

## Christian Noyer: Challenges facing France's Prudential Supervisory Authority

Speech by Mr Christian Noyer, Governor of the Bank of France, President of the Prudential Supervisory Authority (Autorité de contrôle prudentiel) and Chairman of the Board of Directors of the Bank for International Settlements, at the press conference of the publication of the Annual Report 2011 of the Prudential Supervisory Authority, Paris, 14 May 2012.

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Ladies and gentlemen,

Let me say first of all how pleased I am to host this press conference which has been organised to coincide with the publication of this second annual report of the *Autorité de contrôle prudentiel* (ACP).

The “newness” of this institution, which was officially set up in 2010, has no doubt contributed to the dynamism that it has shown during this crisis period. Independent, but operating under the aegis of the Banque de France, the ACP has acted efficiently and quickly to ensure financial stability and enhance the protection of customers and clients of banks and insurance companies. It has also effectively projected France's voice in international negotiations concerning its domains of competence.

Before saying a few words about the challenges facing the Authority in 2012, I would like to develop two points that in my view best characterise 2011: the solidity of our financial system in a period of severe crisis on the one hand, and the evolution of our prudential supervision methods and instruments on the other. Jean-Philippe Thierry, Vice-Chairman of the ACP, will continue this overview by talking more specifically about the insurance and mutual insurance segment.

### **I) My first point: the French financial sector has demonstrated its robustness in a context of severe crisis.**

Whereas the 2008 crisis was above all a global crisis triggered by the rapid deflation of the US real estate bubble and its associated financing, the crisis that began to spread as of mid-2011 is focused on the euro area: a crisis of sovereign debt and financial institutions in the euro area. Because the French banks have the broadest geographic coverage in Europe and because they have the most internationally open scope of activities, they have been particularly affected by the crisis. In just several weeks last summer, French banks lost nearly 250 billion dollars in US money market financing, their share prices fell to half or a third of their value and their capacity to pursue a sustained activity of financing the economy looked seriously compromised, especially as these events coincided with the tightening of regulatory constraints that put even more pressure on them.

However, this was not the case. Of course, what we call the “cost of risk” increased considerably in 2011 with the need to provision the risk associated with Greek debt. But the distribution of credit remained buoyant and the net banking income of French banks remained stable (–1.5% for the five main banking groups). Their aggregated profit, down 36% compared with 2010 to 14 billion euro was substantially higher than the 2008 and 2009 level, and this allowed them to significantly bolster their own funds and to continue financing the French economy.

The ACP's vigilance has been decisive in helping the banks to maintain a satisfactory liquidity and solvency situation. In 2011, the ACP conducted 136 on-site inspections; the risk profiles of 700 institutions were analysed according to a harmonised procedure with, notably, a sustained pace of meetings with the senior managers and heads of the main business

lines, thereby allowing the ACP to draw up detailed maps of the main risks to which they are exposed.

During 2011, the two principal dimensions of prudential supervision – monitoring credit institution liquidity and solvency – required particular vigilance by the ACP. Credit institutions' liquidity levels were monitored more closely, particularly in its dollar resources dimension; this is an area where the rationale behind the ACP's being placed under the aegis of the Banque de France – which is responsible for central bank refinancing – is clearly demonstrated.

By ensuring that the adequate risk provisioning, the reduction of management's and market participants' compensation and the allocation of the bulk of profits to strengthen own funds, the ACP has managed to ensure – over the longer term – the solvency of the French banking sector. Today, all the major banking groups have Core Tier 1 own funds ratios above 9%. This confirms their capacity to meet the targets set for 30 June 2012 by the European Banking Authority (EBA), thereby contributing to their adaptation to the future Basel III regulatory framework and the fulfilment of the objectives announced to the market.

