of various policy positions and the implementation of those positions in the move to Basel 3 and CRD4. The ACP fully understands the issues and is able to meet their prudential mandate. But current approaches risk confusion for marketplace participants.</p>

Core Principle	Grading	Comments
7. Risk management	LC	Specific rules requiring enterprise-wide risk management are relatively new in France and there has not been sufficient time to test them in practice or for ACP to have fully reviewed their operation. Reviews to date are mixed. There are deficiencies in the extent of implantation in major banks of ERM processes with the necessary strong oversight, including at Board level. Supervisory assessments of risk governance are not well developed. Processes to relate capital to risk exist but need to be strengthened in a number of major banks.
8. Credit risk	C	
9. Problem assets, provisions, and reserves	C	
10. Large exposure limits	C	
11. Exposure to related parties	C	Loans at 'normal' terms to related parties do not require Board or auditor approval and so may not get adequate scrutiny to ensure terms are reasonable, thus leading to reputation risk for the regulatory system in case of problems.
12. Country and transfer risks	LC	Banks and supervisors in many countries failed to understand fully the potential for country/ transfer risk to materialize. Major enhancements in the systems of risk management and provisioning of this risk have taken place in banks, and ACP monitoring is now extensive. But the ACP has not fully reviewed whether the new policies and practices are appropriate and effective, though on-site visits are planned in 2012.
13. Market risks	C	
14. Liquidity risk	LC	The ACP has intensified the standards of its liquidity regime, particularly with respect to its interaction with the core systemic firms. The program of continuing enhancements needs to be completed, including the extension of severe stress tests to a wider spectrum of banks, greater standardization of data in some areas and the application of proportionate liquidity risk management standards to all banks, not merely advanced firms.
15. Operational risk	C	

Core Principle	Grading	Comments
16. Interest rate risk in the banking book	C	
17. Internal control and audit	C	
18. Abuse of financial services	C	
19. Supervisory approach	C	Supervisors have excellent understanding of banks. Risk rating criteria for major banks could better promote assessing the adequacy of control and risk governance processes. It could also contain a more-explicit forward-looking dimension.
20. Supervisory techniques	LC	The ACP performs high-quality on-site and off-site supervision. There is evidence that it is not as timely and coordinated as it needs to be for full effectiveness. In addition there is room to improve the effectiveness of ACP interaction with senior bank management and Boards in order to achieve supervisory results. There is room to further formally integrate the view of the insurance risks into the ACP assessment of the risk of the overall banking group and intervention strategy.
21. Supervisory reporting	C	
22. Accounting and disclosure	C	
23. Corrective and remedial powers of supervisors	C	
24. Consolidated supervision	C	
25. Home-host relationships	C	

*Aggregate:* Compliant (C) – 19, Largely compliant (LC)—8, Materially noncompliant (MNC)—3, Noncompliant (NC)—None (note: CP 1 is divided into six components for this analysis.)

## F. Recommended Action Plan and Authorities' Response

### *Recommended action plan*

45. **Table 2 lists the suggested steps for improving compliance.** Recommendations are proposed on a prioritized basis.

**Table 2. France: Recommended Action Plan to Improve Compliance with the Basel Core Principles**

Reference Principle	Recommended Action
1.4 Legal Powers	Give the ACP powers to assess, jointly and severally, the suitability (integrity and expertise) of Board members as well as the associated powers to suspend or dismiss such individuals (CP23). Amend core internal control regulation to specify Board responsibilities for oversight and risk governance. (Relevant also for CPs 3,7,8,13,14,15,16,17 and 23). Enhance ACP meetings with independent Board members and enhance ACP assessments of governance and effectiveness.
5 Major Acquisitions	Grant the ACP powers to ensure that it receives prior notification of major acquisitions and is thus able to consider the acquisition (or establishment of new branch or subsidiary) ex ante. The ACP should also have powers to require the divestment in an entity where it would prevent the effective supervision of the group for which the ACP has responsibility for consolidated supervision.
6 Capital adequacy	Once new capital rules have stabilized, confirm a graduated phase-out of the current preferential treatment of bank-insurance and inter-bank exposures. Provide guidance to ensure enhanced regular accessible and consistent disclosure to allow market assessment of impact of current treatment together with information on relevant intra-group funding and support mechanisms.
1.2 Independence, accountability and transparency	Alter (but do not eliminate) participation of MINEFI in ACP college, limit MINEFI right of reconsideration to systemically important issues. Provide the ACP with a formal role in proposing prudential rules and issue more ACP guidance on prudential matters. Allow the ACP college to set assessment within maximum to be set by legislation. Provide for periodic formal and public review by the ACP of its resource needs.
1.3 Legal Framework	Enhance consultative practices in line with EU 'better regulation practices'.
3 Licensing criteria	Grant the ACP the power to be able to withdraw an authorization immediately should the ACP become aware that the license was granted on the basis of false information.

Reference Principle	Recommended Action
4 Transfer of significant ownership	<p>Ensure, through regulatory changes if necessary, that the ACP receives advance notification of internal group re-structuring even when control of the overall group remains with the EU/EEA.</p> <p>Impose regulatory requirements for a credit institution to notify the ACP in cases where the institution becomes aware of material information which may negatively affect the suitability of a major shareholder.</p>
7 Risk management	<p>Require banks to enhance and implant ERM processes. Put in place more guidance or regulation on ACP expectations for ERM, for capital planning related to risk, and for Board risk governance and oversight. Subject these to regular detailed ACP assessment and feedback.</p>
12 Country and transfer risks	<p>Finalize supervisory work to assess appropriateness and effectiveness of banks' recently-enhanced country/transfer risk process and their process for attributing capital to these risks.</p>
14 Liquidity Risk	<p>Broaden the program of enhanced liquidity risk regime beyond the core systemic banking groups.</p> <p>Ensure that the general principles of liquidity risk management are applied to all institutions, not only advanced approach firms.</p>
20 Supervisory techniques	<p>Improve timeliness and coordination of on-site and off-site supervision to enhance early intervention. Further develop capability to conduct focused on-site/offsite reviews to investigate key issues and follow up on implementation by banks of ACP requirements. Based on new powers vis a vis Boards intervene at that level in a focused way to ensure adequate risk governance. Formally integrate the view of insurance risks into the overall risk assessment and supervisory intervention of banc-assurance groups.</p>
11 Exposure to related parties	<p>Ensure that all lending transactions with related parties above a threshold (whether at normal terms or not) are approved by the Board.</p>

### *Authorities' response to the assessment*

The French Authorities would like to express their appreciation to the *International Monetary Fund* and its staff for their thorough analysis of the French financial sector and the very informative exchanges of views within the context of the BCP assessment. The French Authorities have found the FSAP review of the French regulatory and supervisory banking framework a useful exercise. The ACP expresses its most sincere appreciation for the opportunity to further enhance the “peer review culture” in the ACP’s departments and thanks the IMF and its knowledgeable and experienced assessors for the dedication, time and resources committed to the assessment.

The authorities welcome the IMF’s judgment that France has a high level of compliance with the Basel Core Principles (BCP) and high quality supervision. The authorities broadly agree with the IMF findings and assessment.

Regarding the detailed assessment, the authorities took note of the recommendations regarding ACP powers over the Boards of supervisees (BCP 1.4) and ACP’s prior approval of major cross-border acquisition (BCP 5 – although it should be stressed that cross-border acquisition within EU comes under European treaties and the scope for strengthening the ACP’s powers regarding European cross-border acquisition is unclear). Indeed, the authorities are contemplating changes to the regulation in order to strengthen the powers of the ACP and works on draft legislation are already engaged.

However, the authorities would like to raise a firmly dissenting view in relation with two of the observations of the IMF BCP assessment regarding the independence of the ACP (BCP 1.2) and capital adequacy (BCP 6).

On the ACP’s independence, while stressing that the clear intention of the authorities is to create an independent supervisory authority, soundly governed and adequately resourced, the IMF raises some concerns. The authorities believe that the ACP is indeed fully independent and the assessment itself emphasizes that no evidence of problems has been found. Regarding the involvement of the Ministry of Finance (through the *Directeur Général du Trésor* or his representative) within the ACP Board, it should be noted that the role and powers of the representative of the Ministry of Finance are fully set in the law, which gives no membership status in the Board and Enforcement Committee. This provides for transparency about the position of the Ministry of Finance, to the full knowledge of all stakeholders. The only right attributed by law is to ask for a second deliberation in the Board for matters other than sanctions. The request for a second round of deliberations has no effect on the eventual content of the decision but gives the Board an opportunity to review its decision, within a very short space of time, so as to consider all its consequences and to ensure it is reasonably undisputable. The authorities believe this arrangement provides a clear framework for the ACP and the Ministry of Finance effective and timely cooperation,



bringing valuable benefits and providing for robust guarantees for the independence of the regulators also in comparison to other examples at the international level.

On capital adequacy (BCP 6), the IMF raises two concerns regarding mutual groups, and banc-insurance groups.

Regarding mutual groups, the authorities wish to underline that the ACP applies three levels of supervision to mutual groups while other countries allow mutual groups to perform a simple aggregation at group level. ACP supervises the French mutual groups on an individual basis (for regional banks which are the operating retail banks), on a sub-consolidated basis (at the level of the central body) and at the consolidated group level. The solo and the consolidated supervision are assessed as perfectly compliant with the Basel 2 requirements. The supervision at the sub-consolidation level allows the risk-weighting of the investments the central body holds in the regional banks because of the specific capital structure of mutual groups. Indeed the regional banks hold 50 percent or more of their central body capital, while the latter holds more than 20 percent of the regional banks capital. This is linked to legal arrangements which impose a solidarity mechanism by which the central body guarantees the regional banks operations and ensures their liquidity and solvency. Above all, the authorities insist on the fact that no double-gearing can occur at the consolidated level and that no risks are left unaddressed.

The IMF assessment highlights that market participants may be misled by the “opacity” of some mutual group disclosure. Although this statement is rather surprising as it should be part of the transparency assessment and because it is at odds with the assessment made by the team of assessors on BCP 22 (“compliant”), ACP repeatedly produced evidence that the 2011 financial statements of mutual groups very clearly explain their structure and intra-group relations. The authorities therefore do not share the conclusions drawn by the assessors.

Regarding banc-insurance, some banks deduct their insurance holdings following the preferred approach under Basel II and allowed by the French and EU rules. However, deductions are from total capital as allowed in current applicable EU rules, instead of from Tier 1 and Tier 2 equally. The authorities insist on the fact that this treatment is (1) neutral for the total capital ratio and (2) is only valid until December 31, 2012 on a transitional basis justified by the development of banc-insurance model in Europe. Moreover, this temporary treatment is fully disclosed by institutions, so that analysts can measure its impact on ratios.

The authorities also underline that their main concern is to eliminate any double-gearing at the highest level, be it the conglomerate level for banc-insurance groups or the consolidated level for mutual groups, and that they indeed succeed. Besides, as it reported in the assessment, ACP staff shows an excellent understanding of all the banking groups they supervise even those deemed complex. The authorities believe that these two achievements

demonstrate an “overall effectiveness sufficiently good” and guarantee that “no material risks are left unaddressed”<sup>3</sup> (which define the “largely compliant” assessment). In this context, the authorities believe that BCP 6 implementation cannot be assessed as “materially noncompliant,” which should be given when “there is evidence that supervision has clearly not been effective.”

## II. DETAILED ASSESSMENT

46. **Table 3 below offers the detailed Principle-by-Principle assessment.** It provides a “description” of the system with regard to a particular Principle, a grading or “assessment,” and a “comments.”

**Table 3. France: Detailed Assessment of Compliance with the Basel Core Principles**

Principle 1.	<b>Objectives, autonomy, powers, and resources.</b> An effective system of banking supervision will have clear responsibilities and objectives for each authority involved in the supervision of banks. Each such authority should possess operational independence, transparent processes, sound governance and adequate resources, and be accountable for the discharge of its duties. A suitable legal framework for banking supervision is also necessary, including provisions 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 sharing information between supervisors and protecting the confidentiality of such information should be in place.
Principle 1(1).	<b>Responsibilities and objectives.</b> An effective system of banking supervision will have clear responsibilities and objectives for each authority involved in the supervision of banks.
Description	<b>EC1.</b> The responsibilities and objectives of each French banking authority are provided by the Articles L611-1 to L615-2 (see in particular L612-1) of the Monetary and Financial Code (Code Monétaire et Financier, COMOFI). These Articles were amended as part of creating the new single banking and insurance supervision authority: the Autorité de Contrôle Prudentiel (ACP), which occurred at the beginning of 2010.  The banking supervision framework comprises: <ul style="list-style-type: none"> <li>- the regulation authority which is the Ministry of Finance (MINEFI);</li> <li>- the licensing and supervision authority which is the ACP (closely connected to the French central bank, Banque de France, through joint staff and chairmanship); and</li> <li>- and two consultative bodies: the Financial Sector Consultative Committee (Comité consultatif du secteur financier, CCSF) and the Financial Legislation and</li> </ul>

<sup>3</sup> Core Principles Methodology, Basel Committee on Banking Supervision, October 2006, page 9.

	<p>Regulation Consultative Committee (Comité consultatif de la législation et de la réglementation financières, CCLRF).</p> <p>The DGF insures the depositors in case of a bank failure.</p> <p>MINEFI's regulatory powers cover the full range of regulation including capital and liquidity, rules related to internal control and risk management, banks relations with customers, and depositor protection rules.</p> <p>ACP's missions in the legislation are to preserve financial stability and to protect clients of institutions subject to its supervision.</p> <p>As supervisory banking authority the ACP has competences and powers covering activities previously exercised by the banking commission, the banks licensing authority, the insurance entities authority, and the insurance licensing authority. This includes the prudential aspects of investment firms. The ACP can also trigger the intervention of the DGF.</p> <p>Bringing together banking and insurance supervision was seen as providing considerable benefits of an integrated regulator, which is important in France given the well- developed universal banc-assurance conglomerate model which is prevalent in the industry.<sup>1/</sup></p> <p>Under the legislation, ACP in carrying out its specific functions is charged with considering financial stability in the European economic space, fostering convergence between French and EU 'dispositions' taking account of best practices, and participating effectively in EU supervision structures related to cross-border financial groups. While financial stability has not been further defined, the ACP annual report indicates that ACP considers promoting safety and soundness of regulated institutions is a key component of its contribution.</p> <p>While there is no reference to safety and soundness of institutions in the legislation, it does explicitly task the ACP with ongoing surveillance, including that credit institutions comply with their solvability and liquidity requirements. The legislative mandate does not refer to early intervention.</p> <p>The legislation that created the ACP also broadened regulatory and supervisory powers to include protection of consumers and to control the distribution of financial products.</p> <p>Discussions with ACP senior staff indicate they are aware of the need to ensure that consumer protection does not crowd out safety and soundness matters. It is too early in the life of the new organization to see how this works in practice.</p> <p>A systemic risk council was also created in 2010 (Conseil de Régulation Financière et du Risque Systémique, COREFRIS). It brings together, at least twice a year, the Minister of Finance and the chairmen of the ACP (with its vice-chairman), the Financial Market Authority (Autorité des marchés financiers, AMF, the accounting standards authority, as well as three qualified persons. This council is in charge of ensuring exchange of information on cross-sector issues, examining the financial sector and market conjuncture, assessing systemic risk, and enhancing cross-sector cooperation for setting European and international financial standards. This council has no powers of action or direction in its own right, but discussions in the council can, and have resulted in the various participants taking action in their own spheres on financial stability issues. The council could issue public assessments of such issues, but has not done so to date.</p>
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	<p><b>EC2.</b> The laws and supporting regulations provide a framework of minimum prudential standards that banks must meet. The legislation and regulations are highly principles based. They are contained in the Monetary and Financial code and various regulations and orders. The normal aspects are covered including risk management and internal control, solvency and liquidity, and requirements for authorization.</p> <p><b>EC3.</b> Banking laws and regulations are updated as necessary to ensure that they remain effective and relevant to changing industry and regulatory practices. The French prudential framework is updated on an ongoing basis in order to transpose European directives, reflect EU regulations and to deal with issues specific to France.</p> <p><b>EC4.</b> The ACP verifies that credit institutions comply with disclosure requirements provided by Articles 374 to 390 of the Order of February 20, 2007 which implement the 3<sup>rd</sup> pillar of Basel 2. These disclosure requirements are applied on a consolidated basis and cover information related to risk management, composition of own funds, internal capital adequacy and capital requirements, credit risk and dilution risk, credit risk mitigation techniques, securitizations, market risk, operational risk, equity exposures, interest-rate risk associated with transactions other than those in the trading book.</p> <p>In addition, credit institutions are required to disclose annually their individual and, if any, consolidated accounting statements (Regulations 91-01 and 99-07). The ACP verifies that they comply with these disclosure requirements. Certain major banking groups do not publish quarterly financial information at group level.</p> <p>Besides the regulation 97-02 provides disclosure requirements related to remuneration schemes.</p> <p>The ACP does not provide bank-specific information on its web-site. Nor are extracts from supervisory reports made public.</p> <p>Neither the regular reports of the BdF, nor the recent annual report of the ACP, provide comprehensive information on the sector and various risks, as might be found in a financial stability report. Discussions with the authorities indicate that such an exercise is in place but no decision on publication has been taken.</p> <p>In 2011 the EBA conducted a Europe-wide assessment of Pillar 3 disclosures, in which France participated. The findings were that there was considerable variation in the quality of these disclosures. ACP staff indicated that the results for the French banks that participated were similar to the results overall.</p> <p>The assessors reviewed examples of Pillar 3 disclosure by major banks.</p> <p><b>AC1.</b> The ACP defines its annual supervisory programs based on the results of the Supervisory Review and Evaluation Process (SREP). That in turn takes into account institutions' risk profiles, the robustness of risk management and control systems and adequacy of capital and liquidity.</p>
Assessment	Compliant
Comments	<p>The general reference to protecting financial stability and consumer protection as the core legislated mandates of the ACP risks future lack of clarity. The authorities should take care to see that safety and soundness matters continue to have priority, as they do currently. They also should continue to emphasize in public statements of the ACP mandate the importance of safe and sound institutions to that broader financial stability goal. The Banque de France should publish a version of its financial stability report covering performance, risks and vulnerabilities of the system and its main</p>

	<p>parts. The ACP should include in its annual report information on the micro-prudential aspects of the system, as well as additional information on its use of resources and performance and forward priorities.</p> <p>While disclosure is generally adequate there are selected areas and/or institutions where it could improve, as referenced in CP6.</p>
Principle 1(2).	<p><b>Independence, accountability and transparency.</b> Each such authority should possess operational independence, transparent processes, sound governance and adequate resources, and be accountable for the discharge of its duties.</p>
Description	<p><b>EC1.</b> The ACP is an “independent administrative authority,” i.e., placed outside the regular administrative structures. In France these types of entities perform state functions but have a budget outside that of the state and are governed by independent processes.</p> <p>The ACP comprises a College and a Sanctions Commission, supported by a Secretariat, which is headed by a Secretary General.</p> <p>The college represents the ACP and exercises the authority’s powers. The college is composed of 19 members: the Governor of the Banque de France who chairs the college, a vice-chairman chosen for its individual expertise in insurance activities, the Chair of the financial market authority (AMF), two members designated due to their financial and law expertise by the Chairman of the deputy chamber and by the Chairman of the Senate respectively, the chairman of the accounting standards authority, a member of the supreme administrative court (Conseil d’Etat), a judge of the supreme judicial court (Cour de Cassation), a member of the financial court (Cour des comptes), two members chosen for their individual expertise in consumers protection and quantitative techniques or any expertise particularly useful for the ACP, four members chosen for their individual expertise in insurance activities, four members chosen for their individual expertise in activities related to banking, investment firms and payment services. (COMOFI, Article L612-5).</p> <p>While the Governor of the Banque de France is the Chair of the ACP, in practice his delegate, one of the BdF Deputy Governors, mostly performs this role. Deputy governors are appointed by the Minister on the same basis as the Governor.</p> <p>ACP college members chosen for their individual expertise are appointed for five years (renewable once) by the Minister of Economy (except for those appointed by the Chairmen of the two chambers of the Parliament). The vice-chairman is appointed for the same duration by a joint order of the Ministers of Economy and Social Affairs.</p> <p>Certain business of the College that touches on one sector or the other is dealt with by sub-colleges—essentially smaller groupings of the full College with powers of decision in their own area. The most relevant in the case of banks are the banking college and the restricted college. The former deals with individual or general matters specific to banks. The latter deals with individual or general matters affecting major conglomerates or individual matters affecting the financial system. The banking college comprises eight members of the main college of which four are the banking experts together with the Chair and Vice chair of the College and two others. The restricted college has similar structure except with both banking and insurance expertise.</p> <p>The sanctions commission is composed of six members: two members of the supreme administrative court (Conseil d’Etat), one of whom chairs the sanctions</p>

	<p>commission, a judge of the supreme judicial court (Cour de Cassation) and three members chosen for their individual expertise. The members are appointed for five years period and cannot be members of the college.</p> <p>A senior official of the MINEFI attends the sessions of the college or the banking or restricted college. While the MINEFI representative does not have a vote he/she has the right under the legislation to ask that a matter decided by the college (or the restricted or banking college) be formally reconsidered. This is a new power added in 2010 at the creation of the ACP (prior to which the MINEFI had a vote on the former Commission Bancaire). ACP reported that the power to request reconsideration has not been used in practice at the time of the mission. It does not apply to sanctions decisions. The authorities indicated that this right was important to ensure that all consequences are considered and the decision is secure. In particular the authorities indicated that the MINEFI representative could exercise this right in situations in which decisions of the College could have (legal) consequences for which the government may be held liable and in situations in which decisions of the College could have systemic consequences that may not have been assessed in the first round of deliberations. The authorities indicated that no issues of independence had arisen as a result of this arrangement.</p> <p>The Governor of the Banque de France, who chairs the college, is appointed by the Minister of the Economy for a term of six years, renewable once. He may be removed only in case of incapacity to fulfill his duties or gross misconduct, on the requirement of the majority of the Banque's General Council. There is no legislative requirement for the reasons for dismissal to be publically disclosed.</p> <p>Members of the Council of ACP can only be removed for similar reasons and on a majority vote of the other Council members. Reasons for their dismissal also do not have to be publically disclosed.</p> <p>The general secretary of the ACP has authority over the day-to-day operation of the ACP and prepares recommendations on matters going to the college. The secretary general is appointed by the MINEFI on a proposal of the chairman of the ACP. (COMOFI, Article L612-15) No term is specified and the legislation does not require that there be particular reasons for dismissal. Nor is there a requirement for the reasons for dismissal to be publically disclosed. ACP advised that in practice the MINEFI has no power to remove senior staff by itself, since all action is to be proposed or approved by the ACP Chair. Furthermore, any movement of the kind would fall under French administrative law and jurisprudence, which states that all administrative acts must be appropriately motivated and their reasons can be made accessible to the public if they were to be contested.</p> <p>The first vice secretary general must have experience (banking/insurance) complementary to that of the general secretary. While the Chair of the college makes the appointment, the Ministers responsible for finance, (and insurance and social security matters (if the vice secretary general has an insurance background) must agree to making the appointment.</p> <p><b>EC2.</b> The ACP annual report is the means (together with Internet web site) for ACP to publish its objectives, results, actions undertaken and resources employed. At this stage the ACP does not publish performance measures, but it will be the case for the year 2011 in its annual report.</p>
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**EC3.** The staff of the ACP is a mix of central bank staff members hired via competitive exams and contractual staff members. Professionalism is the hallmark of engagement at the Banque de France. Discussions the assessors had with banks and outside professionals the ACP deals with confirmed the view of the assessors that ACP staff is highly professional and credible. Most of the staff is members of the French civil service.

The assessors reviewed the conflict of interest and post-employment code for ACP staff, and it is broadly appropriate. The staff is subject to strict deontology rules and in particular they are prohibited from acquiring credit institutions securities.

College members must inform the Chairman of the ACP of any interest, functions and mandate they had in an entity in the two years prior to appointment. A member of the college or of the sanctions commission cannot participate in deliberations or decisions of a case in which the member, or its employer or an entity he/she counsels, has an interest. The assessors were told that members do have investments and recuse themselves from specific deliberations. A member of the sanctions commission cannot have a mandate or be employed by an institution subject to the supervision of the ACP (COMOFI, Article L612-10).

According to the internal rules of the College there is a prohibition on college members having shares in a regulated entity. If a college member holds shares when he is appointed, there is no requirement to divest but the member cannot buy new shares and he cannot sell his shares without authorization of the chairman, who informs him if the transaction planned is possible or not at this time. Regardless of their investments College members may participate in a material decision that affects major banks overall or that affects major competitors of the bank where the College member has an investment or interest. In discussions with the assessors it was indicated that tighter restrictions were not put in place in order to ensure that the College could attract suitable persons with industry experience. Reliance is being placed on the professionalism of the College members who are eminent in their field.

**EC4.** Charging the costs of banking supervision to supervised institutions commenced in 2010 with the creation of the ACP. The ACP has an autonomous budget set by the College. A large part of its resources comes from the proceeds of a levy on institutions, which rate is fixed by the Minister of Finance within a range (minimum and maximum) fixed by the law. The Banque de France has the authority under the legislation to supplement ACP resources should the ACP budget be more than the proceeds of the levy on institutions. The computation of the levy is defined by law and is based on own funds requirements computed for the capital requirements for banking regulated entities (insurances entities are also subject to the levy which is related to premiums).

The ACP costs include its own direct costs as well as costs attributed from the BdF for shared services such as IT and premises. Total financial resources of the ACP amounted to Eur 163 million in 2010. FTEs were 974 as of mid-year 2011 up from 900 at the creation of the ACP. Human resources are planned to increase to some 1,140 at the end of 2012. ACP reports that most of this increase has been result of the new mission of consumer protection together with strengthening the headcount in insurance supervision. Between the creation of the ACP and the target end 2012 headcount the FTE in off-site banking supervision are planned to increase from 186 to 205, and in on-site banking supervision from 163 to 192.

	<p>While the budget of the ACP is not subject to formal parliamentary control, the French parliament has set headcount restrictions on all independent agencies. For ACP the maximum is the planned headcount at end 2012. ACP staff indicated that to exceed this would require parliamentary approval.</p> <p>ACP indicated that under the constitutional interpretations by the courts, mandatory contributions such as the assessments on industry are a tax and that the authorities do not have the ability to determine those which were a responsibility of parliament.</p> <p>At the creation of the ACP the budget was set at the combined total of the previous four agencies. No additional provision was made for the new consumer protection mandate, pending working out the resource needs in practice. The increase in resources for the new consumer protection mandate in the last two years was funded temporarily out of reserves carried over from certain of the predecessor organizations.</p> <p>To ensure budget sustainability, ACP has requested an increase in the effective levy rate by the Minister to meet its resource plans for 2012 and the following two years. Discussions the assessors had with representatives of the MINEFI indicated that a decision had not been taken at the time of the assessment but that staff was supportive of an increase. ACP staff advised the assessors that its ability to meet its mandate would be compromised if the increase was not granted. Since the assessment, the levy rate has been increased by the Minister to meet ACP resource plans for 2012.</p> <p>The budget presentation to the college for its approval reviewed by the assessors does not include a functional breakdown of ACP spending (e.g., for banking versus insurance, on-site, off-site supervision, policy development, breakdowns, etc.). The budget is approved one year ahead but the Audit Committee of the College has recently requested a three year projection.</p> <p>Salary scales are not set by the College of the ACP but by the governing body of the Banque de France. The ACP keeps its salaries in line with BDF salaries, though it reported it has a small degree of flexibility in certain cases and some room to recognize degrees and experience in outside hires. Turnover was up to 15 percent, and the ACP in the past two years did not meet its hiring objectives.</p> <p>The ACP does not typically rely on third parties to carry out its supervisory work. ACP has sufficient flexibility to hire outside experts if needed. ACP provided information on its training budget and approach and on its IT expenditures. These have been material in order to alter the previous data reporting system. On average, an ACP staff member has 55 hours of training per year. A junior supervisor's initial training represents up to 140 hours for the first two years. The travel budget (including for supervision and international rule setting) is €4.2 million.</p> <p><b>AC1:</b> The chairman of the ACP (college) is the Governor of the Banque de France, who is appointed by the Council of Ministers for a term of six years, once renewable. ACP council members are appointed for five years renewable once. The SG is not appointed for a fixed term.</p>
Assessment	Largely Compliant
Comments	<p>The clear intention is to create an independent authority, soundly governed and adequately resourced. However, several aspects of the arrangements have the potential to undermine this objective. These include: the presence of the treasury at <b>all</b> deliberations and decision-making on individual bank-supervisory matters of the</p>



	<p>ACP Colleges; the powers of the treasury to request reconsideration of any issue by the Colleges; the lack of legislative requirements limiting the reasons for removal of the SG and Deputy SG; the lack of legislation requiring that the reasons for removal of various persons in the structure be publically disclosed. The fact that the ACP cannot set any prudential rules independently is also a concern (see CP1(3)). The parliamentary limit on headcount and the fact that the effective ACP assessment on industry has to be approved by the Minister (in the current situation where the existing rate is not sufficient to fund the College meeting its mandate), is also a potential concern. While there are constitutional limits on the ability to grant ACP full authority to set rules or its own levy on industry, the ACP role in rule setting for key prudential rules could be enhanced and formalized (e.g., by giving the College the formal power to recommend certain rules to the Minister) and by the ACP issuing prudential guidance. The ACP could also formally input into compensation policies of their staff, which are now set by BdF.</p> <p>There are undoubted benefits, not just for crisis management, for all members of the authorities, including treasuries, to have excellent access to information. But that does not require presence at the College for <u>all</u> individual decisions, nor rights to require reconsideration of any potential issue, as opposed for example to limiting the MINEFI power of reconsideration to those issues that have systemic importance or that could lead to demands on public resources or liability for the state.</p> <p>Subsequent to the evaluation mission, the French authorities have indicated their intention to formalize the modalities of the usage of the right to ask for a second deliberation by the College. The current framework would not be modified but an exchange of letters between the Ministry of Finance and the ACP and AMF would clarify that the right to request a second deliberation would be exercised in the following circumstances:</p> <p><i>Significant error of law or manifest error of assessment: since decisions of the Board could have consequences for which the government may be held liable, if the representative believes that the risk of illegality is too high, they may exercise the right to ask the Board to discuss its position again.</i></p> <p><i>Decisions that could have systemic consequences that may not have been fully assessed during the first round of discussions.</i></p> <p>While the Banque de France can fund amounts to the ACP above and beyond the maximum levy set by the MINEFI, which is a second best solution to the ACP having its own sustainable resourcing within reasonable limits set by legislation if necessary. The budget for international supervision appears low given the extensive cross-border operations of major French banks outside the European Union.</p> <p>Many of these aspects of the structure are new with the creation of the ACP. So, it is not possible to confirm that they do not pose problems in practice. Even if these issues do not undermine the credibility of the ACP in practice, there are reputation risks.</p> <p>In addition, to reduce reputation risk, the authorities should consider adding to the College conflict rules so that members recuse themselves in <b>significant material</b> industry-wide matters that affect entities in which they have an interest or significant material matters that affect competitors of entities in which they have an interest.</p>
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Principle 1(3).	<p><b>Legal framework.</b> A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision.</p>
Description	<p><b>EC1.</b> The COMOFI (Articles L 612-21 and L612-22) grants the ACP exclusive authority to issue and withdraw banking licenses. The ACP may attach conditions to the license that go beyond minimum standard prudential requirements. Based on compliance with the terms and conditions of the original license, or when the institution requests, the ACP can withdraw the license (COMOFI, Article L511-15).</p> <p>The COMOFI also sets out the conditions that must be met by a credit institution for the issuance of a license, including the program of operations (business plan) of the bank, its proposed technical and financial resources, the suitability (fit and properness) of the managers (but not the full Board of Directors) and contributors of the bank's capital and where applicable their guarantors. Any substantive change in the way a bank meets the condition must receive prior approval of the ACP. (COMOFI, Articles L511-9 to L511-20).</p> <p>Regulation 96-13 dated December 20, 1996 provides detailed procedures applied by the ACP for the revocation of authorization and the striking off of credit institutions from the published list.</p> <p><b>EC2:</b> The ACP has no powers to issue regulations. Regulatory powers are reserved exclusively to the MINEFI. Hence there is no delegation of powers for the ACP to issue binding supervisory standards based on (e.g.) EU level directives. The ACP has powers to issue Instructions and Recommendations under the provisions of the COMOFI the ACP may issue Instructions and Recommendations (Articles L. 612-1, L. 612-24 and L. 612-29-1). Instructions are general rules listing the documents the persons supervised by the ACP must report on a regular basis. Recommendations may be issued in the field of consumer protection and are not legally binding, although failure to observe a Recommendation might lead to a warning and failure to observe a warning permits the ACP to launch a disciplinary proceeding.</p> <p>Nevertheless, the ACP has the power (Article L511-41-3 of COMOFI) to require an institution to take prudential measures, for example, specific actions to restore or reinforce its financial situation, to improve its management or organization depending on its activities and development goals within a specific timetable. With respect to solvency, the ACP may, for example, request an institution to hold own funds in excess to the minimum regulatory requirements (Pillar 2 requirements), and to increase its provisions in respect of deterioration of assets.</p> <p>With respect to consultation on new regulation, the ACP has the ability, granted by the COMOFI (Articles L612-14) to establish one or more advisory committees. The COMOFI requires at a minimum a commission to give an opinion on the lists, patterns, frequency and time of transmission of documents that must be submitted to the ACP. The ACP has thus established the Prudential Affairs Consultative Commission, (CCAP in French) which gives advices on any instruction settled by the ACP. The ACP can also consult the Financial And Regulation Consultative Committee (the CCLRF).</p> <p>In practice, consultation on new regulation – for example drafts of the binding technical standards currently being discussed in the context of the new powers of the European Banking Authority, are shared with the relevant industry associations who will participate in the consultation through the association working groups. The ACP will also, on request, scrutinize and endorse guidance that the industry itself has</p>

	<p>developed through its associations. Furthermore, the ACP has the ability to publish interpretative documents to guide institutions in the implementation of prudential rules but this option is little used – the notable exception being the instruction on how to calculate the solvency ratio, which has recently been updated to take account of CRD3.</p> <p><b>EC3:</b> The ACP determines the list, model and submission schedule for the documents and information which must be submitted to it. It may, moreover, request from the persons (individuals and firms) subject to its supervision any information, document, clarification or justification which is necessary for the accomplishment of its mission. It may request sight of auditors' reports and, more generally, any accounting records, which it might require, and request certification thereof, as well as any other relevant information. (COMOFI, Articles L612-24).</p>
Assessment	Largely Compliant
Comments	<p>There is complete clarity with respect to the licensing and revocation powers of the ACP. Moreover, the ACP has strong and comprehensive information gathering powers. However, the ACP has no powers to regulations on its own initiative (without changing the law). It is fully understood that were the ACP to identify gaps in the regulatory framework or in their own powers that they would raise the matter with the regulatory authority (the Ministry). Nonetheless, the authorities may wish to consider establishing a formal legal process whereby the ACP would have a right to propose that a certain matter be covered by regulation and that the Ministry would give a formal response.</p> <p>Consultative practices are currently predominantly restricted to consultation with the CCAP and CCLRF. This practice provides the opportunity for comments to be received from other relevant factors, such as industry participants, but is not as transparent or broad based a process as “better regulation” practices that can be found elsewhere in the EU and which have been adopted, inter alia, by the European Commission.</p> <p>The significance of consultative practices is not only to support the quality and effectiveness of the regulations but to play a part in communicating supervisory expectation to the industry on a fully transparent and comprehensive basis. Consultation with the industry exists but could be considerably strengthened.</p> <p>While it is clear that the systemic firms will have a close relationship with the supervisor and will be well placed to understand supervisory expectations the wider spectrum of firms may not given that many of the regulations and instructions available to firms are expressed at a high level and notwithstanding more detailed instructions available for (e.g.) the calculation of the solvency ratio or the completion of the annual report on internal controls. Thus, while there is an excellent and principles based overarching structure, more could be provided to ensure that firms more fully understand how they are expected to apply such principles in a proportionate manner to their own circumstances. The endorsement of industry developed guidance provides some insight into supervisory expectations of acceptable interpretation or practice but by definition such guidance is provided on a reactive rather than a pro-active basis. Similarly, the CEBS and EBA guidelines and in future the binding technical standards issued by the EBA will provide a further substructure to support firms' understanding, so it will be important to assess the nature of the “gap” between French domestic standards and the European ones before creating additional material, but the task is an important one which should be achieved within the next two years. The publication of issues identified or lessons learned in the course of current thematic, horizontal reviews of firms would be one constructive option.</p>

Principle 1(4).	<b>Legal powers.</b> 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	<p><b>EC1.</b> The legal framework for banking supervision in France is laid down in a number of statutes and regulations, primarily the COMOFI, which authorize the ACP to perform administrative and supervisory powers with regard to the banking sector in France. In particular the Article L612-1 charges the ACP with monitoring compliance with the legal and regulatory requirements for banks and to apply sanctions against compliance. Qualitative, analytical judgment is one of the keystones of ACP supervisory practice and is fully supported by the COMOFI. The assessors saw numerous documented examples of the exercise of qualitative supervisory practices.</p> <p><b>EC2.</b> With one significant exception, the ACP has and takes advantage of unrestricted access to all aspects of an institution's operations, its subsidiaries and direct and indirect controlling shareholders and it can require corrective action when bank fails to comply with any information request (COMOFI, Articles L612-24). It can call a hearing with any person subject to its control if necessary or any person deemed necessary to carry out its supervisory function. Any failure to implement the necessary remedies exposes the bank to progressively harsher sanctions, which the ACP may disclose to the public (COMOFI, Articles L612-25). It may be noted in passing that in practiced the ACP has not yet frequently opted to disclose the identity of persons/institutions subject to sanction.</p> <p>Significantly, however, contact with the firm does not extend to the Board without the presence of management. Hence, it is not ACP practice, confirmed by the firms the assessors met, to seek to meet with the Board though it will have, at a minimum, an annual meeting with the CEO (of major firms) and the CEO will frequently also be the Chair of the Board. Lately the ACP has also been seeking to develop direct contacts with Chairs of Auditing Committees. Correspondence and documentation from the ACP is forwarded to the Board. This includes the annual "lettre de cadrage" issued by the ACP to the CEO of each bank. These letters are circulated to the Board members and contain the main policy orientations that the ACP would like the bank to adopt. Furthermore, the main findings of on-site inspections are circulated to Board members as well as the follow-up to the recommendations based on these inspection missions. Lastly, the annual report on internal control procedures prepared by the bank and sent to the ACP is also sent to the Board. The ACP asks that this report be communicated to it together with proof that the Board has approved it.</p> <p>During the assessment mission the assessors met with a range of ACP staff at all levels of seniority and had considerable dialogue concerning the extent of the supervisors' powers to meet with the Board. The assessors were consistently and unambiguously given to understand that there were legal restrictions placed on the ACP from meeting with the Board without the presence of executive management. ACP staff attributed restrictions on their access to the Board to the fact that the ACP was not allowed to 'control' Board members. Furthermore, ACP staff commented that some banks were resisting the ACP's initiatives to establish contact with independent Board members.</p> <p>During on-site missions, ACP representatives have full access to banks' management, staff and records. Within the frame of off-site supervision, meetings with the representatives from the institutions are planned and held on a regular basis. The frequency of these meetings, some of which focus on specific topics, varies depending on the size and risk profile of the institution, the actual topics of discussion</p>

and the materiality of the issues. The wide range of meetings, both formal and ad hoc is supported by regulatory returns, firm internal management information packs and any other relevant information.

