

GAO

Report to the Honorable  
Charles E. Schumer  
House of Representatives

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August 1995

# BANK REGULATORY STRUCTURE

## France







United States  
General Accounting Office  
Washington, D.C. 20548

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**General Government Division**

B-259977

August 31, 1995

The Honorable Charles E. Schumer  
House of Representatives

Dear Mr. Schumer:

Proposals to consolidate United States bank regulatory agencies have raised questions about how other countries structure and carry out their various bank regulation and central bank activities. You asked us to provide you with information about the structure and operations of regulatory activities in several countries. This report presents the information you requested for France. It describes the French bank regulatory structure and its key participants, how that structure functions, and how banks are examined in France.

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies of this report to Members of the House Committee on Banking and Financial Services, other congressional committees, and other interested parties. We will also make copies available to others on request.

The report was prepared under the direction of Mark J. Gillen, Assistant Director, Financial Institutions and Markets Issues. If you have any questions, please call me on (202) 512-8678. Other major contributors are listed in appendix I.

Sincerely yours,

A handwritten signature in black ink, reading "James L. Bothwell". The signature is written in a cursive, flowing style.

James L. Bothwell, Director  
Financial Institutions  
and Markets Issues

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# Executive Summary

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## Purpose

Proposals to consolidate U.S. bank regulatory agencies have raised questions about how other countries structure and carry out their various bank regulation and supervision and central bank activities. Representative Charles E. Schumer asked GAO to provide information about the structure and operations of such activities in several countries.<sup>1</sup> This report presents the information requested for France, where jurisdiction over the authorization, regulation, and supervision of banks is divided among three different but interrelated regulatory bodies called committees. GAO's objectives were to describe (1) the French bank regulatory and supervisory structure and its key participants; (2) how that structure functions, particularly with respect to bank authorization, regulation, and supervision; (3) how banks are examined in France; and (4) how the central bank handles other bank-related responsibilities.

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## Background

France has a universal banking system in which banks may conduct a variety of activities, including insurance and securities business. In 1994, French banks were the leading participants in the French securities industry and had gained about 50 percent of the French life insurance market.

As of December 31, 1993, there were 425 banks with 9.6 trillion French francs (Fr.fr.) or \$1.6 trillion in assets.<sup>2</sup> These banks represent the largest component of the credit institution sector in France, which also comprises more specialized credit institutions and finance companies.<sup>3</sup> Altogether there were 1,674 credit institutions conducting banking operations in France and Monaco on December 31, 1993, with approximately Fr.fr. 16 trillion, or \$2.7 trillion, in assets.

From 1941 to 1984, the regulation of credit institutions in France was quite fragmented, with banks being regulated separately from other types of credit institutions. By 1984 a consensus emerged among policy makers that the regulatory system placed banks at a competitive disadvantage compared to other types of credit institutions in France. Some of these

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<sup>1</sup>For information on GAO's reports on the German and British regulatory systems, see *Bank Regulatory Structure: The Federal Republic of Germany* (GAO/GGD-94-134BR, May 9, 1994) and *Bank Regulatory Structure: The United Kingdom* (GAO/GGD-95-38, Dec. 29, 1994). GAO is also preparing reports on the regulatory systems of Canada and Japan.

<sup>2</sup>GAO used the December 31, 1993, exchange rate of Fr.fr. 5.9 per dollar.

<sup>3</sup>French regulators have divided credit institutions into six categories: banks, mutual or cooperative banks, savings banks, municipal credit banks, finance companies (including security houses), and specialized financial institutions. Throughout this report, GAO is focusing its discussion on the banks, which are comparable to commercial banks in the United States.

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institutions were becoming strong and direct competitors of banks but were not thought to be regulated as strictly or as comprehensively.

Partly as a result of these perceived inequities and partly to resolve jurisdictional questions among regulatory bodies, the French Banking Act of 1984 (1984 Act) was passed to bring all financial institutions deemed to conduct banking activities under the same legal framework. In addition to changing the structure of bank supervision and regulation, the 1984 Act gave the bank supervisor broader powers and a wider scope of authority than its predecessor.

The banking industry in France also experienced some major changes in the post-war era, including two waves of nationalizations and privatizations in which the ownership of most banks was transferred to the French government and later sold back to the private sector. In recent years, most nationalized banks—with the major exception of France's largest bank, *Crédit Lyonnais*—have once more been privatized. The 1980s also brought an extensive liberalization of restrictions on some banking and securities activities including the lifting of credit restrictions and foreign exchange controls. In part, this liberalization resulted from financial services directives passed by the European Union (EU), of which France is a member.

The Bank of France, France's central bank, was established in 1800 as a private bank and was nationalized in 1946. In August 1993, it was given legal independence in determining and implementing monetary policy.

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## Results in Brief

Since 1984, bank authorization, regulation, and supervision have been divided among three legally independent but interrelated committees. The *Comité des Établissements de Crédit*, or the Credit Institutions Committee (CEC), is responsible for authorizing and licensing credit institutions, must approve any significant changes to a credit institution's structure or ownership, and may disapprove of management changes. The *Comité de la Réglementation Bancaire*, or the Bank Regulatory Committee (CRB), is responsible for developing the regulations applicable to credit institutions, which are then signed into force by the Minister of Economic Affairs. Finally, the *Commission Bancaire*, or Banking Commission (CB), is responsible for supervising all credit institutions authorized under the 1984 Act. It is to monitor the financial soundness of credit institutions and enforce legal and regulatory requirements through a wide range of enforcement actions. In addition, given its jurisdiction over bank

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supervision, CB is expected to provide technical assistance to the other committees—particularly CRB. Under this three-committee structure, no single individual or agency controls decisionmaking in the bank regulatory and supervisory process.

Although there are three regulatory bodies with distinct jurisdictions, the French regulatory and supervisory system is more cohesive than it might first appear from the separation of responsibilities. According to Bank of France and CB officials, responsibilities are often shared on a day-to-day basis among the committees, and decisionmaking, particularly on issues of significance, is generally collegial and involves coordination among committee members and staffs. The catalyst for the frequent collaboration among the committees is the Bank of France. By law, the Governor of the Bank of France is the Chairman of both CEC and CB and a member of CRB, and the staff for all three committees are drawn from the Bank of France.

The Minister of Economic Affairs also has an influential position in bank regulation and supervision because he is the Chairman of CRB and a member of CB and CEC; he appoints the independent members of all three committees, and he must sign credit institution regulations for them to become final. However, the Governor of the Bank of France, according to many French officials and bankers, appears to have a somewhat greater position of power given (1) his authority as the head of the central bank, (2) that his staff develops and proposes actions to be taken by the three committees and implements committee decisions, and (3) his statutory authority to request that the banking industry contribute to resolving a crisis in the credit institutions sector.

Through “permanent” oversight and on-site inspection—or examination—CB obtains information necessary to enforce compliance with regulations and assess the financial condition of credit institutions. Permanent oversight is to be carried out by CB and includes gathering and analyzing institutions’ performance from reports filed by the institutions, discussions with the managers, and information provided by external auditors and other market sources. This permanent oversight is supplemented with full-scope, as well as more limited, on-site inspections that are done for CB by Bank of France inspectors.

In addition to its role in bank regulation and supervision, the Bank of France has responsibilities in other bank-related activities, such as liquidity provision, crisis management, payments settlement, international negotiations, and lender of last resort.

The deposit protection system, which protects French franc deposits up to Fr.fr. 400,000, is administered by the Association Française des Banques (AFB), the French Bank Association, for its member banks. The deposit protection system is not an insurance fund, but is a loss-sharing agreement among member banks that comes into effect once a member institution has failed.

Figure 1: Responsibility for Bank Regulatory and Related Functions in France

Key participants	Developing laws	Developing regulations	Issuing regulations	Licensing/chartering banks	Bank information reporting and analysis	Bank supervisory oversight	Bank examinations	Developing enforcement actions	Enforcement authority	Failure resolution	Liquidity provider	Crisis management	Payment/clearance system	International forum representative	Deposit insurance	Lender of last resort
<b>Public</b>																
Ministry of Economic Affairs	●	◐	●	○	○	○		○	○	○		●		●		
Bank of France	●	○		◐	◐	◐	●	◐	◐	◐	●	●	●	●		●
CEC				●												
CRB		●	<sup>b</sup>													
CB		<sup>a</sup>			●	●		●	●	●		●		●		
<b>Private</b>																
External auditors																
Banking associations		○		○											●	

- Committee, group, or agency with direct responsibility
- ◐ Chairman of committee with responsibility
- Member of committee with responsibility

<sup>a</sup>CB and CEC staff often assist CRB in developing regulations.

<sup>b</sup>CRB proposes regulations that the Minister of Economic Affairs signs into force.

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## Principal Findings

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### Supervisory and Regulatory Responsibilities Are Divided Among Three Interrelated Committees Staffed by the Bank of France

The decisionmaking responsibilities for supervision and regulation of credit institutions are divided among three different but interrelated regulatory committees: CEC for authorization, CRB for regulation, and CB for supervision. The rationale for this structure was twofold. First, the adoption of a committee structure was intended to ensure that no single individual or agency controlled decisions with respect to bank regulation and supervision, while at the same time securing the participation of the major parties who had an interest in bank regulation and supervision: the Bank of France, the Ministry of Economic Affairs, and the credit institutions industry. Second, the division of responsibilities among these committees was to separate enforcement from regulation and licensing in order to reduce potential for conflicts of interest.

CEC, which is chaired by the Governor of the Bank of France and has four independent members and a representative of the Ministry of Economic Affairs, authorizes and licenses credit institutions. In authorizing an institution, CEC procedures require that it (1) assess the proposed business program, (2) ensure that the institution's capital meets or exceeds minimum requirements, (3) check that at least two individuals are responsible for the institution's management and that they have adequate integrity and experience, and (4) assess the institution's technical and financial resources and the suitability of its investors. After authorization, CEC remains responsible for approving any significant changes to a credit institution's structure, ownership, scope of activities, and branch structure within the EU; and it may disapprove of management changes.

CRB is chaired by the Minister of Economic Affairs or his representative and has four independent members and a representative from the Bank of France. It is to propose regulations for credit institutions that, to become final, must be signed into force by the Minister of Economic Affairs in his capacity as Minister, not as Chairman of CRB. The areas for which CRB may propose regulations include (1) minimum capital levels, (2) prudential standards, (3) ownership conditions, (4) branch openings, (5) bank equity participations in other companies, (6) transaction requirements, (7) accounting information, and (8) management standards. According to cognizant French regulatory officials, regulations are drafted in a consultative process involving staff from CB, the Bank of France, the Ministry of Economic Affairs and other interested government agencies;



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representatives of the banking and accounting industries; and other interested parties.

CB is chaired by the Governor of the Bank of France and has four independent members and a representative of the Ministry of Economic Affairs. CB is responsible for supervising credit institutions, ensuring that credit institutions observe legal and regulatory requirements, and monitoring the financial soundness of the institutions. If CB observes regulatory breaches or financial irregularities, it is responsible for taking enforcement actions—ranging from informal warnings to withdrawals of authorization—to resolve any problems.

The committees meet only to make decisions. The preparation for these decisions and their implementation are to be undertaken by Bank of France personnel, who staff all three committees.

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### Day-to-Day Division of Responsibilities Among Committees Is Not Clear-Cut: Bank of France Staff Provide Link

While the division of responsibilities among CEC, CRB, and CB is defined under law, the execution of these responsibilities by the three committees and their staffs on a day-to-day basis is more flexible. Tasks within the jurisdiction of one committee may be performed by Bank of France staff from one of the other committees. Decisionmaking was described to GAO by French officials as being collegial in most cases, sometimes involving discussions among staff of the Ministry of Economic Affairs, the Bank of France, and all three committees. There are a number of factors that the officials said contribute to this sharing of day-to-day responsibilities: (1) CEC and CRB sometimes rely on CB for technical and other assistance; (2) the Bank of France provides the staff for all three committees, which creates a sense of cohesion, collaboration, and common goals; (3) the Bank of France and the Ministry of Economic Affairs are represented on all three committees; and (4) the individuals involved in bank regulation tend to have similar educational and professional backgrounds and are accustomed to working with each other.

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### The Bank of France and the Ministry of Economic Affairs Have Influential Roles in Supervision and Regulation

The Bank of France and the Ministry of Economic Affairs clearly have the most influential roles in the supervision and regulation of credit institutions. The Ministry's influence is derived primarily from its chairmanship of CRB and its membership in CEC and CB as well as from its position of power in the French Cabinet and its power to approve regulations. However, the Bank of France appears to have greater day-to-day influence on bank supervision and regulation than does the

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Ministry, stemming from (1) its chairmanship of CEC and CB; (2) the fact that it staffs CEC, CRB, and CB; (3) its authority to request assistance from financial institutions in a crisis; and (4) its importance in and influence over French financial markets.

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**CB Relies on Many Sources of Information to Carry Out Its Supervisory Responsibilities**

CB has available several sources of information to fulfill its supervisory obligations, including detailed monthly reports by the main credit institutions and quarterly reports by all others, meetings with credit institutions, market information, and on-site inspections—or examinations—conducted by Bank of France staff. Three kinds of bank inspections may be conducted: (1) routine inspections, (2) inspections that focus on perceived problems, and (3) thematic inspections, for example, of real estate lending activities. The frequency of inspections depends on the cumulative information available to CB about the bank and its risk profile and control systems. To date, CB's use of external auditors for information on credit institutions has been limited, but senior CB officials said that CB plans to increase its reliance on the auditors' work to reduce the duplication of effort between the auditors and CB.

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**The Bank of France Has Several Other Bank-Related Responsibilities**

Bank of France officials said the Bank has several other bank-related responsibilities.

