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FEDERATION
BANCAIRE
FRANCAISE

January 15th, 2010

COMMUNICATION FROM THE COMMISSION ON "AN EU FRAMEWORK FOR CROSS-BORDER CRISIS MANAGEMENT IN THE BANKING SECTOR"

The FBF's response

The French banking Federation (hereinafter FBF) is the professional organisation which represents the interests of the banking sector in France. It comprises all the credit establishments registered as banks which carry out their activities in France, i.e. more than 450 commercial and cooperative banks. Banks that are members of the FBF have 40,000 permanent branches in France, 400,000 employees and 60 million customers.

I/ THE EUROPEAN COMMISSION CONSULTATION

The FBF was interested to hear of the communication issued by the European Commission for consultation regarding the legal framework which the European Union may establish for managing crises affecting cross-border banking groups in the European Union. It shares the analysis at the heart of this consultation that the recent crisis revealed a lack of anticipation of such crises in some countries and highlighted the differences in national approaches to address these difficulties.

It has examined with a great deal of interest the measures, both preventative and curative, proposed by the European Commission to attempt to resolve these crises in a coordinated way, and would like to make the following observations.

II/ THE FBF'S OPINION ON THE VARIOUS MEASURES MENTIONED IN THE COMMUNICATION

In principle, the French Banking Federation approves the changes proposed by the European Commission. However, it points out that if we want to go beyond mere measures of coordination between national authorities, the European Union must first be equipped with a harmonised law for the treatment of banking groups in difficulty. Only this solution will enable a legally secure framework for measures such as intra-group asset transfers, restructuring and asset transfers.

A/ Preventative measures described in point 3

The FBF considers that these measures are intended to apply mainly to cross-border banking groups but that they could also apply to purely national institutions where their difficulties could have systemic cross-border consequences.

- The nature of these measures

In the FBF's view, there need to be graduated preventative measures, on the supervisor's initiative, such as: recommendation, formal notification, warning, obligation to submit a recovery plan to the supervisor, placing under special supervision, restriction to certain activities, i.e. the appointment of a provisional director to whom all administrative, management and representational powers for the company or companies involved are transferred.

- The scope of these measures

The FBF considers that these measures should apply to all entities of the group located in the EU that are subject to consolidating supervision.

- The authority which would be competent to apply such measures

Since these measures are intended to apply to all the entities of the group that are subject to consolidating supervision, the sole authority competent to apply them would, in the FBF's view, be the college of supervisors presided over by the parent company's supervisor or, in an emergency, the latter alone.

- Possibility of setting indicators or precise thresholds for these early interventions

Since these interventions concern difficulties which have not yet occurred, but are highly foreseeable, the FBF would prefer it if a fairly large degree of leeway were given to the competent supervision authority to trigger them.

- However, the FBF thinks that, should it prove impossible to set the indicators or precise thresholds for these early interventions, a redress option, in line with an emergency procedure, would have to be established.

- The "living wills" idea

The FBF thinks it is imperative to clarify this idea, both in its purpose and in its content.

- The FBF would be totally opposed to the obligation for banking groups to draw up living wills if, as Lord Turner recognises, this would mean their having to transfer their activities to subsidiaries and put in place internal "firewalls".

  Such an obligation would in effect be at odds with the aims of the single market, which are intended to create greater integration of economic operators, and would destroy the advantages held by integrated multi-service banking groups, among which are numbered many European banking groups, especially French ones (economies of scale, centralisation of key management duties, organisation by product line, mutualisation of risks, diversification, etc.).

  On the contrary, the FBF thinks that the integration card must be played fully, through requesting the extension of the application of Article 69 of the CRD, which at present only allows consolidating supervision inside the same country, to the whole of Europe. Such a solution would assume that the parent company can guarantee its subsidiaries' liquidity and solvency to the supervision authorities in each of the countries it has subsidiaries that are subject to consolidation.

- For its part, the FBF would be justified in asking banking groups a) to provide, for the purposes of prevention, the supervisor of the parent company with a list of the information required for crisis management and b) to carry out regularly with this supervisor an examination of the various types of risks which their group may face and the measures to be taken as soon as possible to address them.