Contact with the firm is proportionate to the scale of the institution. For the systemic firms, depending on the size and the complexity of the group, a range from 30 to 50 in-person meetings are conducted annually with the different levels of staff (CEO, CFO, CRO, heads of business lines and other relevant staff) and this contact will be supported by a considerable degree of more informal exchanges (e-mails and phone call).

The assessors reviewed the work that is done as part of ORAP to assess Board oversight of the institutions.

**EC3.** The ACP has extensive powers with respect to remedial actions and sanctions (see also CP23). It can issue injunctions, administrative sanctions and disciplinary sanctions. (COMOFI, Articles L612-30 to L612-42).

The ACP can issue a recommendation or an injunction to an institution to take all necessary measures within a given period to restore or strengthen its financial equilibrium or to rectify its management methods. (COMOFI, Articles L612-31 and L.612-32)

The ACP is empowered with the following administrative powers it can apply where a credit institution's solvency or liquidity situation is such that the ACP judges that interests of customers are in jeopardy or likely to be so:

- placing the institution under special control,
- prohibiting certain operations,
- suspending or prohibiting the use of institution's assets,
- suspending or prohibiting payment of dividends and
- temporary or permanent removal of senior executives. (COMOFI, Articles L612 33).

The ACP can also appoint a provisional administrator "to whom will be transferred all the powers for administering, managing and representing" the credit institution (COMOFI, Articles L612-34) or appoint a liquidator (COMOFI, Articles L613-24 to L613-31).

The ACP may impose the following disciplinary sanctions: warning; reprimand; prohibition on the execution of certain transactions and any other restriction on the conducting of its business; temporary suspension of one or more persons of the management body, with or without appointment of a provisional administrator; automatic dismissal of one or more of those same persons, with or without appointment of a provisional administrator; partial or full deletion of the credit institution or investment firm from the list of authorized credit institutions or investment firms, with or without appointment of a provisional administrator.

Furthermore, the ACP can request the intervention of the Depositors Guarantee Scheme (DGS) should the ACP find that one of the member institutions is no longer able to repay its deposits. In addition, the DGS, at the proposal of the ACP, may also take preventive action against a credit institution whose situation gives rise to fears that deposits may not be repaid at a future date (COMOFI, Articles L312-5). This option has the capacity to facilitate the rapid transfer of a troubled bank's deposits to sound banks, thus limiting contagion risks.

	<p>In practice the ACP has been making use of its powers. In the context of prompt remedial action, the ACP has used its tools to enhance the levels of capital within individual institutions. Within the French system, the application of a Pillar 2 measure to increase the minimum level of capital requirements for an institution is applied via an injunction, which also means that the firm has the right of legal appeal. Statistics on the application of new injunctions are available in the ACP annual report (10 individual injunctions in 2010, though the overall number of Pillar 2 measures in place is higher than this). The ACP has also imposed formal requirements on an institution relating to liquidity risk management.</p> <p>With respect to more severe measures, the ACP has also appointed provisional administrators in two institutions in 2010. Finally, the ACP opened seven disciplinary procedures in 2010. Sanctions, including fines, are made public by the ACP (although the identity of the firm/individual may be withheld). In 2011 the ACP opened three disciplinary procedures.</p>
Assessment	Materially Non Compliant
Comments	<p>On balance, the ACP has strong legal powers, both with respect to information gathering and powers to intervene with institutions where necessary.</p> <p>CP 1(4) is one of many CPs in the Basel Core Principles methodology which examines aspects of the supervisory authority's relationship with the Board of Directors of the supervised entities. Given that the relationship between the supervisor and the Board of Directors has a material impact on the ability of the supervisor to exercise effective supervision it is important to see the issue holistically rather than attempt to examine it piecemeal in the various CPs where relevant criteria are located. The issue is particularly material in the context of the supervision of systemically important institutions (whether globally or nationally systemic) and where the CEO will typically be the Chair of the Board. Therefore, this issue is assessed in CP1(4), which addresses a foundation issue of the suitability of the ACP's legal powers. Although the individual issues are referred to and discussed elsewhere within the assessment, notably in CPs 3, 7 and 23 as well as CPs 8, 10, 13, 14, 15, 16, and 17 they are assessed under CP1(4) alone as they represent many facets of the same underlying issue.</p> <p>The assessors have identified, overall, significant deficiencies relating to aspects of the ACP's relationship with the Board of Directors of the credit institutions. The deficiencies rest partly in legal limitations placed on ACP and partly in ACP practices to date in its interaction with the Board. Cumulatively these restrictions and deficiencies have a material impact on the ability of the ACP to exercise effective supervision.</p> <p>The areas of concern identified by the assessors are:</p> <ul style="list-style-type: none"> <li>(i) The ability and practice of the ACP to establish and maintain full and unrestricted access to the Board.</li> <li>(ii) The lack of powers of the ACP to assess the suitability (fit and proper test) of the individual Board members;</li> <li>(iii) The lack of powers of the ACP to assess whether the Board as a whole has the appropriate knowledge and skills;</li> <li>(iv) The lack of powers of the ACP to assess whether the Board is exercising its appropriate role in relevant risk management functions; and</li> </ul>

(v) The lack of powers of the ACP to dismiss members of the Board, whether jointly or severally.

With respect to (i), the relationship between the ACP and the Board of Directors of a credit institution is at arms' length at present. Although it may review the papers that are provided to the Board and minutes of Board meetings the ACP does not meet with the Board or speak with the Board. This access to the Board is recommended practice and is common in advanced jurisdictions where authorities consider that this relationship is central to communicating their views effectively, ensuring that their messages are understood, understanding the capacity of the Board to direct the institution, to set the culture, strategy and risk appetite of the firm and providing the firm with the opportunity of exploring avenues to address any potential prudential concerns. Failing to meet with the Board therefore puts the ACP at a disadvantage in terms of understanding the capacity of the Board to direct the institution, or to communicate the ACP's concerns when relevant. There is evidence to suggest that communication from the ACP to the Board, for example, via correspondence to the CEO (such as the annual "lettre de cadrage") that will be distributed to the Board has been less influential than the ACP has the right to expect or that other supervisory authorities would experience.

As noted above under EC2 the assessors were consistently and unambiguously given to understand by ACP staff that there were legal restrictions placed on the ACP from meeting with the Board **without the presence of executive management**. ACP staff attributed restrictions on their access to the Board to the fact that the ACP was not allowed to 'control' Board members. Furthermore, ACP staff commented that some banks were resisting the ACP's initiatives to establish contact with independent Board members. Meetings with firms confirmed that the ACP did not seek to meet with the Boards.

Subsequent to the assessment, the ACP has provided written clarification, supported by legal references (COMOFI L612-24), indicating that it has powers to meet with persons under its control or other persons necessary in order for it to carry out its supervisory function. The COMOFI (L612-24) is silent with respect to whether executive management must be present if the ACP were to meet with the Board. Hence, the assessors conclude that the ACP is likely to have the requisite powers to meet with the Board but has to date failed to utilize its powers effectively and has not, as an institution as a whole, demonstrated that it has understood the extent of its powers. The assessors note and welcome the intention of the ACP to redress this practice and note that there have been some contacts with Board members who chair Audit Committees.

Items (ii), (iii) and (iv) above relate to dimensions of the ACP's powers to assess the Board. With respect to assessment of "fit and proper," the ACP must perform an assessment of the persons who effectively direct the business (Regulation 96-16). This covers the "four eyes" principle but does not extend to the full Board, although the firms are obliged to provide notice of changes to the Board composition within a month of the change having taken place (Regulation 96-16), so the ACP will have timely information on Board composition. The ACP may not however, assess the suitability of the Board as a whole and together with the more distant (though to be remedied) direct contact with the Boards, the ACP is not in a position to assess whether and the extent to which the Board is exercising its proper role in the firm's risk management functions.

	<p>In terms of Board composition, French corporate law (Commercial Code) does provide for companies that are listed on regulated markets to apply on a voluntary basis a corporate governance code. Where a company does not apply such a governance code the firm should indicate why it has not chosen to do so and indicate which rules it has applied. The Commercial Code (L 225-37) governs a number of aspects of the Board, including voting procedures and the requirement for listed companies to provide reports on preparation and organization of the Board's work and the internal auditing procedures put in place by the company as well as any limitations put on the management by the Board. These legal provisions provide some information the ACP can use albeit that the corporate governance code is voluntary and will not apply to all supervised entities (i.e., not all firms are listed).</p> <p>The ACP's scope to apply corrective and disciplinary procedures to the Board (item v, above) are also limited. While the ACP can apply administrative police measures or disciplinary proceedings under which it may suspend or dismiss managers this power does not extend to the full Board of Directors (other than the Directors who have been assessed under the fit and proper requirement).</p> <p>The assessors note and strongly welcome the fact that there is draft legislation currently under negotiation in the European Union that is expected to introduce provisions that should resolve a number of the issues identified here relating to the fit and proper assessment of all Board members, of the suitability of the Board and of the effective function of the Board. It is proposed that the legislation will expressly provide that the structure, size, composition, performance, knowledge, skills and experience of the Board be periodically, individually and collectively assessed. Further development of the EU work on sanctions may also be of assistance over time though the formal proposals put forward for negotiation would permit though not necessarily require the ACP to be granted powers to dismiss members of the Board.</p> <p>It is recommended that there be a comprehensive review of the rights and practices of the ACP in relation to the Board of Directors to ensure access to and ability to assess (and reject or dismiss) the suitability of Board Members. EU legislative developments can be expected to assist in this process over the medium term, but as the negotiation is not yet final it is not yet clear if the legislative changes in the directive (which is not subject to maximum harmonization restrictions) will go far enough. Should this be the case, it will be important for the French authorities to act domestically to ensure the supervisory authority has the requisite full complement of powers. One element of this review would be for regulation to distinguish more clearly between the Board and the management to ensure that clear responsibilities were placed upon Board members in respect of risk management.</p>
Principle 1(5).	<p><b>Legal protection.</b> A suitable legal framework for banking supervision is also necessary, including legal protection for supervisors.</p>
Description	<p><b>EC1:</b> There is no explicit provision in law concerning the protection of staff. However, the ACP operates under French administrative law. However, as the ACP has no legal personality, it cannot incur liability in its own right. Actions against the acts or omissions of the ACP therefore need to be brought against the French State.</p> <p>The State may thus incur liability due to the ACP's acts or omissions which can be qualified as serious negligence: "Toward the powers allotted to the banking supervisory authority, the responsibility endorsed by the state for the claim damages</p>



	<p>caused by carelessness or omissions in the exercise of its mission could only be involved in case of serious fault” (Conseil d’Etat, 30 November 2001, Ministry of Economy vs. Kechichian).</p> <p>Senior officials and employees of the ACP are protected by general principles of administrative law applicable as if they were public servant in charge of a public function. Where senior officials and employees are pursued for actions taken in the course of their duties, they may not incur personal liability for actions taken and/or omissions made while discharging duties in good faith. It may be noted that the collegiate nature of the ACP’s decision-making provides a further layer of protection against suits aimed at any individual one of its college members.</p> <p><b>EC2:</b> As noted above, the staff of the ACP is protected by administrative law as if they were part of the civil service with the state incurring the liability. If a suit were brought against a staff member regarding an action taken in the course of performing their duty, the costs would not fall on them.</p>
Assessment	Compliant
Comments	Despite the absence of explicit legal protection granted to the authority and staff of the ACP when discharging their duties in good faith, the protections of administrative law, backed by case law, are available.
Principle 1(6).	<b>Cooperation.</b> Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Description	<p><b>EC1.</b> Informal and occasionally formal arrangements for cooperation and information sharing are in place. The BdF and ACP naturally coordinate as ACP is part of the Banque and the Governor chairs the ACP college. ACP and the MINEFI share information and coordinate as a result of the MINEFI role on the ACP college. The legislation provides authority for various other bodies to cooperate. ACP and AMF can cooperate and exchange information under the legislation as can both of them with the deposit guarantee scheme. All information exchanged is subject to professional secrecy. Coordination on more macro-prudential issues occurs through COREFRIS.</p> <p><b>EC2.</b> The COMOFI and European regulations provide for the cooperation of the ACP with foreign authorities. European Directives provide a very strong framework for the cooperation of the ACP with financial supervision authorities belonging to Member States of the European Union. These provisions are implemented in French legislation which settles European supervisors’ colleges for credit institutions.</p> <p>As a principle the ACP must cooperate with financial supervision authorities belonging to Member States of the European Union for any supervisory task including on-site supervision. When a credit institution has activities in several European countries the ACP must establish a college gathering European prudential supervisors which are particularly concerned by this credit institution. The EBA is also a member of this college.</p> <p>As a home supervisor, ACP has set up European colleges concerning 14 different French banking groups. Colleges of European supervisors of the three largest groups have regularly met since 2006. Furthermore, ACP is a member of colleges of supervisors of several foreign banking groups.</p> <p>As regards states which are not parties to the EEA the ACP has also power to conclude bilateral agreements with the authorities of these states subject to the</p>

	<p>condition that these authorities are entrusted with duties similar to those entrusted in France to the ACP and provided that such authorities are themselves bound by an obligation of professional secrecy.</p> <p>The ACP has concluded a number of bilateral agreements with non EEA countries, among which Canada, the US, Switzerland, Korea, Qatar, Dubai, Montenegro, Mexico, Taiwan, Morocco, China, Guinea, West African Monetary Union, and West African Banking Commission.</p> <p>For three of the largest groups, colleges gathering the supervisors of the main entities, including non-EEA countries, have met once or twice a year for five years.</p> <p><b>EC3.</b> The ACP and its staff are bound by a professional secrecy obligation, except in cases specifically stipulated by the law. The ACP can use the information it has received only to perform its missions and tasks (COMOFI, Articles L632-3).</p> <p>Bilateral agreements concluded between ACP and non-EEA supervisory authorities include provisions on professional secrecy obligations. Within the EEA, exchange of information between colleges of supervisors' members is governed by multilateral agreements compliant with EBA's guidance. These agreements contain confidentiality provisions.</p> <p><b>EC4.</b> The supervisor is able to deny any demand for confidential information in its possession other than a court order.</p>
Assessment	Compliant
Comments	
Principle 2.	<p><b>Permissible activities.</b> 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.</p>
Description	<p><b>EC 1 and 2.</b> Within EU legislation, the term "credit institution" is defined as taking of deposits and granting of credits. France, in its national legislation, has adopted broader definition of the term "credit institution." Under Article L. 511-1 of the Monetary and Financial Code, "credit institutions" are defined as "legal entities whose customary business activity is the carrying out of banking transactions." Such entities "may also carry out transactions related to their activities. The concepts of such customary and permissible activities are also defined within the Code. Customary activities (Article L. 311-1) are the "receiving of funds, credit transactions and provision to customers of means of payment" while permissible activities (Articles L. 311-2) relate to the additional financial activities that enjoy the freedom of the single market passport within the EEA.</p> <p>However, the Code (Article L511-9) provides a further refinement by requiring all credit institutions to be authorized as a specific category of firm ( i.e., " bank, mutual or cooperative bank, municipal credit bank, finance company or specialized financial institution"). Two of these categories (finance company and specialized financial institution) are not generally permitted to accept on demand deposits or deposits of less than two years maturity from the public. As the definition of credit institution includes firms that provide credits but do not accept deposits, France has a large population of credit institutions (approximately 650 firms) of which roughly only approximately a half are deposit taking institutions.</p>

	<p><b>EC 3.</b> The Code (Article L. 511-8) prohibits – under threat of criminal liability - (Article L. 571-3) - the use of business names, advertising or any expression wrongfully implying that, or causing confusion whether an institution is an authorized credit institution, or even which category of credit institution for which it has been authorized. This is an important distinction given that not all categories of credit institution may accept deposits.</p> <p><b>EC 4.</b> The Code prohibits (Article L. 511-5) “any person other than a credit institution to carry out banking operations on a regular basis ....any company other than a credit institution to receive on demand deposits or term deposits of less than two years from the public.” Furthermore, as noted above, under the terms of (Article L 511-9) only four of the six categories of credit institution are generally authorized to receive such deposits.</p> <p><b>EC5.</b> The ACP publishes each year in its official bulletin the list of licensed banks and branches of foreign banks operating within its jurisdiction. This list is publicly available on the ACP’s website. Moreover, a public register, available on its website, provides a daily updated list of these institutions.</p>
Assessment	Compliant
Comments	<p>The definition for authorization as a credit institution is unusually wide within France, but the law provides for clarity and specificity with respect to the range of activities that these institutions can conduct. The authorities noted that it was possible that in future the definition might be re-considered or reviewed. Such a review would be driven by changes to EU legislation, under which the Capital Requirements Directive (CRD) may be recast, in part, as an EU regulation (which is directly applicable in a Member State and requires no transposition and may not be amended by national authorities) and which would affect the definition of “credit institution.” At present the French definition of credit institution encompasses firms that are not deposit takers, although the EU CRD definition relates to firms who grant credits and take deposits. As this definition would be binding at national level, the French authorities would then have to decide whether to apply the same regulatory framework to non-credit institutions as to credit institutions or whether to develop a regulatory approach tailored to the non-credit institutions which they supervise.</p> <p>Although the wide perimeter provides potential insights into a broader segment of the financial market, it presents challenges to the authority in terms of the requirement to prioritize its resources effectively across-the broad range of type and number of institutions and protect itself against potential reputational risk should there be failures.</p>
Principle 3.	<p><b>Licensing criteria.</b> The licensing authority must have the power 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 ownership structure and governance of the bank and its wider group, including the fitness and propriety of Board members and senior management, its strategic and operating plan, internal controls and risk management, and its projected financial condition, including its capital base. Where the proposed owner or parent organization is a foreign bank, the prior consent of its home country supervisor should be obtained.</p>

Description	<p><b>EC 1.</b> Following institutional changes in France, and the establishment of the ACP, the supervisory authority is now also the licensing authority.</p> <p><b>EC 2.</b> The Monetary and Financial Code (Articles L. 511-10 to L. 511-13), sets out a comprehensive set of criteria that the ACP must ensure are satisfied in order to grant a license. The obligation upon the ACP is to: (a) ensure that the institution meets the minimum capital requirement (Article L. 511-11 and Regulation 92-14 as amended); (b) ensure that there are, at least, two senior managers with the necessary respectability and competence or suitable relevant experience responsible for the overall direction of the institution's conduct of business (Article L. 511-13); (c) review the business plan and the available technical and financial resources (Article L. 511-10); (d) assess the suitability (fit and properness) of the investors (or their guarantors) (Article L. 511-10); 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” (Article L. 511-10).</p> <p>The information needed to take a decision on the granting of the license is largely collected through ACP’s application form (“Authorization Questionnaire”) which requests specific information on: (a) management; (b) proposed management and control procedures; (c) strategy; (d) activity program of the entity, and (e) the origin of the initial capital. The questionnaire will be revised in order to bring it into line with recent changes to EU legislation.</p> <p><b>EC 3.</b> The criteria for authorization are consistent with the standards applied in continuing day to day supervision.</p> <p><b>EC 4.</b> Applications are prepared by the ACP department responsible for authorization, licensing and regulation. This department will investigate and confirm the information provided to the ACP and submit the dossier for decision to the College of the ACP which is empowered to make the decisions. The dossier will include a clear description of the institution’s planned activity, its business plan (under normal and stress scenarios) together with a commentary on the business plan. There is particular attention paid to providing a clear description of the parent and establishing who controls the institution. As there is a formal timeline of one year for an application to be decided upon, an institution can insist on the authorization being submitted to the College, even if the licensing department of the ACP considers that the information is insufficient or the criteria are not met. Should the College deny the application, the decision may be appealed in front of the supreme administrative court.</p> <p><b>EC 5.</b> The Monetary and Financial Code (Article L. 511-10), provides that the ACP “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 persons or legal entities, or by the existence of laws or regulations of a non-EEA country when one or more of the above-mentioned persons are governed by such laws or regulations.” Particular attention is paid to situations involving locations where exchange of information would not be possible.</p> <p><b>EC 6.</b> Particular attention is paid to the beneficial ownership of a group by the licensing process. The application covers all proposed ownership holdings of greater than 10 percent, and an organogram is required which identifies the ultimate chain of</p>
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ownership. Refusal to provide such information would lead to failure of the application. Thus the authorization Questionnaire, in the section "Declarations to be forwarded by the Contributors of Capital" requires shareholders to provide financial information and to confirm that they are aware of Article L. 511-42 of the Monetary and Financial Code, which allows the Governor of the BdF, in his capacity as Chairman of the ACP, to call upon shareholders to contribute further capital if needed, in light of the financial condition of a credit institution. Comfort letters are always required from investors who are outside the banking system or based in a country where prudential supervision is not considered equivalent to the ACP. The function of ensuring the parent company of the institution, whatever its nationality, has the financial means to support the bank belongs to the licensing department when the license is granted or on the occasion of changes in the capital control. In case where the parent company is a foreign regulated entity, the licensing department requests cooperation in that regard with competent regulators.

This Questionnaire also requires information on the origin of the funds used in compliance with AML/CFT regulations. The ACP now has the authority to access data on criminal records in respect of checks carried out in the course of assessing applications for banking authorizations although this authority has not yet been granted by the Ministry of Justice in respect of applications in the insurance sector.

**EC 7.** The minimum capital requirements for banks are consistent with the EU legislation and stipulate EUR 5 million for deposit taking banks (Article 1 Regulation 92-14). Lower thresholds, ranging from EUR 2.2 million to EUR 1 million, exist for the other categories of credit institution.

**EC8.** The ACP does not have the authority to conduct a fit and proper assessment of the Directors of an institution other than the Chief Executive Officer and his deputy. The Commercial Code sets out requirements in respect of Directors of companies and of Boards of Directors and the ACP has not been granted power of scrutiny or assessment in this regard. The COMOFI does, however, provide (in Article L500-1) that only individuals who have never been convicted for one of the offenses listed in this Article can be Directors of a credit institution.

The fit and proper test is applied to the individuals satisfying the "four eyes" criterion. The Monetary and Financial Code (Article L. 511-13) provides that the effective determination of the general orientation of a credit institution's business must be decided by at least two senior managers with the necessary respectability and competence or suitable relevant experience responsible for the overall direction of the institution's conduct of business.

A specific questionnaire has to be fulfilled by the credit institution in order to assess the competence, experience and respectability of the appointed senior manager. The CV of the appointed person, a copy of its criminal record and the minutes of the decision-making body also have to be provided.

**EC 9.** The ACP reviews the strategy and draft bylaws of the entity, the intended organization chart and all information available on future Directors, and financial projections for the next three years. A description of the business model and risk management and internal control process and procedures is also required. The extent of the information requirements of the College in these areas depends on the extent and complexity of proposed operations.

**EC10.** The ACP requires the credit institution to provide a business plan for, at least, the next three years. This business plan, which is submitted on normal and stressed conditions, is reviewed in relation with the financial strength of the credit institution and the amount of the own funds. As noted above, the authorization Questionnaire, under "Declarations to be forwarded by the Contributors of Capital" requires shareholders to provide financial information.

**EC11.** Under the provisions of the single market legislation, an EU (and EEA) Member State may not apply licensing requirements to branches of institutions from other EEA Member States and instead use a process of notification by the home authority. However, the same licensing requirements that apply to institutions incorporated in France are applied to branches and subsidiaries of non-EEA institutions. The ACP routinely requests evidence of a non-EEA home supervisor's prior consent to establish a subsidiary or a branch in France, although a formal requirement to do so is not in place, and ensures that the home supervisor monitor the all group on a consolidated basis.

**EC12.** The ACP does not have the power to immediately withdraw a license should it discover that the license was granted on the basis of false information. Given that the ACP has powers to revoke an authorization (Article L. 511-15 of the Monetary and Financial Code) automatically when the conditions of authorization are no longer met it is probable that false information would de facto provide grounds for revocation. Moreover, Articles L. 612-38 and seq. provide that the ACP is empowered to impose disciplinary sanctions, which include revocation of authorization, in the event of failure to comply with banking regulations. Nonetheless, the ACP would have to launch a revocation procedure rather than have immediate right to withdraw the authorization.

**EC13.** Regulations (Article 38 of Regulation 97-02 modified on February 21, 1997) establishes the requirement that "the executive body and the decision-making body have at their disposal relevant information on the risks incurred by the reporting institution. They are obliged to regularly assess and control the effectiveness of policies, systems and procedures set up to comply with this regulation and take the appropriate measures to remedy possible failings."

Thus there are obligations placed upon the Board although the ACP cannot explicitly assess whether the Board collectively has a sound knowledge of the proposed business activities of the institution. However, as a mitigating factor, in cases where there is one or a few majority shareholders, the bulk of the Directors of the Board are generally nominated by those shareholders. And the fitness and properness of those shareholders –including a sound knowledge of the proposed activities and their ability to supervise them- are assessed and are a criterion of the license). As part of its assessment of the shareholder, the ACP would assess the adequacy of the shareholder representation at the Board. In cases where there were no majority or significant shareholder proposed in the structure of the institution the ACP would seek to deter the application, though a refusal of authorization would have to be based on robust grounds. Nevertheless oversight by shareholders is not a fully equivalent function to direction of an institution by its Board of Directors.

**AC1.** The ACP may insist on increased initial capital in light of the review of the business plan. As mentioned above, the part of the authorization Questionnaire, entitled "Declarations to be forwarded by the Contributors of Capital" requires shareholders to provide some financial information and to confirm that they are aware

	<p>of Article L. 511-42 of the Monetary and Financial Code, which allows the Governor of the BdF, in his capacity as Chairman of the ACP, to call upon shareholders to contribute further capital if needed, in light of the financial condition of a credit institution.</p> <p><b>AC2.</b> No specific or additional requirements or practices, beyond the normal supervisory processes are put in place to monitor the progress of newly authorized credit institutions. However, such institutions are subject to requirements to provide the ACP with accounting, prudential, financial and organization information which allow the ACP to monitor the entity and determine that supervisory requirements outlined in the license approval are being met (Instructions 93-01 modified on January 29, 1993 and 2009-01 modified on June 19, 2009).</p>
Assessment	Largely Compliant
Comments	<p>The ACP processes and procedures surrounding the licensing function are detailed, thorough and diligent. The licensing process is supported by a clear and strong legal framework except in one significant regard, which is the inability of the ACP to assess formally the suitability of the Directors of an institution that is seeking a license. This criteria is assessed under CP1(4) together with other relevant criteria given that CP1(4) is a foundation principle.</p> <p>The function of a Board of Directors is to set the strategy and determine the approach of an institution. It is therefore a major vulnerability in the safety and soundness of the newly licensed institution if its Directors are not suitable. It is also a source of reputational risk for the ACP if the institution were to experience difficulties or to fail due to the actions of its Directors. While the ACP will take into consideration whether the shareholder is (for example) a bank from an EU/major developed country and therefore, in principle, suitable owners, the function of the shareholder is not equivalent to the role that the Directors of the Board are expected to play in the operation of the institution.</p> <p>An additional, though less pressing concern, relates to the inability of the ACP to immediately withdraw an authorization that was granted on the basis of false information. The ACP has powers that are likely to lead to an equivalent outcome but legal and administrative processes could be strengthened in this regard and the EU directive (CRD Article 17(b)) already establishes that the power should be granted to the relevant competent authorities. The ability to launch a revocation procedure on the basis of false information, which is the alternative left open to the ACP, is a second best option in several respects. For example, it is likely that a revocation procedure would be more time consuming than an absolute right to withdraw the authorization, meaning that a newly authorized company would have less time to establish itself and thus less time to operate on a “false” basis. It is recommended that the French authorities enact the necessary legislation to ensure that the ACP has direct powers of immediate withdrawal of authorization on the grounds that false and misleading information has been provided.</p>
Principle 4.	<b>Transfer of significant ownership.</b> The supervisor has the power to review and reject any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.
Description	<b>EC1</b> With respect to credit institutions, concepts of “significant” ownership and “controlling interest” are governed by EU legislation (directive 2007/44/EC on mergers and acquisitions) and transposed into Regulation 96-16. Although specific

definitions of “significant” and “controlling” interest are not provided, the Regulation ensures that thresholds of interest and control are established which are subject to ACP approval or notification, i.e.,

- when a person or a group acting in concert acquire, increase, reduce or cease, directly or indirectly, a holding in an institution or firm which consequently become or cease to be a subsidiary of this person or group; and
- when a person or a group acting in concert acquire, increase, reduce or cease, directly or indirectly, a holding in an institution or firm which exceeds or falls below a half, third, fifth or tenth of the voting rights of the bank.

**EC2.** As noted in EC1 above, Regulation 96-16 specifies changes in ownership which require notification to/ approval from ACP. As the mergers and acquisitions directive has specified that these thresholds are subject to maximum harmonization, the French authorities may not impose more stringent standards.

Although both increase and decrease of ownership interest—when triggering the above thresholds – requires ACP approval, prior authorization is required in relation to an increase of interests (Regulation 96-16, Articles 2.1 and 2.2). Disposal or reduction of interests must be reported immediately to the ACP, and the ACP has 60 working days to inform the owner/controller and the institution whether it opposes the change in control on the grounds of sound and prudent management concerns. (Regulation 96-16 Article 2.3).

There is an exemption to these requirements in respect of internal group restructuring for French or other EEA groups. In these cases it is sufficient to merely inform the ACP changes of control which take place (i) between subsidiaries of one and the same corporation and (ii) located within the EEA (Regulation 96-16 Article 2-2(7)).

**EC3.** In line with directive 2007/44/EC on mergers, the ACP has 60 working days, which may be suspended once in order to require additional information for a maximum of 30 days, to oppose the transaction and to inform the acquirer of the grounds for its decision. The undertaking subject to the regulation is also informed.

**EC4.** Regulation 96-16 requires that each bank file information on each holder of at least 10 percent of its outstanding capital stock with the ACP. Furthermore, the ACP has the right to exact all necessary information on holders of between 0.5 percent and 10 percent of such outstanding capital stock (Articles 5 and 6). The ACP 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 voting rights (Article 3). The accuracy of this information can be verified through on-site investigations.

**EC5.** The ACP does not have the right to modify or reverse a change of control which has taken place without the requisite notifications or approvals. However, where a transaction is completed without first obtaining the required authorization from the ACP, the Monetary and Financial Code (Article L. 611-2) provides that the ACP may apply to the courts to have the voting rights applicable to the shares in the transaction suspended.