- The Bank of France is to determine and implement monetary policy with the goal of ensuring price stability, and also either is to act as lender of last resort or is to request other banks to do so.
- The Governor of the Bank of France has a leading role in crisis management involving credit institutions. The Governor has broad discretionary authority under the 1984 Act to request assistance from an institution's stockholders and the banking industry when an institution or the reputation of French financial markets is in danger.
- The Bank of France has a major role in payments and settlements clearance systems through its legal responsibility to ensure "the smooth operation and security of payments systems."
- The Bank of France participates in developing French positions with respect to financial issues in several international organizations even though it takes the lead only on the Basle Committee on Bank Supervision.<sup>4</sup>

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<sup>4</sup>The Basle Committee on Bank Supervision was created in 1974, under the auspices of the Bank for International Settlements and is the main forum for central bankers and supervisors to reach agreement on how best to supervise international banks. Its members meet several times a year and consist of senior representatives of bank supervisory authorities and central banks from 12 countries.

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## AFB Administers the Deposit Protection Mechanism

AFB, to which all 425 French banks belong, administers the Solidarity Mechanism (the Mechanism) that protects French franc deposits up to Fr.fr. 400,000. AFB members are required to belong to the Mechanism and are required to contribute to the Mechanism after a member institution's failure. The amount assessed is based on a percentage of the assessed bank's deposits, with a per-bank distribution that is the same for banks of all sizes. The Mechanism was intended to protect deposits in smaller banks and, therefore, is subject to an annual payout limit. The handling of a larger bank failure would have to be determined by the French government but has not yet been necessary.

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## Recommendations

This report contains no recommendations.

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## Agency Comments

Senior officials from the Bank of France, the Ministry of Economic Affairs, CB, two French banking associations, and the French auditors' association provided comments informally on a draft of this report. These comments were generally technical in nature and were incorporated in the report where appropriate.

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## Abbreviations

AFB	Association Française des Banques (French Bank Association)
AFEC	Association Française des Établissements de Crédit (Association of French Credit Institutions)
BAFI	Base de Données des Agents Financiers
BIS	Bank for International Settlements
CB	Commission Bancaire (Banking Commission)
CCA	Commission de Contrôle des Assurances (Insurance Control Commission)
CEC	Comité des Établissements de Crédit (Credit Institutions Committee)
CLAMEF	Comité de Liaison des Autorités Monétaires et Financières
CNC	Conseil National de Crédit (National Credit Council)
CNCC	Compagnie Nationale des Commissaires aux Comptes
COB	Commission des Opérations de Bourse
CRB	Comité de la Réglementation Bancaire (Bank Regulatory Committee)
EDP	Electronic Data Processing
EU	European Union
MATIF	Marché à Terme International de France
SBF	Société des Bourses Françaises

# Introduction

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Changes in the structure of the financial regulatory and supervisory system in France reflect the evolution of the post-war French financial system. As distinctions among different classes of financial institutions began to fade, the regulatory structure was altered to provide more even-handed treatment for all institutions involved in banking activities. Other post-war developments in the French financial system included two rounds of nationalizations and privatizations of French banks and a liberalization of credit and exchange controls.

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## Overview of French Credit Institutions

France has a universal banking system in which banks may conduct deposit, lending, discount, securities, safe custody, insurance and real estate activities<sup>1</sup> either directly or through subsidiaries. Indeed, French banks are the leading players in the French securities industry. While banks may not underwrite insurance directly, they may do so in subsidiaries and may sell insurance products in the bank. All of the major universal banks own insurance subsidiaries that together constituted approximately 50 percent of the life insurance market in 1994. Banks may also invest in nonbanking, commercial companies, but no single equity participation may exceed 15 percent of the bank's net capital, and total equity participations in commercial enterprises may not exceed 60 percent of the bank's net capital.

As of December 31, 1993, there were 1,674 credit institutions conducting banking operations in France and Monaco<sup>2</sup> holding approximately Fr.fr. 16 trillion (\$2.7 trillion)<sup>3</sup> in assets. The number of credit institutions is high relative to many other developed countries, partly because the definition of banking and credit institutions in French banking law is quite broad.<sup>4</sup> Credit institutions in France are divided into six categories: banks, mutual or cooperative banks, savings banks, municipal credit banks, finance companies (including security houses), and specialized financial institutions (see table 1.1).

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<sup>1</sup>Real estate and some other nonbank activities are limited to 10 percent of a bank's overall activity.

<sup>2</sup>Since 1945, financial institutions in Monaco have been subject to French banking law. Twenty-five of the 1,675 credit institutions had their home offices in Monaco.

<sup>3</sup>We use the December 31, 1993, exchange rate of Fr.fr. 5.9 per dollar.

<sup>4</sup>Under French law, "banking operations comprise the receipt of funds from the public, credit operations, and making available to customers or managing means of payment." Institutions have only to conduct one of these operations to qualify as credit institutions.

**Table 1.1: French Credit Institutions,  
December 31, 1993**

Type of credit institution	Number of institutions	Percentage of industry deposits	Percentage of industry loans	Percentage of industry assets
Banks	425	46.6%	50.3%	59.6%
Mutual and cooperative banks	146	33.6	22.4	16.2
Savings banks	35	18.7	4.8	5.8
Municipal credit banks	21	0.1	0.2	0.1
Finance companies <sup>a</sup>	1,015	0.8	7.2	10.1
Specialized institutions	32	0.2	15.1	8.2
<b>Total</b>	<b>1,674<sup>b</sup></b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

<sup>a</sup>Includes 158 securities houses.

<sup>b</sup>Includes 25 institutions that had head offices in Monaco.

Source: French Banking Commission.

## Banks

Banks are the largest category of credit institutions in France and may conduct any of the universal banking and financial transactions permitted under banking law. On December 31, 1993, as shown in table 1.1, the banking sector held almost 47 percent of the total deposits of French credit institutions, slightly over 50 percent of total loans, and almost 60 percent of credit institution assets—Fr.fr. 9.6 trillion. The number of banks in France has remained relatively stable in the last half century—around 400 since 1950—with a few large banks accounting for the majority of loans and deposits. As of December 31, 1993, there were 409 authorized banks in France and 16 banks with their head offices in Monaco. The five largest banks<sup>5</sup> held over 63 percent of total bank-only deposits and close to 60 percent of total bank-only loans. Ninety-nine of the 425 banks were foreign-owned subsidiaries—of which 3 were in Monaco—and 90 were foreign-owned branches—of which 6 were in Monaco. Eighty-three of the foreign banks in France—45 subsidiaries and 38 branches—were headquartered in other European Union (EU) member countries.<sup>6</sup>

<sup>5</sup>Banque Nationale de Paris, Crédit Lyonnais, Société Générale, Paribas, and Indosuez. These banks hold close to 30 percent of total financial institution deposits and loans in France. The three largest banks are in a class of their own by reason of the size of their French networks (each has 1,600 to 2,000 branches), the number of staff they employ (33,000 to 43,000 in France alone), the universal nature of their operations, and their international presence.

<sup>6</sup>On December 31, 1994, members of the EU were Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, and the United Kingdom. As of January 1, 1995, three additional countries, Austria, Finland, and Sweden, joined the EU.

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## Mutual and Cooperative Banks

Mutual and cooperative banks are distinguished from banks primarily by their ownership; they are owned by their members (depositors). They were established to provide credit to their members who belonged to certain categories of businesses or individuals—farmers, for example. Mutual and cooperative banks may now conduct all the operations and transactions that banks may, and the largest among them—Crédit Agricole, which is the largest credit institution in France—are difficult to distinguish from banks. As of December 31, 1993, there were 146 mutual or cooperative banks with approximately Fr.fr. 2.6 trillion in assets.

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## Savings and Municipal Credit Banks

Savings banks and municipal credit banks, with few exceptions, are locally owned, nonprofit institutions. Until various reforms were implemented in 1983 and 1984, the powers of savings banks were restricted to offering passbook savings accounts to depositors and investing their funds in the central savings bank—the Centre National des Caisses d'Epargne et de Prévoyance. Today they are able to offer more products and services, including mutual funds and checking accounts; may invest in a wider variety of activities, including cable television, tourism, education, health, and regional planning; and may lend to corporations. The savings banks—which held about Fr.fr. 930 million in assets in 1993—purposefully consolidated their numbers from 468 in 1984 to 35, as of December 31, 1993, in order to allow savings banks to benefit from certain economies of scale.

The bulk of the business of municipal credit banks, of which there were 21 with Fr.fr. 15 million in assets as of year-end 1993, consists of loans granted to the general public.

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## Finance Companies

Finance companies are restricted to certain types of operations, such as leasing, or specialize in the financing of a specific industry or specific customers and may not receive deposits of less than 2 years in maturity. On December 31, 1993, there were 857 finance companies providing 7.5 percent of the total credit provided by the French banking system and holding Fr.fr. 1.6 trillion in assets.

Securities houses, which specialize in the investment and management of transferable securities and negotiable instruments, are included in the finance company category. On December 31, 1993, one-third of the 156 securities houses in France were subsidiaries of foreign finance institutions such as U.S. investment banks.



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## Specialized Financial Institutions

The 32 specialized financial institutions in France were set up by the government to perform certain public interest tasks, such as financing low- and moderate-income housing, providing long-term credit for acquiring industrial equipment, or making financing available to local authorities. These institutions hold over Fr.fr. 1.3 trillion in assets and provide over 15 percent of total credit but collect less than 1 percent of total deposits.

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## History of Bank Regulation and Supervision in France

The current French bank regulatory and supervisory structure was created through legislation in July 1984 and consists of three regulatory committees on which the Ministry of Economic Affairs<sup>7</sup> and the Bank of France (France's central bank) are the most prominent members. Under this structure, all financial institutions that conduct banking activities are subject to common prudential requirements, regulation, and supervision. In addition to experiencing changes in the bank regulatory structure, French banks also were subject to other major changes including two waves of nationalizations in 1945 and 1982.

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## Pre-1984 Regulation and Supervision

Before 1984 the regulation of financial institutions was quite fragmented. From 1941 to 1945, banks were regulated and supervised by two committees: the Standing Committee of Banks, consisting of six bankers and a government representative charged with enacting regulation and taking supervisory measures concerning individual institutions, and the Bank Control Commission, which was responsible for enforcing bank regulations. A banking act passed in 1945 replaced the Standing Committee with the Conseil National de Cr dit—National Credit Council (CNC)—with the regulatory responsibilities remaining the same. The Minister of Economics, Finance and Budget chaired CNC, but CNC was staffed by the Bank of France.

Other categories of financial institutions, such as finance companies, savings banks, or mutual and cooperative banks, were regulated and supervised separately according to special law—in most cases either directly or indirectly by the Treasury Department (Treasury). According to French officials, Treasury is the most influential Department of the Ministry of Economic Affairs, then known as the Ministry of Economics, Finance and Budget.

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<sup>7</sup>Until 1992, the Ministry of Economic Affairs was known as the Ministry of Economics, Finance and Budget. Its name was changed to Ministry of Economics and Finance in 1992. In 1993, the name of the Ministry was changed to its current title and its budget responsibilities were transferred to a new ministry that deals with budget, fiscal, and tax issues—the Ministry of the Budget.

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According to Commission Bancaire (CB), the Banking Commission, officials, by 1984 banks were widely considered to be at a competitive disadvantage compared to other financial institutions as a result of the split in regulatory responsibilities. While prudential regulations for banks had evolved with changes in financial markets, laws and regulations governing institutions such as mutual banks or savings banks remained less stringent. At the same time, these other institutions were expanding their activities, thereby becoming direct and strong competitors of the banks.

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## The French Banking Act of 1984

The French Banking Act of 1984 (1984 Act) was intended to settle these regulatory inequities by placing all financial institutions deemed to conduct broadly defined banking activities under the same legal framework. In addition, it aimed to resolve the sometimes overlapping responsibilities of CNC and the Bank Control Commission by separating bank regulation and supervision into three distinct areas—authorization, regulation, and supervision—and giving jurisdiction over each of these areas to three separate committees. Thus three new committees were created: (1) the Comité des Établissements de Crédit, the Credit Institutions Committee (CEC), was given authority over authorization; (2) the Comité de la Réglementation Bancaire, the Bank Regulatory Committee (CRB), received jurisdiction over most regulatory issues; and (3) CB was made responsible for bank supervision, replacing the Bank Control Commission. The CNC was not eliminated but its authority was reduced to a purely advisory one.

The act also strengthened some supervisory weaknesses of the old Bank Control Commission by giving CB broader powers and a wider scope of authority. First, CB was given authority for supervision of all credit institutions. Second, its powers were broadened by mandating that it scrutinize credit institutions' operations and monitor their financial standing as well as supervise their compliance with regulations. Finally, it was given the authority to inspect (1) bank subsidiaries, (2) the legal bodies directly owning or controlling the bank and their subsidiaries, and (3) overseas branches and subsidiaries of French banks. This increased authority allowed CB to find and address perceived problems in credit institutions as a whole.

French credit institutions are regulated and supervised almost exclusively to ensure the safety and soundness of individual banks and of the system as a whole. For example, French banking law does not directly address

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such issues as fair lending practices or community reinvestment requirements.<sup>8</sup>

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## Banks Experienced Two Waves of Nationalizations as Well as Financial Market Liberalization

The French banking industry experienced some major changes in the post-war era including two waves of nationalizations in which the ownership of most banks was transferred to the French government. The first period of nationalization occurred shortly after the end of the Second World War in 1945. It was intended to prop up the ailing banking industry and to give the French government the power to direct credit to the industries that needed it in order to revive the post-war economy.