  In effect, the FBF is convinced that it is essential, in order to prevent difficulties for cross-border banking groups, to put in place any methods likely to strengthen dialogue with the parent company's supervisor (regular reporting, stress testing, disaster recovery plan, etc.) and enable him to understand the group's organisation better, beyond its apparent complexity.

- The FBF would also be in favour of asset transfers between the various entities of a group inside the EU, without limiting them to transfers between the parent company and its subsidiaries, on condition they were sufficiently restricted.

These transfers would, in the FBF's view, have to be reserved for banking groups in difficulty and to be explicitly specified in the texts.

In particular, those texts would have to specify whether the transfers could be finally imposed on the shareholders of the subsidiaries concerned or not.

Those texts would have to list all the conditions to be fulfilled so that the transfer could not be contested afterwards by the shareholders of these subsidiaries or their creditors. If we refer to the conditions set in 1985 in France by the Court of Cassation, these transfers must be subject to the existence of a genuine group (that is, companies which do not solely have bonds of capital but also an approved common economic, social or financial interest in line with a policy for the entire group) and to the possibility of proving a) the presence of sufficient compensation for the entities making these transfers and b) the fact that these transfers do not exceed their financial means. This final condition would assume in practice that the company to which the assets are to be transferred can in fact acquire the assets from its own cashflow, without borrowing from the markets, and can fulfil its ratios and obligations to its customers.

B/ Measures to resolve bankruptcies (points 4 et seq.)

The FBF must point out that the communication submitted for consultation does not distinguish clearly enough between solutions driven by the logic of prevention and those intended to resolve known crises.

In the FBF's view, crisis resolution measures can range from the restructuring of a group to the transfer of some of its branches of activity. On the other hand, the FBF is opposed to any measures which might be driven by the notion of "moral hazard", since no establishment should escape being penalised by the market if it is undergoing major difficulties.

- The FBF considers that the French law of insolvency procedures is not well-suited to the resolution of cross-border banking crises.

The FBF considers that the "failure" of a financial institution could have damaging consequences for the entire economy if it occurs along classical commercial lines. This analysis seems to it to be even more applicable given that the European Union will not for some time have a completely harmonised law of insolvency procedures that can be applied to groups of companies. Given that this is the case, the law of insolvency procedures can only be applied to cross-border banking groups entity by entity, following legislation which differs from country to country.

- For all these reasons, the FBF considers that a specific mechanism must be put in place to resolve cross-border banking crises.

- **The scope of this new system** must be sufficiently wide to discourage the development of "*shadow banking*", the collapse of which was to a large extent at the root of the crisis in the United States.

  The new system must as a consequence not be restricted to deposit banks, but also must apply to all establishments which carry out at least one activity considered as a banking activity (receiving deposits, granting loans for pecuniary interest and issuing and managing means of payment).

  In the FBF's view, the new system should apply to all entities of the group located in the EU that are subject to consolidating supervision.

- **The nature of this new system**

  This new system must enable the competent supervisor, should major difficulties affect the parent company, to take control of the group to organise the continuation of operations, the transfer of assets, etc.

  It must preserve all the netting agreements, including termination rights in a way that enables the entity concerned to retain the confidence of its partners, especially in order to make new transactions and avoid consequences spreading across the financial system. To this end, the provisions specified in a framework contract referring to setting a single net total balance should not be put into doubt, unless they have a considerable and immediate impact on the method for calculating own funds. Allowing the possibility of terminating or transferring some operations for no payment would have the effect of invalidating the netting considerations.

  In particular, this new system must make it possible to expel the existing management, to distribute losses between all the creditors (taking into account the order of priority of debts) and the obligation for shareholders to agree to restructuring measures which will produce a very minor reduction in the value of their shares, i.e. reduce them to nothing.

- **The competent supervisor to decide on these measures**

  For all the reasons already given and which the crisis has very clearly brought out, the competent supervisor to decide on these measures should be the college of supervisors presided over by the parent company's supervisor or, in an emergency, the latter alone, working with his central bank.