**AC1.** There is no obligation to notify the ACP in cases where the institution becomes aware of material information which may negatively affect the suitability of the major shareholder other than the provisions of Article 5 of Regulation 96-16 which require the annual submission of financial information on shareholders (with an exemption for shareholders that are entities already subject to the regulation and credit institutions



	or investment firms authorized in another EEA member state). The Regulation also requires changes to the composition of Boards of Directors or Supervisory Boards of credit institutions to be reported to the ACP within one month.
Assessment	Largely Compliant
Comments	<p>Broadly speaking the transfer of significant ownership is governed in France by the provisions of the Mergers and Acquisitions Directive. Although the Directive applies maximum harmonization standards, however, not all aspects of transfer of control are addressed by the Directive.</p> <p>The French regulatory approach to change of control provides an exemption for internal group restructuring where the control of the authorized institutions remains within the EEA. Although this appears to be a pragmatic option, based on the harmonized framework within the EEA, and also on the presumption that the ultimate beneficial shareholders will remain unchanged, it creates the potential for significant challenges to the effective supervisory process given that internal management and control issues may arise in the restructured group, in particular where another EEA supervisor might decide to reduce its scrutiny of the group due to the restructuring. Requiring such issues to be dealt with after the fact rather than examined before the fact puts the ACP in a weakened supervisory position that is unnecessary.</p> <p>With respect to the case where a change of control that has taken place without the required notification to or approval from the ACP, the regulatory structure provides a clear deterrent in that the ACP can apply to the courts to have the shares in the transaction suspended. This option, while valuable, falls short of the ability to reverse the transaction. It is recommended that the ACP should be able to apply for the reversal of such transactions and that the courts should have the power to grant such a request.</p> <p>The ACP could and should also be much better placed in terms of there being notification requirements to the ACP in cases where the institution becomes aware of material information which may negatively affect the suitability of the major shareholder. Although there are annual notification requirements regarding the financial information of significant shareholders, this obligation is deficient in terms of breadth of scope and timeliness of application. Financial material is only a subset of possible relevant information and an annual submission does not impose any expectation of timeliness of notification.</p>
Principle 5.	<b>Major acquisitions.</b> The supervisor has the power to review major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and confirming that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Description	<p><b>EC1.</b> Acquisitions by banks are not subject to approval by ACP unless the target institution is also authorized by the ACP.</p> <p>Where the acquisition target is a domestic credit institution, as discussed in CP4, EC3, the transaction will be governed by Regulation 96-16. Thus as the supervisor of the target entity, the ACP would be notified and required to give its approval). The Regulation does not apply to investments or acquisitions made by domestic French credit institutions in non-domestic credit institutions.</p> <p>When the acquisition target is an insurance company, the ACP must receive prior notification via the implementation of Directive 2002/87/EC ("Financial</p>

Conglomerates Directive”). Thus, the ACP can oppose an acquisition in insurance and reinsurance companies applying the same thresholds as used for banking institutions (see in particular Articles L. 322-4 and R. 322-11-1 of the Insurance Code).

For acquisitions by credit institutions in other sectors (except in a financial institutions or an EEA registered insurance company), any participation (i.e., an equity interest over 10 percent or one which would enable a significant influence within the meaning of Regulation 2000-03) in another corporation must be limited to no more than 15 percent of the bank’s own funds (Regulation 90-06, Articles 2 and 3; also see Monetary and Financial Code, Article L. 511-2). The aggregate of such acquisitions must not exceed 60 percent of the bank’s own funds. These limits are applied on a consolidated basis. The ACP may authorize a credit institution to exceed one of limits set out in Article 2, but the excess over and above these limits is then deducted from the bank’s own funds (Article 5).

Exceptions to the limits set out in the above paragraph are permitted for limited periods of time, (Regulation 90-06, Article 3b) when a bank holds the stock as a result of a financial support operation, the shares are held for the account of a third party, the shares are classified as trading securities, result from a purchase order executed on behalf of a third party, or are held in connection with the underwriting of an issue.

**EC2.** Only acquisitions in other domestic supervised institutions would be subject to prior approval by the supervisor.

Article R. 511-3-2 of the Monetary and Financial Code provides that, when the ACP assesses an acquisition in a supervised institution which leads to control over the institution or shareholdings exceeding the above mentioned thresholds, the ACP has to make sure that the target credit institution has a sound and prudent management and taking into account the likely impact of the proposed acquirer on the target, appropriateness of the proposed acquirer and the financial soundness of the proposed acquisition against all of the following criteria:

- Reputation of the proposed acquirer;
- Reputation and experience of any person who, following the proposed acquisition, will direct the activities of the credit institution (i.e., the new seniors managers);
- Financial soundness of the proposed acquirer, particularly given the type of business pursued and planned in the target credit institution;
- The ability of the credit institution to meet and continue to meet the prudential requirements, relating in particular to whether the group to which it belongs has a structure which allow effective supervision, to effectively exchange information between the competent authorities and to determine the sharing out of responsibilities between the competent authorities; and
- The existence of reasonable grounds to suspect that a transaction or an attempt money laundering or terrorist financing is being or has been committed in connection with the proposed acquisition or that the proposed acquisition could increase the risk.

This information must be supplied by the proposed acquirer when completing the application questionnaire.

**EC3.** There is no requirement under current French law and regulations to obtain approval from the French supervisory authorities for the acquisition of interests in banking business in non-French jurisdictions before such investments are undertaken. Hence the supervisor cannot prohibit banks from making major acquisitions/ investments (including the establishment of foreign branches or subsidiaries) in countries where secrecy laws or other regulations would prohibit or impede the flow of information necessary for adequate consolidated supervision. However, where a transaction is viewed as unsound, the Monetary and Financial Code Article L. 511-41-3 authorizes the ACP to “issue an injunction upon the credit institution to take, within a specified period, all measures to restore or strengthen its financial position, improve its management methods or ensure the adequacy of its organization to its activities or its development goals.” This permits the ACP to act, after the event, but except in the case where a provisional administrator was to be appointed, the ACP cannot require the divestment of the acquisition.

Monetary and Financial Code Article L. 511-10, permits the refusal of an authorization when it is likely that the ACP 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 persons or legal entities...” However, this decision making process takes place at the time of initial authorization of the institution, not when the institution wishes to undertake an acquisition. Moreover, the final decision will not rest with the supervisor of the acquiring institution, but the supervisor of the target institution.

**EC4.** The ACP will not necessarily be in a position to determine from the outset that the bank has adequate financial and organizational resources to handle the acquisition. Although the ACP assesses the financial soundness and organizational resources of its supervised entities on a continuous basis, given that it will not necessarily receive notification of the acquisition, the ACP will not always be able to make this determination from the outset.

**EC5.** For acquisitions or investments in non-supervised institutions, no specific notification to the ACP is required. Compliance with regulations on investments in non-banking activities is examined by the permanent control function within the periodic reporting submitted by the banks. The ACP also relies on the internal control annual report to identify any such transactions and check that they are properly monitored by the group.

**EC6.** The Monetary and Financial Code, Article L. 511-3, limits in general terms the extent of non-banking activities that may be carried on by a credit institution. Regulation 86-21 further limits total revenues from non-banking activities to 10 percent of net banking income (Article 3).

**AC1.** When a French institution acquires a significant holding in a financial institution located in an EEA country, the supervision is exercised on a consolidated basis by the ACP. There is no requirement under current French law and regulations to obtain approval from the French supervisory authorities for the acquisition of interests in banking business outside France before such investments are implemented. If, however, the investment requires an authorization in the country of acquisition, the home authority would generally consult with ACP to check that it has no objection.

Indeed EU legislation (Directive 2007/44/EC) provides some safeguards to ensure that the competent authorities within the EEA cooperate and consult in the case of

	<p>cross-border merger and acquisition of a credit institution. This safeguard would not apply in the case of a financial institution that was not regulated or supervised, however.</p> <p>Conversely, the ACP systematically consults the home supervisory authority when a regulated financial entity seeks to take an interest in a French financial institution.</p>
Assessment	Materially Non-compliant
Comments	<p>Acquisitions by banks are not subject to approval by ACP unless the target institution is also authorized by the ACP. Material acquisitions can expose institutions to significant risks, potentially affecting the future viability of the acquiring institution, and that supervisors should therefore should have the power and capabilities to review, on an ex ante basis, acquisitions and investments. The FSB October 2011 update report on enhanced supervisory intensity emphasized the importance of supervisory scrutiny of major acquisitions, noting that “supervisors should have the power and a robust process to review acquisitions and investments—especially material transactions—in order to assess the possible risks prior to their closing and, where necessary, to prohibit the transaction or impose prudential conditions or additional measures to address any concerns identified during the assessment. The importance of a supervisor being satisfied that an institution it regulates has adequate capital, management expertise, integration plans and experience to undertake a material transaction cannot be overstated.</p> <p>Although the authorities informed the assessors that there was a project to introduce prior authorization to such operations, in 2007, within the framework of a more general review of the regulation 96-16 concerning changes in the situation of credit institutions, this larger review and amendment of regulation 96-16 was dropped due to time constraints for implementing the EU directive on mergers and acquisitions. Hence, the ACP does not have the systematic power to review major acquisitions by a bank, in particular, if it does not have the power to review the establishment of cross-border operations.</p> <p>It is clear that where a domestic credit institution is the target of the acquisition, the ACP will be informed and must give its approval, acting in its capacity as the supervisor of the acquisition target. Furthermore, the regulations (notably 90-06) set clear limits on any equity investment that banks may make, which in principle restricts the scope for major acquisitions. However, there are wide exemptions to these limits, notably relating to financial institutions (defined in Regulation 2000-03, including EEA and non EEA banks, investment firms and also insurance/ reinsurance interests). However, even in this circumstance, it is at best unclear whether the ACP has the powers to oppose an acquisition on the basis that the acquisition would be detrimental to the interests of the strength and soundness of the acquiring institution.</p> <p>With respect to cross-border acquisition of a banking target, it can be assumed that most responsible institutions and authorities would ensure notification was made to the ACP, but there are weaknesses in depending on this approach. For example, the credit institution itself is likely to inform the ACP of an acquisition it believed to be significant but it is not obliged to do so before the transaction is completed. The cross-border target acquisition might be a financial institution that is not subject to direct regulation, in which case there would be no host authority that was in a position to notify the ACP. Finally, even where the target acquisition is a regulated and supervised institution in its home jurisdiction, its competent authority may not be under legal obligation to notify the ACP, or may even be subject to restrictions in its</p>

	<p>ability to pass information. It can be assumed that many jurisdictions are likely to have sound legal frameworks and will also, as a matter of good practice, ensure that relevant supervisory authorities are notified and would take account of the ACP's opinion of the proposed acquisition. Nevertheless such behavior cannot be guaranteed nor necessarily assumed and it is unacceptable that the ACP should have to be dependent on such notifications.</p> <p>Hence, there are a range of situations where the ACP would be unable to undertake any ex ante consideration of the quality of supervision in the host jurisdiction, or of whether its own ability to undertake effective consolidated supervision would be impeded. In these instances the ACP would have to rely on other supervisory or remedial powers, which do not include divestment of acquisitions outside of an administration/ liquidation procedure. In discussion with ACP staff they indicated that in such situations they would utilize their powers, to target risk management and in assessing the risk profile of the (new) group, would consider whether Pillar 2 requirements needed to be applied or increased, perhaps by a significant factor. (See also CP24). There is no question that the ACP could and would act assertively if such a situation was to arise. This is a second best option, however, and in practice the inability to approve a major acquisition is one less intervention tool that the ACP should have at its disposal.</p>
Principle 6.	<p><b>Capital adequacy.</b> Supervisors must set prudent and appropriate 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. At least for internationally active banks, these requirements must not be less than those established in the applicable Basel requirement.</p>
Description	<p><b>EC1.</b> Article L.511-40 of the Monetary and Financial Code states that any credit institution must be able to show at any time that its assets exceed its liabilities to third parties by an amount at least equal to the minimum capital. Given the extensive definition of "credit institution" in France, the minimum capital is set at different levels according to the type of institutions concerned. It is set at Eur 5 million for banks. This is consistent with minimum requirements set in EU legislation (see CP3).</p> <p>In addition, Article L.511-41 of the Monetary and Financial Code requires credit institutions to comply with the prudential rules intended on liquidity and solvency. The Order of The Minister of the Economy, Finance and Industry of February 20, 2007 relating to capital requirements for credit institutions and investment firms, lays down those solvency rules in the form of a minimum capital adequacy ratio, which introduce the Basel II Accord into French regulation. Such orders have the same legal status as regulations.</p> <p>The Ministry of Finance determines the policy and capital rules, actively supported by the ACP. The ministry also determines French input into European capital rule setting, represent France in EU rule setting for a, and coordinates the general direction of French positions at other international bodies concerned with capital such as the BCBS or FSB.</p> <p>Credit institutions are required to maintain a minimum 8 percent ratio of own funds to risk weighted assets. The solvency ratio covers credit risk, operational risk and market risk for both on and off balance sheet exposures.</p> <p>Four of the major French banks are global SIFIs and so will face higher capital requirements.</p>

Currently major banks' Tier I ratios are between 10.5 and 11.5 percent. Capital ratios have been rising recently as banks have reduced risk assets and used increased earnings retention and dividend payout partly in shares as methods to bolster capital. The quality of Tier 1 capital has risen considerably at a number of major banks over the past few years in anticipation of the new EU and Basel rules.

While there are no Core Tier 1 formal requirements, the reported ratios on a Basel 2 basis at end 2011 range from 8.5 percent to 10.5 percent. Basel 2.5, which applied as of January 1, 2012, is expected to reduce these ratios by 25-100bps, depending on the bank.

The EBA conducted a temporary capital strengthening exercise in the latter half of 2011 together with EU supervisors focusing on Core Tier 1. This effectively added to capital requirements. Four French banks were included and three were required to increase capital by mid-2012. This was based on a scenario that included write-downs on sovereign debt portfolios. It was computed on a hybrid definition of capital requirements that included Basel 2.5 requirements for additional capital for the trading book and securitizations, and did not count current hybrid capital instruments. Banks have a variety of plans to meet the EBA target 9 percent Core Tier 1 by mid-2012, without going to the market and without state support.

The capital adequacy requirements apply on a consolidated basis to all types of credit institutions, whatever their legal form or their structure, and not only to internationally active banks. Financial holding companies are also subject to the same capital requirements as credit institutions. The major French banking groups do not operate in a holding company structure (they are either headed by a bank or have a mutual structure) but a financial holding company structure is relevant for some mid-size and smaller credit institutions, including those owned by industrial groups, and for foreign banks.

The ACP can also and does 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 or they may be material impediments to transfers within the group or inadequate consolidated risk measurement. Except where provided otherwise, assets and off-balance sheet items are valued in accordance with the applicable accounting framework.

Components of capital and own funds are defined in CRBF Regulation 90-02 and further detailed in Instruction 2007-02. Tier 1 capital is restricted to core capital and general reserves. Hybrid instruments that are dated or have an incentive for redemption ('innovatives') are taken into account in Tier 1, in accordance with the Sydney Press release of the Basel Committee, and European regulation (Directive CRD2) (up to 15 percent of Tier 1), provided they meet strict requirements with regards stability and capacity of absorbing losses.

The rules also allow other hybrid instruments which are not dated and do not have any incentives for redemption, to be counted in Tier 1, with the total of these and the 'innovatives' being limited to 35 percent of Tier 1. In practice the total hybrids is in the range of 20 percent of Tier 1 for major banks. Many of these 'non-innovative' hybrids are legally debt instruments and they are permanent. There was a review in CEBS of the eligibility of these instruments against the CEBS guidelines.

Floors are in place to limit the capital reduction for bank using model approaches vis à vis the capital they would have under Basel 1.

	<p>The ACP has specific powers to ensure loss absorbency of capital instruments including:</p> <ul style="list-style-type: none"> <li>• a prior authorization by the ACP is required before issuance in order for hybrid instruments to be recognized in Tier 1;</li> <li>• the ACP can ask for a replacement by higher quality capital instruments; and</li> <li>• the ACP can oppose the reimbursement of the instruments if such reimbursement would lead to non compliance with the minimum capital adequacy requirements.</li> </ul> <p>The ACP can require a suspension of payment at any time when the objectives of prudential supervision call for it, taking into account notably the financial and solvency situation of the institution.</p> <p>Subordinated debt instruments (Tier 2) are taken into account within the limits determined in Basel 2. Tier 3 instruments are strictly limited to the coverage of market risks (transposition of the Basel market risk amendment of 1993). In practice, Tier 3 capital is not used in a material way in France.</p> <p>Further information on the modalities of calculation of the solvency ratio, including on the composition of its numerator (pp 12-22), is provided in supervisory guidance including what is allowed as a hybrid instrument in Tier 1.</p> <p><b>EC2.</b> The definition of capital, the method of calculation and the ratio required are the same for all credit institutions and based on the Basel 1 Accord, as updated by the Sydney press release and specified by Basel 2 (para 41-49). These rules are set according to the European Capital Requirements Directive (CRD).</p> <p>At the time of the Assessment in early 2012, Basel 2.5 rules (implemented in CRD3) were in effect in the EU and therefore in France. Basel 3 rules text, CRD4, was under consultation and discussion among member states at the European level.</p> <p>Most major banks had announced their intention to meet the Basel 3 rules as of beginning 2013 or early in that year, without regard for proposed transitional measures. A number of banks were starting to report their forecast Basel 3 ratios at that date.</p> <p>The CRD allows countries to exercise some elements of national discretion in implementation of the rules. In addition, there are some differences between the CRD and the Basel standards. For example, there are areas where the EU rules on risk weighting are lower than the applicable Basel requirement such as for certain real estate and equity investments. ACP does not have a calculation of the importance of these differences as their focus is on compliance with the EU rules.</p> <p>For the definition of capital there are two major differences between the applicable Basel requirement on the one hand, and implementation of Basel requirements through the CRD and French regulation, as applied at the time of the assessment.</p> <p>The first concerns the treatment of cross-holdings within major mutual banking groups. Mutual banking groups have a specific scope of consolidation which results from their reverse capital structure. Affiliates are owners of the central body which has in return investments in its affiliates' capital. Therefore there is no parent company head of the group. The mutualist or cooperative banks, with ACP's prior approval, define a consolidating entity according to Article 2 bis of the French Regulation n°2000-03. However, central bodies in the group or other sub-entities can</p>
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themselves be publically listed have public statements and be recognized internationally active banks.

For certain major mutual French banking groups, cross-holdings of equity between the main bank or central body (at the sub-consolidated level in the group) or a subsidiary of the main bank and the regional banks that are shareholders of the main bank are not deducted from capital. Instead they are risk weighted. The main banks or their subsidiaries that have the cross-holdings are internationally active and listed and report that their ratios are following Basel I rules. This treatment (i.e., risk weighting rather than deduction) results in double counting of capital at this level within these groups. This does not affect the consolidated capital ratio for the whole mutual group, which these sub-entities usually also report. For major entities affected the amounts of investment involved are in the \$10-15 billion Euro range and the impact on reported Tier 1 ratios would be an overstatement of approximately 50bps compared to the deduction approach.

This risk weighting treatment was introduced in France as a change from the previous deduction treatment in 2010, and the impact was fully disclosed by the relevant banks at that time. On an ongoing basis the treatment applied to these cross-holdings is disclosed but—the current-period impact on capital ratios is not disclosed.

In terms of transparency, it is not clear from public reports that regional banks are deducting their holdings in the central body, though that is in fact occurring. Nor at the time of the assessment was the consolidated ratio for the whole groups always reported by the main bank or its subsidiaries in their public disclosures. As well, the nature and extent of intra-group guarantees (such as the solvency and , that investors and creditors in the main bank are implicitly relying on is not generally described in any detail. Since the time of the assessment improvements in disclosure have begun and this can be seen in the end year reports for some of the major institutions that were published after the mission.

This risk weighting treatment differs from the Basel 2 rule, but does not affect the group-wide consolidated capital position which is Basel 2/2.5 compliant. It does result in a more favorable reported capital position of the main bank or its subsidiary that has the cross-holdings, which are a listed entities raising debt and equity. Rating agencies advised that they would normally not allow such deductions in their approach. But they tended to focus on the overall consolidated group for debt rating purposes, because of the existence of cross-support agreements within the mutual groups.

Authorities indicated that in some of the cases, capital rules at that level of consolidation within the mutual group were less relevant and the Basel requirements on such entities meeting the rules at that level did not in their view apply. The authorities noted that the central bodies in the mutual group structures provide a guarantee and solidarity (i.e., solvency) mechanism for the support of the group. These mechanisms are required by the COMOFI (i.e., Article L. 512-47 and 512-107(6)).

ACP staff demonstrated a full understanding of the capital position at all levels in these banking groups and of the nature of intra-group investments, guarantees and exposures, as well as of the consolidated capital position of the groups.



The second issue concerns the treatment of bank-insurance cross-holdings in a number of major banks. It is recognized that Basel 2 has some flexibility in the treatment of banks' investments in insurance companies. To avoid double counting the Basel rules express a preference for deduction of these investments from the capital of the bank, but do not require it. However, they indicate that, if deduction is used, half is to be from Tier 1 and half from Tier 2 capital. The Basel 2 rules also explicitly permit other treatments including the conglomerate directive method.

Basel 3 will alter the current treatment including requiring deduction of such investment from Core Tier 1, a treatment that was confirmed by the BCBS in statements just prior to the assessment.

In France the approach to insurance investment differs across-major banks. Certain banks have opted to use the EU conglomerate directive method (which is not contrary to Basel rules in force at the time of the assessment).

However, many major banks do deduct insurance cross-holdings as per the preferred approach under Basel 2 and allowed by the French and EU rules. But they but do so from total capital, not from Tier 1 and Tier 2 equally. They are applying the treatment under Basel 1 rules. The Basel 2 rules are that, when deductions are followed, they are to be half from Tier 1 and half from Tier 2. The difference in France makes Tier 1 (and Core Tier 1) capital appear larger than it would be if Basel 2 rules were applied. In France this treatment was to be a transitional rule for five years until beginning 2013 and in respect of insurance holdings that banks had as of 2007.

At the time of the assessment, the CRD4 rules implementing Basel 3 were under active discussion in Europe. If the new EU legislation (not finalized at the time of the assessment) transposes Basel fully and completely through an EU regulation, then the regulatory treatment will be in conformity with Basel at that time. However, if there were to be a continuation of an approach that would have such holdings risk weighted as other equity investments (350 percent risk weights) compliance would not be achieved. The result would be actual or potential double counting of capital within the main banc-assurance groups or counting capital that might not be available to the group. For most but not all major banks the impact is material. Insurance investments (50 percent) that should be deducted from Tier 1 capital, for example, range for major banks from Eur 1.3 billion to Eur 12 billion. It can range from 100 bps to 220 bps of RWA for the major banks most affected (so impact on Tier1 can be an overstatement of 50-100bps). Moreover, comparisons of available Core Tier 1 capital relative to benchmarks could be understated accordingly.

The assessors discussed with banks the treatment of insurance cross-holdings they were using in their internal and external calculations and plans, including for the EBA temporary capital strengthening. Banks indicated that the impact of this item was often material. At the time of the mission, in public disclosures of their 2013 targets for Core tier 1 or common equity ratios no banks that the assessors talked to were applying the actual current French rules, which include an end of the existing preferential treatment by January 1, 2013. Most were assuming that some form of preferential treatment would continue indefinitely, and the publicly disclosed ratios were calculated on that preferential basis.

The ACP staff the assessors met indicated that many banks were assuming that the new EU Legislative requirements (CRR/CRD4) would successfully retain the risk weighting approach to equity investments and would come into effect before the

currently-scheduled French transition rules expired. Certain rating agencies assessors met indicated that they received regular questions from investors about these issues, that the degree of confusion was often high.

**EC3.** The ACP has the power to impose higher capital charges than the regulatory minimum, and higher provisions. In application of Article L.511-41-3 of the Monetary and Financial Code (paragraph 2).

Discussions with ACP staff indicate that Pillar 2 is actively used in France. The ACP imposed additional own funds requirements under Pillar 2 for approximately 80 institutions and groups that account for 97 percent of the risk exposure of the national banking system, including subsidiaries of foreign institutions. Pillar 2 requirements have legal force. Normally these are set as Tier 1 requirements though they may be set as total capital requirements. The ACP also uses selective Pillar 1 add-ons in certain cases, such as additional multipliers for model-determined capital requirements for market risk.

Tier 1 capital requirements including Pillar 2 charges are 7.5-8.0 percent for a 1-rated bank, 8–8.5 percent for a 2-rated bank and 8.5-9 percent for a 3-rated bank. Banks rated 5 would have a requirement of 9.5 percent or more. There was a considerable range of Pillar 2 requirements in practice, depending on the ACP's assessment of risk.

Currently, banks are transitioning to Basel 3/CRD4, which is leading them to focus on new Core Tier 1 definitions. So is the target set under the EBA temporary capital strengthening exercise which was a modified Core Tier 1 measure. Major banks have set public targets in this regard. As a result the impact of the current ACP Pillar 2 regime based on Tier 1 is limited.

A number of banks the assessors met indicated that the ACP Pillar 2 result was less meaningful for them as a result of the EBA process and market pressures for higher capital. Their focus was on different ratios than used by ACP and the ACP ratio was not the effective constraint or influence of their behavior. ACP is aware of this issue and has plans to update their Pillar 2 approach.

**EC4.** The major banking groups have been approved to use advanced approaches under Basel 2 and Basel 2.5. This by itself results in capital requirements related to risk. In addition, the ACP conducts a thorough risk assessment processes, using both its internal rating system and the European methodology developed in EBA guidelines. (see CP19/20 description). Financial, prudential and supervisory information are used to develop a systematic evaluation of the risk profiles of all reporting institutions. This is based on the ORAP methodology which results in a risk rating on a five point scale for each credit institution. There are ranges of Pillar 2 capital requirements associated with each ORAP rating scale, though the ACP can and does occasionally impose a Pillar 2 requirement outside these ranges.

The solvency ratio covers both on and off balance sheet exposures. (cf Article 2-1 of the Order of February 20, 2007).

**EC5.** The conditions under which the French banking system operates has not to date required specific amendments to the general minimum capital adequacy ratio at 8 percent.

**EC6.** The Monetary and Financial Code gives large powers to the ACP to require institutions to take the necessary corrective actions, under a predetermined

timeframe (Art L.612-32), in case the compliance with regulatory requirements would be, or about to be, breached. The ACP can request banks to provide a detailed capital plan (programme de rétablissement) with all adequate measures necessary to restore its financial situation, upgrade its risk management, governance or strategy (Art L. 612-32). In particular, when the solvency or liquidity of a credit institution are at risk the ACP can take a range of administrative measures listed in Article L. 612-33 and following, including restrict or prohibit the payment of dividends and take other remedial powers as described under CP23.

In addition, in case of breach of legal or regulatory requirements, including a breach of the minimum capital ratio, the ACP can use the sanctioning powers conferred by Article L.612-39, which includes for example restrictions in the exercise of the banking activities or a partial withdrawal of the banking license?

**EC7.** The use of the internal approaches, whether for credit, counterparty, market or operational risks, is subject to the formal prior approval of the ACP, as provided for in the Order of February 20, 2007. In broad terms, in order to receive approval to use the internal approaches, subject institutions must have systems for managing and rating risk exposures that are based on sound principles and implemented with integrity, as reflected in the satisfaction of the following qualitative standards, e.g., for credit risk:

- a) the subject institution's rating systems shall provide for a meaningful assessment of obligor and transaction characteristics, a meaningful differentiation of risk, and accurate and consistent quantification of risk;
- b) internal ratings and estimates of default probabilities and losses used in the calculation of capital requirements, along with associated systems and processes, shall play an essential role in the institution's risk management and decision-making process, as well as in its credit approval process, internal capital allocation, and corporate governance;
- c) subject institutions shall have a credit risk control unit responsible for its rating systems. This unit shall carry out its control functions on an ongoing and independent basis;
- d) subject institutions shall collect and store all data that can provide effective support to its credit risk measurement and management process;
- e) subject institutions shall document their rating systems and the rationale for their choice of in the design of those systems;
- f) subject institutions shall validate their internal rating systems.

This prior approval, which takes into account the internal assessment conducted by the internal audit of the applicant credit institutions, consists of off-site analysis and on-site missions and is subject to the final decision of the College of the ACP. The ACP reported that initially only some banks were approved for internal approaches and that several requests were declined or deferred.

Currently, all major banks are on advanced approaches for credit risk, market risk, and operational risk since 2007. The ACP did not have a policy for requiring major banks to use advanced approaches, but certain banks the assessors talked to indicated they were strongly encouraged to move to these approaches. Pillar 3 disclosures indicate on a consolidated basis there remain a material proportion of

	<p>assets on the standardized approaches (e.g., 40-50 percent for certain major banks).</p> <p>The models group within ACP (covering credit/market/operational risk) numbers 20-25 people. ACP advised that they can call on an additional approximately 10 people in the supervisory groups with model and related process experience to assist in on-site, off site and model assessment processes.</p> <p>Validation requirements on banks and use test requirements meet the Basel standards. Significant changes to the internal models are subject to new formal ACP approval requirements since 2011.</p> <p>General sanctioning powers (see CP23) also apply to model approval issues. The ACP has turned down model approval requests.</p> <p>The ACP has also been willing to approve models with some non-material deficiencies on the condition that there is a substantial add-on (e.g., 4-6 times the capital for specific market risk model results instead of the normal 3x).</p> <p>For AMA banks the ACP allows insurance to reduce capital required up to 20 percent though for major banks the reduction is in the 5-10 percent range. ACP monitors that the conditions are met.</p> <p>The assessment team reviewed examples of model approval on-site reviews and discussed the nature, extent and results of these reviews with the specialist team.</p> <p><b>AC1/AC2.</b> The same rules apply to all credit institutions and financial holding companies, regardless of whether they are internationally active.</p> <p><b>AC3.</b> As part of the Pillar 2 process ACP can require banks to adopt a forward looking approach to capital planning.</p> <p><b>AC4.</b> ACP has the authority to require adequate distribution of capital within groups and has done this in practice.</p> <p><b>AC5.</b> ACP may require a bank to maintain capital above the minimum as a way of ensuring that banking groups are operating with appropriate capital.</p>
Assessment	Materially Non Compliant
Comments	<p>While capital requirements are in many ways prudent and appropriate, there are material weaknesses in the definition of capital, and related public reporting vis a vis current Basel 2/2.5 requirements. Weaknesses (highlighted in EC2 above) relate to the treatment of cross-holdings, especially for banc-assurance but also in relation to mutual groups. In part, these are issues at an EU level, not specific to France, but the EU directives did not bind French choices. The identified issues with respect to banc-assurance groups produce a material overestimate of reported Tier 1 capital ratios compared to the applicable Basel requirement, by up to 100bps for some major banks and more for major internationally active subsidiaries, and can produce reported measures that involve double counting of capital and/or recognizing capital that may not be available. Basel 2/2.5 was in place at the time of the assessment (and is the basis of the assessment). It allows for some flexibility in these issues which France utilizes. However, the flexibility operating in France at the time of the assessment goes beyond that contemplated by the Basel rules. The assessors do not take a position on the desirability of various policy positions and the implementation of those positions in the move to Basel 3 and CRD4. Nonetheless, some of these issues also affected reporting by French banks of their pro-forma Core Tier 1 or Common equity ratios at the time of the assessment. In the case of the banc-assurance issues the</p>

	<p>calculation of total capital (as opposed to Tier 1) was Basel compliant. In the case of the mutual groups the issues occurred at the publically-reporting central bodies within these groups and/or at other major publically-reporting internationally-active subsidiaries within the groups, but are treated appropriately at the overall consolidated mutual group level.</p> <p>Furthermore, the current approach in France to inter-bank cross-holdings in certain mutual groups and bank-insurance investments risks confusion and undercutting credibility without better understanding by marketplace participants, which requires better disclosure to the market, although subsequent to the assessment improvements are starting to be made by the major institutions.</p> <p>The assessors did not believe based on discussions with banks and the authorities that it was clear that the current treatment, especially the treatment of bank-insurance cross-holdings, would be replaced with a fully Basel compliant regime, notwithstanding the formal deadline for the end of the current treatment set out in regulation 90-02 (Article 5a).</p> <p>ACP staff fully understand the issues, monitor capital at various levels in these complex banking groups, monitor major financial flows between the insurance and banking parts of the groups, and so are in a position to meet their prudential mandate. They need to maintain a complete understanding of the intra-group financial arrangements.</p> <p>While the Pillar 2 process is well developed and has been applied to a large number of banks, it needs to be revamped given the move to focus on new higher Core Tier 1 requirements. The ACP is aware of the need to review its Pillar 2 regime to make it relevant in the new Basel 3/CRD4 environment. It is essential that this proceed.</p> <p>There is evidence of high-quality implementation of Basel 2/.2.5. However, there is also evidence that commitments to ACP made by banks several years ago to fix issues in their advanced models had not been fully implemented and the follow up by ACP was delayed. There therefore may be room to increase the frequency of ongoing determination for advanced banks to ensure that the requirements of the French regulations and ACP conditions imposed are being met.</p>
Principle 7.	<p><b>Risk management process.</b> Supervisors must be satisfied that banks and banking groups have in place a comprehensive risk management process (including Board and senior management oversight) to identify, evaluate, monitor and control or mitigate all material risks and to assess their overall capital adequacy in relation to their risk profile. These processes should be commensurate with the size and complexity of the institution.</p>
Description	<p>The French prudential regulation 97-02 February 1997 is the main rule relating to internal control, including risk management, in credit institutions and investment firms. It covers all risks and control and risk management processes including for AML/CTF. It requires a comprehensive risk management process including Board and senior management oversight, the control system for operations and internal procedures, the organization of accounting and information processing systems, the risk and result measuring systems, the risk monitoring and risk control systems and the remunerations framework.</p> <p>Credit institutions and investment firms are to apply this regulation on a consolidated basis. Risk management processes are to be commensurate with the size and risk profile of the institution.</p>

This regulation is deliberately high level and very principles based (it covers all of the internal control, risk management and individual risk matters in some 40 pages). It is not supplemented by formal detailed guidance. There are additional qualitative requirements related to individual risks (credit/market/operational) contained in the capital regulation that implemented Basel II. ACP advised that this principles-based approach is effective and has been designed to accommodate the situation of the wide range of credit institutions that the ACP regulates and supervises.

More detailed supervisory expectations are communicated to banks in the feedback on the results of individual supervisory reviews. The assessment of the compliance with the regulation is notably made through the examination of the annual **internal control report** and through on-site examinations. The annual update of instructions to banks on filling in the internal control report is also used as an opportunity from time to time to communicate supervisory expectations.

**EC1.** Regulation 97-02 requires credit institutions and investment firms to have in place a comprehensive risk management framework in particular:

- A control system for operations and internal procedures, including the risk function and in particular the chief risk officer (though the scope and duties of that role are not specified).
- A sound organization of accounting and information processing systems.
- Risk and result measuring systems for all types of risks, including explicitly credit, market, interest rate, settlement and liquidity risk.
- Risk monitoring and risk control systems including all types of risks and in particular conditions applicable to outsourcing and new products.