At the same time, the Bank of France, which had been established in 1800 as a private bank at the instigation of Napoleon Bonaparte and, beginning in 1803, was granted the right to issue banknotes, was also nationalized. The Nationalization Act of 1945 transferred the Bank of France's capital to the State effective on January 1, 1946, and reimbursed the Bank's previous shareholders with 20-year bonds.

With the exception of the Bank of France, the banks nationalized in 1945 were gradually privatized by the end of the 1970s under conservative French governments. The second wave of nationalizations occurred in 1982 through 1983 after the election of a Socialist president and a Socialist Assemblée Nationale, National Assembly, in 1981. This return of bank ownership to the government was justified by the ruling party as a part of its political program to promote the financing of small- and medium-sized businesses and a stronger industrial policy. These nationalizations were followed by a privatization program implemented by a Conservative government in 1986, which stalled for several years after the election of another Socialist government in 1988. In recent years, however, the election of a Conservative National Assembly has once more prompted a series of privatizations, and the vast majority of French banks are now in private hands. To date, Crédit Lyonnais, the country's largest bank, remains the only large nationalized bank, although there are also a handful of smaller nationalized banks. There are plans that these remaining nationalized banks be privatized within the next five years since both the Socialist and Conservative parties now agree that having nationalized banks conflicts with the premise of a free market that is one of the cornerstones of the EU. For example, Crédit Lyonnais—which lost

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<sup>8</sup>The French banking industry is expected to follow French banking industry rules of conduct with respect to issues such as fair lending. Incentives to provide certain types of loans, such as low-income housing loans, are provided more directly through government subsidies, not through government regulation of private institutions.

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Fr.fr. 6.9 billion in 1993, principally as a result of poor commercial and real estate investments—benefited from a Fr.fr. 4.9 billion bailout in July 1994, raising questions about the role the government plays as the owner of the largest French bank and the effect that has on competition in the French banking industry.<sup>9</sup>

The 1980s also brought an extensive liberalization of restrictions on some banking and securities activities. Credit restrictions—credit ceilings and interest rate controls—were completely removed by 1987. Foreign exchange controls were eliminated in 1989. Deposit interest rates have been decontrolled, although paying interest on demand deposits held by residents is prohibited by French law to allow banks to maintain free checking services. Securities commissions and fees were also deregulated and new markets, such as the Marché à Terme International de France (MATIF)—the French financial futures market—and the short- and medium-term notes markets, have been organized.

Overlaying these events has been the development of a unified financial services market in the EU, which has also affected French bank regulation and supervision. Central to the liberalization of financial services under the EU's Single Market Program<sup>10</sup> is the concept of a "single passport," a concept which the French have been influential in helping to develop. Once a financial firm is established and licensed in one EU member country—its home country—that firm can use a single passport to offer financial services in any other EU member state—its host country. Underlying the single market program is an understanding that a minimum level of harmonization in regulation is necessary among the member countries to ensure the safety and soundness of the financial system. For instance, the EU Second Banking Directive requires all EU banks to have a minimum capital base and a minimum level of shareholder disclosure and limits equity participation in nonfinancial firms. Consequently, EU member countries have had to change their banking laws and regulations as necessary to meet the minimum requirements imposed by EU financial services directives. To date, EU directives have not resulted in major changes to the structure of bank regulation and supervision in France.

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<sup>9</sup>Further losses of Fr.fr. 12 billion in 1994 and a second government rescue plan in 1995 involving a multi-billion franc government guarantee of some of Crédit Lyonnais' debts, raised additional complaints by two large French banks that the proposed aid package strengthened the position of Crédit Lyonnais compared with other banks in a way capable of distorting competition.

<sup>10</sup>For additional information about the Single Market Program, see European Community: U.S. Financial Services' Competitiveness Under the Single Market Program (GAO/NSIAD-90-99, May 21, 1990).

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The recent independence of the Bank of France is, however, a result of an EU mandate in the Treaty on European Union that all EU member countries have independent central banks. As a result of this mandate, the purpose and structure of the Bank of France were redefined in the 1993 Act on the Status of the Banque de France and the Activities and Supervision of Credit Institutions (the 1993 Act). This act made the Bank of France independent of the Ministry of Economic Affairs in formulating and implementing monetary policy. As a result, the Bank of France “shall neither seek nor accept instructions from the Government or any other person in the performance of its duties” with respect to monetary policy. Before the passage of the 1993 Act, the government determined monetary policy, which the Bank of France was in charge of implementing.

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## Supervision of Banks’ Securities and Insurance Activities

Securities activities may be conducted within the banks or other credit institutions or in separate subsidiaries. CB is responsible for the supervision of these activities when securities activities are conducted within the bank or in separate *maison de titres* subsidiaries, of which there were 26 on December 31, 1994. When securities activities are conducted in *société de bourses* subsidiaries, of which there were 54 at year-end 1994, these are supervised by the Conseil des Bourses de Valeurs, the regulator of the French stock exchange, and the Société des Bourses Françaises (SBF), which runs the day-to-day operation of the stock market.<sup>11</sup> In either case, CB is responsible for the supervision of the parent bank and the consolidated entity. Under banking law, it may also inspect all of the subsidiaries of a bank, even when these are supervised by another supervisory authority. In practice, however, it relies on information provided by the supervising authority rather than on the imposition of its jurisdiction.

All insurance activities are supervised by the Commission de Contrôle des Assurances, the Insurance Control Commission (CCA), which is headed by the Ministry of Economic Affairs. If an insurance company is a subsidiary of a bank, then CB is responsible for the consolidated entity, but CCA supervises the insurance subsidiary. If an insurance company owns a bank, then CCA supervises the consolidated entity, but CB supervises the bank subsidiary.

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<sup>11</sup>Maisons de titres and sociétés de bourses may both conduct securities activities; the major difference between the two is that maisons de titres are credit establishments and supervised by CB. In addition, sociétés de bourses may not underwrite securities. Most sociétés de bourses belong to banks as a result of consolidation in the financial services industry.

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According to CB officials, coordination and cooperation between supervisory authorities have grown steadily stronger in recent years in response to the development of financial conglomerates and the increasingly global nature of financial activities. In 1992, for example, secrecy restrictions were lifted between CB and CCA. As a result, periodic meetings now take place between CB and CCA to (1) discuss the situation of individual institutions or financial groups of concern to both authorities, (2) exchange views on problems of common general interest, such as the supervision of financial conglomerates and the transposition<sup>12</sup> of EU directives, and (3) promote mutual understanding of risk evaluation methods and supervisory techniques.

In addition, the regulators of all financial institutions and markets meet as a group three or four times a year at the Treasury, according to Treasury, CB, and Bank of France officials, to exchange information on the institutions for which they are primarily responsible and on financial markets in general. This informal group, called the Comité de Liaison des Autorités Monétaires et Financières (CLAMEF), includes the heads of its member organizations.<sup>13</sup> In addition, a group called mini-CLAMEF, consisting of lower rank individuals from each of the member groups, meets every month to discuss financial market issues of concern and interest.

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## Overview of Participants in French Bank Authorization, Regulation, and Supervision

Regulation, supervision, and examination of banks in France is shared among several regulatory participants, some more influential than others. These include CNC; the three regulatory committees that have responsibilities over authorizing, regulating, and supervising credit institutions; the Bank of France; and the Ministry of Economic Affairs.

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### CNC Is an Advisory Body

Although CNC was initially created in 1945, its structure and purpose were changed in the 1984 Act, and its function is now purely advisory. It is primarily a forum for studies on issues relevant to credit institutions and the economy. The Minister of Economic Affairs is CNC's Chairman, and the Governor of the Bank of France is its Deputy Chairman. In addition to

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<sup>12</sup>The process of changing national laws and regulations to meet the minimum requirements imposed by EU directives.

<sup>13</sup>The members include the Treasury, Commission des Opérations de Bourse (COB); MATIF; Conseil des Bourses de Valeurs, the self-regulatory organization covering the seven French stock exchanges; SBF; CCA; and the Bank of France.

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these two individuals, CNC has 51 members appointed by the Minister of Economic Affairs. These members are to be drawn from the government, Parliament, credit institutions, professional and consumers' organizations, and trade unions, and include other professionals chosen for their competence in banking and financial matters.

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## CEC Is Responsible for Authorization

CEC, an independent regulatory committee, authorizes individual credit institutions to conduct banking activities as defined in the 1984 Act. CEC's membership consists of the Governor of the Bank of France, who acts as its Chairman; the Director of the Treasury; and four other members chosen from CNC membership and appointed by the Minister of Economic Affairs for 3-year terms. These four members include a representative of the Association Française des Établissements de Crédit (AFEC), the French Association of Credit Institutions; a representative of the trade unions for credit institution employees; and two prominent individuals chosen for their knowledge of financial issues.

Decisions of CEC are made by majority vote, with the Chairman having the deciding vote in case of a tie. In addition to CEC members, the association representing the credit institution about which a decision is being made is represented during the meeting and has a vote in any decision affecting that institution. The Director of the Treasury may request a postponement of any decision of CEC.

The Secretariat of CEC is staffed by approximately 60 staff who work in the credit institutions directorate of the Bank of France.

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## CRB Is Responsible for Regulation

CRB, which is an independent committee, is responsible for developing regulations applicable to all credit institutions. CRB has six members including the Minister of Economic Affairs, who is its Chairman; the Governor of the Bank of France; and four other members chosen from CNC membership, who are appointed by the Minister of Economic Affairs for 3-year terms. Similar to CEC, these members are to include representatives of AFEC and the trade unions, and two prominent individuals chosen for their knowledge of financial issues. Decisions of CRB are made by majority vote, with the Chairman having the deciding vote in case of a tie.

A two-person Secretariat of CRB is provided by the Bank of France. According to Bank of France and CB officials, the Secretariat works closely with the Banking Division of the Treasury, whose Director is president of

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the committee. The Bank of France also provides staff from its Credit Institutions Directorate and from the General Secretariat of CB to assist CRB when necessary.

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## CB Is Responsible for Supervision

CB is a six-member independent committee, which has the responsibility for supervising credit institutions in France. It is chaired by the Governor of the Bank of France and its membership includes the Director of the Treasury, who acts as its chairman, and four other members appointed by the Minister of Economic Affairs for 6-year terms. These four members are two senior judges and two members chosen for their expertise in banking and financial matters. In case of a tie vote, the Chairman has the deciding vote.

The Bank of France currently provides the staff and resources for the General Secretariat of CB. An amendment to the 1984 Act also gives the General Secretariat the authority to hire staff outside the Bank of France, although this provision has not yet been used.

The General Secretariat of CB is divided into two divisions (1) micro supervision, responsible for permanent oversight of individual banks—but not including examination—and (2) macro supervision, responsible for legal affairs, international affairs, European affairs, banking analysis, accounting and reporting, and information technology. These divisions share approximately 230 staff who are located in Paris. In addition, CB is assisted by 95 Bank of France inspection staff who conduct credit institution inspections for CB.

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## The Bank of France

The Bank of France is managed by a Governor, who is assisted by two Deputy Governors. All three are appointed by a decree of the French Cabinet for irrevocable 6-year terms, which may be renewed once. The Bank's responsibilities include (1) issuing legal tender, (2) determining and implementing monetary policy, (3) regulating the relationship between the French franc and foreign currencies, (4) ensuring the proper functioning of the banking and payments systems, (5) keeping treasury accounts and managing treasury bills and similar obligations, and (6) monitoring the state of the economy and the health of business enterprises.

In August 1993, in the Bank of France Act of 1993, the Bank of France was given complete independence in determining and implementing monetary



policy; and the terms of the Governor, Deputy Governors, and the members of the Monetary Policy Council were made irrevocable. The Bank of France is required, though, to carry out its duties “within the framework of the government’s overall economic policy” without this requirement affecting its independence. In practice, the government can communicate its point of view to the Monetary Policy Council through the Prime Minister or the Minister of Economic Affairs, as both are entitled to attend the Monetary Policy Council meetings but do not have voting privileges. This facilitates direct dialogue between the government and the monetary authority.

The Bank of France has two governing bodies—the Monetary Policy Council and the General Council. The Monetary Policy Council was created by the 1993 Bank of France Act to formulate monetary policy, which is then implemented by the Governor. The Council has nine members: the Governor, who chairs the Council and who has the deciding vote in case of ties; the two Deputy Governors; and six other members. These members are appointed by a decree of the Cabinet from a list drawn up by mutual consent or, failing that, in equal parts by the President of the Senate, the President of the National Assembly, and the President of the Economic and Social Council. The six appointed members have 9-year, nonrenewable, irrevocable terms.

The General Council is responsible for administering the Bank of France and meets approximately every 2 weeks. It is headed by the Governor and comprises the members of the Monetary Policy Council and a representative of the Bank of France staff. The General Council prepares the Bank’s estimated expenditures, draws up its annual accounts, and proposes the distribution of profits and the amount of the Bank’s dividend to be paid to the government. A Censor, appointed by the Minister of Economic Affairs, is to attend the meetings of the General Council and may submit proposals for the consideration of the Council and may also oppose decisions of the Council. Among other things, the presence of the Censor allows the government to follow the Bank’s budgetary process. In practice, the General Council exercises little independent authority vis-a-vis the Governor, according to Bank of France officials with whom we spoke.

As noted above, the Bank of France was nationalized in 1946, and its stock is held by the Treasury. It is required to pay annual dividends to the Treasury, but these dividends vary from year to year, depending on the Bank’s profits, and are not based on any specific formula.