The ACP verifies that credit institutions and investments comply with regulation 97-02 on an ongoing basis through its off-site and on-site examination.

In particular the ACP can issue a recommendation or an injunction toward an institution to take all necessary measures within a given period to restore, to strengthen or to rectify its risk management processes. (Articles L.612-31 and L.612-32 of the Financial and Monetary Code). The ACP is also empowered to enforce disciplinary sanctions against institutions which do not comply with the requirements provided.

Amendments to this regulation in 2010 required banks to have a “head of risks” responsible for all risk oversight on a group-wide or ‘transversal’ basis. This was not universal practice at the time and a number of banks the assessors met, including some major banks, needed to adjust the perimeter of the responsibilities of this CRO role. Discussions with banks confirmed the ACP view that there was still some work in progress. It was also noted that having this function working in practice at major banks can also be challenging in practice given the complexity of their structures or desire for autonomy of their constituent parts, especially in mutual groups.

**EC2.** Regulation 97-02 provides that the executive body and the decision-making body (e.g., the Board of Directors in a bicameral setup) are **together** responsible for approving appropriate risk management strategies and in particular they are to regularly assess and control the effectiveness of policies, systems and procedures set up to ensure risk management and take the appropriate measures to remedy possible failings.

There are no clear requirements for Board approval of risk strategies, high level risk policies or overall limits. This is because the regulation does not have a full set of requirements for the decision making body (the Board) as distinct from the executive body. ACP staff advised it is also because the regulations applied to the entity as a whole. There are requirements for the executive body to inform the decision making body of certain key matters. ACP staff advised that this was in part due to the general structure of the regulation (applying to the wide range of entities ACP regulates not all of whom may have fully developed Board structures) and to the legal inability to impose control requirements on the decision making body (see CP 1(4)).

In practice, the ACP aims at ensuring that the bank has a well-defined and controlled risk-taking strategy, approved and reviewed by top management and the Board of Directors, and that it is regularly audited by the internal auditor of the bank. Since 2009, large banks have been asked to benchmark themselves against risk-appetite criteria defined by the Senior Supervisors Group. In 2010 and 2011, dedicated meetings were held with large banks to discuss their internal approaches to risk appetite, including: how they define their risk capacity, decide about their risk appetite, and monitor their risk profile. On-site missions reviewed risk information reported to Board and management in some banks. ACP staff also confirmed that the degree of Board involvement in setting and monitoring risk appetite, limits and risk strategy varied considerably at major banks.

The assessors reviewed public documents of banks and discussed these matters, including the degree of Board involvement, with the senior staff of banks it met. A few would likely meet or be close to expected practice as set out in the SSG report with a central risk oversight function tradition of strong risk culture and authority that had a track record of effectiveness. Some were part way to implementing that structure and a few others appeared to have a considerable improvement to make. Having oversight over the bank and the insurance entity in the banking group was sometimes an issue. This pattern of whether progress was acceptable to ACP was not closely correlated with whether the bank was larger or not.

Development of formally-approved risk appetite or tolerance statements at Board level is under development at some banks, though others have progressed considerably farther. A number of banks have recently broadened the responsibility of the Audit Committee to include risks or have set up a separate risk committee.

In a number of major banks the only formal limit approved at the Board level is a global VAR limit for market risk. In other cases the group-wide limits and tolerances set by management were reviewed (but not approved) by the Board. Some banks reported that for some risks the setting of group-level limits for certain risks including stress limits (as opposed to limits at the level of subsidiaries) existed, but was relatively new.

As well it appeared that the stature of the Chief risk officer also varied somewhat between major banks, with in some cases the person not being fully involved in all major risk matters or having veto power over major risk issues. In other cases a comprehensive structure was in place.

ACP reported that compliance with the enhanced 2010 requirements for enterprise-wide risk management and governance had not been as good as desired.

**EC3.** Regulation 97-02 requires institutions to draw up and regularly update manuals of procedures relating to their various activities. The Articles 11 and 17 of the

	<p>regulation 97-02 require banks to regularly review their risk measurement systems and their relevance to the risk profile of the bank. These manuals must describe the methods for recording, processing and retrieving data, accounting procedures and procedures for entering into transactions. The institution's systems must measure and monitor internal limits, both overall and operational.</p> <p>Risk management strategies, policies, processes and limits are discussed by ACP off-site teams with business and support functions at almost all their bilateral meetings, and checked at the occasion of on-site missions. More extensive off-site visits of a few days can also review parts of these processes.</p> <p>The ACP ensures that any identified failings in applying institution's established policies, processes and limits are promptly addressed: depending on the severity, several courses of action are possible. The ACP can take administrative or disciplinary sanctions against institutions which do not comply with such requirements. In exceptional cases the ACP will also publish a high level summary of findings as a way of alerting other institutions to its expectations.</p> <p>It may then use this publication as de facto guidance that it can follow up on or ask institutions to report against. The assessors reviewed examples of this approach.</p> <p><b>EC4.</b> Articles 38 and 39 of regulation 97-02 require senior management and the Board (together) to have relevant information on the risks incurred by the institution and to determine risk management policies and processes adjusted to the institution's risk profile including on a consolidated basis. Board minutes and documents are sent to the ACP and reviewed.</p> <p>The Article 33 of the regulation 97-02 provides that the executive body and, where appropriate, the decision-making body shall set and review overall risk limits as and when necessary, taking into account the institution's capital and consolidated capital where appropriate, and giving consideration to whether the distribution of capital within the group is suited to the risks incurred. The regulation leaves the issues of how to divide responsibilities to credit institutions.</p> <p>The ACP checks the relevance of these processes, in particular through the examination of the annual report on internal control and through on-site missions. The assessors saw evidence of how ACP supervisory letters following on-site reviews provide details to credit institutions of supervisory expectations.</p> <p>The assessors discussed senior management and Board involvement in risk matters with a range of institutions. A number of other observers, including banks, rating agencies and auditors that the assessors met, indicated that the degree of Board involvement in oversight of strategic risk matters was evolving and differed considerably amongst banks.</p> <p>The assessors also reviewed the supervisory methodology being used to rate governance (which is included in one strategy and governance rating). Assessors also reviewed examples of the results of those processes in the risk assessment (ORAP) summaries of major banks and in the overall feedback to major banks. The methodology focused more on the Boards (and senior management's involvement in strategy and on the overall view of the strategy of the banks, and less on the Boards understanding of risks and the quality of risk oversight.</p>
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Discussions with ACP staff indicated awareness of needed risk governance improvements. However, annual supervisory letters sent to major banks reviewed by assessors did not usually include improvements needed at Board level.

**EC5.** Article 17 bis of regulation 97-02 requires institutions to have sound, effective and complete processes to assess and maintain, the amounts, types and distribution of internal capital that they deem to be appropriate in terms of the nature and level of risk to which they are or might be exposed. These systems and procedures are be subject to regular internal reviews to ensure that they remain comprehensive and proportionate to the nature, scale and complexity of the bank's activities.

In 2008 and 2009, on-site missions at large banks reviewed their economic capital models or approaches. Regular meetings are also held with large banks to discuss their capital planning. As resolution and recovery plans are required by major banks by mid 2012 the ACP is currently discussing with banks the appropriateness of their initial stress scenario for purposes of these exercises. ACP reported that a number of major banks needed material improvements in their internal ICAAP process, including reorienting it from being an input into the supervisory Pillar 2 process to being a tool for the bank's own strategy formulation and capital planning.

The assessors discussed the ICAAP process and bank stress testing with the ACP and with major banks and with some smaller banks. Banks had participated in the stress tests run by the EBA in 2010 and 2011.

The range of practice appears considerable. In several cases a more fully articulated process was in effect while in others it is at an earlier stage. For example, stress and scenario testing, which is a key component of relating capital to risk in some major banks was until recently been done for each major risks, but not for the overall bank. As well the degree to which such processes done at major subsidiaries had been integrated into a bank-wide roll up appeared to vary considerably. In other cases the frequency was only annual.

A number of banks also noted that their main **enterprise-wide** stress testing related to capital over the past few years has been the EBA-driven stress tests.

Major banks the assessors met also indicated that their capital planning currently was heavily focused on meeting the EBA Core Tier 1 targets of 9 percent plus a slight additional amount for buffer (e.g., 25-50 bps), and on meeting their public commitments re Basel 3 at the beginning of 2013. They confirmed that regulatory (and market) influences are the major driver of firms' capital processes currently, rather than well-articulated processes to relate capital to risks.

**EC6:** The Article 17 of regulation 97-02 requires institutions to have in place risk analysis and risk measurement systems that are suited to the nature and volume of their transactions in order to assess the different types of risk to which these transactions expose them. Validation requirements are set out in ministerial orders relating to introduction of Basel II in 2007. The ACP expects in its on-site and off-site inspections that Internal validation and testing of such models/approaches should be performed by units which are independent from those that developed the models.

The ACP staff the assessors met confirmed that supervisory results have generally showed validation processes to be satisfactory.

	<p><b>EC7.</b> The Articles 32 to 37 of regulation 97-02 provide in particular that institutions must set up risk monitoring systems, with regard to all types of risks. These systems must allow the entities and appropriate persons including Board and senior management to be adequately informed.</p> <p>Assessing whether the information received by the Board and senior management allows them to monitor the bank's risk profile is a key dimension of the ACP's SREP and is performed through both ongoing off-site and targeted on-site work.</p> <p>At the same time banks learned in the crisis that information systems were not adequate, as documented in the SSG reports. French banks that the assessors met confirmed that these issues were relevant for them and that considerable work had been done to remediate the situation. Some also noted that the major improvements were only now coming on stream, understandably given the nature and complexity involved.</p> <p><b>EC8.</b> As regards new products or changes to existing products with significant implications for the institution or the market, the Articles 11-1 and 32-1 of regulation 97-02 require institutions to set up procedures to ensure preliminary and forward-looking analysis of the risks incurred, and systematic prior approval, including from the compliance function.</p> <p>New products/activities prior implementation is systematically discussed with the risk department, internal audit and the heads of business lines. In addition, on-site missions conduct targeted checks.</p> <p><b>EC9.</b> The Article 7 of regulation 97-02 requires that units responsible for initiating transactions operate independently of those responsible for validating them, in particular at the accounting level, for settling them and for implementing the missions of the risk function. A clear description of the setup is asked in the annual report on internal control, a copy of which is sent to the ACP. Practices are constantly discussed with bank personnel and principals through the SREP.</p> <p><b>EC10.</b> ministerial orders implementing Basel2 imposed certain standards on banks re credit, market, liquidity risk, interest rate risk in the banking book and operational risk.</p> <p><b>AC1:</b> See EC2.</p> <p><b>AC2.</b> According to the Article 17 of regulation 97-02 institutions must set up risk management processes that enable them to gain a forward-looking understanding of risk analysis and measurement.</p> <p><b>AC3.</b> Reputation risk is explicitly covered by the French regulation. Strategic risk is included indirectly and by the requirement for banks to set up their own risk categorization.</p>
Assessment	Largely compliant
Comments	<p>The standards for an effective, comprehensive risk-management approach, and an effective process to relate capital to risk are demanding in countries with major complex global banks, such as those in France. Thus, compliance with this CP requires performance at a high level by both banks and supervisors and involves adequate rules, policies and effective practice. Certain of the rules requiring enterprise-wide risk management are relatively new in France and there has not been sufficient time to test them in practice or for ACP to have fully reviewed their operation. Reviews to date are mixed. There are deficiencies in the extent of</p>

	<p>implantation in major banks of ERM processes with the necessary strong oversight, including at Board level. Supervisory assessments of risk governance are not well developed, and there appears to be little feedback to Boards about the enhanced expectations of them. This may be related to the general problem of lack of ACP access or authority over Board matters (CP1(4)).</p> <p>Processes to relate capital to risk exist but need to be strengthened in a number of major banks. They also need to be reoriented so they are not just a means for banks to challenge the regulator's Pillar 2 capital requirements but are a genuine management and Board tool to determine the appropriate buffer of capital over minimum requirements.</p> <p>As in other major countries, French banks and the ACP have made significant progress in putting these processes in place and are on the right approach. More time is needed, as is further action by some banks and further focused supervisory intervention and verification of processes that are relatively new in some banks. It is possible that further clarity of supervisory expectations will be necessary.</p> <p>ACP needs to find a way to review and reinforce the quality of desired risk governance and consider a theme supervisory review in this area.</p> <p>As well, a number of banks confirmed that, while significant progress had been made in integrating risk measurement across-the group, more was needed and some major system enhancements were only coming on-stream in 2012. ACP has not had the time to assess these systems.</p> <p>As noted in other CPs concerning risk, the role of the Board at major French banks in setting and approving risk strategy, approving key risk policies and risk limits seems underdeveloped compared to international expectations and best practice. Nor is there clear evidence that the ACP supervisory assessment of Board effectiveness, as distinct from senior management, is as robust as it needs to be to encourage desirable developments. This is also an issue in other major countries. This appears hampered by legal limits on ACP's interaction with Boards, which is unique to France.</p>
Principle 8.	<p><b>Credit risk.</b> Supervisors must be satisfied that banks have a credit risk management process that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor and control credit risk (including counterparty risk). This would include the granting of loans and making of investments, the evaluation of the quality of such loans and investments, and the ongoing management of the loan and investment portfolios.</p>
Description	<p><b>EC1:</b> The main supervisory rules concerning credit risk management strategy and policies are provided under the credit risk part of Regulation 97-02. It provides that "The executive body and the decision-making body are responsible for making sure that the reporting institution complies with its obligations under this regulation, including credit risk selection and assessment. In particular, the executive body and the decision-making body have at their disposal relevant information on the risks incurred by the reporting institution. They are obliged to regularly assess and control the effectiveness of policies, systems and procedures set up to comply with this regulation and take the appropriate measures to remedy possible failings."</p> <p>As noted in CP1(4) and CP7, there are no specific standards for the role of the Board in setting strategy, risk tolerance and limits, as distinct from the executive management. Supervisors for major banks review information going to the Board</p>

	<p>and more recently supervisors have been pushing major banks to adopt the approaches to Board involvement contained in the SSG reports and in the industry reports on risk appetite best practices. Supervisors report that progress is mixed. Discussions the assessors had with banks confirmed that not all major banks' Boards formally approve credit risk strategy and significant policies.</p> <p>Credit risk is currently generally assessed as moderate in major banks by the ACP. Authorities currently expect credit risk to be rising as the economy slows. They do not consider there is a bubble in real estate or mortgage finance but want enhanced vigilance. So more recently the council on financial stability on which ACP is a member (COREFRIS) has decided to invoke additional monitoring of the mortgage market and as a result ACP will be doing more on-site and off-site activity in this area. The president of ACP (the Governor of the Banque de France recently wrote to the banking associations about potential concerns in that regard, for distribution to banks. In order not to cause more general speculation the association decided to pass the Governor's letter on to only the major banks.</p> <p>Certain aspects of the mortgage market in France mitigate against major credit risk. These include bank policies and practices to lend against ability to pay measures rather than loan to value ratios, lending on long term fixed rates and no HELOC lending.</p> <p><b>EC2.</b> The regulations are designed to create an appropriately controlled credit risk environment. The requirements relate to underwriting and risk assessment criteria, credit administration, policies and procedures, diversification and control of concentration and risk measurement system that allows centralized review of exposure including to connected counterparties (including on and off-balance sheet commitments).</p> <p>At least once every quarter, reporting institutions must update the files on counterparties which have unpaid or doubtful debts or which involve significant risks or amounts. For large transactions, quarterly review and if necessary update of risk rating is required as is a review of provisioning and possible impairment.</p> <p>Decision-making procedures for loans or commitments, particularly where they involve delegation of authority, must be clearly formalized and suited to the institution's characteristics, in particular its size, its organization and the nature of its activity.</p> <p>Major banks are required to have that loan or commitment decisions taken by at least two persons and that the credit files must be analyzed by a specialist unit that is independent of operational entities.</p> <p>At least once every six months, the executive body is required to carry out an <i>ex post</i> analysis of the profitability of credit operations. Banks the assessors met indicated that there is usually reporting to the Board on this review.</p> <p>For major banks, quarterly ACP off-site, half day meetings with the CRO business leaders and other senior staff allow supervisors to monitor developments in credit risk. Material going to the executive management and/or Board of the bank is reviewed by ACP. Annual internal control reports to the ACP cover credit risk with the institution providing detailed information on its loan approval procedures, measurement and monitoring systems for credit and counterparty risk, how concentration risk is handled, and matters such as limit exceptions. This report also includes summaries of internal audit reviews of credit activities and internal</p>
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	<p>management reports provided to the executive Board and decision-making Board. These internal control reports are extensively reviewed by ACP staff and are an input into supervisory ratings and on-site supervision planning.</p> <p>Credit risk procedures are reviewed as part of general on-site inspections and in selected more focused on-site specific or theme reviews. In ACP planning for 2012, reviews of corporate credit exposures and of mortgage credit at several major banks are planned.</p> <p><b>EC3.</b> Article 7-1 of Reg. 97-02 requires the independence of the units in charge of the control of transactions from the units which grant the credits in order to avoid any conflict of interest. The issue of credit granting to entities with relation to the bank is covered in CP11. Detailed on-site reviews of the credit risk processes cover these issues and issues of ensuring that credits are granted free of conflicts of interest.</p> <p><b>EC4.</b> ACP is legally entitled to exercise permanent and unrestricted supervision of banks and credit institutions. This includes a right to any piece of information or officer within a supervised institution, including for credit risk matters.</p> <p><b>AC1:</b> Regulations do not explicitly require that credits above a certain size are escalated to senior management or the Board. However, the general requirements in regulation 97-02 are that credit decision policies and delegations must be formalized and suited to the institution's characteristics. This is interpreted by ACP that transactions above certain thresholds must be escalated to senior management. It is verified by off-site and on-site inspections.</p> <p><b>AC2:</b> As mentioned above, regulation 97-02 provides extensive obligations on banks for them to set policies and processes to identify, measure, monitor and control counterparty credit risk exposure. ministerial orders (with the same force as regulations) ensure counterparty risk includes both trading book and nontrading book exposures.</p> <p><b>AC3:</b> By regulation banks must take account of the financial position of the beneficiary of credit extension. Banks have access to a detailed credit register and in-house rating system at the Banque de France. This permits them to have information on all the indebtedness of their borrowers.</p>
Assessment	Compliant
Comments	<p>ACP has a well-developed approach to credit risk. In addition to the current focus on mortgage lending, it should specifically consider, together with the Banque de France, the sectors likely to be most affected by the economic downturn in Europe and ensure that its detailed supervisory coverage of credit risk practices for those portfolios are adequate and timely. Several aspects of the comments with respect to risk management generally (CP7) and to supervisory approach CP20 also apply to credit risk and would enhance credit risk effectiveness.</p>
Principle 9.	<p><b>Problem assets, provisions and reserves.</b> Supervisors must be satisfied that banks establish and adhere to adequate policies and processes for managing problem assets and evaluating the adequacy of provisions and reserves.</p>
Description	<p>EC1/EC10/EC12: Banks must respect requirements relating to internal control, and provisioning rules, set out in two different sets of accounting standards. IFRS is used for the preparation of the consolidated accounts of listed banks and French GAAP is used for the preparation of the solo accounts of all banks and the consolidated accounts of unlisted banks.</p>

Regulation 97-02 includes requirements on banks related to quarterly review of the quality of the portfolio including risk rating and related provisions, and quarterly review of credits that are unpaid or doubtful or that involve significant risks or amounts.

Banks follow the EU implementation of IAS 39 for provisioning. Individual provisions must be set up where there is objective measurement of impairment and collective provisions are possible if various criteria are met. IFRS requires individual review of potential impairment for all significant assets. For French GAAP banks must classify claims and off-balance sheet items in three categories: sound, doubtful and compromised. Doubtful credit classifications are linked to overdue periods-- some payments are three months overdue (six months for property loans, nine months for loans to local authorities) as well as to general requirements such as there being a deterioration in the debtor's financial position. These are used as indicators of impairment in IFRS statements, together with other measures.

The implementation of these Regulations by the banks is reviewed on a regular basis by the ACP through both off-site examinations and periodic on-site inspections. Increases in provisions and non-performing loans and declines in coverage ratios are flags in the ORAP risk assessment system. As well, attention has been paid since 2007-2008 to the policies and processes adopted by large banks for managing their portfolios of structured products ("legacy assets"). These were material at some banks but have been considerably reduced.

Coverage ratios in major French banks (total individual plus collective provisions as a percent age of impaired and doubtful loans are in the 65–75 percent range. ACP monitors this ratio closely and it is a trigger for risk assessment.

**EC2.** Scrutiny of the bank rating classifications is conducted by the ACP on a regular basis, both on-site and off-site. The procedures are examined as part of the review of internal control systems. Ongoing supervision makes use of the ratings awarded by the Banque de France to companies registered in the FIBEN Companies Database.

During on-site inspections, loan classification and provisioning are reviewed by ACP inspectors (thoroughly or through sampling), making use of information obtained from the Central Credit Register operated by the Banque de France, from the rating agencies and various other sources. In addition, developments in the level of provisioning are reviewed by off-site teams (based on the regular prudential returns) and discussed with the bank on a regular basis (at the quarterly meetings with the CFO and with the CRO for large banks).

**EC3.** The credit risk measurement and provisioning systems must cover all on-balance sheet and off-balance sheet transactions in which the institution is exposed to a risk of counterparty default.

**EC4.** ACP inspectors are in charge of checking, in the course of on-site inspections, whether provisions and write-offs reflect realistic repayment and recovery expectations, and whether banks have appropriate policies and processes to ensure that.

**EC5.** Off-site and on-site activities in this area also assess whether banks are obtaining recent and reliable information on the financial situation of their customers. In particular banks have access to information obtained from the Central Credit

	<p>Register operated by the Banque de France and to the ratings awarded by the Banque de France to companies registered in the FIBEN Companies Database.</p> <p>Banks that use statistical systems to select and measure their credit risk must regularly verify their relevance in the light of payment incidents recorded in the recent past and taking into account developments in the economic and legal environment.</p> <p><b>EC6.</b> The ACP collects prudential, accounting and statistical returns from banks on a periodic basis. Specific templates collect information on classification of assets and impairment. Based on this information, off-site teams conduct regular analyses, both at the individual and cross-sector levels, and discuss their results with the banks. ACP itself uses the Banque de France credit register.</p> <p><b>EC7.</b> Where relevant, the ACP may reduce banks available for regulatory purposes by the amount of unrecorded provisions ACP think banks should take. If ACP disagrees with the accounts as presented, it can demand the publication of rectified accounting statements. Loan classification and provisioning are reviewed by ACP inspectors in special credit risk targeted reviews or in general on-site reviews.</p> <p>Based on their reports, off-site teams may formulate recommendations for re-classifications and additional provisions. These recommendations are sent to the external Auditors of the institution. Auditors the assessors met confirmed this did happen but that it was infrequent.</p> <p><b>EC8:</b> The off-site supervision and risk assessment system explicitly includes assessment of the adequacy of provisioning based on ratio analysis. ACP on-site inspectors are in charge of checking adequacy of provisions in credit risk reviews. ACP can use its general powers to require additional provisions. ACP also uses information on the performance of banks IRB models and EL calculations (and information from the French credit register as indications of potential loan classification problems.</p> <p><b>EC9.</b> Banks must ensure that the risk mitigants (guarantees and collateral) taken into account when setting the level of provisions can be called and that a recent valuation exists, carried out on a prudent basis. Risk-mitigant procedures are reviewed by off-site teams as part of credit reviews.</p> <p><b>EC11.</b> Banks must draw up suitable statements for the monitoring of their operations and in particular for the information to be provided to the executive body, the risk committee, the decision-making body and the Audit Committee.</p> <p>The ACP receives and reviews Board meetings' minutes and documentation. Moreover, on-site inspection conducted at large groups in 2010/11 on their Management Information System assessed the nature and frequency of the information Boards receive.</p> <p>Discussion the assessors had with banks indicates that the extent of information received by Boards varies considerably and their involvement in oversight of specific risk areas is generally being enhanced.</p> <p><b>AC1</b> As described under EC1, a claim must be classified as doubtful as soon as it is probable that the creditor will not recover all amounts due because some payments are three months overdue (six months for property loans, nine months for loans to local authorities).</p>
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	However, loans restructured in relation to the borrowers' financial difficulties may be reclassified by the banks as sound claims.
Assessment	Compliant
Comments	Discussions the assessors had with ACP, auditors and banks have led it to the conclusion that provisioning practices are generally adequate, despite the questions raised by a few high-profile cases in 2010 related to adequacy of provisioning for sovereign debt restructuring, which assessors reviewed with banks, auditors and authorities. However, the degree of ACP and auditor vigilance in this regard needs to be heightened, especially as the economic downturn leads to potential pressure on loan classification and provisioning practices.
Principle 10.	<b>Large exposure limits.</b> Supervisors must be satisfied that banks have policies and processes that enable management to identify and manage concentrations within the portfolio, and supervisors must set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties.
Description	<p><b>EC1.</b> The French regulation on large exposures (LE) is the transposition of the European Capital Requirement Directive - CRD This is incorporated into French regulation by various regulations and ministerial orders (same force as regulations). Guidelines issued by the CEBS/EBA are also used by French supervisors.</p> <p>According to Article 3 of Regulation 93-05, a group of "connected clients/counterparties" for the purpose of LE calculation is a group of natural and legal persons that are interconnected in such a way that, were one of them to encounter financial problems, the others would probably experience repayment difficulties. Such links are presumed to exist in certain cases, such as between two or more entities or persons in cases of common or joint control (indirect or direct), de facto common management, or entities who depend on a common source of important financing.</p> <p>The ACP may authorize a credit institution to not consider the persons/entities referred to above to constitute a group of "connected clients/counterparties" if the credit institution provides evidence that they are sufficiently independent of one another that the financial problems encountered by one of them will not lead to repayment difficulties for the others. ACP staff report that use of this exemption power is uncommon.</p> <p><b>EC2.</b> The term "exposure" used in the French LE regulation means any asset or off-balance sheet item, where such item is subject to credit risk, or for items booked in the trading book position risk, settlement risk or counterparty risk.</p> <p>Exposures do not include investments deducted from capital, and various short term exposures related to clearing and settlement of payments, FX, and securities transactions.</p> <p>Article 1 of Regulation 93-05 sets the limit as 25 percent of the bank's own funds on a client or on a group of connected counterparties (with higher limits for very small credit institutions).</p> <p>While the legal limit is 25 percent, in practice Pillar 2 has been used to limit exposures to a client or group of connected counterparties to 10 percent of capital. A specific report is sent to the ACP (see EC 3).</p> <p><b>EC3.</b> The regulation requires centralized tracking of exposures to permit timely identification and aggregation of connected lending. On-site processes review the adequacy of these processes in detail.</p>



	<p><b>EC4.</b> Regulation 97-02 requires banks to put in place adequate monitoring procedures for large exposures, actively involving top-management in the assessment process. However, there is no specific requirement that material concentrations above specified thresholds be reviewed and periodically reported to the Board of Directors. On-site processes review this process. Also for major banks the regular off-site process obtains information going to the Board, reviews its adequacy and has follow-up as necessary with the bank.</p> <p><b>EC5.</b> The ACP obtains detailed information on the loan portfolio of each credit institutions on a quarterly basis. To assist in checking the risk concentration features of the portfolio, the ACP has access to comprehensive databases at the Banque de France, which cover, capital links between companies, management and Board functions, and outstanding loan balances. Staff of local Banque de France branches can provide more detailed information about companies and individuals whenever required. The ACP has built an information system that aims at a flexible exploitation of these databases, used in preparing and performing on-site inspections. Various remedial powers exist and are used in cases where concentrations present significant risks (see CP23).</p> <p><b>AC1.</b> The term 'large exposure' refers to a credit institution's exposure to a client or group of connected clients when this exposure is equal to or exceeds 10 percent of the capital of the credit institution concerned. The term 'exposure' refers to all net risk-weighted assets or net risk-weighted off-balance-sheet items.</p> <p>The LE limits are defined on the basis of exposure to a client or group of connected clients.</p> <p>According to CRD provisions, minor deviations were made possible for smaller banks. For those with capital below Euro150m the limit for exposures to credit institutions or to groups that include a credit institution is 100 percent of capital, with reducing limits from there as the capital of the credit institution increases between Euro150m and Euro 600m, beyond which the 25 percent limits apply.</p>
Assessment	Compliant
Comments	The decision to eliminate the overall limit on how large the total of large exposures can be relative to a bank's capital may expose certain entities to excessive concentration. It is important to continue to actively monitor this.
Principle 11.	<p><b>Exposures to related parties.</b> In order to prevent abuses arising from exposures (both on balance sheet and off balance sheet) to related parties and to address conflict of interest, supervisors must have in place requirements that banks extend exposures to related companies and individuals on an arm's length basis; these exposures are effectively monitored; appropriate steps are taken to control or mitigate the risks; and write-offs of such exposures are made according to standard policies and processes.</p>
Description	<p><b>EC1:</b> The Commercial Code (L 225-38) establishes the list of persons who are deemed to be related parties. The definition includes general manager, one of its assistant general managers, one of its Directors, one of its shareholders holding a fraction of the voting rights greater than 10 percent or, in the case of a corporate shareholder, the company which controls it (within the meaning of Article L. 233-3). The definition also captures familial relationships (including spouse, parents, and children).</p>

There are therefore potential loopholes in that a natural person holding less than 10 percent of the voting rights of the company would not be captured by this definition. Nevertheless, particular attention is also paid to transactions between the institution and another company where there may be a common link arising from the management of the two companies (i.e., any manager or Director of the institution being in any way involved in the management of the second company). Such transactions are subject to the same approach to Board approval as transactions with the related parties as defined.

In addition, according to Article 3 of Regulation 93-05, natural and legal persons that are interconnected in such a way that, were one of them to encounter financial problems, in particular the difficulties concerning the financing or the repayment, the others would probably experience repayment difficulties, shall be deemed to constitute a single beneficiary. Hence the financial connectedness of related parties will also be captured by the overall approach.

**EC2.** The Commercial Code (L225-43) provides that where the transaction takes place under “normal conditions” agreements with related parties are permitted. This is because transactions with related parties are permissible where the transaction is consistent with the normal operations of the institution. As a bank is a lending institution it is acceptable, for example, to offer current accounts or loans to the related parties as defined. However, such arrangements must be under “normal” and not preferential terms.

Equally, “normal conditions” should be interpreted to mean that the transaction should not be exceptional in terms of amount or purpose of loan. The normal character of the conditions (price, guarantees, obligations, duration, and penalties) is estimated according to the conditions usually applied in the company.

However, when nature or purpose of the transaction with the related party (related party as defined above) is not consistent with the firm’s normal business or if normal market conditions are not being applied then the transaction is not prohibited but a specific authorization regime under the Commercial Code must apply.

All these criteria (the nature and purpose of bank loans) are assessed at the moment when the said loan is granted by comparison to similar loans portfolio and common market conditions (Article 21 regulation 97-02). Moreover, the Commercial Code provides (L225-42) that any transaction can be canceled if it were to be prejudicial to the firm, thus providing an extra layer of protection.

**EC3.** Transactions with related parties (as defined in L225-38) must be subject to prior Board consent where they take place under non normal conditions (L225-39) but must in any case be notified to the Board (L225-38). There is no materiality threshold for these notifications.

The process for authorization at the Board includes the following: the interested party must inform the Board immediately upon becoming aware of the agreement. The interested party shall not participate in the vote and their shares shall not be taken into account for the calculation of the quorum (L. 225-40 et L. 225-88 Commercial code). The chairman of the Board of Directors shall advise the auditors of all agreements authorized and shall submit them to the general meeting for approval. The auditors shall present a special report on the agreements to the general meeting.

Moreover, without prejudice to the liability of the interested party, if such an agreement were made without the prior authorization of the Board of Directors it may be cancelled within three years of the date of the agreement. Should the agreement have been concealed, the three year cancellation period shall date from the point at which it came to light.

**EC4.** As provided for by Article 21 of Regulation 97-02, which is the primary regulation concerning internal controls and procedures, where the nature or scale of transactions so require, institutions shall ensure, within the framework of compliance with any delegation procedures that may have been defined, that the analysis is carried out by an independent function.

When loans or commitments are granted to principal managers or shareholders as defined at Article 6ter of Regulation 90-02, institutions must examine the nature of the transactions and the conditions governing them, notably in the light of the provisions of Articles L. 225-38 to L. 225-43 of the Commercial Code and in relation to equivalent transactions customarily carried out with persons other than those referred to above.

**EC5:** French regulations provide for the deduction of certain transactions with related parties. According to Article 6 of Regulation 90-02, all commitments to shareholders or linked staff exceeding 3 percent of own funds are subject to deduction from the bank's regulatory own funds of. The commitments may include asset items and off-balance sheet commitments granted by an institution to its senior managers or principal shareholders, including commitments that guarantee performance of an obligation contracted by the senior managers or principal shareholders. The deductions shall be calculated by applying the provisions of Articles 4, 5, 6 and 7 of Regulation 93-05 on supervising large exposures (rules relating to globalization, risk mitigation, and risk weighting). Not all transactions will be subject to the deduction approach, including the following:

- a) transactions entered into with principal shareholders that have a rating better than 4 on the rating scale of the Banque de France or whose securities and bank debt have a rating at least equal to the rating set forth in Appendix I to the aforementioned Regulation (investment grade);
- b) transactions entered into with the senior managers or principal shareholders and guaranteed explicitly in favor of the institution by a company that has a rating mentioned in paragraph a) above;
- c) transactions entered into between institutions affiliated to the same central body as mentioned in Article L. 511-30 of the Monetary and Financial Code;
- d) commitments relating to legal entities over which the institution exercises exclusive control in accordance with Regulation 2000-03;
- e) commitments relating to legal entities over which the institution subject to this Regulation exercises joint control, if such control is shared with persons other than those deemed to be principal shareholders;
- f) the share of exposure to a single beneficiary within the meaning of Article 3 of Regulation 93-05 not exceeding 3 percent of the own funds of the institution.

**EC6.** Article 21 of Regulation 97-02 relating to the credit decision process, requires banks to identify such transactions using an independent process (see EC4).