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The Bank of France performs its tasks through 9 directorates general and its network of 211 branches. It had 15,065 “banking” staff as of December 31, 1993, plus 1,997 staff employed in its bank note printing department. Fifty-seven percent of its banking staff were employed in the Bank’s branches. These branches are used for various activities including note and coin circulation, studying and reporting on the local economy, and meetings to solve over-indebtedness problems of individuals.

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## The Ministry of Economic Affairs

The Ministry of Economic Affairs is considered to be the most powerful government ministry, according to French officials with whom we spoke. It is headed by the Minister of Economic Affairs, a political appointee, who is part of the government’s cabinet. The Ministry has three main functions: to (1) promote economic growth in France and formulate market regulations; (2) observe the state of the French economy and forecast its evolution; and (3) manage public finances.

Within the Ministry, the Trésor, the Treasury, is the most important department. It is headed by the Director of the Treasury, who is a civil servant, not a political appointee. Within the Treasury, the Division of Banking Regulation and National Banks is responsible for fulfilling the Ministry’s responsibilities with respect to bank regulation and supervision. Because the Banking Division has a relatively small staff of 12, it relies on other agencies to gather the data that it needs to conduct its work.

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## Objectives, Scope, and Methodology

At the request of Congressman Charles E. Schumer, we examined various aspects of the French bank regulatory and supervisory system. Specifically, our objectives were to describe (1) the French bank regulatory and supervisory structure and its key participants; (2) how that structure functions, particularly with respect to bank authorization, regulation, and supervision; (3) how banks are examined in France; and (4) how the Central Bank handles other bank-related activities. We completed similar studies on the bank regulatory and supervisory structures in the Federal Republic of Germany<sup>14</sup> and the United Kingdom<sup>15</sup> and are currently performing studies of the systems in Canada and Japan.

In preparing this report, we carried out interviews with senior officials from CB, CRB, CEC, the Treasury, and the Bank of France. They also provided us with various documents and statistics including three volumes

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<sup>14</sup>Bank Regulatory Structure: The Federal Republic of Germany (GAO/GGD-94-134BR, May 9, 1994).

<sup>15</sup>Bank Regulatory Structure: The United Kingdom (GAO/GGD-95-38, Dec. 29, 1994).

of statistics that banks submit to CB; annual reports of the Bank of France, CB, CEC and CRB; and selected banking regulations.

In addition to our interviews with those responsible for bank regulation and supervision, we met with senior representatives of the Association Française des Banques, the French Bank Association (AFB), and AFEC; several senior executives at French banks; senior executives from external auditing firms and from the Compagnie Nationale des Commissaires aux Comptes (CNCC), the association representing accountants in France, which is responsible for setting standards for annual audits of French corporations, including banks; as well as several other individuals expert on French bank regulation and supervision and the auditing of banks in France.

Finally, we reviewed translations of the 1984 Act, the law that relates most directly to bank regulation and supervision in France, and the Bank of France Act of 1993. This review does not constitute a formal legal opinion on the requirements of either law, however.

We conducted our review, which included three visits to France, from September 1994 through March 1995 in accordance with generally accepted government auditing standards.

We gave senior officials of the Bank of France, the Ministry of Economic Affairs, CB, AFB, AFEC, and CNCC a draft of this report for their informal comments. They provided primarily technical comments that were incorporated where appropriate.

# Banking Law Divides Responsibilities for Authorization, Regulation, and Supervision Among Three Committees

Under the 1984 Act, the responsibility for bank authorization, regulation, and supervision is divided among three committees—the Credit Institutions Committee (CEC) has responsibility for authorization, the Bank Regulatory Committee (CRB) for regulation, and the Banking Commission (CB) for supervision. A fourth committee, the National Credit Council (CNC), is purely advisory. While the overall division of responsibilities is clearly defined under law, it is not as evident in the day-to-day operations of the three committees. For instance, the Bank of France provides the staff for all three committees to ensure both a common background and the basis for cooperation among the staff and at least some Bank of France influence over the committees' work. Furthermore, CB may contribute to the work of the other two committees, if needed. Finally, the chairmanships of the three committees and CNC are divided between the Bank of France and the Ministry of Economic Affairs—the two most influential participants in bank regulation and supervision—providing both an incentive and an opportunity for cooperation and collaboration among the chairmen and the committees.

## Membership in Supervisory and Regulatory Structure Designed to Be Inclusive; Enforcement Powers Are Separated From Other Responsibilities

Bank regulation and supervision were structured under the 1984 Act specifically to accomplish several goals. These goals related both to the composition of the separate committees and the division of responsibilities among the committees.

## Composition of Committees Provides for Shared Responsibility Among Interested Parties

According to a senior Bank of France official, the decision to assign bank regulation and supervision to separate committees was designed to ensure that (1) all major parties who had an interest or stake in bank regulation and supervision also had a part in it and (2) no individual or agency was solely responsible for making decisions that could affect individual institutions or the industry as a whole. Thus membership in the three regulatory and supervisory committees includes the Bank of France, the Ministry of Economic Affairs, representatives of the credit institution industry, and various outside experts. This structure allows for decisions to be based on a broad range of knowledge and experience and acknowledges different points of view. It also takes into consideration the

perceived imperative that both the central bank and the government be involved in bank regulation and supervision. The central bank is involved because of its role in financial markets and in developing monetary policy, and the government because of the nationalized sector of the banking industry and the government's role as a potential financial resource if a large bank were to fail.

Since the committees have distinct legal powers, they are able to behave independently of the institutions their members represent and thus allow the Ministry and the Bank of France to distance themselves from committee decisions, to a certain degree, if they so desire. However, the preparation for committee decisionmaking and the implementation of these decisions is done by Bank of France personnel who staff all three regulatory and supervisory committees. According to Bank of France officials, this helps ensure that the Bank of France has all the information it needs for the monetary policy and other work it does while also lending a consistency to the decisionmaking process.

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**Functional Division of  
Responsibilities Intended  
to Reduce Concentration  
of Power and Ensure  
Independent  
Decisionmaking**

When the structure of regulation and supervision was being developed, it was felt advisable to separate enforcement and supervisory responsibilities from regulatory and licensing responsibilities. A senior Bank of France official likened this separation to that of separating the judicial from the legislative authority. Such a split was intended to (1) avoid giving too much authority to one entity, particularly since the supervisor has very strong enforcement authority, and (2) ensure independent decisionmaking so that conflicts between initial regulatory decisions and future enforcement actions were less likely to arise. For example, if omissions in the licensing process allowed an institution to get into trouble, the supervisor might be less willing to take enforcement actions against the institution for fear of having to acknowledge its own regulatory mistakes.

While the separation of enforcement and other regulatory actions only necessitated two committees, the regulatory functions were split into two committees, for a total of three, to allow the Bank of France and the Ministry of Economic Affairs to each chair one of the two committees.

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**CEC Authorizes  
Banks**

CEC is responsible for authorizing and licensing credit institutions to undertake banking operations. Thus, any bank or credit institution must receive permission from CEC to operate. It also may withdraw

authorizations and must approve any significant changes to a credit institution's structure or ownership. For example, it must approve any changes in controlling ownership interest and the crossing of ownership thresholds—purchases of shares that increase ownership to 10, 20, or 33.3 percent. It must also be kept informed of any management changes and may disapprove such changes. In addition, it must approve modifications to the institution's legal form, business name, location of head office, scope of activities, and branch networks within the European Union (EU). Finally, CEC may grant exemptions provided for in law and regulations to individual institutions.

In authorizing a bank, CEC is to assess several criteria. First, it must judge whether an institution qualifies for a banking license or whether its license should be limited to that of another type of credit institution. This is a very important part of CEC's work, since a banking license carries more prestige than a license for a more specialized institution and, consequently, many institutions that do not intend to take deposits and grant loans—one of the principal requisites of a banking license—apply for a banking license. In addition, CEC must ensure that the applying institution meets the minimum required capital standard. Particularly in the case of banks, CEC usually requires start-up capital higher than the minimum requirement because new credit institutions generally lose money in their first year of operation, according to Bank of France officials, and CEC is responsible for ensuring that minimum capital standards are still being met at the end of the first year of business. According to Bank of France officials with whom we spoke, CEC also checks that at least two individuals are responsible for “the effective direction” of the institution, and that they have “the necessary integrity and adequate experience for their duties.”

CEC must also assess the institution's business program, its technical and financial resources, and the suitability of the individuals investing capital in the institutions and their guarantors, where applicable. If CEC decides that the main shareholder of a proposed bank is not satisfactory, either in terms of experience or financial resources, its policy is to ask that the bank obtain a shareholder who is among the world's 500 largest banking institutions and operates in France. The bank shareholder must have a seat on the applicant bank's board and must participate actively in the management of the bank. This is intended to ensure that the applicant bank benefits from the shareholder bank's experience in the French market as well as from its financial resources, if necessary. CEC requests to banks that they obtain French bank shareholders are made quite frequently, according to Bank of France officials, particularly when the

applicant bank is not among the world's largest 500 banks. When a bank does not have a controlling shareholder, the larger shareholders must sign a written agreement that guarantees their cohesion and their actions should additional financial resources be necessary for the bank. In 1993, CEC authorized 53 new credit institutions.

In 1993, CEC reviewed approximately 600 total applications, about one-quarter of which concerned credit institutions surrendering their authorizations. A growing proportion of the other applications was made under the provisions of the Second European Banking Coordination Directive dealing with the freedom of EU member banks to provide services anywhere in the EU. In 1993 and 1994, CEC received a total of 22 applications from French credit institutions to open branches in EU countries. Such applications must be approved by CEC before the French institution may open the branch. By EU agreement, once the home country authority—CEC in this case—gives its approval, the host country in which the French bank is expanding has no authority to disapprove the establishment of the branch. In the same time period, CEC also received 149 declarations from French credit institutions that intended to provide cross-border services in other EU countries. The provision of cross-border services does not require CEC approval, although CEC sometimes deems that the services being proposed require a branch, in which case it will request that the bank proposing those services apply to establish a branch. Finally in 1993 and 1994, CEC received 64 notifications from non-French EU banks that they wanted to provide cross-border services in France, and 17 notifications from EU banks that they had received permission from their home country authorities to establish branches in France.<sup>1</sup>

CEC meets approximately once a month but can be called into session more often when necessary. Meetings of CEC are generally divided into sessions, each of which is devoted to a specific category of credit institution as represented by the professional associations—of which there are four—or their central organizations—of which there are six<sup>2</sup>—plus a session for interbank brokers, which are also licensed and authorized by

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<sup>1</sup>Although CEC has no authority to disapprove such entry, it has, in one or two cases, written to the home supervisor and the notifying bank to request that the bank open a branch instead of merely providing cross-border services, to which the institutions have agreed.

<sup>2</sup>Central organizations are credit institutions in their own right, but are also responsible, under law, for “ensuring the cohesion within their network and the smooth functioning of their member institutions. To this end, they shall take all necessary measures, in particular to safeguard the liquidity and solvency of each of these institutions and of the network as a whole.” These measures include taking disciplinary actions and inspecting the institutions that are their members. All files that are sent to CEC by the central organizations’ members are first sent through the central organization, which can decide whether to forward these files on to CEC.

CEC and supervised by CB.<sup>3</sup> With the exception of interbank brokers, each session includes a voting representative of the category of institution being discussed, either a member of the institution's association or its central organization. As a result, CEC decisions are generally voted on by seven individuals.

CEC meetings are chaired by the Governor of the Bank of France or his representative—usually the Vice-Governor. We were told that the meetings usually begin with the committee staff presenting the cases to be discussed. After the case presentations, the committee members discuss the issues and vote. The Chairman of the committee does not significantly influence the outcome of the discussions, and unless there is a tie vote, in which case his vote counts double, his vote is no more significant than those of the other five members. However, because CEC staff are all from the Bank of France, and because they present the issues for discussion, prepare the files upon which committee members rely for information and propose specific actions, the Bank of France position on the cases presented does carry significant weight. Nevertheless, the committee sometimes votes contrary to the course of action proposed by the staff, albeit infrequently, according to Bank of France officials with whom we spoke.

The Minister of Economic Affairs—or his representative—enjoys a unique right not given to the other committee members, namely to ask for adjournment of the committee. He generally uses this privilege to obtain more information on a case before voting on the issue. For example, since the Minister has a specific responsibility toward the provision of social housing, which is partially financed by the state, he may require additional information if a case involves a credit institution that provides credit for public housing.

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## CRB Proposes Bank Regulations

In France, the National Assembly has the authority over all laws and legal provisions. It may, however, delegate the authority over some types of legal provisions, such as regulations, to other official bodies. Consequently, the Banking Act of 1984 gave CRB the responsibility to develop the regulations applicable to credit institutions. This delegation of authority is quite significant since in France most legal actions concerning credit institutions are taken through regulations, not through law, as is the case in some countries such as Germany.

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<sup>3</sup>Interbank brokers are responsible for bringing individual banks together for financial deals, such as interbank lending, that involve just banks.



The areas in which CRB may propose regulations include (1) minimum capital levels; (2) prudential standards, such as minimum solvency and liquidity requirements; (3) the conditions under which individuals may own voting powers in a credit institution; (4) the opening of branches; (5) bank equity participations in other companies; (6) transaction requirements, such as interest rates on deposits and rules on information provided to borrowers; (7) the disclosure of accounting documents and information; and (8) management standards, particularly with respect to safeguarding institutional liquidity, solvency, and stability.<sup>4</sup> All major prudential rules—such as regulations with respect to solvency, liquidity, and financial structure requirements—must be observed by all categories of credit institutions. However, CRB may differentiate among types of credit institutions.

Although CRB has a broad scope, more and more regulations are being determined at the international level through the EU. In such cases, the responsibilities of CRB are reduced to transposing international decisions into French law. Rules that are still determined primarily at the national level include those established to protect consumers as well as prudential norms that have not yet been harmonized within the framework of the EU.

Regulations are usually proposed and initially developed by the Credit Institutions Directorate of the Bank of France, acting in its capacity as CRB Secretariat, or in prudential supervision matters by the CB Secretariat, according to Bank of France and CB officials. Regardless of who initially drafts and is responsible for the technical work on a regulation, the Ministry of Economic Affairs and the Bank of France are in close contact before a regulation is proposed and are almost always in agreement on a text before it is sent forward to CRB, according to Bank of France staff. The process for obtaining agreement between the Treasury and the Bank of France is not always an easy one, however, according to CRB and CB staff, primarily because of differences in points of view.

The other committee members are also consulted before any measure is brought to CRB for its approval because, according to Treasury staff, it is not sufficient to have Ministry and Bank of France approval to get a regulation through CRB. The other committee members must agree with any proposal since they have four of six votes. Finally, CRB and other agency staff involved in the drafting process have created working groups as well as an informal consultative process involving the banking

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<sup>4</sup>While CRB used to have responsibility over determining compulsory bank reserves, that responsibility has been transferred to the Monetary Policy Council of the Bank of France.

community, the associations that represent banks, and other interested parties such as accounting and law firms. This consultative process between the bank regulators and the industry is viewed by the Association of French Credit Institutions (AFEC) and AFB as one of their primary responsibilities and helps promote cooperation between the regulators and the regulated. However, extensive consultations do not always mean that there is full agreement on proposed regulations by the regulated or other interested parties.

As a result of the external and internal consultative process, agreement on proposed regulations is usually unanimous among the six CRB members, according to CRB and Treasury staff. Nevertheless, there are occasions when there are serious discussions among the members of CRB, particularly between the Treasury and the Bank of France. Amendments are sometimes made to a proposed regulation as it is being considered by CRB—word changes to address legal uncertainties, for example—but if a regulation is formally proposed to the committee, it generally is passed.

All regulations proposed by CRB must be stamped and signed into force by the Minister of Economic Affairs, not as Chairman of the CRB, but by virtue of his position as Minister of Economic Affairs. Thus, the Minister has veto power over any regulations proposed through CRB. As of March 1, 1995, no regulation had ever been vetoed, in part because discussion and consultation involved in preparing a regulation includes the Ministry, and also because the Minister, as Chairman of the CRB, would not present a regulation for CRB approval if he did not agree with it, according to Treasury officials.

While CB has no formal role in approving regulations, it does have the responsibility of making sure that they are implemented. As part of this duty, it will issue clarifications and further details on specific regulations that, according to CB officials, credit institutions would regard as seriously as a regulation—even though these clarifications do not have the force of law. Such clarifications are generally of a relatively minor nature, however, since the responsibility for the interpretation of law lies with CRB and the Minister, according to Bank of France officials with whom we spoke.

There is another agency in France that contributes to the drafting and clarification of banking regulations that specifically address accounting issues. This agency, the Conseil National de la Comptabilité, is an advisory committee attached and reporting to the Ministry of Economic Affairs. Its

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membership of approximately 100 is made up of representatives of the accounting profession, private industry, and government agencies. Its purpose with respect to bank accounting regulations is twofold. First, it is to comment on proposed regulations when asked for its opinion by CRB. Second, and perhaps more significantly, it is to publish its opinion on how accounting standards should be implemented. These opinions are generally used as precedents by courts of law and CNCC, the accounting profession's association, recommends that its members apply CNC opinions when auditing banks as well as other organizations. CNC has no authority, however, over the way in which auditors conduct their financial audits. This authority rests with CNCC (see ch. 3).

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## Supervision Is the Responsibility of CB

The primary responsibility for ensuring that deposits in credit institutions are safeguarded—one of the goals of the 1984 Act—lies with CB. CB thus has responsibility over the supervision of all credit institutions authorized under the 1984 Act. It is the duty of CB to ensure that credit institutions observe legal and regulatory requirements, as well as the industry's rules of good conduct;<sup>5</sup> to ensure that the rules of sound banking practice are observed; and to monitor the financial soundness of credit institutions. If CB observes regulatory breaches or financial irregularities in a credit institution, it is responsible for taking enforcement actions to resolve any problems.

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## CB's Supervisory Philosophy Focuses on Concentration Risk and Maintaining Adequate Internal Controls

According to CB, its experience has proven that “failures of credit institutions are always attributable to overconcentration of risks, notably credit or liquidity risks.” Historically, French banks have often become specialized in specific industries—leading to concentration problems. In addition, French companies tend to rely on only one major bank for all banking services, again leading to concentrations. Many of CB's efforts are therefore focused on examining the concentration of a bank's loan portfolio and other businesses.

In turn, according to CB, concentration risks “can only arise as a result of shortcomings in the system of internal controls.” CB, therefore, places a significant amount of emphasis on a bank's internal control systems, which establish a set of procedures designed to guarantee the quality of the information provided to bank management, shareholders, supervisors and other interested parties. It also attaches importance to a bank's

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<sup>5</sup>CB has not specifically delineated the industry's rules of good conduct, but they are often based on case-law determinations of best practices.

internal control department, which is responsible for verifying the effectiveness and coherence of these internal control systems. All banks are required to have both.

To help ensure that banks are implementing internal controls properly, CB proposed a regulation approved by CRB and the Minister of Economic Affairs in 1990 that specifies certain requirements for internal audit systems. CB officials have described this regulation as one of the most important that it enforces. The regulation requires that bank internal audit systems must be able to ensure an adequate audit trail with respect to information that is contained in published accounts. This audit trail must make it possible to (1) reconstruct operations in a chronological order, (2) support all information with original documents, and (3) account for the movement in balances from one statement to the next. Institutions are also required, at least once a year, to provide CB with a report on how internal auditing is carried out. Furthermore, the decisionmaking body of the institution is required to review the activities and results of the internal audit at least once a year. According to CB, it is “determined to take a strict line with regard to internal controls” and will assess the competence, independence, and results of the internal control departments.

In doing its work, CB maintains that it “must refrain from interfering in the management of credit institutions.” It emphasizes that it is not its role to substitute for credit institution managers, and that CB’s task “in no way detracts from the obligations and responsibilities incumbent upon” those managers. For example, CB does not set derivatives limits for banks; instead, banks are required to set individual derivative risk limits about which they must report to CB.

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## **All Enforcement Actions Are Taken by CB**

CB is solely responsible for taking enforcement actions against credit institutions when they are “in breach of the rules of sound banking practice” or when they have “contravened a law or regulation” relating to their business. The 1984 Act gives CB a wide range of enforcement powers, ranging from warnings to disciplinary actions culminating in the withdrawal of an institution’s authorization. Because CB has the ability to take very strong enforcement actions—including replacing bank management or withdrawing a bank’s authorization—credit institutions fully understand that if they do not comply with less forceful actions, such as warnings, they will be subject to stronger actions that will follow. As a result, CB does not have to resort to forceful actions frequently since

warnings—both official and unofficial—and injunctions are generally respected by banks.

Official warnings have been issued at the rate of about 50 a year and are meant to formally bring a CB concern to an institution's attention without penalizing the institution, and they usually follow at least one, often more, unofficial warnings, according to CB staff. If, for example, an institution is contravening sound banking practices, CB may, after giving management an opportunity to explain the situation, issue an official warning. It can request an institution to increase its provisioning against doubtful loans or to match its funds more closely to lending. CB may also issue a warning if it finds a breach of the industry's rules of good conduct, something which it has done only once in the last 3 years,<sup>6</sup> although it has issued more unofficial warnings. If an unofficial or official warning is heeded, no further action is taken or sanction imposed by CB.

If a warning is not heeded, CB can enjoin an institution to take all necessary measures to resolve financial or management problems by a specific deadline. According to CB, this type of injunction is used quite frequently. In the last 3 years, CB has issued 63 injunctions that ordered institutions to (1) transmit periodic documents to CB on time, provide more information on share ownership, strengthen their financial structure, and appoint a second responsible manager, as required under law; (2) institute efficient internal control systems; (3) comply with the rules on risk distribution; (4) provision adequately for losses; (5) amend management methods; and (6) strengthen liquidity ratios.

Finally, CB may sanction an institution when it has disregarded an injunction or warning, or has contravened a law or regulation. Sanctions, which are categorized as disciplinary procedures, range in severity and include (1) cautions, (2) reprimands, (3) prohibitions or limits on the conduct of certain operations, (4) temporary suspensions or permanent dismissal of senior bank management, and (5) the withdrawal of an institution's authorization. In addition, CB has the power to impose fines. In the past 3 years, CB has appointed acting managers 23 times and has initiated disciplinary proceedings 36 times. Reasons for taking such actions have included, among others, breaches of capital, solvency, and liquidity requirements; supplying misleading information to CB; breaches of risk distribution and exchange rate rules; and inadequate internal controls.

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<sup>6</sup>In this case, CB issued a warning to a mutual bank that was offering credit to customers at inflated prices because of its influential position with these customers.

Eight of the 26 disciplinary proceedings initiated in 1992 and 1993 have ultimately resulted in the revocation of an institution's authorization.

Recommendations to take enforcement actions against individual institutions are made by the staff of CB but must be approved by the six-member Commission. In 1993, CB met 9 times and issued 19 injunctions, appointed an acting manager 7 times, instituted 17 disciplinary proceedings, and withdrew authorizations 7 times. While CB would normally issue warnings to a bank before it takes more formal enforcement action, in an emergency it can act very quickly and require a bank to close operations immediately, according to CB staff. When taking an enforcement action, CB acts as an administrative court, and all enforcement actions must be agreed to unanimously by CB's members. This may delay action to some extent until all CB's members are present to vote.

Enforcement actions are generally not made public at the time they are taken. Nevertheless, once a situation is resolved, CB's policy is to publish the major actions taken and their outcomes in its annual report.

The Chairman of CB—the Governor of the Bank of France—plays an important role in the decisionmaking of CB, even though the committee is deemed collegial by Bank of France and CB staff. Nevertheless, if the Treasury strongly supports or opposes a particular action, then it is difficult to contradict the Treasury, particularly because such situations happen very infrequently, according to CB staff.

The Bank of France is also afforded another significant opportunity to influence the decisions of CB members through its staff who present the cases and proposed solutions to CB. Although CB generally follows the recommendations of the staff, we were told that concerns about perceived legal problems with staff proposals are not infrequent.

According to CB staff, they always discuss every important decision with the Governor before any meeting so that the Governor is prepared to argue the proposed solutions. On very important decisions, the staff also discusses the case with the Treasury before CB meetings.

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**CEC and CB Share**  
**Authority to Revoke**  
**Authorization**

An institution's authorization may be withdrawn either by CEC or CB. If an institution ceases operation voluntarily it can petition CEC to withdraw its authorization. In the 5-year period from 1988 through 1993, CEC withdrew

207 authorizations for institutions that ceased to operate. If, however, an institution's authorization is withdrawn due to financial difficulties or other supervisory problems, CB is responsible for taking such action.

When it becomes clear to CB that an institution can no longer be rescued, it must initiate disciplinary proceedings against the institution and appoint an acting manager. According to CB staff, this is a difficult decision to make because it must not be taken too early, if there is still a chance for the institution's survival, or too late because of the increasing cost over time of resolving an eventual failure. Usually when a problem situation develops, CB and the involved institution develop a solution to the problem in which the bank will slowly self-liquidate. This obviates the need for a liquidator and generally ensures that depositors' funds are not endangered and that the deposit protection mechanism need not be activated.

Since AFB—the French bank association—member banks are responsible for protecting depositors when a bank fails, as described further in chapter 4, AFB has an interest in how failing banks are resolved. Nevertheless, there is no legal requirement for CB to involve AFB in the failure resolution process, and CB staff stated that AFB's role in failure resolution is very limited. Sometimes, however, AFB has been informally involved in determining potential solutions as was the case in 1992 when a small bank suddenly got into trouble and was eventually acquired by another bank, which had acted as the failing bank's administrator. In this case, AFB worked with the acquiring bank and used the deposit protection structure to finance part of the acquisition.

CB may appoint a liquidator when a bank's authorization has been withdrawn and has done so 11 times in the last 2 years in cases when it has not been able to reach an agreement to allow the bank to self-liquidate.

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## CEC, CRB, and CB Are Politically Independent

CEC, CRB, and CB are all established as politically independent committees. They do not report to Parliament or to the President of France. Their independence notwithstanding, we were told by Bank of France staff who work with the committees that there has not been a case when the government has disagreed with actions taken by them.

Decisions taken by CEC and CB may be appealed before the highest administrative court in France, the Conseil d'Etat. We were told that such appeals have been infrequent, occurring approximately once or twice a year. While CEC had always won any appeals, as of May 1, 1995, CB has lost

a few cases. However, its staff do not believe that these legal setbacks or the possibility of an appeal have affected their ability to get credit institutions to take corrective actions.

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## **CNC Is an Advisory Committee**

CNC is described by the 1984 Act as an advisory committee to be consulted on monetary policy and credit policy. Its mandate includes studying the banking and financial system, particularly with respect to customer relations. It may issue opinions in these areas and set up working groups to conduct research. It may also be asked to give its opinion on bills and draft decrees within its area of responsibility.

The 1984 Act also established a new committee that reports to CNC called the Comité Consultatif (Advisory Committee). The Advisory Committee is mandated to study the relations of credit institutions with their customers and to suggest recommendations in this area. The committee is composed predominantly of representatives of credit institutions and representatives of their customers.