	<p>The risk function, (Art 11-8) is in charge of the independent monitoring and review process, and is responsible for timely reporting to senior management and Board.</p> <p>Agreements covered by Articles L. 225-40 and L. 225-89 of the Commercial Code shall be submitted to the Board, and then to the general meeting of shareholders for approval. The statutory auditors shall present a special report on these agreements. This report shall be disclosed, and shall be sent to ACP (Instruction 93-01 of the Commission Bancaire, Article 8).</p> <p>In addition, the annual internal control report, which is submitted to the ACP and provided to the Board, the Audit Committee where applicable, and the statutory auditors must include an appendix listing of transactions concluded with the principal managers and shareholders (Articles 42(1)(g) and 44 of regulation 97-02).</p> <p>According to the ACP's guidance on the structure of internal control annual report, this appendix shall provide:</p> <ul style="list-style-type: none"> <li>– the characteristics of commitments for which a deduction has been made from regulatory capital: the identity of the beneficiaries, type of beneficiary (natural or legal person, shareholder or senior manager), type of commitment, gross amount, deductions (if any), risk weight, date of assignment and expiry date;</li> <li>– the nature of commitments to principal shareholders and senior managers for which a deduction has not been made from regulatory capital.</li> </ul> <p><b>EC7.</b> See EC6. ACP obtains and reviews information contained (i) in the special report of statutory auditors; and (ii) in the annual report on internal control.</p>
Assessment	Compliant
Comments	<p>The French law pays attention to the potential conflict of interest in a firm (or, in extremis, abuse of a firm) by its Directors, managers and owners. Although the Commercial Code appears to permit the potential for loopholes (notably transactions with shareholders with fewer than 10 percent voting rights), the requirement to deduct from own funds related party transactions that are in aggregate greater than 3 percent of own funds provides for both a cap on and a deterrent to such activity. Loans at 'normal' terms to related parties do not require Board or auditor approval and so may not get adequate scrutiny to ensure terms are reasonable, thus leading to reputation risk for the regulatory system in case of problems.</p>
Principle 12.	<p><b>Country and transfer risks.</b> Supervisors must be satisfied that banks have adequate policies and processes for identifying, measuring, monitoring and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining adequate provisions and reserves against such risks.</p>
Description	<p><b>EC1:</b> Regulation 97-02 requires banks to maintain Management Information Systems that allow for the proper identification, monitoring and controlling of on- and off-balance sheet risks on a given borrower or group of related borrowers, including sovereign(s). Credit institutions are required to submit regular reports on their consolidated country risk exposure. The frequency of these reports was annual (semi-annual in the case of the large banking groups) until the end of 2011 and will become quarterly in 2012. Since the beginning of 2011, the 4 largest banking groups have been requested to submit a monthly report on their consolidated exposures on a selection of European countries.</p>

	<p>Major French banks along with many global banks were materially exposed to country/transfer risk in the recent past.</p> <p>The assessors discussed what had occurred with the ACP and with banks, auditors, and rating agencies. In light of recent events, major banks assessors talked to have revamped their country risk systems.</p> <p><b>EC2/EC4:</b> The ACP off site process and internal control reporting covers large international groups' internal control systems for country risk. On an ad hoc basis, the ACP conducts cross-firm analyses of banks' exposures to a selection of countries and performs stress-tests to assess the resilience of French banks to a deterioration of economic or financial conditions in emerging countries, and to evaluate the potential impact of a crisis. Starting recently off-site teams are reviewing the results of bank's internal stress tests on country risk and other country risk information at their regular quarterly meetings with banks. The ACP also now reviews bank's internal management risk committee assessments dedicated to country risk.</p> <p>Banks' exposures to country risk and related procedures are also reviewed through active off-site monitoring and discussions with banks and supervisory intervention has recently occurred. In 2012 dedicated on-site inspections have also been scheduled to review a selection of geographical exposures of these groups and their procedures, but this program was not completed at the time of the assessment. These reviews will also form a view whether the IRB approach to modeling sovereign risk, which banks have revised, is acceptable.</p> <p><b>EC3</b> Country risk provisions are not prescribed by regulations and credit institutions are responsible for setting up the level of their provisions in their audited financial statements. Changes in 2008 in IFRS permitted banks to reclassify exposures out of the available for sale (fair value) category into held to maturity categories. A number of French banks did this in 2008 with respect to sovereign and other exposures. A few also did major reclassifications of exposures in 2010 and 2011.</p> <p>The ACP can consider the appropriate level of these provisions. Discussions the assessors had with ACP and with auditors indicated that such intervention can occur. It did occur in the third quarter of 2011 with respect to certain sovereign exposures, after the level of provisioning in French banks came to be questioned in the market and indirectly by international bodies.</p> <p>The assessors also discussed country risk provisioning with auditors and with banks. In 2011, the situation of determining appropriate provisioning was complicated by developments in markets which lead some banks to conclude that determining fair values was not reliably possible. In France this issue was compounded by the fact that French banks had made a previous undertaking not to sell their Greek sovereign portfolios at the request of the Minister of Finance and the Economy.</p>
Assessment	Largely Compliant
Comments	<p>Banks and the supervisor in many countries did not fully understand the potential for country and transfer risk. Pursuant to the CRD French banks often had zero risk weight to sovereign risk exposures. However, banks systems, and the ACP, did not until recently consider intra-European exposures as generating country or transfer risk. This CRD approach was in line with Basel 2 where the STD method imposed no capital requirements for sovereign risk above AA- and the IRB method required very low capital on sovereign risk as well. However, starting in 2011 intra-European exposures have been considered as risky and led to an increase of provisioning above 70 percent in certain cases.</p>

	<p>While major enhancements in the systems for country/transfer risk management and provisioning have occurred in banks, and ACP monitoring now is extensive, the ACP has not fully reviewed whether the new policies and practices are appropriate and effective. It will complete this work in 2012.</p>
Principle 13.	<p><b>Market risk.</b> Supervisors must be satisfied that banks have in place policies and processes that accurately identify, measure, monitor and control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposures, if warranted.</p>
Description	<p><b>EC 1.</b> The detailed requirements for the capital treatment of market risks for credit institutions and investment firms are set out in the ministerial order of February 20, 2007. This text is closely modeled on the content of the relevant EU legislation (in particular Capital Requirements Directive 2006/49/EC).</p> <p>With respect to the institution operating suitable policies and processes, the ministerial order sets out qualitative, as well as quantitative criteria, which have to be met for internal models to be used – subject to ACP approval - for the computation of market risk capital requirements. Regulation 97-02 of February 21, 1997 relating to internal control in credit institutions and investment firms defines, for both credit institutions and investment firms, internal control requirements and sets out requirements for the effective supervision of market risks by the senior management and Board of Directors.</p> <p>More generally, the ministerial order describes the criteria to be met for a position to be allowed to be booked in the trading book, specifies the prudent valuation rules that apply to positions marked to market or marked to model and requires banks to include trading book positions in the assessment of the bank's large exposures to counterparties. The Regulation establishes the requirements for the measurement of market risks (daily measurement of market risks and daily assessment of market risk capital adequacy) and monitoring of market risks (daily recording of foreign-exchange transactions and trading book transactions &amp; definition of a granular system of limits).</p> <p>Compliance with market risk requirements is tested through off-site supervision, as well as by on-site supervision. For the major firms there is an intensive on-site program of model approval and periodic thematic reviews. For example there have been horizontal reviews into "rogue trading," or more recent focused interventions on such topics as commodities trading or correlation products. A major model review might take up to six months, and would produce a substantial and highly detailed report, while other reviews could be of shorter duration, such as one to two months. The assessors were able to examine a number of inspection reports, and noted that in addition to scrutinizing the technical performance and assumptions of the models the inspections have increasingly identified governance and risk control issues over recent years. For the smaller institutions, the on-site inspection of market risk practices would be included as one component within the periodic on-site inspection that addresses all areas of the bank's activities. The on-site unit has twenty persons but this is supplemented by additional resource both from the off-site teams and from the other, more general inspectors who have greater technical skills in this area. Altogether there is a complement of thirty-five quantitative experts.</p> <p>Off-site supervision mainly relies on analysis of mandatory quantitative reporting, interviews with business units and risks management function, and exploitation of mandatory internal control reporting and internal audit reports. Work is currently in progress to further develop and refine the indicators that are being used. There is</p>

also a program to map the structures being used by the banks, which is a challenging process given the degree of evolution at the institutions at present. At large banks, the off-site supervisory review includes a wide range of meetings with business and risk officials at various levels throughout the year, as well as the communication of many internal documents and dashboards. Off-site supervision also includes the review of bank's internal models in case of authorization for the calculation of regulatory own funds requirements or as part of regular general inspections of banks' systems and controls. The annual internal control report which institutions must submit to the ACP includes requirements to report descriptions of the institutions policies on proprietary trading (including all systems for measuring and managing market risk, stress tests and the institutions own observations on the main shortcomings it has observed over the previous year and the measures it has taken to remedy such shortcomings in a timely manner, including verification of the effectiveness of the remedies).

Thus the ACP obtains a very thorough view of the banks' adherence to its required policies and processes. The evolution and development of the off-site team's practices has been supported by the recruitment of market professionals over the past few years, adding to the confidence of the team. Within the units that are responsible for the major systemic institutions there will be around three to five persons focusing on market risk, with some overlap between the teams to assist cross-reference and consistency between the major groups.

**EC 2.** Regulation 97-02 establishes a clear requirement for banks to have risk control systems providing for visible internal limits, including market risk limits. The executive body and the decision-making body is required to set and review these market risk limits on an ongoing basis and at least once a year, taking into account the institution's capital and risk measurement system. Furthermore, the ministerial order of February 20, 2007 requires institutions to have a clearly documented trading policy approved by the executive body, specifying allowed instruments and positions. Limits to positions must be set and monitored for appropriateness and position-taking by dealers must be subject to predetermined limits according to defined policies. Positions must be reported to the executive body as an integral part of the institution's risk management process. In discussion with banks it was clear that market risk limits are typically reviewed at Board level.

The governance and operation of the limits system must be reported to the ACP in the annual internal controls report (by level, type of risk incurred, in relation to capital, any breaches of the limits as well as confirming the frequency with which the limits are reviewed and the system for monitoring the limits).

For the major banks, off-site teams hold regular discussions with business and risk departments about the adequacy of and adherence to these limits. A key issue is to assess how overarching limits are set are cascaded down at a more granular level, and whether the whole set of limits is consistent with the bank risk appetite.

**EC3.** Ministerial order of February 20, 2007 requires banks to actively monitor their positions with reference to market information sources and to regularly assess the marketability or hedge-ability of positions and the quality and availability of market inputs to the valuation process. Furthermore, banks have to assess the level of market activity as well as the size of positions traded in the market. The ministerial order specifies prudent valuation rules that apply to positions marked to market or, where marking to market is not possible, marked to model and rules applying to less

	<p>liquid positions. It requires banks to have procedures for determining valuation adjustments or reserves, including for less liquid positions. On-site visits in 2009 were particularly focused on valuation techniques, especially regarding illiquid assets. The assessors saw evidence that the inspectors had challenged, in some cases very intensively, the valuation processes, practices and assumptions adopted by firms.</p> <p><b>EC4.</b> Banks using their internal models to compute capital requirements for market risk must establish a rigorous and comprehensive program of stress tests. These stress tests must be tailored to the bank's trading activity and risks. They must be both quantitative and qualitative and include situations that the bank identifies as being the less favorable based on the characteristics of its portfolio. The conclusions of such stress tests must be reviewed by the executive body and taken into account in the risk policies and limits. When stress tests reveal a particular vulnerability to a given set of circumstances, appropriate measures have to be promptly taken to reduce the revealed risks. At large banks, the results of internal stress-tests are discussed on a quarterly basis with the risk department.</p> <p>In 2010 and 2011, large banks have been required to prepare recovery plans as recommended by the FSB. This is aimed at supplementing existing contingency plans and includes, in particular, a systematic review on how they could adjust their market activities in a case of a shock—either idiosyncratic or systemic.</p> <p><b>AC1.</b> Independent price verification has to be performed, including a periodic verification of the accuracy and independence of the market prices and data used by the model. When daily marking to market is performed by dealers, the verification of market prices and model inputs has to be performed by a unit independent of the front office, at least monthly, or more frequently depending on the nature of the market or the trading activity. At large banks such independent units are responsible for calculating the daily NPL on market activities. The models used for valuation purposes have to be independently tested.</p>
Assessment	Compliant
Comments	<p>The over-arching regulatory framework and supervisory powers are in place for market risk requirements and the ACP's market risk supervision is of a very high quality, with the technical standards of the model reviews being exemplary.</p> <p>The current market context, confirmed both by the ACP and individual banks, is one in which the majority of firms are scaling back their exposures to market risk, away from proprietary trading and more complex products and back to a focus on their core franchises. The banks' profiles are therefore less complex and, in the current environment, more constrained by liquidity. At the same time new regulatory standards (particularly Basel 2.5) are being introduced, requiring a sequence of on-site inspections to verify and approve the models.</p> <p>The ACP is able to focus its resources on the systemic banks (four large groups and a handful of relevant foreign participants in the local market) and thus maintain close contact and in depth scrutiny of firm level practice, most particularly with the core domestic firms. Recent recruitment of market professionals means that the ACP is increasingly well placed to understand and to challenge the firms in their market risk activities. In addition to undertaking the requisite model reviews that are driven by regulatory changes Basel 2.5/CRD3 (e.g., stressed VaR, incremental risk) the ACP is responding to this overall environment by continuing to develop its off-site</p>



	<p>capacities, leading to more regular technical meetings with firms to explore the structure of the risk management, nature of risk and use of relevant indicators. In particular the ACP is taking the opportunity to intensify its off-site analysis and understanding of groups' management of corporate and investment banking activities, to press firms to improve the sophistication of their systems, and to widen the ACP's in-depth focus from the chief systemic banks to the next tier of institutions relevant for the French market. There was a particular focus in the second half of 2011 on identifying and collecting relevant data on a regular basis to support these initiatives.</p> <p>Given the international nature of market activities, the ACP noted that it was satisfied that French parented firms retained a tight management grasp on their overseas operations, but on-site inspections do take place in the major international financial centers (notably London and New York).</p>
Principle 14.	<p><b>Liquidity risk.</b> Supervisors must be satisfied that banks have a liquidity management strategy that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor and control liquidity risk, and to manage liquidity on a day-to-day basis. Supervisors require banks to have contingency plans for handling liquidity problems.</p>
Description	<p><b>EC1:</b> The French liquidity regime is made up of two main texts: the Order of May 5, 2009, on the identification, measurement, management and control of liquidity risk which has been in effect since June 30, 2010, and the regulation 97-02 relating to internal control in credit institutions and investment firms, which provides for rules on all major risks, including explicitly liquidity risk.</p> <p>The French liquidity regime is based on a single management principle which requires all institutions to manage their liquidity effectively and ensure that at all times there will be sufficient liquidity to honor commitments as they fall due and including under stressed assumptions. The core principle is applied in two ways in order to achieve a proportionate approach.</p> <p>A standardized approach which is applied on solo basis (but including foreign branches) which incorporates:</p> <ul style="list-style-type: none"> <li>i) a one-month regulatory ratio - where the ratio of the numerator (assets that are liquid or can be liquidated on the basis of some discount assumptions) to the denominator (liabilities and commitments, again subject to some adjustment criteria) must exceed 100 percent;</li> <li>ii) a cash forecast on at least a weekly basis (prepared from the seven-day cash flow projections of an institution, in euro and in other currencies and aimed at calculating their liquidity gap; the report is completed on the basis of contractual maturities);</li> <li>iii) a stock-take of liquidity sources immediately available;</li> <li>iv) information on unsecured financing costs;</li> <li>v) qualitative requirements via the internal control report; and</li> <li>vi) reporting of off-balance sheet elements with their contractual maturity date.</li> </ul> <p>An advanced approach for credit institutions having a specialized risk profile: based on internal methodologies developed by banks which require an authorization from the French ACP. It is closer to liquidity risk management methods used by credit</p>

institutions which set up strengthened measure and management systems. An advanced firm must design its own ratio which is subject to the approval of the ACP and which cannot go below the requirements of the standard ratio. Consequently, the calculation of the standard ratio acts as the minimum basis for any advanced ratio.

Undrawn commitments and other off-balance sheet liabilities are taken into account as well as existing on-balance sheet liabilities. The templates COEF-LIQU (i.e., calculation of standardized regulatory ratio) and MATURITES take into account both on and off-balance sheet instruments.

The standardized approach takes into account, inter alia:

- commitments in favor of customers due to be drawn in the coming month under contractual terms;
- drawdown of commitments in favor of customers calculated statistically;
- permanent credit facilities in favor of individual customers; and
- financing commitments in favor of ad hoc entities.

In addition, EU level guidance is available to firms, including the CEBS issued guideline on liquidity such as Liquidity Identity Card (June 2009), Guidelines on Liquidity Buffers & Survival Periods (December 2009) and Guidelines on Liquidity Cost benefit allocation (October 2010).

The assessors saw some examples of the ad hoc and management information supplied to the ACP as well as more standard reporting data. The assessors were also able to review ORAP2 analyses based on current reporting.

**EC2 and EC3.** Regulation 97-02 (Article 38) places the responsibility for governing liquidity risk on the management and Board of Directors (“They are obliged to regularly assess and control the effectiveness of policies, systems and procedures set up to comply with this regulation and take the appropriate measures to remedy possible failings.”). However, as noted in CP1(4) and CP7, there are no specific standards for the role of the Board in setting strategy, risk tolerance and limits, as distinct from the executive management. Nonetheless, Article 31 of Regulation 97-02 governs policy procedures specifically in relation to liquidity risk and states “Reporting institutions shall have policies and procedures adapted to their size, the nature and complexity of their activities and their exposure to risk for measuring and managing their liquidity risk on an ongoing and forward-looking basis. Alternative scenarios shall be considered. The assumptions underpinning the management of this risk shall be reviewed regularly. Contingency plans to deal with any liquidity crisis shall be in place.” The institutions must transmit the criteria and limits used to manage their liquidity risk to the ACP. Systems for monitoring and controlling liquidity risk (among other risks) must contain overall limits.

Hence there is a clear obligation placed on the management to ensure firms have in place policies and procedures in place for liquidity risk management, including consideration of adverse situations. The executive Board must inform the ACP of any significant breaches (Article 38). The regulation does not, however, create an explicit requirement for the bank to have a liquidity risk strategy.

The ACP has been enhancing its supervisory oversight of firms since 2008. The ACP receives regular reporting from all firms and in the case of the major institutions, has supplemented its data requests and enhanced its contacts particularly since 2010. Broadly, the liquidity risk profile and management are assessed within the SREP process – notably the ORAP assessment (see CP19/20) performed at least once a year (more frequently in case of higher risk profile) though obviously regular liquidity reports are analyzed on an ongoing basis when they are submitted.

A set of ad-hoc internal data on liquidity risk is regularly transmitted by all large banking groups. This data includes liquidity ratios and information of the structure of liquidity and funding – for example by term, counterparty, instrument, currency. The ACP decides when and how frequently the ad hoc data is received. Management information reports from the major banks are shared with the BdF. In periods of stress, such as during market turmoil times or specific funding issue a bank may face, the ACP requires banks to report their liquidity situation weekly or daily, depending on the situation. Daily calls with the major banks treasuries' have taken place since summer 2010 and the outcome of these calls is discussed with the BdF also.

A series of regular “*entretiens de surveillance rapprochée*” are held (closed thematic regulatory meetings) between off-site supervisory division and large banking groups' senior managers who manage the liquidity risk. In addition to that, thematic reviews of liquidity risk management are regularly performed through on-site investigations. For instance, on-site missions were conducted in 2011 in the large banking groups on their preparation to the future Basel liquidity requirements (LCR/NSFR).

The annual internal control report requirements with respect to liquidity risk includes:

- an appendix describing the assumptions used to prepare the cash forecast, as well as, when necessary, the significant changes that have taken place during the period under review; and
- an analysis of the changes in liquidity gaps calculated in the cash flow statement prepared during the period under review.

**EC4.** With respect to the management of funding risks and requirements, the standardized approach, within the Order of May 5, 2009 (Art 17) creates a high level requirement applying to all firms to take steps to ensure sufficient diversification of funding sources by geographical zone, currency, maturity and counterparty. Additionally, this Article requires institutions to “periodically test, directly or indirectly through their refinancing entity, the possibilities available to them for borrowing from their counterparties, both under normal circumstances and in a crisis.”

Detailed demands are relatively restricted for the banks using the standard approach. For example, standard-approach institutions prepare a cash forecast on a seven-day horizon. Under the advanced approach, the institution establishes its net funding requirements by calculating liquidity gaps for all the maturities it has pre-defined as well as determining how to cover them. Liquidity gaps are calculated according to the contractual or expected maturities of transactions, taking into account the effects of conditional commitments like off-balance sheet transactions concluded in the form of guarantees or financing commitments not yet drawn down and for each significant currency (according to the nature and scale of its activities (Article 42 of the 2009-05 Order).

	<p>The impact of other risks on the overall liquidity strategy is not specifically addressed by the regulations but is taken into account through the requirements of Regulation 97-02 (Article 17c) which requires reporting institutions to “introduce systems and procedures that enable them to gain an overall understanding of all the risks associated with the institution’s banking and non-banking activities, particularly credit risk, market risk, overall interest-rate risk, intermediation risk, settlement risk, liquidity risk and operational risk. These systems and procedures should enable institutions to draw up a risk map that identifies and evaluates exposure to risk in the light of internal factors (...) and external factors (...).”</p> <p><b>EC5.</b> The ad hoc data requested from large groups includes detailed information on their U.S. dollar assets and liabilities – including a special focus on short-term liabilities (instruments, residual maturities, prices paid etc.) and of collateral. Other less significant currency exposures, such as sterling, Swiss francs and Japanese yen are reported on a periodic basis also.</p> <p>The standard approach institutions are required to distinguish between flows in Euros from flows in other currencies, the latter being expressed in the equivalent value in Euro at the prevailing exchange rate on the calculation date when preparing the regulatory reporting on 1 week cash forecasts (Article 22 of the 2009-05 Order).</p> <p>All banks are required to test their liquidity by currency and to ensure a sufficient diversification of their funding sources by currencies. The advanced banks have to define a set of limits i) relating to the monitoring of individual and overall liquidity positions regarding high-quality unencumbered assets in the main currencies used within the management scope and ii) relating to the calculation of liquidity gaps in each significant currency.</p> <p>There additional monitoring for standard institutions having more than 10 percent of their business in foreign exchange:</p> <p>the MATURITIES template (maturity ladder reporting template, completed on a solo basis) must be filled in euro and in other currencies;</p> <p>the one-week cash forecast (seven-day cash flow projections) must be filled in euro and in other currencies.</p> <p>There is only one combined template, in Euros, for credit institutions below the 10 percent threshold of activities in foreign currencies.</p> <p><b>EC6.</b> Contingency plans are required by virtue of a high level requirement in Regulation 97-02 (Art 31). More specifically Article 52 of the 2009-05 Order states that “the institution shall analyze the results of the stress tests and take account of them in the measurement and operational management of liquidity risk, in particular in defining internal limits, the stock of liquid assets, the diversification of funding sources and the preparation of contingency plans.” Moreover, Article 53 requires the institution to draw up contingency plans that enable it to prepare for and cope with crisis situations. The plans shall set out the strategy and procedures for managing liquidity according to the different scenarios. The procedure requires the firm to define: the persons concerned; their level of responsibility and tasks; alternative solutions for access to liquidity; and communication strategy with the public.</p> <p>Contingency funding plans of the large banking groups are regularly and closely monitored. The ACP has been working closely with the major groups on stress testing, requiring them to test for the “ultimate” scenario of the total close down of the</p>
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	<p>market to identify and explore what the firms' actions would be. The firms themselves would prefer dynamic scenarios but the ACP finds this approach fruitful and plans to roll out the stress test to a wider group of firms.</p> <p><b>AC1.</b> The "Maturities" report enables the institution and the supervisor to monitor potential maturity mismatches in foreign currencies when a credit institution has more than 10 percent of its business in foreign currencies. Stress testing would be required for the U.S. dollar – other currencies not strongly significant.</p> <p><b>AC2:</b> Ensuring awareness in firms of the need to manage continued access to funding is one dimension of the 2009-05 (Art 9) which states as a general principle that the institutions "shall periodically test, directly or indirectly through their refinancing entity, the possibilities available to them for borrowing from their counterparties, both under normal circumstances and in a crisis." Additionally, Regulation 90-07 relating to the monitoring of interbank risks states that institutions shall have a system for the internal monitoring of the distribution of their sources of interbank financing.</p> <p>Firms must set limits for each banking counterparty, paying particular attention to banking counterparties. These amounts must be set in a way which ensures a satisfactory spread of the financing funds obtained from banking counterparties which do not belong to the same group or which are not affiliated to the same central body.</p> <p>They must have:</p> <ul style="list-style-type: none"> <li>- An information-recording and processing system which allows to establish the amount contracted from each banking counterparty; and</li> <li>- A system for monitoring the risks incurred which in particular permits observance of the limits laid down.</li> </ul> <p>The institutions shall make the results of this monitoring available to the ACP.</p>
Assessment	Largely Compliant
Comments	<p>The French supervisory authorities (first the Commission Bancaire and now the ACP) have responded to the ever more challenging market liquidity environment of recent years by delivering a steady program of regulatory improvements which is continuing.</p> <p>The domestic liquidity regulation was revised significantly in 2009 and has been in force since mid-2010 and incorporates both quantitative and qualitative requirements. Liquidity data (both according to standard templates and use of firms' management data) from the core systemic firms to France has been improved and the ACP has intensified its contact with firms in multiple ways, ranging from systematic "ad hoc" data reporting, increased emphasis on intra-group liquidity allocation, more penetrating thematic investigations (including on site) and daily calls with the group treasurer for the systemic groups. The core firms are now also required to perform severe stress tests. The ACP plan to extend out these stress testing requirements to a wider spectrum of firms. Liquidity risk was one of the priorities for off-site as well as more in depth on-site review work during 2011 and will remain so during 2012. All the firms with whom the assessors met have confirmed that the ACP is placing an ever greater emphasis on the importance of liquidity risk management, particularly since 2009.</p> <p>The areas in which the ACP needs to maintain momentum in order to achieve a comprehensive and effective oversight of liquidity risks in its entire system include</p>

	<p>the further development of data submission (for example standardization of higher frequency data currently received via banks' own management information systems), extending its stress testing program beyond the systemic group of banks and reviewing its existing regulatory requirements (specifically the Order of 2009) to firms to ensure that all firms, whether using standard approach or not, understand and are implementing good practice liquidity risk management standards in a commensurate manner. Further enhancement of the contact with the BdF, building on existing daily, exchanges would also be valuable.</p>
Principle 15.	<p><b>Operational risk.</b> Supervisors must be satisfied that banks have in place risk management policies and processes to identify, assess, monitor and control/mitigate operational risk. These policies and processes should be commensurate with the size and complexity of the bank.</p>
Description	<p><b>EC1.</b> Supervisory requirements are set out clearly in Regulation 97-02 (Arts 17 and 32) requiring credit institutions and investment firms to have in place risk management policies and processes to identify, assess, monitor and mitigate operational risk. All the provisions of this regulation are applied on a proportional basis:</p> <ul style="list-style-type: none"> <li>- Risk and result measuring systems for all risks including operational risk (Article 17, 97-02). The system shall also enable credit institutions to a cross-cutting and forward looking understanding of risk analysis. The measurement systems should be suited to the nature and volume of their transactions that allow them to assess operational risk on a consolidated basis. All the system should be regularly updated and assessed.</li> <li>- Reporting institutions shall provide themselves with suitable means for controlling operational risk including legal risks (Article 32 97-02). According to Article 32-1 reporting institutions shall regularly re-evaluate their systems for measuring risk and determining in order to verify their relevance in the light of developments in the business cycle, the market environment, the macro-economic environment in which it operates in relation to the business cycle and analytical techniques.</li> </ul> <p><b>EC2.</b> As relevant for all the CPs devoted to specific prudential risks, Article 38 of regulation 97-02 provides that the executive body and the decision-making body are responsible for making sure that the reporting institution complies with its obligations under the 97-02 regulation, e.g., policies and processes for the management of operational risk.</p> <p>In particular, the executive body and the decision-making body should have at their disposal relevant information on the risks incurred by the reporting institution. They are obliged to regularly assess and control the effectiveness of policies, systems and procedures set up to comply with this regulation and take the appropriate measures to remedy possible failings.</p> <p><b>EC3.</b> The ACP conducts its supervision in respect of operational risk through on and off-site programs. More specific requirements governing operational risk (implementing the EU Capital Requirements Directive which is based on the Basel 2 capital framework) are to be found in the Order of February 20, 2007 (Basel 2). A particularly valuable input is the annual report on internal control which covers operational risk provides one of the substantial inputs into the off-site examination process (ORAP2).</p>

	<p><b>EC4.</b> Business continuity and contingency plans are required by Regulation 97-02 (Art 14-I) which establishes that reporting institutions shall:</p> <ul style="list-style-type: none"> <li>a) have business continuity plans;</li> <li>b) provide for regular assessment of their organization and the availability of their human, property, technical and financial resources from the standpoint of business continuity-related risks; and</li> <li>c) ensure the coherence and effectiveness of business continuity plans in the framework of a master plan which incorporates the objectives defined by the executive body and, where appropriate, the decision-making body.</li> </ul> <p>The ACP reviews the business continuity plans annually thanks to the information provided by the internal control report that are:</p> <ul style="list-style-type: none"> <li>– objectives of business continuity plans, definitions and scenarios used, overall architecture (comprehensive plan versus one plan per business line, overall consistency in the case of multiple plans), responsibilities (names and positions of the officers responsible for managing and triggering business continuity plans and for managing incidents), scope of business covered by the plans, businesses assigned priority in the event of an incident, residual risks not covered by the plans, timetable for implementing plans;</li> <li>– formalization of procedures, general description of IT backup sites;</li> <li>– tests of business continuity plans (objectives, scope, frequency, results), procedures for updating plans (frequency, criteria), tools for managing plans (software and IT development), reporting to senior management (on tests, and on any changes to systems and procedures);</li> <li>– audit of business continuity plans and results of permanent controls; and</li> <li>– management of incidents occurring during the course of the year (for example, the H1N1 flu pandemic).</li> </ul> <p>Like any other significant operational risks, risks that may arise from disruptions to payment and settlement systems should be included in this review if they are material.</p> <p>The existence and the quality of business continuity plans are taken into account when ACP assesses operational risk criteria off site (ORAP 2) and on-site (depending on the scope of the mission) – see BCP 19 and 20.</p> <p><b>EC5.</b> The ACP assesses whether that banks have established appropriate information technology policies and processes covering areas such as information security and system development through the regular off-site analysis and assessment of the information provided by the internal control report. This report will, inter alia, provide:</p> <ul style="list-style-type: none"> <li>– responsibilities for IT system security;</li> <li>– objectives of IT security (in particular, the procedures for ensuring data preservation, integrity and confidentiality, and the specific measures taken for online banking); and</li> <li>– a description of permanent controls of the level for security for IT systems, and the results of those controls.</li> </ul> <p>On-site supervision has a team dedicated to the supervision of IT with its methodology of on-site assessment. IT security examinations are, in general,</p>
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	<p>modules within on-site examinations. The topics addressed in these on-site examinations are: security policy, its implementation (physical security, protection of data, telecom security, and business continuity), controls or any other issues related to IT. In 2011, large-scale on-site missions were conducted at large groups to assess whether they have appropriate information technology policies, processes, and systems commensurate with the size and complexity of their operations.</p> <p><b>EC6.</b> Reporting mechanisms are in place to keep the ACP apprised of developments affecting operational risk:</p> <p>Operational risk is discussed quarterly with large banks' risk departments (the off-site process).</p> <p>COREP templates: Standardized approach and AMA banks must report periodically two templates presenting the aggregated amounts of losses by event type and business lines and the top ten losses. Details of capital requirements calculation are provided through the OPR CA templates including the use and impact of operational risk mitigation instruments for AMA reporting institutions.</p> <p>Alert mechanisms for significant incidents defined by the 97-02, whereby, significant incidents (based on criteria and threshold set up by the decision making body and reviewed by the ACP) limits must without delay be brought to the attention of the executive body and the decision-making body of the bank and, if necessary, the central body of the reporting institution. There are also requirements for reporting to ACP.</p> <p>Off-site analysis and assessment of the information provided by the internal control report required annually by the ACP which mainly covers the description of the framework (organization, system, measurement, methodology) and of the main findings of the banks' internal reviews.</p> <p>On-site inspections, carried out mainly for banks intending to move to internal approach.</p> <p><b>EC7.</b> Legal risk is incorporated into the regulatory definition of operational risk that should be used by firms in the Order that implements Basel 2/CRD within France (Article 4-1 (c) of the Order of February 20, 2007). The definition is as follows:</p> <p>“operational risk' means the risk of loss resulting from inadequate or failed internal processes, people, and internal systems, or from external events, including events with a low probability of occurrence but a high loss. This definition includes legal risk but excludes strategic and reputation risk.”</p> <p><b>EC8.</b> The ACP determines that banks have established appropriate policies and processes to assess, manage and monitor outsourced activities. Article 37 of the 97-02 regulation, provides the regulatory framework for outsourced activities. The outsourcing risk management program has to be compliant with a wide range of conditions that encompass those presented in EC8 (see Article 37 of the 97-02 Regulation).</p> <p>The control of outsourced activities is regularly done within the ORAP 2 supervisory review. When necessary, on-site controls could be conducted.</p> <p>The main conditions are designed to ensure that outsourced activities are included in their control system and subject to a clear documentation. Stringent provisions are applied to outsourced essential service.</p>
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	<p><b>AC1.</b> The operational risk management framework should cover all the aspects of operational risk which definition is detailed in annex IV of the Order of February 20, 2007 (Basel 2).</p> <p>“Guidelines on the scope of operational risk and operational risk loss (Sept 2009)” from the EBA are also used to complement the regulatory definition.</p> <p>The operational risk framework is applied on a group wide basis. For banking groups, the ACP conducts its evaluation process essentially on a consolidated basis in order to capture all risks regardless of where they are located. Solo assessments can also be conducted whenever the assessment of a specific risk profile and the risk measurement and management systems are of prudential interest.</p> <p>Like any other significant operational risks, risks that may arise from certain operationally intensive businesses, such as custody and correspondent banking, should be included in the assessment.</p>
Assessment	Compliant
Comments	
Principle 16.	<p><b>Interest rate risk in the banking book.</b> Supervisors must be satisfied that banks have effective systems in place to identify, measure, monitor and control interest rate risk in the banking book, including a well defined strategy that has been approved by the Board and implemented by senior management; these should be appropriate to the size and complexity of such risk.</p>
Description	<p><b>EC1.</b> Article 38 of regulation 97-02 provides that the executive body and the decision-making body are responsible for making sure that the reporting institution complies with its obligations under the 97-02 regulation. The executive body and the decision making body are thus responsible for ensuring the institution meets its requirements in respect of IRRBB.</p> <p>In particular, the executive body and the decision-making body should have at their disposal relevant information on the risks incurred by the reporting institution. They are obliged to regularly assess and control the effectiveness of policies, systems and procedures set up to comply with this regulation and take the appropriate measures to remedy possible failings.</p> <p><b>EC2.</b> Banks are required to have in place comprehensive and appropriate interest rate risk measurement systems. Indeed, the Regulation 97-02 (Article 32) which states that reporting institutions shall set up risk monitoring and risk control systems with regard to overall interest-rate risk, such systems providing for visible internal limits and means to assess whether compliance with these limits is effective. Reporting institutions must also have systems for monitoring and controlling overall interest-rate risk that enable them to assess these risks on a consolidated basis.</p> <p>Models and assumptions are validated on a regular basis. Article 30 of 97-02 regulation states that the validity and consistency of the parameters and assumptions used in this assessment of overall interest-rate risk must be periodically monitored.</p> <p>The results of these measurements shall be provided to the executive body, which must inform the decision-making body in order to assess the institution's risks, particularly with regard to its own funds and results.</p>

Article 33 (97-02) states that systems for monitoring and controlling overall interest-rate risk must contain overall limits. The executive body and, where appropriate, the decision-making body shall set and review overall risk limits as and when necessary, and at least once a year, taking into account the institution's capital and consolidated capital where appropriate, and giving consideration to whether the distribution of capital within the group is suited to the risks incurred.