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## **The Day-to-Day Division of Supervisory and Regulatory Responsibilities Is Not Clear-Cut**

While the division of responsibilities among CEC, CRB, and CB is clearly defined under law, the execution of these responsibilities by the three committees and their staffs on a day-to-day basis is more flexible. There are a number of factors that contribute to this flexibility. First, by law, the Bank of France provides the staff of CEC, CRB, and CB. Being Bank of France employees, the staff may rotate back to the Bank of France or among the regulatory and supervisory committees. Consequently, the staffs of the committees are more likely to work together when necessary since they are all part of the same organization.

Second, CB staff are often called upon to assist the other two committees in preparing some of their work in prudential supervision matters. Thus, for example, CB does the technical work on many of the bank regulations considered by CRB.

Finally, the individuals involved in bank regulation and supervision often have similar backgrounds and have studied together, according to Bank of France staff. They tend to replace each other as they move from one job to another within the group. Furthermore, they are often in work groups and committees together. Both formally and informally there is a continual interchange of ideas among the committees and their staffs, and decisions are made on the basis of continuous discussions and give-and-take among



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the players. As a result, both in terms of staffing and decisionmaking, the system is not as disaggregated as it may look on paper.

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## The Bank of France and the Ministry of Economic Affairs Have the Most Institutional Influence Over Supervision and Regulation

Institutionally, the Bank of France and the Ministry of Economic Affairs clearly have the most influence in the supervision and regulation of credit institutions. They split the chairmanships of the three regulatory and supervisory committees and CNC and are members of the committees they do not chair. The Governor of the Bank of France chairs CEC and CB, and the Minister of Economic Affairs chairs CRB and CNC.

The decisionmaking on the committees has been described as collegial by Bank of France and CB staff. However, they also suggested that there is some rivalry between the Bank of France and the Ministry, and disagreements between the two do occur—both between their staffs and within the committees. If either the Governor or Minister, as chairman of a committee, strongly disagrees with the direction in which a meeting is moving, he may adjourn the meeting. A chairman may also deflect opposition by other committee members through his power over the committee's agenda.

In their roles as chairmen, they are sometimes identified with the work that is being done by their committees. For example, in several of our discussions with banks or their associations, the Bank of France was often mentioned as the authorizing agency, not CEC. In other cases, banks identified their supervisor as the Bank of France, not CB. The frequency of these portrayals may reflect the fact that the committees are chaired by the Governor of the Bank of France as well as the fact that the staff of the committees are Bank of France employees.

The Ministry of Economic Affairs has significant influence (1) through its powerful position in the government's cabinet; (2) because it appoints the other members of CEC, CRB, and CB, and is a member of all committees it does not chair; (3) because the Minister must sign any credit institution regulation before it may take effect; and (4) because it is the major stockholder in nationalized banks, which include the largest bank in France, Crédit Lyonnais. The extent of financial support the government is in the process of providing Crédit Lyonnais accentuates the role of the government in the banking industry and the effect its ownership could have on competition in the banking industry. To date, Crédit Lyonnais, the country's largest bank, remains the only large nationalized bank, although there is a handful of smaller nationalized banks. There are plans that these

remaining nationalized banks be privatized within the next five years since both the Socialist and Conservative parties now agree that having nationalized banks conflicts with the premise of a free market that is one of the cornerstones of the EU. For example, Crédit Lyonnais, which lost Fr.fr. 6.9 billion in 1993, principally as a result of poor commercial and real estate investments, benefited from a Fr.fr. 4.9 billion bailout in July 1994, raising questions about the role the government plays as the owner of the largest French bank and the effect that has on competition in the French banking industry.<sup>7</sup>

In addition to the influence the Bank of France obtains through its chairmanship of CEC and, in particular, of CB, which is the largest and arguably the most important of the three regulatory and supervisory committees, the influence of the Bank of France stems most directly from (1) the fact that it staffs all three committees, (2) its power to require credit institutions to contribute funds in a crisis to “ensure the smooth functioning of the banking system and safeguard the reputation of the financial center” whenever it deems such assistance is necessary, and (3) its importance in and influence over French financial markets. (See ch. 4 for a discussion of the crisis resolution powers of the Bank of France.)

While both the Minister of Economic Affairs and the Governor of the Bank of France have a significant influence on the regulation and supervision of credit institutions, it is the Governor—both as Governor and as Chairman of CB—who is considered by banks to be the more influential player on a day-to-day basis and is considered to have a greater knowledge of the banking industry, according to banking and Bank of France officials with whom we spoke. For example, whenever a serious problem or question arises, we were told that a bank chairman would be likely to call the Governor of the Bank of France—not necessarily because of his position as the Chairman of CB, but because of his position as Governor. Furthermore, we were also told that the participants in France’s banking system know that the Bank of France staffs the regulatory and supervisory committees and understand the influence that conveys. Finally, we were told that in the eyes of the public, the Bank of France and CB, not the Minister of Economic Affairs, are held responsible if there are bank problems, unless the bank in question is nationalized, in which case the Treasury, as the representative of the state, would be held equally responsible.

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<sup>7</sup>Further losses of Fr.fr. 12 billion in 1994, and a second government rescue plan involving a government guarantee of some of Crédit Lyonnais’ debts, raised additional complaints by two large French banks that the proposed aid package strengthened the position of Crédit Lyonnais compared with other banks in a way capable of distorting competition.

# CB Obtains Information Through Permanent Oversight and Bank Inspections

The Banking Commission (CB) obtains information necessary to enforce compliance with regulations and assess the financial condition of credit institutions through a combination of permanent oversight and inspection visits conducted by separate sections within CB and the Bank of France. These two sections—microsupervision within CB and inspection within the Bank of France—must coordinate closely to ensure the exchange of information relevant to the performance of CB duties.

## Permanent Oversight Provides Basis for Bank Supervision

Information gathered and analyzed by the microsupervision section of CB in the performance of permanent oversight includes periodic reports filed by the institutions, discussions with their managers, and information provided by external auditors and other market sources.

## CB Relies Primarily on Information Filed by Banks

In order to fulfill its supervisory responsibilities, CB receives regular information filed electronically with CB by all credit institutions, according to CB officials with whom we spoke. Banks must file most of these reports quarterly, with the exception of larger banks who are required to file monthly, but some reports are filed semiannually or annually.

CB is responsible for determining the content and frequency of any reports that must be filed by banks. In 1993, CB implemented a new reporting system for credit institutions called Base de Données des Agents Financiers (BAFI), the data base of financial agents. The new data base serves the purpose of collecting and analyzing information for prudential, monetary, and balance of payments purposes and is intended to provide an early warning of potential problems in individual banks or in the banking industry as a whole. BAFI includes several hundred pages of information on institutions' balance sheets, profit and loss statements, solvency, liquidity, concentration risk, large exposures, exchange rate positions, and other areas. Appendixes to BAFI include information on risks associated with activities such as market making, trading, and derivatives.

CB spent several years developing and implementing BAFI and intends to place a significant amount of emphasis on the information obtained through it. It relies on this information not just to assess a bank's current financial status but also to monitor bank risk-taking, to determine whether a bank is entering new business areas, to follow up on banks' actions in response to CB warnings or enforcement actions, and to assess whether a bank should have an inspection scheduled. Through BAFI, CB can check banks' controls on concentration and exposure and assess the likelihood of future risks. It can conduct peer group comparisons, analyze individual

banks' break-even points, and forecast trends in the industry. If a bank is in good financial condition and has not expanded its risk-taking or entered into new activities, BAFI will be the primary source of information for CB. Approximately half of its staff—about 100 individuals—are devoted to the permanent microsupervision of credit institutions, which focuses on analyzing BAFI data.<sup>1</sup> About 10 to 12 individuals in this group are involved in the microsupervision of the 10 largest banks in France.

All BAFI data are filed with CB, and any statistics useful to develop monetary policy, as well as aggregate data on the banking industry, are forwarded to the Bank of France after they have been processed by CB staff, according to CB officials with whom we spoke. Banks are also required to separately report some information directly to the Bank of France, which CB may access. Information is to be submitted to the Bank of France on (1) material credits outstanding to companies, (2) current balance sheets of companies, (3) dishonored checks, and (4) repayment problems on loans to private individuals. Banks may access this data base for a fee and obtain information, for example, on their percentage of the total material loans outstanding to specific companies.

In addition to BAFI information, banks are required to file with CB quarterly reports on loans to any one company or group of companies that exceed 15 percent of capital, quarterly reports on bank policies with respect to derivatives limits and how their derivatives activities compare to those limits, monthly foreign exchange position reports, monthly liquidity reports, monthly balance sheet reports, and annual reports on nonperforming loans.<sup>2</sup>

CB is moving toward a system—planned for completion by mid-1996—that should be able to analyze all of the quantitative and qualitative information on credit institutions available to CB—including information collected through on-site inspections—to conduct analyses of bank client activities, market activities, service operations, compliance with prudential regulations, and statistical analyses. The system is intended to allow for an analysis of a bank's activities, risks, and profitability in greater detail than is now possible as well as for comparisons with a bank's peer group.

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<sup>1</sup>The microsupervision staff are usually not involved in bank inspections, which are normally carried out by the Bank of France for CB, as discussed later in this chapter.

<sup>2</sup>Larger institutions submit reports on a monthly basis; medium and small institutions submit them quarterly.

Institution specific information collected by CB through BAFI and other reports is not automatically shared with the Bank of France, even though CB staff are Bank of France employees. As part of the agreement to give the Bank of France independence in 1993, CB was officially separated from the Bank of France—it is now independent—and information does not automatically flow between them. Nevertheless, information on individual banks may be requested by the Bank of France, or any other member of CB, if there is a specific need—in the event of a financial crisis, for example. Furthermore, since the Bank of France chairs CB, it is regularly informed of any problems in the banking industry and, therefore, is aware of situations that it might be asked to resolve.

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### Meetings With Banks Also Provide CB With Information

If CB has any concerns or questions about a bank's operations based on periodic filings by banks or other information it has received, CB has the authority to request and receive from banks any "information, clarification or proof necessary to the exercise of its functions." CB officials told us that CB often obtains such information or clarification through discussions with bank management. For example, the bank's accounts may be sent to CB and discussed with CB staff before they are released in June and December, if CB requests that information. If there appear to be any problems, the discussions are moved up to higher levels of CB staff. In April, CB is to receive a list of all the nonperforming loans at all the banks and information detailing how the banks have provisioned against these loans. This information is intended to allow CB to compare levels of provisioning at banks and then to recommend increases when banks fall below the normal level. The same is true for country risk provisioning. If a bank disagrees with CB's assessment, then discussions are held between the bank and CB to clarify the bank's position.

According to CB staff, CB has numerous meetings with banks. There is no formal schedule for such meetings; instead, they are set up whenever there is a need. CB staff at different levels meet with banks every day and have numerous contacts by telephone and by fax. The level of the individual involved in the discussions depends on the issue being discussed. If a concern about a bank is being discussed, they said it will involve higher-level individuals—the General Manager or President of the bank—than if there is a question on appropriate accounting methods. In addition to bank specific questions, there are also many contacts between banks and CB on more general industry-related topics such as real estate problems.

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Finally, CB addresses numerous issues in correspondence. It sends and receives about 40,000 pieces of correspondence a year. BAFI-related questions are frequently asked and responded to in this fashion, for example. Technical questions about asset weighting for capital adequacy purposes or loan provisioning, for instance, are also generally the subject of correspondence between a credit institution and CB.

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**Market Information  
Deemed of High  
Importance by CB Staff**

Informal discussions with banks and other market sources sometimes provide CB with its first warning of potential problems in an institution and are consequently considered extremely important by CB staff. Such information may come through an informal notification that a market participant has stopped dealing with a particular bank because of perceived problems, for example, or that an institution's method of operating in a specific business area differs significantly from that of its peers.

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**On-Site Inspections  
Also Provide  
Information**

Permanent oversight of credit institutions is supplemented with full-scope,<sup>3</sup> as well as more limited, on-site inspections—or examinations. These inspections, which are to cover all elements of an institution's activities, are done for CB by Bank of France inspectors. Inspection follow-up, on the other hand, is the responsibility of CB, and CB may differ with bank inspectors on the supervisory conclusions to be drawn from an inspection.

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**Bank of France Inspectors  
Examine Banks for CB**

According to Bank of France and CB officials, all credit institution inspections are led by high-level staff (inspectors), with at least 10 years of on-site inspection experience, of the inspection division of the Bank of France. They are assisted by a team of lower-level staff. Although the inspectors conduct inspections on behalf of CB, the inspection division reports directly to the Governor of the Bank of France.

After the inspection is conducted, we were told that the inspectors write an inspection report, which is provided to the bank and CB, and brief CB on their findings and conclusions. CB then writes a follow-up letter to the bank notifying the bank of the actions it must take to resolve any problems found during the inspection. It is this CB letter, not the inspection report, that is binding on the bank. If the bank does not follow CB recommendations, it would be subject to enforcement actions; however,

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<sup>3</sup>Full-scope examinations include examining bank asset quality, assessing banks' systems and internal controls, judging capital adequacy and reserves, and assessing compliance with laws and regulations.

no action would be taken if the bank disregarded a problem addressed in an inspection report that was not addressed in CB's letter.

When opinions differ on the content of the CB follow-up letter to the bank, Bank of France and CB officials said that CB and the inspectors generally try to harmonize their views, primarily because they do not want to send the credit institution mixed signals. However, if they are not able to agree, CB sends the bank a follow-up letter that, on certain points, may not coincide with the inspection report, and both the inspector and CB will take responsibility for not coming to agreement.

Although the inspection division is separate from CB, officials told us there is a significant exchange of information between the two. There are monthly meetings between the inspectors and the General Secretariat of CB assisted, as necessary, by CB experts; and the inspectors are to receive all of the BAFI reports. Furthermore, inspectors are to meet with CB staff before inspections and, after their inspection, when on an as-needed basis, they explain their major findings or especially complex points to CB experts. Finally, if the inspectors find any serious problems during their inspections, they are to report to the top management of CB immediately.

Nonbank credit institutions that belong to central organizations are to be inspected by those organizations. For example, a savings bank would be inspected by the central savings bank—the Centre National des Caisses d'Epargne et de Prévoyance. The inspections are to be conducted by the central organization's staff and their inspection reports are sent to CB. If CB believes that a further inspection is necessary—based on the inspection reports from the central organizations or for any other reason—then a Bank of France inspection team is to conduct a further inspection.

In 1994, the Bank of France conducted 173 inspections for CB, including 117 full-scope reviews of credit institutions and 55 examinations of specific problems or thematic subjects. This frequency is considered to be insufficient by the Bank of France and CB, and the Bank of France is currently planning to increase its inspectorate staff by 30, from 95 inspection staff in December 1994, to 125 in 1995. This increase in staff is intended to reduce the average inspection rate to every 4 years, with problem banks being inspected much more frequently.

When necessary, the Bank of France may call on other members of the Inspection Division, who normally work on internal audits of the Bank of France and its branches, to assist in bank inspections. In addition, the

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Bank of France could call on any Bank of France employee who has ever worked for CB or in the Inspection Division to assist on an inspection.

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## Bank Inspections Assess Soundness of an Institution

According to CB, inspections “provide an opportunity for a more detailed review of the institution’s decisionmaking procedures and its financial situation.” They also serve to verify information collected through the reporting process, particularly with respect to judging the adequacy of an institution’s prudential ratios.

Bank of France inspectors conduct three kinds of bank inspections for CB: (1) routine inspections, (2) inspections that focus on perceived problems, and (3) thematic inspections. All credit institutions are to receive a routine inspection at some time, according to Bank of France and CB staff. The timing of such an inspection depends on a number of factors. On average, Bank of France officials said banks will be inspected more frequently than other credit institutions, partially because they are involved in riskier and more extensive activities and partially because many other credit institutions are inspected by their central organizations, as discussed above. Finally, inspection rates depend on the individual institution. Based on information gathered through BAFI or market sources, institutions may be inspected more frequently—up to twice a year—if they are perceived to have financial difficulties; to be expanding into unfamiliar or more risky activities; or to be heavily involved in activities that may be experiencing a market downturn, such as real estate in the past several years.

According to Bank of France policy, the primary purpose of on-site inspections is to assess the soundness of a bank—to judge its ability to conduct its business without a deterioration in its liquidity, solvency, and profitability. A routine inspection, therefore, is to cover all elements of an institution’s activities including organization, management, internal controls, capital, assets, earnings, and liquidity. Specific areas of a bank’s activities that are to be inspected include the bank’s market activities, electronic data processing (EDP), technology, derivatives activities, mergers and acquisitions, mutual funds, and leasing, among others. In the course of their mission, inspectors also are to check the accuracy of banks’ reported loan loss reserves and the bank’s prudential ratios: risk diversification, foreign exchange, maturity mismatch, capital, and liquidity.

According to CB staff, CB is focusing more attention on management quality, internal controls, and corporate governance. With respect to management quality, inspectors are to assess the results of management



strategies and the extent to which management is informed about the bank's activities. The inspection is to include an assessment of the kind of information management receives—whether it is accurate and concise—and whether management reacts quickly to the information it has. Because the quality of information managers are provided with depends, to a large extent, on the efficiency of the institution's internal controls, inspectors also are to test internal control procedures. According to CB, inspectors verify "the effectiveness and coherence of internal control systems" by determining whether "the procedures [for internal controls] are appropriate to the needs of the institution." Since the mid-seventies, the inspection process has placed particular emphasis on an institution's EDP, both to assess its reliability and to conduct inspection controls. CB is currently in the process of developing a new methodology for testing EDP for use by Bank of France inspectors.

An important by-product of an inspection is the checking of the accuracy of the institution's BAFI reports. Both CB and the Bank of France stressed the significance of these checks since CB relies very heavily on BAFI information in its permanent oversight. Generally, the testing finds that banks submit accurate information, but if a bank is found to be submitting inaccurate information, there is no question that it will be disciplined, according to CB staff.

During an inspection, inspectors may examine bank subsidiaries—including subsidiaries located in other European Union (EU) countries. How often such subsidiaries are inspected depends on their significance to the institution as a whole—whether they significantly contribute to profits, asset size, or risks. If they do, then they are generally inspected with the parent company, according to Bank of France and CB officials with whom we spoke.

During an inspection, the facts relevant to the inspection are to be discussed with the institution's department heads in order to get their agreement on those facts, and the inspection team then writes a draft report. Although it is not compulsory, it is an established tradition for the inspectors to provide bank management with an opportunity to review the draft report or parts thereof, according to Bank of France officials with whom we spoke. After a short time—2 to 7 days—the inspector is to return to discuss the report with management but is only to change the report if the facts upon which he based his judgments were wrong, or if the bank's situation has changed since the draft was written—for example, if a unit that was in trouble was sold. The president of the institution gets

the final inspection report, which is confidential. CB is to use this report and any other information it has—including information on the general economy or the situation of the banking industry—to send a follow-up letter to the institution telling it what CB expects it to do in response to issues raised in the inspection. This letter is then to be followed up with meetings, additional correspondence, and monitoring of BAFI information to ensure that the institution is taking the recommended actions, according to CB staff.

Depending on the size of the institution, an inspection could be from 2 months in length with an inspection staff of 2 to 4 for a medium-sized bank, to 4 to 6 months with an inspection staff of 4 to 8 for a larger bank.<sup>4</sup> If a bank has significant credit activities, it requires a larger inspection staff to examine credit files than if it has extensive market operations. No inspectors are located full-time in any bank or other credit institution.

If a bank is believed to have a problem based on the examination of reports available to CB, a specific inspection is to be conducted by the Bank of France that focuses on the area of the bank believed to have problems. If, for example, a bank's loan portfolio is thought to be weak, inspectors are to examine the bank's procedures for granting the loans and its loan administration. They are to also inspect the measures that were taken after a loan was determined to be in trouble, the provisioning taken against the loan, and the operations of the problem loan unit. In addition, they are to review the bank's management and its internal controls in order to assess the criteria for decisionmaking. Finally, they are to inspect the bank's loan portfolio, particularly its larger loans, to assess the amount of residual risk. Examinations of banks with problems may occur as often as twice a year.

The inspectors of the Bank of France may also conduct thematic inspections. In these inspections, the inspectors are to examine a specific area of business or operation—such as derivatives activities, property risks, or the organization of internal auditing. Such inspections would be done across a sample of all institutions if the issue, such as internal controls, were relevant to them all; or across a sample of larger banks in areas such as derivatives activities. In this way, the inspectors can do a peer comparison of the banks as well as judge the impact a specific line of business is having on the industry as a whole.

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<sup>4</sup>If needed, the size of inspection teams may go as high as 30 staff.

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## Information From External Audits Is Growing in Importance

Historically, external audits of credit institutions have not played a major role in bank supervision in France. However, CB is beginning to place more reliance on information from external auditors and sees their role developing further.

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## Banks Are Audited Under Corporate Law

French credit institutions are required to receive annual audits, according to French corporate law. Such audits of banks are automatically sent to CB. The main duty of the statutory auditor is to certify to the shareholders as to the fairness of presentation of the financial statements. In addition, as of 1935, all audit firms have been required to report to the public prosecutor any criminal offense by their clients related to the auditor's account that the auditors discover during their audit. They are not specifically required to look for such offenses, however.

Under the 1984 Act, French banks, with the exception of those below a certain balance sheet size threshold, are required to be audited by at least two auditors, who split the annual audit responsibilities between them. According to CB officials, at least one of the auditors of most large banks is likely to be a "big six" international accounting firm,<sup>5</sup> although the second firm is often to be a large French firm. Smaller banks are more likely to be audited by a small French accounting firm.

CB has no minimum audit requirements for bank audits, but may take action against an external auditor, described below, if a bank audit is deemed unsatisfactory. In carrying out their audit work and in preparing their report on the financial statements, auditors are to comply with auditing standards developed by the national association of auditors (CNCC). CB is a member of the banking committee of the CNCC, which develops these standards and, consequently, has some input. Accounting rules, on the other hand, are proposed by the CRB—the regulatory committee.

In conducting their annual audits, the external auditors typically are to check that banks are complying with capital requirements; to assess asset quality, loan loss reserves, earnings, and management capability; and to review internal controls. This work includes checking a bank's balance sheet, its profit and loss statement, and related footnotes; and testing the bank's internal controls. The auditors are to take samples of the bank's loan portfolio but generally are to focus on the bank's largest credits. They

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<sup>5</sup>In the United States, these firms are known as Ernst & Young, Arthur Andersen LLP, Deloitte & Touche, KPMG Peat Marwick, Coopers & Lybrand, and Price Waterhouse.

are then to determine whether the bank's provisioning has been set adequately and may recommend increases. They also are to review the market risk calculations that all banks are required to include in their annual reports.<sup>6</sup>

Until the relatively recent development of financial problems—primarily due to real estate difficulties—banks, particularly larger ones, did not place much importance on the results of their audits, according to external auditors with whom we spoke. They said that they did not feel their reports were valued by the banks, and because French banks are not required to establish audit committees, auditors with whom we spoke felt that communication with the banks' presidents or boards of directors was difficult. More recently, however, auditors have had more access to bank boards and their chairmen because of the financial difficulties many banks are facing, and said that they feel that their role has been enhanced. Nevertheless, the external auditors with whom we spoke felt that their work would be more valued if banks had an audit committee requirement. Such a requirement is strongly supported by CB, but is opposed by some of the larger banks, according to CB and AFB—the French Bank Association—officials.

According to a manager of one of the large banks with whom we spoke, obtaining an audit opinion without qualification is extremely important to the bank. Consequently, he said, bank management will discuss and try to resolve any problems in audit reports with the bank's auditor before the reports are finalized. While there is nothing unusual about such a process of consultation in his view, it could raise some questions about the usefulness of bank auditors' opinions to CB or Bank of France in discharging their bank supervision responsibilities.

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### Recent Developments Have Increased CB Reliance on External Audits

While, to date, external auditors have not been relied upon by CB for any significant informational contribution to bank supervision, the relationship between the auditors and CB is evolving, according to CB staff. Until 1992, audit firms were prohibited by their client confidentiality responsibilities from providing CB with information. Legislation implemented in 1992 removed that barrier to reporting and now allows the auditor to provide CB with information. While there is no requirement that the auditor report any problems it uncovers unless CB specifically asks the auditor about the

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<sup>6</sup>CB has no specific requirements for calculating market risk, and every bank may judge its risk according to its own models.

issue,<sup>7</sup> auditors may report problems in banks to CB of their own volition. In addition, auditors sometimes approach CB with specific questions that make clear to CB that they have some concerns, according to CB staff. As a result, CB may then follow up with questions of its own.

While CB staff assert that they may receive auditor reports on specific problems as frequently as once a month, CNCC, the association representing accountants in France, asserts that such reports are quite rare because of the client confidentiality protection under French criminal law. CNCC representatives said that, in any case, if an auditor were to report a specific problem to CB, separate from the annual audit report, he or she would usually notify the bank first before reporting to CB.

On CB's part, we were told that since 1992, when CB was first allowed access to auditors' workpapers, it has been moving toward a greater reliance on them and would like to develop the relationship with auditors further. Part of the reason for this development is that CB is focusing more attention on internal controls and corporate governance issues, topics typically covered in an auditor's report. A greater reliance on the auditors could, therefore, help reduce some duplicative efforts. The use of auditors for supervisory information is still in its nascency, however. CB officials told us that CB does not generally ask auditors for a meeting unless CB already suspects a problem in a bank. Audit workpapers also have not been used to any great extent. CB has, however, designated one of its staff to work specifically on auditor relations.

Auditors with whom we spoke, on the other hand, were generally cautious about embracing a broader supervisory role, questioning the added cost of such efforts to banks and the willingness of their clients to pay for them.

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### CB May Disapprove of an External Auditor's Appointment

External auditors in France are to be appointed every 6 years by bank shareholders. Under the 1984 Act, credit institutions must notify CB of the appointment of their auditors, and CB has the authority to disapprove the appointment of an auditor by a bank within 2 months of the appointment. CB may disapprove of entire firms or it may disapprove of specific branches or individual partners of a firm. It may also disapprove an audit firm working for one bank but approve its working for another one.

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<sup>7</sup>An EU directive to come into effect on January 1, 1996, will impose a duty on bank auditors to report to bank supervisors if they uncover any fact that could lead to the qualification of their audit and if they uncover any breaches of laws or regulations.

While CB action against external audit firms is not frequent—one to five times a year—it has been using the threat of disapproval more frequently in order to ensure that auditors have adequate training, knowledge, and experience. In 1991, for example, CB notified two audit firms that “it could give no assurance as to the position it would adopt” if credit institutions were to notify CB of the appointment of these two firms. Such a notice is tantamount to disapproving the appointment of the firms, even though it comes before the actual appointment is made. CB took this action because the firms had failed to qualify the accounts of two financial companies despite knowledge of factors that should have led to such a qualification.<sup>8</sup> That same year, CB drew attention to another external auditor whose lack of vigilance had been cited by the regulator of the French stock exchange. In 1992, CB reviewed the audits conducted by seven firms and contested the appointment of two auditors. No actions were taken by CB against audit firms in 1993.