Exceptions to established policies, processes and limits should be identified and receive the prompt attention of designated persons. According to the Regulation 97-02 Article 34, reporting institutions shall set up systems which, according to formal procedures, allow them to:

- a) constantly ensure compliance with the set procedures and limits;
- b) analyze the causes of any noncompliance with procedures and limits; and
- c) inform the entities or persons designated for the purpose of the extent to which the procedures or limits have been disregarded or exceeded and of the corrective action proposed or undertaken.

Whether banks comply with such requirements is assessed through a review of the annual report on internal control (which must include specific detailed developments on interest-rate risk-management) and for, major banking groups, through dedicated meetings with their ALM teams or specific on-site missions, to review in particular:

- the quantitative results of the measurement of overall interest rate risk carried out by the institutions themselves in application of Article 28 and 30 of Regulation 97-02 relating to internal control;
- the results of the measurement of the impact that wide fluctuations in market parameters would have on capital (economic value) and on earnings capacity, based both on hypothesis defined by the institutions and on a standard shock defined by the ACP.

**EC3.** Firms are required to assess the risks to which they are exposed in the event of substantial changes in market parameters or breakdowns in the assumptions used in simulations (Article 30 of 97-02 regulation). The results of internal stress scenarios are also communicated at least once a year to the ACP by the annual report on internal control and feed into the ORAP assessments which the assessors were able to review.

As stated in its document "implementation of the supervisory review and evaluation process (Pillar 2): criteria and methodology used by the Commission Bancaire" the ACP expects institutions to adopt stress testing programs designed to provide a periodic evaluation of the risks that they run – in particular, risks associated with wide fluctuations in market parameters – based on assumptions that are suited to their business and which they define themselves. In this context, the following aspects are analyzed:

- the breadth of stress scenarios, in order to ensure that all activities and all material entities are covered;
- the assumptions used, in order to assess their relevance in relation to the type of business conducted by

	<ul style="list-style-type: none"> <li>• the results obtained, in order to measure the impact of the occurrence of these scenarios on the institution's own funds and earning capacity; and</li> <li>• how these results are used in setting overall risk management policies.</li> </ul> <p><b>AC1.</b> The ACP has wide powers of information gathering and in addition, Article 30 of 97-02 regulation states that reporting institutions must be able to inform the ACP as to the impact on their own funds of a sudden and unexpected change in the interest rates relating to their activities based on assumptions determined by the ACP.</p> <p>This requirement is also established by the document “Implementation of the supervisory review and evaluation process (Pillar 2): criteria and methodology used by the Commission Bancaire.” According to this set of requirements, institutions should be capable of providing the ACP a measure of the impact of a sudden and unexpected shift in interest rates specified in advance by the ACP, expressed in terms of its effect on the institution's own funds. The magnitude of this shock, identical for all institutions, is based on the EBA recommendations.</p> <p>ACP obtains the results of IRRBB measurement both from an earning value perspective and from an economic value perspective from the annual report on internal control. Reported information includes:</p> <ul style="list-style-type: none"> <li>– the effect on current net banking income of a uniform 200 basis point shock over one year, and—where appropriate—the effect on capital of a uniform 200 basis point shock upwards or downwards, taking into consideration only activities other than trading. Presentation of the assumptions used;</li> </ul> <p>For institutions that do not have their own methodology, a methodology similar to the BCBS one that could be used to calculate the consequences of a uniform shock of 200 basis points is proposed in annex 1 of the internal control report canvas.</p> <p><b>AC2.</b> Requirements are in place (Regulation 97-02 - Article 28) to ensure that reporting institutions have a system for measuring overall interest-rate risk, when it is significant, that allows them to:</p> <ol style="list-style-type: none"> <li>a) assess certain or foreseeable positions and flows resulting from all balance sheet and off-balance sheet transactions;</li> <li>b) assess the different overall interest-rate risk factors to which such transactions expose them; and</li> <li>c) periodically assess the impact of these different factors, if they are significant, on their results (earnings at risk approach) and own funds (economic value approach).</li> </ol> <p>The document articulating the Pillar 2 criteria and methodology used by the ACP in assessing firms covers the assessment of the risk profile of institutions for IRRBB – including an assessment of institutions’ strategies, their internal organization, their control and information processes, the tools and methodologies they use, and the quantitative results of the measurement of overall IRR. The assessment is conducted essentially through a review of the annual report on internal controls and, for major groups, through dedicated meetings with ALM teams and specific on-site verification missions and is based on the following elements:</p> <ul style="list-style-type: none"> <li>• the quantitative results of the measurement of overall interest rate risk carried out by the institutions themselves (Article 28 and 30 of Regulation 97-02); and</li> </ul>
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	<ul style="list-style-type: none"> <li>the results of the measurement of the impact that wide fluctuations in market parameters would have on capital (economic value) and on earnings capacity, based both on hypothesis defined by the institutions and on a standard shock defined by the ACP.</li> </ul> <p><b>AC3.</b> As mentioned with respect to EC2 and AC1, Article 30 of 97-02 Regulation states that reporting institutions shall ensure that they regularly assess the risks to which they are exposed in the event of substantial changes in market parameters or breakdowns in the assumptions used in simulations.</p> <p>The validity and consistency of the parameters and assumptions used in this assessment of overall interest-rate risk must be periodically monitored. The results of these measurements shall be provided to the executive body, which shall inform the decision-making body in order to assess the institution's risks, particularly with regard to its own funds and results.</p> <p><b>AC4.</b> Interest risk management falls under the same requirements as those applying to risk functions in general, which should be independent from business activities. The 97-02 Regulation (Article 7) states that the organization of reporting institutions, and in particular the systems referred at risk functions (Article 6.a)) above, shall be designed to ensure that units responsible for initiating transactions operate independently of those responsible for validating them, in particular at the accounting level, for settling them and for implementing risk monitoring procedures.</p> <p>Such independence may be secured by ensuring that the units report to different management bodies at a sufficiently senior level, or by setting up an organization in which duties are clearly segregated, or by implementing procedures (which may be computerized) specifically designed for this purpose, in which case the institution must be able to prove that they are appropriate and sufficient.</p>
Assessment	Compliant
Comments	
Principle 17.	<p><b>Internal control and audit.</b> Supervisors must be satisfied that banks have in place internal controls that are adequate for the size and complexity 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 the bank's assets; and appropriate independent internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.</p>
Description	<p><b>EC1/EC3.</b> Regulation 97-02 relating to internal control in credit institutions, defines the executive body (also called the senior managers) as the persons who, in accordance with Articles L. 511-13 of the Monetary and Financial Code, are responsible for the effective direction of the bank.</p> <p>The regulation defines the decision-making body as the Board of Directors, Supervisory Board or partners' meeting of firms governed by the Commercial Code, and includes the Board of Directors or policy and Supervisory Boards of the mutual credit institutions.</p> <p>The onus to ensure that the institution meets its internal control regulatory obligations is on the executive and decision-making bodies. They are obliged to assess and monitor the efficiency of the policies, mechanisms and procedures and to take appropriate measures to deal with any issues. There is no separate distinction in the</p>

	<p>regulation as to the role of the decision making versus the executive Board in that respect.</p> <p>French regulation has the two concepts of 'periodic control' and 'permanent control'. The permanent control of the compliance, security and validation of completed transactions and compliance with other measures related to the risk function must be performed, by, central and local staff assigned exclusively to that task or other staff carrying on operational activities.</p> <p>Periodic control of the compliance of transactions, the level of risk effectively incurred, compliance with procedures and the effectiveness and appropriateness of the permanent control must be performed by means of investigations carried out by staff other than those mentioned above (i.e., by an internal audit function).</p> <p>Notable control failures have occurred occasionally in major French banks, as elsewhere. ACP has followed up to assess lessons learned and ensure these are communicated to other banks, usually through the supervisory process.</p> <p><b>EC2.</b> According legislation banks must have an adequate system of internal control, including when they entrust to third parties the provision of services or operational tasks.</p> <p>Bank internal control requirements are defined in Regulation 97-02 and include:</p> <ul style="list-style-type: none"> <li>• a control system for operations and internal procedures;</li> <li>• the organization of accounting and information processing systems;</li> <li>• risk and result measurement systems;</li> <li>• risk monitoring and risk control systems;</li> <li>• a documentation and information system; and</li> <li>• a system for monitoring flows of cash and securities.</li> </ul> <p>The control system for operations and internal procedures is to provide optimal conditions (in terms of security, reliability and comprehensiveness) for:</p> <ul style="list-style-type: none"> <li>• ensuring that the institution's operations, organization and internal procedures comply with relevant laws and regulations, customary business practice and ethics and the business strategy determined by the executive body;</li> <li>• ensuring strict compliance with decision-making procedures, and risk-taking procedures, whatever the kind of risk, and with the management standards set by the executive body, in particular in the form of limits;</li> <li>• ensuring the quality of financial and accounting information, whether destined for the executive and decision-making bodies, for the supervisory authorities or for publication;</li> <li>• verifying the conditions in which such information is assessed, recorded, stored and made available, in particular by ensuring that there is an audit trail as defined at Article 12 of the Regulation 97-02;</li> <li>• ensuring the quality of information and communication systems;</li> <li>• making sure that the corrective measures decided on are implemented by reporting institutions within a reasonable timeframe; and</li> <li>• making sure that the compensation policy is in line with the risk control objectives, in accordance with the provisions of Title IV, Chapter VI of the Regulation 97-02.</li> </ul> <p>Article 7-1 of the regulation 97-02 requires bank's internal structure to be designed in a way that separates clearly units responsible for initiating transactions from that for</p>
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	<p>validating them, in particular at the accounting level, for settling them and for implementing the missions of the risk function. To that end, the respective units must have different reporting lines up to a sufficiently senior level.</p> <p>Regulation 97-02 also sets principles for the organization of the internal control function, and its reporting to the executive and decision-making bodies. Periodic reports on internal control activities must be submitted to the ACP. Internal control incidents must be reported to the ACP (which is also consulted on the relevance of internal thresholds defined for reporting such incidents).</p> <p>Banks submit annual detailed internal control reports describing their systems and procedures, and any major changes. The assessors saw examples of these reports and discussed with ACP staff the extensive review they receive. Since 2010 internal control breakdowns (above a threshold) must be reported to the ACP. Whether banks' internal controls are adequate for the nature and scale of their business is assessed by the ACP through on-site and off-site work. On-site missions are regularly dedicated to such issues. Since 2009, banks have also been asked to perform regular self-assessments of their internal control using the Senior Supervisors Group methodology.</p> <p><b>EC4.</b> ACP does not have the authority to require changes in the composition of the Board. For senior management, where solvency or liquidity of a bank or where the interests of its customers, or beneficiaries are at risk or likely to be, the ACP can use general authorities to suspend any or all members of the executive body.</p> <p><b>EC5.</b> Banks must have depending on the size and the nature of their activities, staff at operational, central and, local levels who carry out permanent or periodic controls.</p> <p>Under Article 9 of the same regulation, they also must ensure that the number and qualification of these persons and the resources placed at their disposal, in particular the monitoring tools and risk analysis methods, are adapted to the institution's activities.</p> <p><b>EC6.</b> According to Article 11 of regulation 97-02, banks must appoint an officer responsible for ensuring the coherence and effectiveness of controls and must inform the ACP of the person's identity. The compliance officer, if not a member of the executive body (as defined above), may not carry out any commercial, financial or accounting transaction. This is a senior position in banks and the comprehensive internal control requirements and related reporting to ACP results in high focus on this in banks that assessors met.</p> <p>There are requirements for informing the executive and decision making bodies about compliance matters and in certain cases directly to the Audit Committee. Assessing whether these conditions are met is a key part of the SREP, through off-site and on-site examination.</p> <p><b>EC7.</b> Regulations require the periodic control function (i.e., internal audit) to have adequate resources. The periodic control function must be independent and their functions are specified in regulation as noted in EC1, including determining that controls are sufficient and appropriate for the bank's business.</p> <p>Assessing whether these conditions are met is a key part of the SREP, through off-site and on-site examination. At large groups, regular meetings are held with internal audit functions, their reports and their work plan are extensively reviewed.</p> <p><b>EC8.</b> Regulation 97-02 (Article 9) requires banks to ensure that the number and qualification of the persons in charge of permanent or periodic controls and the</p>
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	<p>resources placed at their disposal, in particular the monitoring tools and risk analysis methods, are appropriate to the institution's activities, size and establishments.</p> <p>The resources allocated to internal control must be sufficient to enable a full audit review of all operations over as few years as possible. A schedule of audit tasks shall be drawn up at least once a year on the basis of the annual internal control objectives set by the executive and the decision-making body. At large groups, it is communicated to the ACP. Regulations also ensure full scope of the periodic control function and access to information.</p> <p>Regulations also require banks to have procedures to make sure that the corrective measures decided on by the internal control system are implemented within a reasonable timeframe, and enable the internal auditor to inform directly and on his own initiative the Audit Committee any failure to implement corrective measures.</p> <p>According to Article 42 of regulation 97-02, at least once a year, banks must draw up a report on the conditions in which internal control is conducted. This report includes, for each risk category defined in regulation 97-02: a description of the main actions taken, lessons learnt, and corrective actions decided by the permanent control function in relation to internal control. The law requires that this report, as well as an extract of the minutes of the deliberations from the decision making body to whom the report has to be submitted, has to be communicated to the ACP, no later than April 30 following the end of each year.</p> <p>Article 37-1-1 of the regulation, requires banks to ensure that their control system includes their outsourced activities.</p> <p>Assessing whether these conditions are met is a key part of the SREP, through off-site and on-site examination. These issues are included in the annual report on internal control, which allows a regular examination.</p> <p>Assessors reviewed examples of these extensive internal control reports and discussed with ACP how they are assessed and integrated into ACPs supervisory methodology. Assessors also discussed the operation of the control system with those responsible in major banks.</p> <p><b>AC1.</b> In France, both unicameral and bicameral Board structures are allowed and exist in practice. Some banks with a unicameral structure separate the chairman and CEO while others do not. Many French banks have a mutual structure which affects Board composition.</p> <p>The French commercial code requires an Audit Committee which cannot include Board members who are also members of management. In addition many major banks have chosen to respect the AFEP-MEDEF guidelines for listed companies, which include provisions on independent Directors and recommend that half the Board members be independent in widely held companies. Companies. As a result major banks in practice have significant number of nonexecutive Directors.</p> <p><b>AC2</b> There are no specific requirements for the internal audit function to report to the Audit Committee. However, the when either the executive body or the decision-making body of a bank deems it necessary, those responsible for control functions, including the internal auditor also report directly to the full decision-making body or the Audit Committee. Regulations give the internal auditor the duty to report to the Audit Committee when corrective measures have not been implemented. In a number of banks the assessors met it was clear that the internal audit function had full access to the Audit Committee.</p>
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	<p><b>AC3.</b> Audit committees are required for banks by regulation. It prevents members of the executive body from being members of the Audit Committee.</p> <p><b>AC4.</b> As part of their ongoing contacts with off-site teams, banks inform them on any information that may negatively affect its principals and, as a result, create reputation risk for the bank or compromise its governance.</p> <p>ACP also exchanges with domestic or foreign authorities supervising the financial sector on any sanctions pronounced against a member of the Board or senior management.</p>
Assessment	Compliant
Comments	France has a well-developed system of regulation of internal control. The supervisory process has an elaborate component to review this area and detailed, comprehensive reviews of internal controls are a major focus of on-site examinations. Enforcement actions and material penalties are being directed to enforcement lapses. The inability of there to be regulation of the Board or decision making body also affects compliance with certain aspects of this CP but the impact on ratings is considered in CP1(4).
Principle 18.	<b>Abuse of financial services.</b> Supervisors must be satisfied that banks have adequate policies and processes in place, including strict “know-your-customer” rules, that promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities.
Description	<p><b>EC1.</b> One of the missions of the ACP under the monetary and financial code is administration of the AML/CTF provisions of the code and related regulations. So AML/CTF issues are included extensively in the ACP on-site and off-site inspection programs and in enforcement. They are also part of the licensing process.</p> <p><b>EC2.</b> The code (Article L. 561-32/38) requires banks to have systems for assessing and managing risks of money laundering and terrorism financing. Regulation 97-02 imposes know-your-customer requirements. The Code also requires banks to report to the French FIU (TRACFIN) amounts entered in their books or transactions involving sums which they know, suspect or have reasonable reasons to suspect that they come from an offense punishable by a term of imprisonment exceeding one year, or part the financing of terrorism.</p> <p>This has been evaluated by the FATF (between February and March 2010). On the banking side France was largely compliant or compliant with most FATF requirements. No major know your client issues were identified. However, compliance was found to be less than satisfactory in overseas French territories and departments.</p> <p><b>EC3:</b> In addition to reporting to TRACFIN, banks also report directly to ACP. Regulations require the decision-making body of the bank (e.g., the Board) to set criteria and thresholds for significant incidents to be reported by the internal control procedures, depending on the size of the institution. Any fraud resulting in a loss or gain that exceeds 0.5 percent of the institution’s tier 1 capital and whose amount is no less than EUR 10,000 is presumed significant.</p> <p>Information about significant anomalies detected by the anti-money laundering and terrorist financing monitoring and analysis system and about shortcomings of the system, particularly those found by national and foreign supervisory authorities, must also be brought to the attention of the executive body and the decision-making body and, if necessary, the central body of the reporting institution.</p>



	<p>The executive body is in charge of communicating to the ACP, without delay, the significant incidents with regard to the criteria and thresholds mentioned above.</p> <p>ACP staff that the assessors met indicated that there was good cooperation and information sharing between TRACFIN and ACP.</p> <p><b>EC4.</b> Consistently with Article L.561-5 of the Monetary and Financial Code, banks are required to identify their customer and, where relevant, their representatives, by means of conclusive documents such as described in Article R. 561-5 I of the Monetary and financial code.</p> <p>Banks are also required to identify beneficial owners by means adapted to the situation.</p> <p>The ACP issued nonbinding guidelines in October 2011 regarding beneficial owners. This document contains concrete example of the requirements concerning beneficial owners for banking and investments activities. These guidelines are publicly available on the website of the ACP.</p> <p>As mentioned above banks must have arrangements for monitoring and analyzing their business relationships, based on the know-your-customer principle, so that they can notably detect transactions that are anomalous in relation to the business relationship profile and could be the subject of strengthened scrutiny as provided for at Article L. 561-10-2 II or the report to the French FIU (TRACFIN) provided for at Article L. 561-15 of the Monetary and Financial Code.</p> <p>Banks are expected to adapt the contents of their customer due diligence measures to the level and nature of AML-CFT risks -whether defined by Law or individually assessed by each financial institution- customers, products or services, or relationships are exposed to, namely</p> <ul style="list-style-type: none"> <li>- simplified (Articles L.561-9 and R.561-8 of the MFC);</li> <li>- standard (Articles L.561-5 and L.561-6 of the MFC); and</li> <li>- complementary and enhanced (Article L.561-10 of the MFC to Article L.561-10-2 of the MFC).</li> </ul> <p>For example, Banks, among several other complementary measures shall have senior management approval for establishing, or maintaining, business relationship with politically exposed persons. The ACP issued non-binding guidelines in January 2010 regarding politically exposed persons. These guidelines are publicly available on the website of the ACP.</p> <p>According to Article L. 561-12, bank must retain for five years from the closing of their accounts or the termination of their relationship documents relating to the identity of their usual or occasional customers. They also keep for five years after their execution the documents relating to transactions made and the documents relating to the operations subject to a strengthened scrutiny.</p> <p><b>EC5.</b> Due to Article L. 561-10-1 and R. 561-21 of the MFC, in respect of cross-frontier correspondent banking relationships with institutions from countries outside UE, not party to the Agreement on the European Economic Area or not located or in a third country which imposes requirements equivalent, it is required that banks:</p> <ol style="list-style-type: none"> <li>1) gather sufficient information about a respondent institution to understand fully the nature of the respondent's business and to determine from publicly available information the reputation of the institution and the quality of supervision;</li> </ol>
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	<p>2) assess the respondent institution's anti-money laundering and anti-terrorist financing controls;</p> <p>3) obtain approval from senior management before establishing new correspondent banking relationships;</p> <p>4) stipulate in the correspondent banking agreement procedures relating to the transmissions of information at the request of the bank; and</p> <p>5) with respect to payable-through accounts, be satisfied that the respondent credit institution has verified the identity of and performed ongoing due diligence on the customers having direct access to accounts of the correspondent and that it is able to provide relevant customer due diligence data to the correspondent institution, upon request.</p> <p><b>EC6.</b> The ACP is in charge of controlling, the existence and quality of compliance control systems, including anti-money laundering and terrorist financing systems which are part of them, through on-site and off-site inspections. Credit institutions report annually on their AML/CTF program through the extensive internal control report to ACP. AML/CTF issues are part of general on-site programs and more focused and thematic reviews. The assessors saw the prevalence that AML/CTF review has in ACP planning and on-site examination schedules. The ACP works with TRACFIN in the planning of the on-site examination program.</p> <p>On-site examinations check compliance control systems, procedures and verification on customer files and operations on samples of transactions. At the end of 2010 ACP had approximately 65 people regularly involved in AML/CTF activity.</p> <p>Supervisory priorities are set by the ACP College every year and it is planned to have an AML/CTF theme review every year. For 2012 it will be related to private banking. ACP staff indicated that after theme reviews there will be a public report (no names basis) on best practice and lessons learned, applicable more widely to credit institutions.</p> <p>In discussions with the assessors, ACP detailed how the (relatively few) issues affecting banking raised in the 2010 FATF report were being dealt with. In particular ACP has appointed a counselor for overseas departments and territories to deal with local authorities and is increasing the focus and priority to AML/CTF issues in those areas. Additional on-site work is also planned.</p> <p><b>EC7.</b> A bank that does not comply with its obligations related to criminal activities may be subject to the general ACP's extensive powers of administrative investigation, sanction and notification in respect of the entities and persons subject to its supervision (see CP23).</p> <p>The assessors saw examples of the use of these powers. In addition the ACP can refer matters for criminal prosecution. This is without prejudice to the sanction that the ACP may impose.</p> <p><b>EC8.</b> According to the Article R. 561-38 of the MFC, banks must meet a variety of requirements including: appointing a member of management responsible for the implementation of the AML/CTF system, and a person in charge of the system for reporting suspicious transactions to TRACFIN and responding to their requests; having a system for identifying assessing and managing AML/CFT risk including customer due diligence procedures and suspicious transaction identification; implement controls and internal audit of these procedures; and provide regular</p>
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	<p>training to staff. ACP receives and analyses the extensive annual report from banks on their internal controls policies and procedures which includes AML/CTF controls. Whether banks comply with these requirements is checked through off-site and on-site work (see BCP 19 and 20).</p> <p><b>EC9.</b> Article 17-7 2.4 of regulation 97-02 imposes that banks have internal procedures to identify and centralize the reporting and analysis of detected anomalies meeting the criteria and thresholds specific to money laundering and terrorism financing and other internal control breakdowns.</p> <p>Furthermore, significant anomalies detected by the anti-money laundering and terrorist financing monitoring and analysis system must be brought to the attention of the executive body and the decision-making body of the bank.</p> <p><b>EC10.</b> According to Article L561-22, both the company and the employee having made in good faith a declaration of suspicious activity to French FIU TRACFIN and to ACP could not be sued for breach of confidentiality or false accusation.</p> <p><b>EC11.</b> Under the legislation when an on-site inspection reveals facts that could justify criminal prosecution, ACP's chairman informs the public prosecutor of the territorial competent jurisdiction. ACP also is able to notify prosecutors when it commences a formal disciplinary procedure against a bank.</p> <p>ACP also is able to inform the French FIU (TRACFIN), if when performing its duties it discovers facts that could be related to money laundering or terrorism financing.</p> <p><b>EC12.</b> According to art. L. 631-1 of the MFC, domestic authorities supervising the financial sector have to cooperate, and exchange all information they may have which could be useful to the accomplishment of their respective duties.</p> <p>Exchanged information is covered by professional secrecy.</p> <p>A protocol has been signed between ACP and TRACFIN and ACP reports that information sharing is working well in practice.</p> <p>Consistently with Article L. 632-1 of the MFC, ACP is allowed to cooperate and share information with foreign authorities - from the EU or EEA, including information related to suspected or actual criminal activities where this information is for supervisory purposes. This occurs in practice.</p> <p>ACP is also authorized by legislation to sign cooperation agreement with other foreign authorities and has done so. This includes for exchange of information related to suspected or actual criminal activities where this information is for supervisory purposes. Exchanged information must be covered by local professional secrecy, which has to be as strong as French confidentiality provisions.</p> <p><b>AC1:</b> The ACP has several staff with expertise in address criminal matters. It also reported to the assessors that necessary links with police authorities were well developed.</p>
Assessment	Compliant
Comments	

Principle 19.	<p><b>Supervisory approach.</b> An effective banking supervisory system requires that supervisors develop and maintain a thorough understanding of the operations of individual banks and banking groups, and also of the banking system as a whole, focusing on safety and soundness, and the stability of the banking system.</p>
Description	<p><b>EC1.</b> Each credit institution, investment firm, is evaluated through the Supervisory Review and Evaluation Process (SREP).</p> <p>The SREP consists of:</p> <ul style="list-style-type: none"> <li>- A systematic review of the main risks faced by a firm, its compliance with prudential and other regulatory requirements (including Pillar I capital requirements) and of the adequacy of its internal control system. This review is conducted using an internal methodology (“ORAP 2” –see EC 3);</li> <li>- A dialogue with the supervised entity to share and discuss the RAS; and</li> <li>- A final assessment of the firm’s risk profile that may lead to corrective actions required from the firm and/or Pillar 2 measures.</li> </ul> <p>In the case of European cross-border groups, this process is conducted along the lines defined by the CRD 2 and CEBS Guidelines in order to reach a joint risk assessment and decision by the supervisory college. As a home supervisor, the ACP uses the harmonized templates defined by the CEBS to translate the outcome of the various national RAS into a common presentation.</p> <p>The assessors discussed this process with supervisors, reviewed supervisory documents, and outputs of these systems and the methodology, and discussed the supervisory process with individual banks.</p> <p><b>EC2.</b> Trends, developments and risks for the French financial system at large are monitored, summarized in a bi-annual report and input to off-site analysis carried out for individual firms. Another input is the bi-annual, nonpublic, Banque de France Financial Risk Assessment to which the ACP contributes.</p> <p>Off-site departments are also responsible for a number of cross-sector analyses which consider market trends in various areas such as mortgage financing.</p> <p>ACP has access to a large amount of external resources from both public sector (BIS, EBA, ESRB, IMF) and private sector sources (e.g., bank and rating agencies research). The assessors saw evidence of use of these resources in setting supervisory priorities.</p> <p>With the creation of a single supervisor for banks and insurance companies, contacts between their respective supervisors have increased. This is important given the mixed banc-assurance nature of major French banking groups. The assessors discussed with ACP the progress in integrating the risk assessment of the insurance part of these groups with the banking assessment and the consolidated views (given that most groups are headed by banks). ACP indicated that the supervisory functions is an area where integration has not yet occurred as a result of the formation of the ACP.</p>

Depending on the supervisory division practices there are periodic meetings between the division head to share perspectives on their part of the group as high level input into risk assessments and to coordinate planning.

The bank rating methodology does not include specific sections for input related to the risk of the insurance part of the group.

Separately, the ACP has long-established coordination channels with the Autorité des Marchés Financiers, which is responsible for market practices.

**EC3.** The nature, importance and scope of the risks to which individual banks or banking groups are exposed is assessed on an ongoing basis through an internal Risk Assessment System (RAS) called Organisation et Renforcement de l'Action Préventive (ORAP2), which was last updated in 2008. The outcome of this analysis is used to prioritize supervisory work and the ORAP rating drives the Pillar 2 capital requirement. The rating and components and the analysis that supports them is a major input into the annual supervisory synthesis ("lettre de cadrage") of issues and actions needed, that is communicated to the senior management and Board of the bank.

The risk assessment methodology is based on the analysis of 13 individual indicators: 1) Quality of credit portfolio; 2) Doubtful (non performing) loans and provisions; 3) Concentration risk; 4) Operational risk; 5) Organization of internal control; 6) Anti-Money Laundering policy; 7) Safeguarding of client assets (specific to investment firms); 8) Strategy and Organization; 9) Market risk; 10) Liquidity risk and the level of transformation; 11) Interest rate risk in the banking book; 12) Earnings and profitability; 13) Own funds. For most indicators, both the materiality of the risk and the adequacy of the internal control system for that risk are separately assessed. Each major risk category is rated (with a combined score of 1 to 4 (check) where both the materiality of the risk and the adequacy of the internal control system for that risk are assessed). Both financial ratios and rating of the quality of risk management and control systems feed into the analysis.

Following the rating of these individual criteria, a global rating (ranging to 1, best, to 5, worst), encompassing all 13 individual scores, is attributed to the institution. This global rating is based on a combination of expert judgment and peer analysis, based on rating principles aimed at ensuring consistency in global ratings across-banks.

Both the individual ratings and the global rating are supported by written qualitative (and, for the larger groups, quantitative) analysis, which also underlines the specific areas that may require closer monitoring.

The ORAP summary reports are provided to senior management in ACP and to the College as it reviews the supervisory findings and potential interventions. Banking groups are generally assessed on a consolidated basis. However, for major groups there is often a separate sub-consolidated rating for material entities (e.g., the corporate and investment banking entity).

The ORAP review is performed bringing together all the information the ACP has about individual banks. The output of the ORAP review drives the Pillar 2 process and the annual synthesis of feedback to the bank senior management and Board. It is a key process in ACP

ACP indicated to the assessors that it is intended that the ratings be forward looking. However, there is not an explicit requirement in the methodology for the

	<p>supervisor to specifically assess the trend of risks or the trend of risk management and control systems.</p> <p>There are criteria for assigning the overall numerical rating or the numerical rating for sub components, but they are very general in nature. The online tool for ratings often ins based on yes/no answers to questions about the existence of various internal control or risk management procedures, rather than encouraging supervisors to form a view on the quality of those systems based on criteria. Partly these features of the system are due to the need to apply it to a large number of credit institutions of very different sizes and complexities. There is a process within and across-supervisory groups to review consistency and reasonableness of supervisory ratings.</p> <p>The supervisory college process for major banking groups performs a rating process according to EBA guidelines. Assessors reviewed the results of those colleges and discussed them with ACP staff. Ratings by foreign supervisors of their part of the group can and do influence the overall ACP rating and intervention approach.</p> <p>The assessors reviewed the process and examples of the risk assessment summaries for major banks, including the evolution of ratings over the 2008–2011 period.</p> <p><b>EC4.</b> The SREP includes assessing whether banks and banking groups comply with prudential qualitative and quantitative regulations and with requirements imposed by the ACP. Annual analysis of detailed internal control reports of banks (see CP17) is a major input to this assessment as is more general off-site analysis and targeted on-site work. Review of internal audit reviews in banks and work of auditors is also an input into this assessment Control functions in major banks keep information on the status of follow-ups to ACP requirements and this is available to the ACP.</p> <p><b>EC5.</b> There are no formal requirements for banks to notify ACP of substantive changes in their overall condition. However, the extensive off-site monitoring process and the close links between banks' internal control processes and ACP allows ACP to have a current view of major changes in bank's conditions.</p> <p><b>EC6.</b> Supervisory work relies on a well-developed information system that includes the following tools: SURFI (Système Unifié de Reporting Financier) collects, sorts and verifies data submitted by banks and feeds the regulatory and accounting reporting (COREP, FINREP). The software that implements ORAP 2 provides a supervision tool to off-site teams for organizing the use of their resources, performing their periodic risk assessments, and identifying those areas that may require immediate action.</p> <p>This supervision tool has three main components:</p> <p>Firstly, based on a set of rules defined by regulatory requirements, the software issues quarterly a list of entities to be assessed. This list is based on initial inputs provided by the off-site teams and can be adjusted by them according to priorities and external circumstances provided that this does not significantly affect the frequency of the periodic assessment.</p> <p>Secondly, the software produces a quarterly high-level quantitative analysis based on the treatment of prudential data and the ORAP methodology. There is an alert procedure that may prompt the off-site team to conduct a full ORAP2 analysis and reconsider the rating of the entity.</p>
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	<p>Thirdly, the ORAP methodology includes qualitative analysis underpinning the ratings.</p> <p>In addition, an on-line <i>Système d'Information de l'Inspection Générale</i> (SIGAL) is accessible to inspectors on their laptops during inspections. SIGAL analyzes accounting statements and prudential reports, extracts statistical information concerning the structure and quality of a credit institution's loan book and allows scans for connected borrowers.</p> <p>Finally, the ACP has access to Banque de France-maintained databases, such as:</p> <ul style="list-style-type: none"> <li>- The Service Central des Risques (SCR), which contains information on performance of all loans of more than 75 000 Euro to nonbank entities reported to the BdF by credit institutions; and the Fichier Bancaire des Entreprises (FIBEN), which collects information on businesses and managing Directors and contains accounting and financial data reported to the BdF by all nonbank businesses in France with annual gross revenues exceeding 750 000 Euro, covering 250,000 firms.</li> </ul> <p><b>AC1.</b> There are certain forward-looking elements in the ORAP methodology but they are not as explicit as can be observed in some other country's supervisory rating systems.</p>
Assessment	Compliant
Comments	<p>Supervisors demonstrated a comprehensive and high level of understanding of banks and banking groups, at both the detailed level and the overall level, which was confirmed by the banks the assessors met. The quality of individual on-site and off-site work reviewed by the assessors was excellent. Explicitly splitting in the methodology the assessment of inherent risk from the quality of risk controls is best practice that is not always followed in major supervisors. As with many other countries, the rating process does not produce very responsive changes or forward looking changes to individual bank ratings. Written ORAP material reviewed by the assessors did not always provide strong clear rationales for global ratings or for key downgrades. Nor did it universally highlight key issues in a clear way.</p> <p>ACP indicated and the assessors observed that progress has been made but that there are major further steps to take to ensure a more-integrated view across-the banking and insurance functions. Specifically that the risk assessment of the insurance entities needs to be fed more explicitly into the groups risk assessment.</p> <p>There is room to have clearer criteria to assist in qualitative rating judgments. Having these descriptions of the major overall ratings (e.g., what is a '2' versus a '1' rated bank) could enhance communication within ACP and with banks (see CP20). Ratings of overall enterprise-wide risk management and risk governance do not appear well developed or clearly influence assessments, perhaps reflecting the recent nature of requirements for such functions and the difficulty ACP has in interacting with banks at Board level.</p>
Principle 20.	<p><b>Supervisory techniques.</b> An effective banking supervisory system should consist of on-site and off-site supervision and regular contacts with bank management.</p>
Description	<p><b>EC1.</b> ACP employs a mix of focused and detailed on-site work and off-site supervision to identify inherent risks and corrective measures. Article L.612-23 of the COMOFI gives formal responsibility to the Secretary general of the ACP to organize bank off-site and on-site supervision.</p>

Off-site banking supervision is performed through two ACP departments (the Direction du Contrôle des Etablissements de Crédit Généraux et Spécialisés and the Direction du Contrôle des Etablissements Mutualistes et Entreprises d'Investissement). The former includes responsibility for the two major listed banking groups while the second has responsibility for the major mutual banks. They total 185 staff together, split approximately equally between the two groups. Within each of these department there is a division responsible for the large banks or large mutual banks numbering about (10-15) staff for each bank. In addition, there are divisions in each department responsible for other groupings of banks or credit institutions such as foreign banks, consumer credit, market firms and trading infrastructure etc.). Each of the major banking groups has a responsible off-site staff person who leads the team.