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### External Auditors Generally Are Not Subject to Joint and Several Liability

According to French external auditors with whom we spoke, liability is not yet a big issue for external auditors in France—the level of claims and premiums for insurance are considered to be quite low. Furthermore, external auditors in France are not subject to joint and several liability, unless it can be proven that the auditor was an accomplice in any attempted deception. In case law, an auditor is only responsible for a proper and reasonable audit and is not required to be 100-percent accurate. Consequently, we were told by external auditors with whom we spoke that civil suits have not been a big problem for audit firms since the courts have simply apportioned part of the total judgment to each of the parties in the case. Thus, for example, they said that an institution’s own accountant is likely to be apportioned more blame than its external auditor since the accountant was responsible for the development of the financial statements, according to auditors with whom we spoke.

The external auditors said that criminal cases against external auditors are more of a problem, since French prosecutors are leaning toward suits against all parties when some criminal activity is uncovered in an institution.

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<sup>8</sup>In one case, the external auditor knew that contracts in progress contained a potential liability arising in connection with a lawsuit that was not reflected in the books and records. In the other case, the CB annual report said the external auditor “failed to draw attention to the practice of undue netting of assets and liabilities and the insufficient provisions set aside by the institution.”

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# The Bank of France Has Other Bank-Related Responsibilities; AFB Administers Deposit Protection

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In addition to its role in bank regulation and supervision, the Bank of France has responsibilities for other bank-related activities such as liquidity<sup>1</sup> provision, crisis management, payments clearance, international negotiations, and lender of last resort. The French Bank Association (AFB) administers the system that protects deposits in French banks.

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## The Bank of France Has Other Bank-Related Responsibilities

The Bank of France's bank-related responsibilities are not limited to supervision and regulation. It also plays a role in liquidity provision, crisis management, payments clearance, international organizations, and serves as lender of last resort.

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### Liquidity Provider

The Bank of France intervenes in the money market to implement its monetary policy with the goal of ensuring price stability. The Monetary Policy Council of the Bank of France was made responsible for defining the terms and conditions of such operations by the 1993 Bank of France Act, which gave the Bank of France independence over defining and implementing monetary policy.

According to Bank of France officials, the Bank of France undertakes daily operations in the French money markets to supply or withdraw liquidity to the banking system, primarily in the form of repurchase agreements. Credit institutions obtain money from the Bank of France by selling securities under an agreement to repurchase them at a later date at a price that includes the agreed upon interest rate. The Bank of France may also grant cash loans to credit institutions but does this less frequently and only if the loans are collateralized.

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### Crisis Management

The Governor of the Bank of France plays a leading role in crisis management involving credit institutions in France reflecting both his authority as Governor, as well as his role as Chairman of the Banking Commission (CB). More specifically, though, the Governor is given a broad discretionary authority under Section 52 of the 1984 Banking Act to request assistance when a credit institution is in danger. This assistance may be requested in the first instance from the institution's stockholders who will be asked to contribute more capital. Such requests for assistance have been made more frequently by the Governor, particularly in the past several years, as a result of the credit industry's financial difficulties. The

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<sup>1</sup>Liquidity is the ability of an organization to meet its current financial obligations; for instance, depositors' demands for funds.

Governor's power to request assistance from stockholders stems from the general belief that, since banking is considered a special industry and money a public good, a bank's stockholders also have special responsibilities. It was also recognized by the drafters of the 1984 Act, though, that owning a bank should not be too onerous. Consequently, the Governor was given no enforcement authority with respect to his requests for assistance, other than his moral authority as Governor and Chairman of CB.

If assistance from stockholders is not forthcoming—if the shareholders do not have money to give, for example—Section 52 also allows the Governor to request assistance from the banking industry to take “the measures needed to protect the interests of depositors and third parties, ensure the smooth functioning of the banking system and safeguard the reputation of the financial centre.” Again, Section 52 does not provide the Governor with sanctions if banks do not honor his requests for assistance. Nevertheless, banks would generally not refuse such a request because of the authority of the Bank of France, according to Bank of France officials with whom we spoke.

According to Bank of France officials, the Governor has used his Section 52 authority to request assistance from the banking industry only once, in the case of the failure of Al Saudi Banque, S.A. (Al Saudi) in 1988. Although Al Saudi was a small bank, Bank of France officials said that the Governor felt that its depositors and creditors—many of whom were foreign, including several foreign banks who were lending short-term funds in the interbank market<sup>2</sup>—should be protected in order to safeguard the reputation of French financial markets. The French deposit protection mechanism does not protect deposits in foreign currencies or interbank deposits. Consequently, French banks were requested by the Bank of France to provide over Fr.fr. 200 million in assistance to Al Saudi, and those who were creditors of Al Saudi were asked to forgive that debt.<sup>3</sup> Because the primary goal of the rescue was to protect the reputation of French markets, foreign depositors and creditors of Al Saudi were

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<sup>2</sup>Banks borrow from and lend to each other in the interbank market. In its last several years of operation, Al Saudi found it difficult to borrow from banks in France, which were aware of its weak financial situation.

<sup>3</sup>Most of Al Saudi's shareholders refused to contribute funds to rescue the bank.



completely paid off, while French depositors and creditors were only partially compensated under the terms of the rescue.<sup>4</sup>

The Bank of France has no specific criteria for using Section 52, preferring some uncertainty about whether a bank will be rescued and how much creditors might lose if a bank fails as a means of encouraging investors to use good judgment in investing their funds. According to Bank of France officials, the general wording of the Section 52 mandate gives the Governor extensive leeway in determining the extent of any action that should be taken with respect to a credit institution problem. The amount of the assistance that he requests of stockholders or banks, for example, is completely up to his discretion, as is the extent to which depositors and other creditors are reimbursed under any rescue.

The Bank of France is able to act in financial crises because it has access to information about individual institutions through its role in the bank regulatory and supervisory structure and in the financial markets.

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## Payments Clearance

The Bank of France plays a major role in payments clearance, primarily because of its legal responsibility to ensure “the smooth operation and security of payment systems.”<sup>5</sup> It also has a significant amount of influence over the players in payments clearance since the 1984 Act restricts the right to issue and administer payment media to credit institutions, which the Bank of France helps regulate and supervise.

The Bank of France is in charge of managing all 102 provincial clearing houses, the computer clearing centers, the interbank teleclearing system accounting system, the regional check record exchange centers, and SAGITTAIRE (automated system for the integrated handling and settlement of foreign transactions by means of telecommunication). It also acts as settlement agent for the members of those systems. In 1992, over 3.7 billion items were presented in the clearing houses, representing a total value of Fr.fr. 55,192 billion. In addition, about 3.3 billion messages representing Fr.fr. 59,219 billion were processed by SAGITTAIRE.

There is no statutory supervision or regulation of the payment systems operating in France, over and above the supervision of credit institutions

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<sup>4</sup>Al Saudi's assets were transferred to new owners, including France's Banque Indosuez, which supplied 35 percent of the new bank's capital; Indosuez's Middle Eastern affiliate, the Hariri group of Saudi Arabia; and Thomson, a state-owned electronics firm.

<sup>5</sup>A payment system is a mechanism for transferring money between suppliers and users of funds.

undertaken by CB and the general task of oversight of the payment system vested in the Bank of France by its statutes. The regulations on interbank payment and settlement systems have been developed by interbank consultative and standardization groups in which the Bank of France is represented and where its views are given great weight due to its role as central bank and banker of the Treasury. According to a recent Bank for International Settlements (BIS) report, the Bank of France does “regularly perform audit procedures for the interbank exchange and settlement systems which it administers. It pays particularly close attention to maintaining continuity of service.”<sup>6</sup>

According to BIS, the Bank of France also “has consistently promoted measures to modernize the French payments system. Consequently, it has played an active role in reforms, carried out in consultation with the banking industry, designed to lower the cost of bank intermediation by automating payment media and rationalizing payment circuits.”<sup>7</sup>

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## Participation in International Organizations

The Bank of France participates in developing French positions with respect to financial issues in several international organizations, even though it takes the lead only on the Basle Committee on Bank Supervision under BIS auspices, on which CB is also represented.<sup>8</sup> In other groups, such as the EU and the Organization for Economic Cooperation and Development, the Bank of France and the General Secretariat of CB play active roles in negotiations and consultations, even though the lead role is played by the Treasury. COB, as the overseer of the securities markets, is the representative to the International Organization of Securities Commissions.

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## Lender of Last Resort

While France historically has not had a problem with bank runs, it has experienced numerous occasions when banks have cut other banks off in the interbank market. If the Bank of France determines that the bank being cut off is simply experiencing liquidity problems, and not solvency

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<sup>6</sup>Payment Systems in the Group of Ten Countries, BIS (Dec. 1993). Prepared by the Committee on Payment and Settlement Systems of the Central Banks of the Group of Ten Countries.

<sup>7</sup>Payment Systems in the Group of Ten Countries (Dec. 1993).

<sup>8</sup>The Basle Committee, whose primary purpose is addressing bank supervision-related issues, is made up of the banking supervisors and central banks of the Group of Ten countries: Germany, Belgium, Canada, the United States, France, the United Kingdom, Italy, Japan, the Netherlands, Sweden, and Switzerland. For further information on the Basle Committee, see International Banking: Strengthening the Framework for Supervising International Banks (GAO/GGD-94-68, Mar. 21, 1994).

problems, it may step in and provide liquidity, although it does so infrequently.

In addition, separately from his authority under Section 52, discussed above, the Governor of the Bank of France may “request” banks to provide liquidity to other institutions who need it. For example, in 1993, the Bank of France asked some of the larger banks in France to provide lower-rate overnight loans to another large bank that had large liquidity needs but could not afford the high rates that had resulted from government intervention in the currency markets.<sup>9</sup> Such requests for assistance have been made infrequently; however, and the Governor is only to ask banks for assistance if he is confident that they will accede to the request, according to Bank of France staff, since the Governor has no legal authority to enforce his requests. In very rare cases, the Bank of France may agree to cover potential losses from such lending, according to Bank of France officials with whom we spoke.

The Bank of France has no strict policy regarding when it will provide liquidity or “encourage” other banks to do so. According to Bank of France officials, the Bank of France prefers to maintain a policy of “constructive ambiguity” in order to preserve market discipline to the greatest extent possible.

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## **AFB Administers System to Protect Deposits in Banks: the Solidarity Mechanism**

AFB administers the system, called the Solidarity Mechanism (the Mechanism), whose purpose is to protect deposits in its members—the 425 banks.<sup>10</sup> Although there is no legal requirement that banks join the Mechanism, there is a provision in the 1984 Act that requires all credit institutions to belong to an association or body that is affiliated with AFEC, the umbrella organization for French credit institutions. The AFB is that association for banks, and membership in the Mechanism is a requirement for AFB members. As of July 1, 1995, when the EU deposit insurance directive took effect, all EU banks were required to belong to the deposit protection schemes of their home countries. Consequently, branches of non-French EU member banks are not required to belong to the

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<sup>9</sup>In this case, overnight interest rates had skyrocketed due to central bank action to support the French franc and thus hampered borrowing by banks needing liquidity.

<sup>10</sup>Cooperative, savings, and mutual banks have a different system for protecting depositors. Cooperative banks or savings banks have agreements with each other to resolve problems in any individual institution either through financial assistance or through merger so that no institution will fail and put depositors at risk. Mutual institutions are protected by their central organizations, which pay in case of problems.

Mechanism, but all French banks and non-EU banks are legally required to belong, according to AFB officials with whom we spoke.

The Mechanism is not a deposit insurance system in which banks pay premiums into a fund that is then used to cover insured deposits in failed institutions. Instead, after a member bank fails, the full membership of the Mechanism provides the funds as needed to cover the protected deposits in the failed bank. A determination of the level of funding needed and the burden sharing among the Mechanism's members is determined by AFB staff. Until recently, the amount each bank was assessed to address a bank failure was based purely on the bank's deposit size. As a result of complaints by larger banks who argued that they paid the most when a bank failed but were unlikely to fail themselves, the assessment system was changed. Now, only half of the agreed upon payment is based on deposit size. The other half is a per bank distribution divided evenly among the Mechanism's membership, affecting small banks—and foreign banks who often have very low French franc deposits—in the same manner as large banks.

French franc deposits, and since the beginning of 1994, EU currencies and European currency unit deposits, in failed banks are protected up to Fr.fr. 400,000 per capita.<sup>11</sup> Foreign currency deposits, deposits in branches of French banks in other countries, and interbank deposits are not protected by this system.<sup>12</sup>

There is also a global limit of Fr.fr. 200 million on Mechanism payouts in any 1 year. However, since the unused funds of the previous 2 years plus the funds of the following 2 years may be used in any 1 year, the actual ceiling for bank failures in any 1 year is Fr.fr. 1 billion. Even this limit is fairly small compared to the size of France's largest banks and indicates that the Mechanism was meant to cover small banks. If a large bank were to fail, the Bank of France, using Section 52 of the 1984 Act, or the French government would have to determine what action to take.

Since the Mechanism was established on January 18, 1990, 10 banks have failed, costing the Mechanism's membership a total of about Fr.fr. 450 billion.

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<sup>11</sup>Using a December 31, 1993, exchange rate of Fr.fr. 5.9 per dollar, the deposits are protected up to about \$67,797 per capita.

<sup>12</sup>As of July 1, 1995, when the EU deposit insurance directive became effective, deposits in branches of French banks located in EU member countries are also covered.



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# Major Contributors to This Report

General Government Division, Washington, D.C.	Tamara E. Cross, Evaluator Hazel J. Bailey, Writer-Editor Phoebe A. Jones, Secretary
European Office	Maja C. Wessels, Evaluator-in-Charge
Office of General Counsel, Washington, D.C.	Paul G. Thompson, Attorney

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