On-site inspections are conducted by the Délégation au Contrôle sur Place (DCP), which numbers around 190 staff. Within the DCP, one unit specializes in the assessment of banks' quantitative risk management approaches and one in the assessment of banks' IT infrastructures and security. Major on-site reviews are extensive and would often take 4–6 months involving 4–8 people. There are 'general' on-sites for smaller banks that are wide ranging. For major banks the on-site approach is more focused reviews. Approximately, five reviews a year are planned at each major bank with the potential for more as the year develops and new issues emerge. In general the total of on-site reviews numbers 5–8 a year for the major banks. These cover model reviews and follow-ups, reviews of selected businesses or risk areas and related controls and governance, and AML/CTF.

On-site reports are issued under the name of the lead inspector who is responsible for the quality of the work done. On-site reports are focused more on actual findings and may contain suggestions, but do not contain the final ACP specific recommendations to the bank. These are developed by the off-site teams, working with the inspectors report. Banks have a formal right to comment on the draft report before it is finalized (a process of 'contradictoire'). This is part of the reason for the timing of the reports.

Some of the on-site and off-site reviews may be specific to the bank or involve theme reviews. Going forward into 2012 the CORIFRIS has identified mortgage financing as a potential area of concern and this will lead to theme reviews at some banks.

More recently, certain of the off-site divisions have developed a hybrid approach of Enquetes sur place (ESP). These are more lengthy 1–2 days' meetings between off-site teams and the bank, focused on a specific topic in more depth than is possible in the normal off-site monitoring.

The head of the off-site divisions and direction are responsible for the effectiveness and integration of the off-site and on-site work. Off-site teams are responsible for the overall risk assessment and rating of the bank. They are also responsible for receiving the reports of the on-site inspectors and based on those developing the follow-up letter to the bank (which is issued with the report), including the overall statement of findings, ACP recommendations and action plans the banks must meet.

Exchanges of personnel between on-site and off-site teams are frequent and are used as a method of training.



	<p>The assessors reviewed examples of the reports of on-site and off-site programs and analysis. They also discussed with ACP staff how the on-site and off-site programs operate together.</p> <p>ACP Internal audits assess the quality, effectiveness and integration of on-site and off-site functions. At the time of the assessment these had recently commenced. Findings were to be available later in 2012.</p> <p>The assessors reviewed several examples of reports of on-site and off-site programs and analysis, the resulting risk assessments, the ratings, and the supervisory letters (specific and annual synthesis). They also discussed with ACP staff how the off-site and on-site programs operate together.</p> <p><b>EC2.</b> There are specific processes for planning and executing on-site and off-site work. This is a combination of bottom-up and top-down assessments. The annual plan is prepared through an iterative process led by off-site teams that involves all ACP departments. Once vetted by the ACP Executive management, the supervisory program has to be approved by the ACP College. It can be modified during the year depending on circumstances. Supervisory priorities are identified taking into account the outcome of the supervisory review process, economic and financial developments, and the degree of coverage of the supervised universe by on-site missions over a multi-year period; and resources available. For the largest groups, annual supervisory objectives are also discussed beforehand within supervisory colleges, to identify common concerns and possible synergies. There is also coordination with the internal audit schedule of the bank.</p> <p>There is not a formal target coverage model or coverage standards for supervisory reviews. For banks rated 1–3 the desired detailed review of major business lines is every five years and in practice there is a three-to-five-year cycle at major banks. Institutions rated 4 or 5 must have an on-site every three years, while 10 years is the maximum period between on-sites for smaller institutions, which will not be deposit taking institutions. In practice major institutions have 10–12 on-sites covering some part of their operation every year.</p> <p>The off-site teams define the objectives and scope of the on-site mission. On-site and off-site teams, as well as other specialist in regulation and interpretation interact at various points during the on-site review. During the inspection (especially when a supervised institution appears in distress or when issues of particular relevance are identified) the on-site team leader prepares progress reports. Draft inspection reports are discussed with the top management of the credit institution who may submit written comments. Where the inspection report contains matters of concern, the Senior Inspector usually discusses its content in detail with the off-site team, so as to cross-check the technical or regulatory aspects. The final report is signed by the Senior Inspector.</p> <p>Upon receipt of the report, the off-site team meets with the on-site team to discuss the findings presented in its report. In most cases (i.e., in the absence of sanctions), the off-site team determines the recommendations and action plan and drafts the follow-up letter which includes a remediation action plan (“<i>lettre de suite</i>”). This is based on the report and discussed with the on-site team (including the implementation timetable). It is then signed by the ACP’s Secretary General or, in certain instances, by the Governor of the BdF, as Chairman of the ACP, sent to the CEO of the bank. The bank must communicate it to the institution’s Board of</p>
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	<p>Directors or the managing or Supervisory Board (or other similar decision-making body) and to the external auditors. The off-site team then follows up on the implementation of the action plan. It may request additional on-site work in case of doubts about the actual implementation of the remediation actions.</p> <p>The assessors reviewed several examples of this process and discussed it with the ACP. The issue of ACP interaction with Boards of Directors is covered in CP 1(4).</p> <p><b>EC3.</b> On-site inspections scope is either general (i.e., encompassing all types of risks faced by a smaller bank) or focused on specific risks, business units or support functions in a major bank. The scope is decided taking into account the characteristics of a bank (size, nature of activities) and those specific areas of the bank where off-site teams may need additional information. On-site missions combine an assessment of a bank's risk factors and of the adequacy of its risk management and internal control systems. They also can be used to verify the quality of the prudential information submitted by a bank and its implementation of previous corrective actions required by the supervisor.</p> <p>On-site inspections at smaller banks may also have a specific focus (e.g., rapid growth in assets, marked deterioration in observance of prudential standards or, on a general basis, a specific activity, such as lending to particular segments of the economy).</p> <p>In 2011, 37 percent of the on-site missions were general covering multiple risk areas, and 63 percent had a special focus - such as market risks (18 percent), AML (16 percent), liquidity risk (11 percent), credit risk (3 percent), or other issues (15 percent).</p> <p>On-site "teams" are helped, as needed, by two groups of specialists, which are part of the on-site division, specifically on Information Technology and Model Risk Analysis,</p> <p>The assessors reviewed examples of on-site work on major banks.</p> <p><b>EC4.</b> Off-site work is used to assess institutions' financial condition, individual risk profiles and provide a high-level assessment of internal controls and risk management. Off-site teams carry out a regular assessment of a bank's risk profile based on prudential returns and publicly available information. The supervisory review process is based on the ORAP methodology (see CP19). The assessment of an individual bank is at least annual but can be more frequent depending on the overall bank's score. In practice for large banks it is often updated quarterly. Off-site work relies primarily on:</p> <ul style="list-style-type: none"> <li>- An analysis of a wide range of individual information and data;</li> <li>- Cross-sector reviews on selected topics (e.g., mortgage financing; factoring.)</li> <li>- Regular meetings with the supervised firms (e.g., for the most significant banks quarterly meetings with Risk departments, quarterly meetings with Finance departments, regular meetings with management and heads of business units, frequent meetings at a more technical level etc.) and foreign (especially through supervisory colleges); and</li> <li>- The analysis of on-site reports.</li> </ul>
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	<p>Over the first three quarters of 2011, off-site departments held 852 meetings with supervised firms (not including regular conference calls on specific issues), conducted nine on-site visits (i.e., on-site meetings lasting one to two days), organized/ attended 45 supervisory college meetings and devised follow-up actions based on the analysis of 82 on-site reports.</p> <p>The assessors reviewed examples of on-site reports and how they feed into risk assessments.</p> <p><b>EC5.</b> Off-site teams maintain very frequent contacts with each of the major banks senior and middle management to assess its strategy, risks, organization and processes. For the largest banks there is an annual program of high-level meetings (annual meeting with the CEO and the executive committee to review strategy and risks, quarterly meetings with the CFO and CRO, bi-annual meetings with the heads of internal audit and around 10 meetings with heads of business units or support functions – such as compliance or ALM)</p> <p>This is supplemented with ad hoc meetings to address a wide range of issues (e.g., the follow-up of on-site missions, issues arising from regulatory initiatives, new activities developed by the banks).</p> <p>As noted in CP14 this has been supplemented by daily contact on liquidity and funding issues in times of actual or potential stress.</p> <p>For smaller banks, off-site teams meet with their senior management at least once a year and more frequently if necessary. They have other contact with middle management, in general to discuss issues arising from its prudential returns.</p> <p><b>EC6.</b> The quality of the Board and management features is included in the ‘strategy and governance’ ORAP risk factors. For cross-border groups, it is also discussed in supervisory colleges. In 2011, missions at the largest banking groups which focused on Management Information Systems also assessed the quality of the risk information received by the groups’ Boards and top management.</p> <p>The methodology used to get to ORAP ratings, is more weighted on strategy and the Board role in strategy, than on the quality of risk governance and risk understanding. So are the ORAP results reviewed by the assessors.</p> <p>In 2010 and 2011, meetings were held by ACP with the Chairs of the internal risk and Audit Committees at the largest French banking groups. However, the ACP advised that they do not meet with the Board as a whole or as individual Board members without management as that would amount to control, which is not permitted under the legislation.</p> <p><b>EC7.</b> The work of a bank’s internal audit function is an input into the off-site and on-site process. It is also evaluated through:</p> <ul style="list-style-type: none"> <li>- regular meetings with the function (two to three times a year at the largest banking groups) and ACP pre-review of the internal audit plan;</li> <li>- analysis of the regulatory annual report on internal control to be provided by banks, which includes summaries of all internal audit report findings;</li> <li>- the analysis of internal audit work reports - audit reports requested by the ACP on selected topic and the regulatory annual report submitted by the function on its activities and findings;</li> </ul>
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	<ul style="list-style-type: none"> <li>- the assessment by on-site inspectors at the occasion of their missions; and</li> <li>- discussion with the bank’s Executive management (and Board) about their expectations from and assessment of the internal audit function.</li> </ul> <p><b>EC8.</b> The outcome of the supervisory process is communicated to the group on an ongoing basis. Each on-site review is followed by a letter de suite as noted above. These (together with the on-site report) are sent to the CEO and Board chair for distribution to the full Board and to the external auditors.</p> <p>An annual meeting is organized between the ACP and the firm’s top management. For the largest groups, this includes the communication of the ORAP score, the related Pillar 2 requirement, with a formal letter sent afterward by the Secretary General of the ACP to the bank CEO – “lettre de cadrage”). This is also provided to the bank’s Board, but is not available to its auditors.</p> <p>The letter also presents the rationale for the Pillar 2 requirement. While this could be an aid to supervisory intervention, currently banks are much more focused on meeting their disclosed targets under Basel 3/CRD4, which are considerable higher than the previous rules. Banks that assessors met indicated that the Pillar 2 regime did not have the impact (if any now) that it once had.</p> <p>ACP staff is aware of the issue and is planning a Pillar 2 revision.</p> <p>The ACP does not have the authority to meet with the Board of the bank independent of management, though in some cases the chair of the Board or of key committees is included in meetings with management. (add cross-reference)</p> <p>The assessors reviewed examples of these communications and discussed them with the ACP, with banks, and with auditors. Banks reported that the detailed ACP recommendations/requirements were clear and were generally useful. Auditors reported that Boards sometimes had difficulty assessing the importance of the various aspects covered in detailed on-site reports and related letter de suite.</p> <p><b>AC1.</b> The results of supervisory examinations are discussed at the occasion of meetings with senior management and select Board members (see EC6 and EC8).</p>
Assessment	Largely Compliant
Comments	<p>While the ACP system consists of on-site and off-site supervision, with many examples of high quality work, there is evidence that it is not as effective as it needs to be in certain respects. In addition there is room to improve the effectiveness of ACP interaction with bank management and Boards in order to achieve supervisory results.</p> <p>The strength of on-site reports lies in their thoroughness and the resulting detailed knowledge of the banks that they bring to the ACP. On the other hand the assessors saw several examples where the considerable time taken to schedule and complete these reviews, coupled with the additional time for off-site staff to develop the recommended action plan, lead to multi-year delays in supervisory action. The time taken to complete detailed on-site work can also mean that the bank considers the findings dated when received by senior management, thus reducing the credibility and impact of the findings. There appeared to be a need escalate material findings from on-site processes while work was in progress.</p>

	<p>Normal off-site monitoring work, while able to react more quickly to developments in banks, can sometimes not be detailed enough to credibly show existence of issues that need bank management or Board attention. And it often cannot be detailed enough to support a formal sanction. ACP has taken some steps to develop more focused timely approaches that are in between full on-site and off-site processes, but there is room for more of this.</p> <p>The assessors reviewed several examples where follow-ups were only conducted several years after the initial issues were to be dealt with by banks, and a while after ACP had an initial sense through off-site processes that banks follow-up was not what it needed to be. And some of these detailed on-site follow-ups lasted considerable time before they came to conclusions that could be the basis of ACP action.</p> <p>In several areas over the recent past ACP reported that there was reluctance of a number of banks to follow key ACP high level recommendations. This tended to happen in areas that would have affected key elements of business plans or profitability. The assessors saw examples in material that it reviewed. This included in material risk areas that ACP identified early, and that later turned out to be problematic and significant for the banks involved. ACP needs to find ways to more forcefully impress on bank managements and Boards in a timely and focused way the importance of action. This should involve the combination of further senior level ACP intervention with CEOs and Boards, including outside of the regular annual supervision cycle.</p> <p>That could focus (more than the assessors observed in existing processes) communication on the <u>few</u> key issues that top management and the Boards need to improve and on the adequacy of their plans in that regard. Making sure the rating process (see CP19) better surfaces the key risk management and control and governance issues in a focused way, would help in that regard, as could incorporating an explicit forward looking element.</p> <p>Because of the move to Basel 3/CRD4 by banks, and their focus on the related targets they have set for the market, the Pillar 2 regime does not have the same impact in reinforcing supervisory messages that it had previously. Plans to revamp it will assist in that regard.</p> <p>The development of mini-on-site reviews by off-site teams, and of shorter more focused off-site inspection is a good development and should be pursued and extended.</p> <p>There is also room to more-fully and formally take advantage of the integrated nature of the ACP to make sure that the assessment of the insurance part of major banking groups and is included in the risk assessment and supervisory findings and intervention approach for the whole group. This needs to be done in a way that recognizes that certain risks and challenges posed by banking and insurance are different and so identical methodologies are not always appropriate.</p>
Principle 21.	<p><b>Supervisory reporting.</b> Supervisors must have a means of collecting, reviewing and analyzing prudential reports and statistical returns from banks on both a solo and a consolidated basis, and a means of independent verification of these reports, through either on-site examinations or use of external experts.</p>

Description	<p><b>EC1.</b> In accordance with the Monetary and Financial Code ( art L612-24), the ACP has the authority to specify the documents and data to be submitted to it and determine their form and the deadlines for filing. Report instructions establish the list of templates required by the ACP and specify their contents. Information reported is used to perform the Supervisory Review and Examination Process, following the “ORAP 2” methodology (see BCP 19) and thus covers all risk factors.</p> <p>There are 55 templates covering among others: on- and off-balance sheet assets and liabilities, profit and loss, liquidity, large exposure, market risk. Reporting makes extensive use of the FINREP (financial) and COREP (capital and risk data) templates agreed at the European level.</p> <p>In addition, the ACP has the capacity to make ad hoc information requests and does so in practice for major banks. Much of this is based on bank’s own MIS reports.</p> <p><b>EC2/EC3.</b> Instructions specify the accounting standards which, in practice under accounting standards, are IFRS for consolidated accounts of banking entities and French GAAP for solo statements. ACP reporting systems include both consolidated and solo returns. Each accounting standard includes a variety of rules for valuation and use of fair values (some of which are not recognized for prudential returns).</p> <p><b>EC4.</b> The nature and the frequency of the returns collected by ACP depend on the status, the activity and the risk profile of the reporting entity. Supervisory templates that need to be collected are generally asked on a quarterly basis from major banks. An analysis is performed each quarter based on standardized dashboards (prepared by the ORAP2 program – see BCP 19) – either a limited or full review depending on the riskiness of the institution.</p> <p>A few templates are collected on semi-annually or annual basis (e.g., international activity, anti-money laundering). Monetary statistics templates delivered by the largest institutions are gathered on a monthly basis.</p> <p>Ad hoc data requests may have a higher frequency, e.g., the daily conference calls with large banks Treasurers started in August 2011, and their weekly internal liquidity reports). Other recent examples include regular ad hoc data on refinancing and on certain sovereign exposures.</p> <p><b>EC5.</b> Reporting frequencies, reference dates as well as filing periods are harmonized and allow for appropriate benchmarks.</p> <p>As for ad hoc information and data requests, they are generally calibrated in formats that try to strike a right balance between building on an institution’s internal reporting system as much as possible and allowing for cross-sector analysis.</p> <p><b>EC6.</b> Legislation allows ACP to receive any information it needs from all entities that control a banking group, from entities that a banking groups controls even if they are not financial institutions and from affiliates of the bank.</p> <p><b>EC7.</b> The ACP is entitled by the law to all information it requires including the ability to summon and question persons under its supervision or whose information is necessary for the accomplishment of its mission (i.e., Art L612-24 §4 CMF)</p> <p><b>EC8.</b> Reporting requires an electronic secure signature of an executive Director, who is responsible for the accuracy of supervisory returns, even if he delegates his signature. The ACP can impose penalties for misreporting in accordance with the Article L612-25 CMF.</p>
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	<p><b>EC9.</b> Controls are included in the system of reporting. In addition, the ACP's IT system (ORAP2 described in CP19) encompasses several levels of control to monitor data quality. Potential anomalies detected automatically are then discussed by off-site teams with the banks to determine whether data need to be corrected and re-sent.</p> <p><b>EC10.</b> The ACP may call upon any competent person to carry out inspections. (Art. L612-23 CMF). In practice, this happens extremely but has recently with respect to model assessment work. When they were used, it is with clear roles and responsibilities and as part of teams overseen by ACP staff.</p> <p><b>EC11.</b> Given the ACP approach to not depend on external experts for supervisory work, they are not subject to requirements to bring material shortcoming to ACP attention.</p>
Assessment	Compliant
Comments	France has a well-developed reporting system that is updated from time to time and used extensively in on-site and off-site work. They are also making good use of information from banks' own internal reports in their off-site work.
Principle 22.	<b>Accounting and disclosure.</b> Supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with accounting policies and practices that are widely accepted internationally, and publishes, on a regular basis, information that fairly reflects its financial condition and profitability.
Description	<p><b>EC1/2.</b> According to Article 13 of the regulation 97-02 relating to internal control, credit institutions must ensure that the information and the valuation and accounting methods are exhaustive, of a high standard and accurate. The accounting standards used are regulated by a combination of EU rules and French regulations. Consolidated accounts of listed companies must be prepared according to IFRS, as set out in EU regulations, and IFRS is on option for other consolidated accounts. Other entities must use French GAAP as specified by the ANC (Autorite des Normes Comptables). Auditors and accounting authorities assessors met confirmed that the differences between IFRS and French GAAP do not cause issues in preparing accounts or in determining prudential ratios or analyzing financial data. Certain areas of difference (such as fair value option) are areas that are adjusted for prudential purposes for banks using IFRS in any event. ACP reported that the different GAAP used by entities in French banking groups does not cause them problems of reporting or analysis.</p> <p>Article L. 511-38 of the Financial and Monetary Code sets out that external auditing is carried out in each credit institution by at least two auditors ("Commissaires aux comptes"), appointed on the advice of the ACP. Institutions with assets below a threshold (currently EUR 450 million), only one auditor is required.</p> <p><b>EC3.</b> For major banks the rules/interpretations on valuation are those under IFRS. The ACP has not issued any further valuation guidance. The French accounting standard setter, has elaborated 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 not covered by IFRS. For valuation these rules are the same as those under IFRS. In 2010 the ACP did a thematic on-site review of valuation practices for complex instruments for major banks. A number of issues were raised in supervisory letters to major banks. These were followed up in the off-site monitoring process.</p>

**EC4:** Annual financial statements of credit institutions are audited. In addition, quarterly financial statements for major banks are subject to an audit 'review' engagement.

According to the Commercial Code (Article Annexe 8-1), audit standards are those approved by the French Ministry of Justice. Auditors must also take into account best practices identified by the H3C (Haut Conseil du Commissariat aux Comptes), the French audit oversight body. The French audit standards are in conformity with, but not identical to, the International standards on auditing (ISAs). The ACP does not have the authority to specify the scope of audits.

**EC5.** National auditing standards require auditors to verify that the financial statements give a true and fair view in accordance with the applicable financial reporting framework and cover such matters as loan portfolios provisioning, and valuations. Also general duties of the auditors contain the review of internal control processes. In addition auditors have to give a specific opinion (Monetary and financial code L621-18-3) on the internal control report given by the Supervisory Board (only for listed companies).

**EC6.** Under CMF Article L.612-43, The ACP must be consulted concerning any proposal to appoint or reappoint the statutory auditors (the signing partner) of the entities subject to its supervision. Where the situation so warrants, the ACP may also appoint an additional statutory auditor. The ACP does not have authority to approve, but it has used the notification requirement to indicate that it was not in agreement with a bank's potential choice, which accordingly did not proceed. Nor can ACP remove an auditor who is appointed.

According to the CMF Article L. 511-38, banks (except very small entities) must appoint at least 2 auditors. The ACP considers such matters as the work balance between the two auditors to, independence, knowledge and experience.

**EC7.** Article L. 511-37 of the Financial and Monetary Code requires credit institutions and investment firms to publish their annual accounts which are certified by external auditors (cf. EC2 abovementioned).

For the consolidated accounts, listed banking groups are obliged to use IFRS (and therefore are not subject to the French regulation 99-07). IFRS is an option for private (i.e., nonlisted) banking groups in their consolidated accounts. Other companies (nonlisted, for unconsolidated accounts) must use French GAAP.

IFRS adopted in France is that contained in the EU directives, which differs in several ways from IFRS adopted by the IASB. From time to time the EU has not adopted the full financial instruments rules. Currently, the major difference relates to hedge accounting where the EU version of IFRS is more permissible than IFRS standards.

As well, there have been several high-profile situations that have caused some observers to question the implementation of IFRS standards in France. Examples include Soc Gen allocating the material 2008 rogue trading losses to the previous year under the IFRS 'true and fair view' override, and questions raised in 2011 about the adequacy of the write-downs taken by some French banks and insurers on their Greek sovereign debt, compared to that in other jurisdictions. Some banks appear to have made more use than others of the special IASB rule adopted in 2008 as a result of the financial crisis to allow certain exposures to be reclassified out of trading and available for sale books that must be fair valued regularly. into loans and investment



books that do not. The last such reclassification was by one major bank in relation to its Greek debt in 2011. Issues have also been raised about the consistency between banks in implementation of IFRS standards. For example criteria for impairment differ among French banks.

The assessors discussed with ACP their role in these matters. In the case of sovereign write-downs, the head of the ACP (Banque de France Governor) did write the banks after the fact and after the reaction from the IASB, directing the banks that they must in subsequent quarters, take write downs of at least a specified percentage. Staff of the ACP indicated that in general they prefer to leave these issues to banks and their auditors. They do meet with audit firms once a year to orally discuss the areas that ACP believes need

Interaction between ACP and the auditors of individual banks takes place lead by the individual off-site teams, and occurs at their discretion. The ACP has annual interaction with the senior technical and banking partners of the six major firms that perform bank audits in France to discuss areas of focus and concern.

Recently the public reports of the H3C have identified various issues that affect auditing including the need for more professional skepticism. Assessors discussed these issues with H3C, auditors, and ACP. Through its various processes ACP is aware of any audit issues in major banks and can take action if necessary.

**EC8.** Listed French banks are required to publish and file with the French Financial Markets Authority an annual financial report, a half-yearly financial report and a quarterly financial statement. Other credit institutions whose most recent total balance sheet exceeds Eur 450 million must publish quarterly in the Bulletin des Annonces Légales Obligatoires a quarterly financial statement having the same layout as the annual individual balance sheet.

**EC9.** For major listed banks the required disclosures include both qualitative and quantitative information on financial performance, financial position, risk management strategies and practices, risk exposures, transactions with related parties, accounting policies, and basic business, management and governance. Pillar 3 reports are often part of these disclosures and in some cases are integrated into them.

**EC10.** According to the Article L. 511-37 of the Financial and Monetary Code, the ACP must ensure that the annual accounts published by credit institutions and investment firms appear regularly. It may order them to make amendments in the event of any inaccuracies or omissions being found in the published documents, and has done so.

When publications are missing or delays observed, banks are reminded of their obligations by off-site teams and ask to promptly conform to those. ACP accounting staff responds to issues of quality/accuracy of financial statements that are raised by supervisory teams coming out of their other reviews.

The ACP participated in the 2010/2011 EBA reviews of Pillar 3 disclosures of banks. That review found identified a number of areas for improvements ACP staff indicated that the general findings were also relevant for French banks.

**EC11.** Each year the ACP publishes an analysis of the French banking system. It includes information in particular on the credit institutions' population, aggregate data from the income statement and the balance sheet are provided. Some aggregate prudential data (own funds, capital requirements, liquidity...) are also disclosed.

	<p><b>AC1.</b> Accounting affairs division of the ACP meets audit firms (through the national Company of the Statutory Auditors) at least twice a year in the context of the preparation of the half-yearly and annual accounts. In addition, exchanges of views and additional meetings are organized as often as needed, for instance when a specific issue or an event could significantly impact the financial statements of credit institutions.</p> <p><b>AC2.</b> Statutory auditors are required to inform the ACP as soon as possible of any fact or decision concerning the entity subject to its supervision which they have become aware of in the performance of their duties and which could:</p> <ol style="list-style-type: none"> <li>1. Constitute a breach of the laws or regulations applicable to them and have a significant impact on their financial situation, solvency, profits or assets;</li> <li>2. Jeopardize its continued exploitation;</li> <li>3. Give rise to the issuing of reservations or to a refusal to certify its accounts.</li> </ol> <p>The same obligation applies relating to a parent company or a subsidiary of the supervised entity.</p> <p>Statutory auditors are released from professional secrecy and liability in relation to the ACP.</p> <p><b>AC3.</b> According to the Code de Commerce (art. L.822-14) Individual auditors and signing members of auditing firms are prohibited from auditing the accounts of legal entities which make public issues for more than six consecutive financial years.</p> <p>If it has knowledge of a breach of the provisions of the present code committed by an auditor of a credit institution, or if it considers that the conditions of independence necessary for the proper conduct of that auditor's assignment are not met, the ACP may ask the competent court to relieve him of his duties. The ACP may also report the offence to the relevant disciplinary authority, to which end the ACP may provide any information which that authority might require.</p> <p><b>AC4.</b> Banks have internal disclosure policies and committees which review financial statements and other publications (such as press releases and investor presentations) that are based on financial statement information.</p> <p><b>AC5:</b> According to the Article L. 613-9 of the Monetary and Financial Code, the ACP may ask the auditors of credit institutions for any information concerning the business and financial situation of the entity that they audit and the work they have carried out within the scope of that assignment.</p> <p>This includes audit working papers. The ACP may also send written observations to the auditors, who are then required to provide written answers.</p>
Assessment	Compliant
Comments	Despite the inability to formally, approve appointment of auditors ACP has used the requirement for pre-notification to achieve the same result. ACP should be given the formal approval authority.
Principle 23.	<b>Corrective and remedial powers of supervisors.</b> Supervisors must have at their disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability, where appropriate, to revoke the banking license or to recommend its revocation.

Description	<p><b>EC 1</b> The ACP has a formal process, the frequency of which is driven by the supervisory cycle, through which it will raise supervisory concerns with the institution. For its part the institution is required to respond within a formal timeframe (two months) indicating how it will address the concerns that have been identified.</p> <p>In more detail, at the conclusion of an on-site inspection the ACP is required, (COMOFI Art L 612-27), to issue a formal follow-up letter to the supervised entity's Board of Directors, Executive Board and its Supervisory Board (where the Board structure is bi-cameral). The letter may also be communicated to other recipients such as institution's statutory auditor. The letter identifies the issues of concern and detailed recommendations by which the supervisory authority wishes to bring to the attention of the institution and ensure are remedied.</p> <p>Credit institutions are generally required to reply within two months giving the details of the measures taken and the timeframe for their implementation. The follow-up of the recommendation is made in the light of i) the analysis of such answers ii) regular or specific meetings and iii) on-site visits.</p> <p>Additionally, for the for the 5 largest banking groups, an annual letter is send by the Secretary General to the Executive Board, after a bilateral meeting, presenting the annual assessment of the group and requiring the attention of the groups regarding their risks.</p> <p>Therefore, the formal contact with the institution is primarily structured around on-site examinations the frequency of which will be determined by the decisions made on the supervisory cycle under which the institution is monitored. Thus, for the major groups there will be frequent and continuous on-site contact, but other institutions will be subject to a much longer cycle of general on-site examination under normal circumstances (such as a 3, 5, or 10-year cycles: see CPs 19 and 20). The system is flexible however, as the ACP can use its off-site surveillance systems identify whether additional on-site examinations would be necessary. Recently the ACP is starting to institute very short (several days), focused, examinations to explore or address specific issues or concerns.</p> <p>Additionally, the ACP may use an emergency procedure by issuing a formal statement.</p> <p>The ACP participates in deciding when and how to effect the orderly resolution of a problem bank situation (which could include closure, or assisting in restructuring, or merger with a stronger institution).</p> <p><b>EC 2</b> The ACP may appoint a provisional administrator (COMOFI Article L. 612-34). On its own initiative or at the management initiative, when the supervised institution can no longer be run under normal conditions, or when the managers have been suspended temporarily or been dismissed. The full powers relating to the legal entity's administration, management and representation are transferred to the provisional administrator (the DGF may, on a proposal from ACP, decide to guarantee payment of his fees).</p> <p>Furthermore, in accordance to Article R. 613-14 of the COMOFI, any legal proceedings instituted in France cannot be initiated until prior ACP's opinion has been obtained. The Law governs the division of responsibilities between the ACP's provisional administrator (or liquidator) and the court-appointed administrator (or receiver).</p>
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**EC 3 and EC4**

Depending on the findings of the supervisory process, in particular the on-site examinations, the ACP has a wide range of instruments that it may use which are considered protective or corrective actions (these actions are distinct from sanctions which are discussed in EC6). The ACP is not obliged to progress stage, by stage, through each of the measures listed. It has discretion to adopt the measure that is most suited to its supervisory needs. It should be noted, though, that the follow up letter is a formal legal requirement that the ACP must issue following any on-site inspection. The College of the ACP is responsible for taking the decisions to adopt these measures. Protective and corrective supervisory tools thus include the measures noted below but do not include powers in respect of the Board of Directors of the supervised institution.

**Follow-up letter** (see above EC1): in order to request the supervised credit institution to adopt, if need be, the appropriate measures following an on-site inspection. As noted above, the follow up letter has formal standing under the law and must be issued following any on-site inspection.

An **injunction**: in order to propose a series of measures that the entity subject to control should take to comply with the prevailing regulations. For banking sector institutions, such measures may consist to restore or strengthen their financial situation, improve their management techniques or ensure the adequacy of their organization with their activities or their development objectives. An injunction will be used when the ACP has a highly specific prudential objective in mind, such as a Pillar 2 adjustment (see EC5). An injunction is not a public document but it creates an obligation upon the institution which would have to lodge an appeal in court if it wished to dispute the contents of the injunction, as has already been the case. If an injunction is not respected (as with other protective and corrective measures) this is a formal trigger and the ACP can initiate a remedial action program or sanction.

**Administrative police measures**: provided in Articles L. 612-30 to L. 612-34 of the COMOFI. Such measures may be include:

- **A caveat** (i.e., warning), in order to prevent or remedy any breaches related to the best practice applicable in banking sector.
- **A formal notice**, in order to require a supervised credit institution to remedy, in an appropriate timeframe, all breaches of the obligations placed under the control of the ACP imposed by the laws or regulations or by professional rules.
- **A remedial action program**, in order to restore or bolster the institution's financial situation, improve their management methods or ensure that their organization is suitable for their business or their development plans.
- **Protective measures** (placing under special supervision; restriction or temporary ban on executing certain operations; suspension, restriction or temporary ban on the free disposal of all or part of the assets of the entity under supervision; order to suspend or limit the payment of surrender values, the arbitrage facility, the payment of contract advances or the opt-out facility; restriction or ban on paying a dividend to shareholders or a remuneration of company shares; suspension of one or more executive managers).
- **Appointment of a provisional administrator** The grounds for appointing the administrator are very broad, no criteria are set, permitting the ACP full use of

supervisory discretion and judgment. The appointment of an administrator would be (as noted above) a formal decision of the College, made on the basis of evidence from on-site examination. The dossier for the College to assess would be prepared by the legal department in conjunction with the supervisory department. In case of extreme urgency the President of the ACP can appoint an administrator. This power was used in the 2008 financial crisis.

**Sanctions procedure** (see below EC6).

Reference to the **public prosecutor** in cases where there has been an incident warranting criminal prosecution.

**Receivership or liquidation proceedings** (see above EC2).

**EC 5** As set out in Article L. 511-41-3 of the COMOFI (“pillar II injunctions to credit institutions”), the ACP is able to require higher solvency ratios than the legal minimum whenever they deem this justified by specific risk characteristics of a credit institution. The ACP has full discretion to exercise this power, no binding policy or line of conduct having been published in this respect.

The College of the ACP has reviewed [**all banks**] and decided that Pillar 2 requirements were necessary for all major groups and their main subsidiaries and for around 50 other banks or investment firms. For institutions with subsidiaries in EEA countries, such decisions are now based on an annual assessment that is conducted jointly within College of supervisors. ACP’s annual report for 2010 (page 38) shows that the ACP has pronounced 10 new injunctions in respect of higher minimum capital requirements to be applied on a solo basis (3 for 2011).

Moreover, if a credit institution fails to meet the requirements, or whenever the trend of its ratios indicates that it is at risk of shortfalls, the ACP may require the credit institution to take protective measures (COMOFI, art. L. 612-33, see above EC4) or corrective action in order to restore or bolster their financial situation, improve their management methods or ensure that their organization is suitable for their business or their development plans (COMOFI, art. L. 612-32).

**EC 6** The decision to impose a sanction upon an institution rests with the Sanctions Committee which is separate from the College of the ACP. However, to initiate the procedure, the College of the ACP must make a decision to open proceedings on the basis of a dossier brought by the Secretary General. Should the College decide to recommend proceedings, the President of the College will send a formal notice of infringement to the entity/person and simultaneously notify the President of the SC. The SC is charged with conducting disciplinary proceedings referred to it by the College, and with issuing penalties where appropriate. There is no overlap of membership between the SC and the College as “the functions of member of the Sanctions Committee are not compatible with the function of a member of the College” (COMOFI Art L 612-9). The European Court of Human Rights gave a ruling in 2009 which found that the procedure of the Commission Bancaire had not complied with the European Convention on Human Rights (Article 6) as it had not achieved a clear distinction between the policing, investigation and sanction functions in the exercise of its jurisdiction.

The current sanctions process was introduced when the ACP was established and differs from the arrangements of the former Commission Bancaire. Furthermore, with a view to achieving convergence with the AMF disciplinary procedure, additional changes – namely the introduction of the role of the rapporteur - were

introduced in October 2010 (the Banking and Financial Regulation Act of October 22, 2010). Only one case, to date, has had a rapporteur appointed to it since the change in the procedures.

Finally, pursuant to Article L.612-2 of the COMOFI, the SC is responsible for imposing sanctions upon credit institutions and investment firms, which fall under the scope of its supervision (i.e., any violation of banking capital requirements foreseen in the laws transposing Directives 2006/48/EC and 2006/49/EC).

The sanctions are listed under Article L. 612-39 COMOFI as follows:

- 1) **warning**;
- 2) **reprimand**;
- 3) **prohibition on conducting certain transactions**, and any other restriction on the conduct of its business;
- 4) **temporary suspension** of one or several managers (but not Director, unless the CEO sits on the Board) or, in the case of a payment institution providing mixed services, of the person registered as in charge of the management of payment services activities, with or without appointment of a provisional administrator;
- 5) **compulsory dismissal** of one or several managers (but not Director, unless the CEO sits on the Board), or, in the case of a payment institution providing mixed services, of the person registered as in charge of the management of payment services activities, with or without appointment of a provisional administrator;
- 6) **partial withdrawal of authorization or approval**; and
- 7) **total withdrawal of authorization or approval or striking from the list of authorized persons, with or without appointment of a provisional administrator**.

(Sanctions mentioned in 3) and 4) above may not exceed a period of 10 years).

The sanctions committee may also impose an **administrative fine**, which shall not exceed €**100,000,000**, instead of or in addition to those sanctions.

In accordance with the principle of proportionality, the SC can issue one or more penalties, depending on the seriousness of the violation.

Penalties apply to the organizations that are subject to ongoing supervision. However, a proceeding directed at a legal entity can also lead to the imposition of sanctions concerning the managers of the entity (namely temporary suspension or compulsory dismissal).

Sanctions may be accompanied by daily fines, the amount and the effective date of which shall be determined by the sanctions committee.

The decision of the SC must be published in the journals or other publications which it has designated. Its format shall be proportionate to the violation perpetrated and to the sanction pronounced. The sanctioned entity shall bear all publication expenses. However, the SC may conclude that disclosure of the sanction may severely jeopardize financial markets or cause disproportionate damage to the person concerned, and thus decide against publication.

	<p><b>AC 1</b> Despite the fact that the French legal framework does not formally provide safeguards or requirements to prevent the prudential supervisor delaying action unduly. Nevertheless, the ACP may be held liable in cases of undue delay (see CP 1).</p> <p><b>AC 2</b> The ACP has a wide range of possibilities to limit the activities of institutions (See above EC 2, 3, and 4.)</p> <p><b>AC 3.</b> In accordance with Article L. 631-1 of the COMOFI, the ACP may exchange with the French financial market Authority (Autorité des marchés financiers or AMF) and the Banque de France the information they require to accomplish their respective missions. Such transmission is covered by the professional secrecy.</p> <p>Moreover, since the Law n°2010-1249 of October 22, 2010, a Council of financial regulation and systemic risk (Conseil de Régulation Financière et du Risque Systémique or COREFRIS), chaired by the Minister of the Economy, has been established. It is composed of the Governor of the Bank of France (who is also chairman of the ACP), the Vice-President of the ACP, the President of the of the AMF, the President of the Autorité des normes comptables (ANC) and three other qualified members appointed by the Minister of Economy and is notably vested with the mission to ensure cooperation between the institutions they represent.</p>
Assessment	Compliant
Comments	<p>The ACP enjoys a wide range of remedial and sanctioning powers which were augmented with the creation of the ACP itself and which it is using. As such, experience with the new powers and processes is still at an early stage. This is particularly challenging for the ACP as the new procedures are much closer to a judiciary process than hitherto and there is a learning curve in terms of ensuring that referrals are made with the full and appropriate levels of justification, and that the ACP understands the expectations of the SC in terms of how evidence is presented and assessed. The ACP is thus in the process of reflecting on its experiences to date and focusing on how to refine and streamline its practices moving forward (for example a sanctions process might take a year and there may be scope for improvements here).</p> <p>A further challenge that the ACP must reflect upon is an increasing and, on balance, welcome expectation within its own College that it should take a more proactive approach to pursuing sanction procedures (as opposed to solely remedial procedures) than it may have done in the past. Formerly the supervisory culture might have regarded the use of a sanctions procedure as a sign of failure of the supervisory process, rather than a more severe tool – effectively a proactive supervisory tool – that the supervisor might adopt in order to put pressure on an institution. The ACP has an important opportunity to impose and strengthen its authority with firms and is encouraged to take it.</p> <p>Risks to the effectiveness of the remedial and sanctioning processes lie in the ability of the supervisory process to identify an issue at an early stage and then promptly begin the process of intervention. However, this discussion is equally relevant to the consideration of CPs 19 and 20 (supervisory processes and techniques) and contributes to the grading of CP20. Equally, an effective outcome will depend on the ability of the ACP to bring a sanctions procedure to a timely and successful conclusion without undue or extended delays in the process.</p>

	<p>A final area to consider is that of coordination with other relevant supervisory authorities when a sanctions process is contemplated/underway/concluded upon. As noted in the discussion on home/host relationships the ACP would typically keep relevant foreign authorities informed. Within France, the AMF would be kept informed via the COREFRIS. However, this financial stability council may be at too senior a level for effective supervisory coordination between the supervisory authorities and the ACP are encouraged to work with the AMF to identify robust procedures for ensuring that they are each fully and appropriately informed of remedial and sanctioning procedures.</p>
Principle 24.	<p><b>Consolidated supervision.</b> An essential element of banking supervision is that supervisors supervise the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential norms to all aspects of the business conducted by the group worldwide.</p>
Description	<p><b>EC1:</b> Consistent with EU directives, the ACP applies supervision on consolidated basis to groups, as required by Articles L.511-41-2 and L.533-4-1 of the COMOFI, where the EU/EEA parent institution is a credit institution or an investment firm under ACP supervision. To this end, the ACP obtains full information on the overall structure of the supervised groups (i.e., the parent company and the financial undertakings over which it exercises, directly or indirectly, exclusive or joint control) and has an understanding of the operations conducted therein.</p> <p>The ACP risk assessment policies and procedures require an understanding of the business model, risk profile and structure of supervised groups. To facilitate the exercise of consolidated supervision, the ACP, as consolidating supervisor, has established colleges of supervisors for 14 groups under its supervision (including for SIFs). The ACP participates in a further 21 colleges where it is not the consolidating supervisor.</p> <p>In accordance with the guidelines defined at the EU level (EBA) for the operational functioning of supervisory colleges, the setting up and structuring of these colleges are based on a mapping of the groups' entities considering their relevance within the group as well as their significance for the local markets. Where applicable, non-EU/EEA competent authorities participate in the colleges though the joint activities and decision making processes required for relevant EEA authorities do not apply to the non-EU/EEA authorities.</p> <p><b>EC2:</b> The COMOFI empowers the ACP to supervise the entire activities of banking groups, whether those activities are carried on directly (including through foreign branches) or by means of subsidiaries and/or affiliates (either domestic or cross-border).</p> <p>Regulation 2000-03 obliges supervised institutions to comply with prudential standards on a consolidated basis without distinction whether consolidated entities are domestic or not. Those standards include capital adequacy, participation rules, large exposures as well as ICAAP. Regulation 97-02 imposes risk management and internal controls on a consolidated basis. Institutions submit reports to the ACP on a consolidated basis, and internal control reports must also be submitted on a solo basis to ensure a full understanding of group controls and dynamics.</p> <p>Regulation 2003-03 (Art 3) further subjects Financial Holding Companies to consolidated supervision with respect to capital requirements, large exposures and</p>



market risk. A Financial Holding Company (Art L517-1 COMOFI) is an entity which has as its subsidiaries, exclusively or principally, one or more credit institutions or investment companies or financial institutions, and which is not a mixed financial holding company. This provision does not apply when the parent entity is the holding company of a financial conglomerate. The ACP is required to maintain an updated list of the financial holding companies that it supervises on a consolidated basis.

On-site examinations may be extended to any subsidiary of the supervised group, to the legal persons indirectly or directly controlling the group, to the subsidiaries of these legal persons as well as to any entity belonging to the same group in accordance with the Article L.612-26 of the COMOFI. A significant focus of on-site examinations is on the review of cross-border business lines or the adequacy of centralized risk management and controls. Subject to cooperation arrangements with other competent authorities, on site activities may also be extended to foreign branches and subsidiaries. Seven foreign branches were covered by the 2011 on-site examination program.

Again, the college of supervisor framework (Article L.613-20-2 of the COMOFI), provides a structure for the ACP and other competent authorities to review the overall activities of a banking group on a cross-border basis, particularly within the EU/EEA area. In 2010, the ACP, as consolidating supervisor, chaired 11 physical meetings of supervisory colleges to review the overall activities and risk profiles of supervised groups.

**EC3:** The ACP supervisory approach seeks to evaluate all material activities conducted by banks or a banking group, whether or not these constitute “banking activities” as defined by the COMOFI (Article L.311-1 and essentially comprising deposit taking and granting of credit and provision of payment services). Banks or banking groups are allowed to perform non banking activities within the limits determined by regulation 86-21 providing these shall not endanger the reputation of the supervised institutions or represent a significant part of their profitability. Participations in corporate entities are also limited by regulation 90-06 (see also CP 5).

The ACP risk assessment policies and procedures requires the evaluation of the risks posed by non banking activities, in particular with respect to operational and reputational risks (taking due account of the nature and the significance of non banking activities) and to the compliance function. In particular, the ACP monitors and governs intra group transactions. Limits are established for transactions with the group insurance entities (where applicable), and transactions with asset management entities and commercial conduits are monitored. As previously noted (EC 2), on-site examinations may be extended to any legal persons, whatever their activities, within a banking group.

When a banking group is defined as a “financial conglomerate” according to Article L.633-1 of the COMOFI due to its insurance interests, and when the ACP is designed as coordinator of the supplementary supervision set out in the Directive EC/2002/87, the ACP coordinates the collection and exchange of information between competent authorities. The authority also assesses the financial situation of the conglomerate, its compliance with prudential rules (capital adequacy, risk

concentration and intra-group transactions) and its internal control processes and procedures. Annual reporting is received on intra-group transactions (e.g., description, objectives, pricing, amount, and fees), large exposures, capital adequacy, equity portfolio and mortgage investments of the conglomerate.

**EC4** The COMOFI (e.g., Arts L.511-41-3 and L.621-24) provides the ACP with powers to impose prudential standards, remedial actions and reporting on a supervised institution, including on a consolidated basis for a banking group. In 2009-2010, the ACP has used this power for the 4 large banking groups under its supervision as well as for their major domestic subsidiaries on a consolidated basis. On a cross-border basis, the ACP coordinates with other EU/EEA authorities to reach joint decisions on the consolidated capital adequacy of the banking group as well as for each supervised entity within the group. Where the ACP is the consolidating supervisor it has powers to decide the level of consolidated capital adequacy in cases of disagreement.

**EC5:** As mentioned (EC 1), the Article L.613-20-2 of the COMOFI provides for the establishment of colleges. When the ACP is the consolidating supervisor of the group, it determines the membership of non-EU/EEA taking into account the relevance of the entity within the group and the equivalence of confidentiality requirements which is assessed jointly with EU/EEA members of the college. The college tasks include exchanging information, views and assessments, voluntary work sharing and delegation, developing a common understanding of the risk profile of the group at both the group and solo levels, developing examination programs based on the risk assessment of the group, coordinating supervisory reviews, carrying out joint risk assessments, coordinating decisions taken by individual authorities and seeking to reach consensus. Templates designed at the EU level (EBA) are used to structure exchange of views on the risk assessments of a given banking group and its entities covering areas such as credit risk, concentration risk, market risk, operational risk, liquidity risk, interest rate risk in the banking book, internal governance and control, business risk, overall strategy and risk appetite, results and profitability. Written arrangements laying out the basis for the operational functioning of the colleges, also based on EU level templates, are determined by the ACP as consolidating supervisor (14 colleges) after consultation with the other competent authorities.

Bilateral supervisory agreements are also possible (COMOFI Arts L.632-7 and L.632-13) with non-EU/EEA supervisory authorities for the purpose of exchanging information subject to confidentiality provisions at least equivalent to those applicable under the French legislative framework. Such bilateral arrangements may also include provisions laying out a cooperative framework in terms of on-site examinations. To date, 17 written bilateral cooperation arrangements are in place between the ACP and supervisory authorities of these non EU/EEA countries.

At the domestic level, Article L.631-1 of the COMOFI provides the legal basis for cooperation between the ACP, the Banque de France, and the Autorité des marchés financiers which exchange information necessary to the performance of their respective tasks.

**EC6:** When the capital adequacy or liquidity of a supervised institution (including banking groups) is threatened or when customers' interests are compromised, the

COMOFI (Article L.612-33) empowers the ACP to limit or temporarily forbid the performance of certain activities. Remedial powers of the ACP (Article L.612-39) also include the power to forbid or limit some activities carried out by supervised institutions.

Importantly, however, the ACP lacks certain powers. Given that the ACP may not prevent or require the divestment/closure of a foreign branch or subsidiary (note CPs 4 and 5) it must instead, seek to exclude entities from the scope of consolidation where necessary, or establish ring fencing mechanisms. In addition, pursuant to COMOFI Article L612.32 (injunction process), ACP may also require a bank to take any necessary action to mitigate risks arising from this branch/subsidiary, to reinforce internal control of this branch/subsidiary entity, and may take into account the situation of a specific branch/subsidiary when assessing the risk profile of the group and deciding Pillar 2 requirements.

**EC7:** Banking groups are expected by the ACP to make sure that their foreign subsidiaries and branches respect both the local rules applicable to their activities and French rules in terms of compliance. Regulation 97-02 on internal control, requires the management of institutions supervised on a consolidated basis to ensure that (i) the group's entities (including branches, joint ventures and subsidiaries) take all the necessary steps to comply with the regulatory requirements in terms of internal governance and controls; (ii) the policies and processes implemented at the local level within the group are mutually consistent with a view to allowing risk measure, oversight and mitigation at the consolidated level; and (iii) the group's entities adopt appropriate procedures to produce information necessary to the oversight at the consolidated level. The annual internal control reports form an important part of the supervisory oversight of the ACP in this respect.

On a cross-border basis, the cooperation arrangements, including the colleges of supervisors provide a framework to support an assessment of the adequacy of internal policies and processes implemented at the local level within a cross-border group. Indeed, within the EU/EEA colleges, corporate and internal governance is one of criteria that is jointly assessed by the authorities (see also EC4). College members assess governance and risk management procedures with regard to the business model and operations of the group and discuss whether the risk control frameworks and internal control procedures are appropriate for the chosen business model and organizational structure. Special attention is paid to recent material changes in key business lines, areas of activities and range of products to assess the long- term sustainability of the business model in all material markets in which the group operates.

**EC8:** Regulation 97-02 on internal control applies on a consolidated basis to the group, including, where relevant, the holding company. Its provisions address information requirements (including quarterly data on operational limits), evaluation and development of policies and procedures on internal controls, taking remedial action where necessary, and also effective local oversight of foreign operations.

Evaluating the quality of group-wide management oversight is part of the ACP risk assessment processes. The authority evaluates e.g., the scope of internal controls (permanent, periodic, compliance) which should include any type of activities whatever its geographical location within the group, the organization of risk

management on a group-wide basis, the risk management procedures, the frequency and adequacy of risk reporting to the management, the set of operational limits, the quality of data used for the purpose of consolidated oversight, the regular review by the management of internal control processes and results.

Where obstacles impede the transmission of information between the parent bank and its subsidiaries, the ACP has the ability (Regulation 2000-03) to exclude the non-domestic entity from the scope of consolidation for the purpose of compliance with main prudential rules. Without this, the ACP would not be able to conform with EU legislation which requires competent authorities ensure there are no legal impediments to access and availability of information from and between entities that fall within the scope of consolidated supervision, whether the entities are regulated or unregulated.

Firms are obliged to inform the ACP when local regulation hinders the implementation of French rules relative to internal control on a consolidated basis. In such cases the management of the group would not be in conformity with the requirement in Regulation 97-02 that states the parent should have access to all relevant information in the group. While the ACP is not empowered to require the group to divest itself of the holding, remedial measure or sanctions based on failure of the group management to meet the regulation may be possible. Again, and in addition, pursuant to COMOFI Article L612.32 (injunction process), ACP may also require a bank to take any necessary action to mitigate risks arising from this branch/subsidiary, to reinforce internal control of this branch/subsidiary entity, and may take into account the situation of a specific branch/subsidiary when assessing the risk profile of the group and deciding Pillar 2 requirements.

**EC9:** The ACP does not have the power to require the closing of foreign offices. However, when the capital adequacy or liquidity of a supervised institution (including banking groups) is threatened or when customers' interests are compromised, the COMOFI (Article L.612-33) empowers the ACP to limit or temporarily forbid the performance of certain activities. Remedial powers of the ACP (Article L.612-39) also include the power to forbid or limit some activities carried out by supervised institutions.

In practice, where the ACP determines that the group-wide oversight on foreign entities is not adequate relative to the risks that they present, it may first require corrective actions to strengthen consolidated risk management and control. In the case of non-EU/EEA branches or subsidiaries, any supervisory measure is likely to involve cooperation with competent host authorities along the lines defined by existing written arrangements.

**EC10:** Regulation 97-02 on internal controls and risk management is applied on the basis of proportionality. Hence, in proportion to the nature and volume of performed activities, to the significance of consolidated entities and to their risk profiles, there is an obligation on group management to ensure closer oversight of foreign activities which have a higher risk profile.

The principle of proportionality is implemented by the ACP through the supervisory review and evaluation process. The supervisory review of foreign operations and of their oversight by bank's management is reinforced where those operations are

deemed e.g., particularly complex, bearing a significant level of risks, posing risks to the smooth operation of the banking system or insufficiently framed by the risk measurement, monitoring and control systems. For the largest cross-border banking groups supervised by the ACP, sub-structures of supervisory colleges has been put in place (i.e., “core colleges”) to facilitate cooperation with the competent supervisory authorities of countries where foreign operations of a group are deemed significant. When the operations are conducted in jurisdictions or under supervisory regimes differing fundamentally from those of the bank’s home country, the ACP pays particular attention to the adequacy of the internal control framework, in particular in terms of compliance and anti-money laundering.

**AC1:** As noted above (EC 2), the ACP has the power to review the activities of corporate parent companies and of their affiliates. The corporate parent of a credit institution will be defined as a financial holding company under Regulation 2000-03 (Art 3.1). In accordance with the Article L.612-26 of the COMOFI, on-site examinations may be extended to the legal persons indirectly or directly controlling the group, to the subsidiaries of these legal persons as well as to any entity belonging to the same group. In respect of owners of parent companies, the regulation 96-16 requires the prior authorization by the ACP of the acquisition of defined levels of direct or indirect equity interests in supervised institutions: “fit and proper” standards for owners are accordingly established and enforced. For senior managers of credit institutions and financial holding companies, the regulation 96-16 (Article 9) requires notification of changes in senior management to the ACP affording the authority the opportunity to state whether an appointment is seen as compatible with the authorization provided to the supervised institution. This provides a means to establish and enforce “fit and proper” standards for senior management, but not of the owners or Directors of parent companies of supervised institutions (unless they are financial holding companies).

The ACP reviews whether the management has the necessary expertise, experience, competencies and personal qualities, including professionalism and personal integrity, to properly carry out its duties.

The Code further provides (Art L. 500-1) that only individuals who have never been convicted for one of the offenses listed in this Article can be Directors of a credit institution or a financial holding company.

**AC2:** No explicit assessment of EU/EEA jurisdictions is carried out, in conformity with EU single market legislation which provides a minimum harmonized framework for supervision. With respect to non EU/EEA countries, the COMOFI (Article L.632-7) empowers the ACP to conclude bilateral cooperation arrangements with the supervisory authorities of these countries with the objective to exchange information and/or facilitate the supervision on a consolidated basis.

In practice, the main conditions for concluding bilateral cooperation arrangements with non-EEA supervisory authorities are that the counterpart authority is subject to similar professional secrecy rules, that the regulation and supervision in the foreign country concerned is reasonably equivalent to the French ones, and that the reciprocity principle is fully respected.

**AC3:** In accordance with the Article L.632-12 of the COMOFI, on-site examinations conducted by the ACP can be performed in establishments situated in another

	<p>EU/EEA country. The ACP may agree and delegate examination tasks to the other competent authority, or conduct joint assessments. In accordance with the Article L.632-13 of the COMOFI, the ACP can conclude with supervisory authorities of non EU/EEA countries, subject to professional secrecy rules, bilateral arrangements in particular with the objective to extend on-site examinations to foreign branches and subsidiaries.</p> <p>The need to conduct on-site examinations of a bank's foreign operations is assessed as part of the definition process of the yearly on-site examination program taking due account of the results of risk assessments. When EU/EEA colleges of supervisors are in place (e.g., in the case of SIFIs), college members define a coordinated action plan to have a clear group-wide view of risks, to increase consistency of supervisory work and to avoid duplication of work among supervisors. The action plan encompasses the main types of planned supervisory activities, including on-site examination and off-site work. The action plan is drawn between EEA members of the college. ACP on-site teams routinely conduct missions in offices and subsidiaries of French banks located in foreign countries (20 to 30 missions per year).</p>
Assessment	Compliant
Comments	<p>The ACP have a strong legal and regulatory framework which is applied in practice, both in terms of ensuring the application of prudential standards at consolidated and (as appropriate) sub-consolidated level to ensure adequate distribution of capital across-the group.</p> <p>Nonetheless, and as noted above (CP5) the ACP's ability to ensure effective global oversight of groups, including all non-domestic establishments and locations, is seriously impeded by its lack of powers to prevent the establishment or acquisition of foreign interests or to require the divestment of such establishments even in cases where there are obstacles to the supervisor and/or the group's management obtaining sufficient information to ensure the effective oversight or control of the group. Although the application of higher capital requirements, reinforcement of internal controls or de-consolidation or ring fencing of such problematic entities is a pragmatic response by the ACP, such tools are themselves limited and are a second best option as they cannot meaningfully substitute for an understanding of the risks that a foreign branch or subsidiary might pose to the safety and soundness of the group. It is recommended that powers are introduced to ensure that the ACP has the ability to receive prior notification and thus consider ex ante whether the acquisition (or establishment of new branch or subsidiary) is compatible with its effective oversight of the group. The ACP should also be granted the complementary power to insist on divestment of a cross-border entity where such an entity impedes the effective consolidated supervision of the group.</p>
Principle 25.	<p><b>Home-host relationships.</b> Cross-border consolidated supervision requires cooperation and information exchange between home supervisors and the various other supervisors involved, primarily host banking supervisors. Banking supervisors must require the local operations of foreign banks to be conducted to the same standards as those required of domestic institutions.</p>

Description	<p><b>EC1.</b> In practice, the nature and frequency of exchanges of information between home and host supervisors depends on a number of factors, including: i) the type of the information exchange arrangement (see EC2); ii) the size and scale of a bank's foreign operations assessed from the perspective of their materiality to both the banking group and the local financial systems (see EC3); iii) market or bank-specific conditions; iv) the needs of the respective supervisors.</p> <p>The ACP has a long tradition of exchanges of information with foreign supervisors and seeks to continue building on its working relationships with its main counterparts through day-to-day supervisory activities and participation in a large number of international groups or initiatives. Maintaining mutual trust and an open dialogue are seen as critical to effective information-sharing. In the EU/EEA context, peer reviews conducted by the CEBS in 2009 and 2010 concluded that there had been satisfactory exchanges of information between home and host supervisors among ACP-organized colleges.</p> <p><b>EC2.</b> The ACP conducts regular (in general annual) reviews of banks' foreign entities, thus facilitating the identification of relevant supervisory authorities of the non-domestic branches and subsidiaries.</p> <p>ACP has full power to enter into any agreement or arrangement to mutually share information with its peers abroad concerning internationally active banks, subject of course to the requirements of professional secrecy and confidentiality being met.</p> <p>As noted above, the ACP is the consolidating supervisor for 14 colleges of supervisors. Harmonized multilateral memoranda of understanding have been signed with EU/EEA host supervisors involved in these colleges, governed by the EU/EEA legislative framework. As a host-supervisor, ACP is also member of Colleges organized by other European supervisors. The intensity of college work depends on the importance of foreign operations, both for the parent group and for the local financial system. In 2011, the ACP participated in 50 college meetings, including those it organized. Crisis management groups were also held in Paris for the largest banks, to discuss their preparations to implement FSB recommendations on recovery and resolution plans. So far a total of 19 MoUs have been concluded with non EEA authorities and there are active discussions concerning some further jurisdictions. When cooperation agreements have been reached they are publicized on the website of the ACP.</p> <p><b>EC3.</b> The ACP follows BIS standards and EBA guidelines on exchanges of information between home and host supervisors (i.e., EBA GL 34 on the functioning of colleges and GL 39 on the joint risk assessment and capital decision).</p> <p>In particular, starting in 2009, the ACP has been using uniform templates recommended by the CEBS/EBA for exchanging quantitative and qualitative information on various topics such as banks' liquidity positions ("liquidity ID card") or organization structures ("mapping templates"), and supervisors' risk assessments (in order to translate their respective RAS into a common language).</p> <p>The frequency of college meetings and the type and frequency of supplementary exchanges is determined on a proportionate basis. For major banks, for example, where the ACP is the home state supervisor, college meetings are held three times a year in Paris. In addition to meeting documentation, information is regularly shared</p>
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via bank-dedicated college websites (e.g., bank public announcements, the results of European stress-tests etc.).

During the 2007–2008 crisis and more recently with tensions in U.S. dollar funding markets, the ACP had even more frequent exchanges of information with US and other relevant host supervisors to discuss banks' risk profiles. Since August 2011, this included for instance weekly conference calls with the FRBNY, ad hoc conference calls with individual supervisors or college members and regular liquidity updates posted on college websites. In November 2011, the ACP organized a series of individual meetings in Paris with large banks and the FRBNY to discuss the banks' liquidity situations and their adjustment plans.

The ACP does not systematically share the key documents used in the course of its supervisory process with the host supervisors, for example the “follow up letters” (« lettres de cadrage ») sent each year, after a meeting with the credit institution (“entretien de synthèse des ESR”) to sum up the main messages given during the meeting, or the annual internal control reports of the French entity/group. However, the relevant issues drawn from the reports and the messages delivered to the institution are communicated to the host supervisory authorities. It should be noted in this context that a French entity/group's annual internal control reports (i.e., hundreds of pages written in French) is a key input (together with other elements) into the ACP's SREP (ORAP2). It is as such reflected in the ACP's written assessment of the bank's “risk factors” and “risk controls,” which is shared with the home/host supervisors within the supervisory college and factors into the overall joint supervisory assessment of the group.

**EC4.** The ACP maintains an ongoing dialogue (emails, correspondence and conference calls) with home supervisors, in particular with the supervisors of large banking groups operating in France. 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 take supervisory action whenever serious problems might occur. Off-site supervisors regularly verify the rules that apply to foreign institutions.

The ACP would inform the home supervisors of any major changes in the local entities, especially non-compliance with prudential requirements or risk management controls. This would typically occur after an on-site inspection in order to provide them with the main observations. A copy of the follow-up letter is sent to home supervisors when there is a significant issue of concern.

As a host supervisor, the ACP conforms and complies with home supervisors' requests and procedures, participating in 21 colleges as a host supervisor. In the European context, exchanges of information have been fairly harmonized with the CRD and resulting guidelines. In 2011, the ACP has thus actively participated in Joint Risk Assessment and capital Decisions processes led by home supervisors of other EU jurisdictions. Thus within the EU framework, notification of adverse developments would be addressed by normal home/host arrangements.

**EC5.** Incorporated subsidiaries are legally French entities and as such must be subjected to the same regulatory and supervisory treatment as all other French supervised institutions. Prudential standards, on-site inspections and remedial and sanctioning powers are thus completely consistent.



Likewise, ACP frequently organizes on-site supervision of the branches of non-EEA banks, as for branches of French banks. In the event of a serious deficiency, the matter may be referred to the home country authorities. After on-site inspection of the branches of foreign banks conducted by the ACP, a copy of the follow-up letter sent to the firm is systematically transmitted to home supervisors. Within the EEA, responsibility for cross-border branches rests with the home state supervisor except in relation to liquidity and anti-money laundering requirements.

**EC6.** When assessing an application for an authorization, the ACP notifies the home supervisor, asks for confirmation that the new undertaking will be supervised on a consolidated basis. The supervisor is invited to comment on the proposal.

When the home supervisor is located in the European Union and EEA, this prior consultation is undertaken on the basis of Article 15 of Directive 2006/48 of June 14, 2006. Moreover, bilateral agreements concluded since 1992 between the French authorities and their relevant EU/EEA partners facilitate the ability to exchange information including all significant information about the owner of the institution and the overall share ownership structure.

For non-EEA countries, the same kind of prior consultation is undertaken in conformity with the Sound Practices issued by the Basel Committee.

In the case of an incoming branch or subsidiary, the ACP formally requests a notice of non-objection from the home state supervisor provided that the relationship between the home and host authority has been formalized through the agreement of an MoU which would clarify the following arrangements:

“5. During the process of authorization of a Cross-border Institution the authorities agree to proceed in the following way:

- (a) The Host Authority shall inform the Home Authority upon receipt of all applications for authorization in its jurisdiction and obtain the Home Authority’s prior opinion before the authorization is granted;
- (b) The Home Authority shall specify to the Host Authority whether the Supervised Institution that made the application, must also obtain its approval in order to perform the activity for which it is seeking authorization;
- (c) At the request of the Host Authority, the Home Authority shall supply the Host Authority with any relevant information about the Supervised Institution regarding its compliance with laws to which the institution is subject including its compliance with national legislation and any information relating to the degree of the fitness and properness, reputation and experience of prospective senior managers of a Cross-border Institution.”

**EC7.** ACP typically has access to local offices and subsidiaries. As noted above, on-site teams routinely conduct missions in offices and subsidiaries of French banks located in foreign countries (20 to 30 missions per year). In some instances, these missions will include joint work with the host authorities.

Such missions aim at assessing a wide range of topics, including the groups’ safety, soundness and compliance with KYC requirements but not only: these are generally part of missions dedicated to global business lines or support functions. Interactions with local authorities are generally very easy, including in those countries where

	<p>home-host relationships are more recent or less codified (e.g., in the absence of an MoU). Local supervisors are informed at the appropriate level of the ACP's intention to conduct on-site work in their jurisdictions well in advance, and debriefed afterwards.</p> <p><b>EC8.</b> Generally, the ACP takes action to avoid the presence of shell banks in its jurisdiction. When the entities have no activities, the ACP encourages them to apply for a withdrawal of their license.</p> <p><b>EC9.</b> ACP usually clarifies in its MoUs that Authorities will share any relevant information to assist each other in the performance of their respective functions and inform each other of administrative penalties imposed or any other formal enforcement action taken on a cross-border Institution. Article L.632-14 of Monetary and Financial Code provides for the application of a sanction on the basis of an on-site inspection.</p> <p>Critical information received on a bank's foreign entity from its local supervisor is systematically discussed by the ACP with the institution's head-office first, to establish context and give the bank an opportunity to react. As a result, the ACP will not take supervisory action upon a bank based on information transmitted by a third party that it would not have verified and double-checked first.</p> <p>For EEA banking groups it is mandatory for the ACP to consult, at least, for prudential major actions (such as Pillar 2 decisions, or internal model approvals). For other topics, even without a formal requirement in the Directive, there are exchanges, bilateral or in college.</p> <p>There is no general obligation placed on the ACP to consult with supervisory authorities outside the EU/EEA, but in practical terms the level of cooperation will be dependent on the presence of a bilateral MoU. Hence the ACP may be less likely to consult with a non-EU home supervisor before determining on a Pillar 2 requirement for a French subsidiary (recalling that the Pillar 2 process has to be delivered via an injunction) but it would be usual to inform counterparts in the case of problems identified in a firm.</p> <p><b>AC1.</b> The communications strategy is generally defined within the supervisory college and is essentially addressed to the bank (not the general public). For example, according to EBA guidelines, it is the home supervisor's responsibility to inform the bank's management about the joint risk assessment and decision achieved by the college.</p>
Assessment	Compliant
Comments	<p>France is the home state for four globally systemic financial institutions. As such the quality of home/host relationships will be critical to the effective supervision of these groups and thus the systemic stability of the French system. Equally, France is a relatively well developed financial centre, attracting a proportion of internationally active firms whose activities also have the capacity to impact upon the stability of the French financial system.</p> <p>In common with many of the more advanced jurisdictions, the French authorities have had long established home/host relationships with key supervisory counterparties. Such relationships have evolved over time and many of the home/host supervisory</p>

interactions now fall under the more developed and recently introduced framework and structures prescribed in the European Directives. The legislative framework has brought new challenges, including joint activity and joint decision making for the relevant competent authorities and all EU/EEA authorities are in the relatively early stages of bedding down the structure and practices. The French authorities have made particularly strenuous efforts in this regard and the assessors were able to consider the nature of information flows between the home and host relationships that underpin college meetings and joint assessment decisions.

Nevertheless, the significance of effective home/host relationships, whether collegiate or bilateral, remains at an absolute premium given the persisting fragilities and vulnerabilities within the global financial system, so it is imperative that the supervisory relationships continue to deepen and become more practiced in order to support a more penetrating and robust whole group supervision. The French contribution to this effort will be significant and they can be expected to be one of the main drivers of the global level of success in this dimension.