Lastly, the ACP has resolutely placed its individual supervision within a macro-prudential perspective. Our Authority has been particularly attentive to the way banks fulfil their role in financing the economy via the extension of loans to non-financial companies and to households, in a context in which both regulatory changes and liquidity constraints, particularly in dollars, have prompted certain groups to deleverage. It has undertaken an in-depth analysis and published studies on developments in household credit as well as the reallocation of households' financial investments, particularly between bank savings products and insurance savings products.

## **II) 2011 – and this is my second point – was a year that saw the reinforcement of the methods used in prudential supervision.**

*It was above all the year in which the process of merging banking and insurance supervision was completed.*

Having been set up in the midst of the crisis that we are going through, the ACP continually reviews the methods it uses to deal with new challenges.

On the one hand, the traditional activities of on- and off-site inspections have been enhanced by taking the best procedures and practices from each of the two sectors, leading to improved quality and comparability in the assessment of the situation of the different institutions being inspected. During the year, the ACP thus developed a more cross-functional mode of operating, thereby responding to the intention that led the Government to merge the former authorities in 2010. The ACP's College has set out priorities for the supervision of each of the two sectors in a coordinated manner, and the ACP has set up an autonomous and cross-functional research directorate.

On the other hand, in line with international and European initiatives, the ACP's supervisory methods are complemented by the "stress test" approach to ever more complex scenarios and by the monitoring of the systemic nature of certain institutions. Organised by the European authorities (the EBA for banks and the EIOPA for insurance companies) and the Basel Committee respectively and implemented concretely in France by the ACP, these approaches supplement the individual supervision of banks and facilitate the macro-prudential supervision of the financial system.

*The ACP's supervision methods have also fully taken on board its remit with respect to consumer protection, which is an essential condition for maintaining consumer confidence in the French financial sector.*

The ACP's mandate is to promote, in coordination with the AMF – the report of our joint unit will be presented to you shortly – the sound conduct of market players' commercial practices

without hampering responsible financial innovation that is suited to each category of customers.

In 2011, the ACP thus took a whole range of measures, of which I will only mention the main ones. The ACP has put in place a system for monitoring advertising and contracts that enable it to analyse promotional material. By means of a survey conducted among over 300 institutions, the ACP also checked compliance with the provisions made by banks to facilitate banking mobility. In addition, in order to reinforce its activities at local level, the ACP works with the Banque de France branch network, which is mobilised to carry out inspections of insurance intermediaries. All of these actions have made it possible to identify good practices in the area of the marketing of banking and insurance products and five recommendations in the area of consumer protection were published during 2011. I may mention in particular the recommendation relating to the measures that insurance undertakings must implement to deal with conflicts of interest when consumers are offered unit-linked insurance policies composed of bonds and other debt securities from an issuer that is financially linked to the insurance undertaking.

To conclude on this point, I will add that, although the legislation applicable to the revised sanctions procedure was only published in the middle of the year, the ACP began to exercise its power to impose sanctions with three decisions that mainly concern breaches in terms of internal control and anti-money laundering procedures.

### **III) 2012 is a year of intense preparations for the forthcoming regulatory developments.**

Throughout 2011, the ACP actively participated in the preparation of the transposition of the “Basel III” agreements into European law which is due to be adopted in mid-2012 and in the negotiations preparing the entry into force of “Solvency II”.

At national level, the preparation of banks for the new “Basel 2.5” and “Basel III” regulations was one of the priorities of the on-site inspections and of the teams responsible for preparing authorisations for the use of internal models notably for market risk.

In 2012, the ACP will continue with its work helping the market to adjust to the new regulatory frameworks, notably by putting in place, in coordination with the supervised institutions, the new procedures for prudential reporting.

With regard to banks, I also see a number of areas where decisive progress is expected in 2012. Without going into detail at this stage, I will just mention:

- the work on the regulatory framework applicable to systemic banks, which will be pursued with the idea of taking into account that, owing to their size relative to a domestic market, certain banks can generate major systemic risk in a given country;
- the finalisation of liquidity regulation, which must revisit the stress test scenarios applied to banks’ assets and liabilities as well as the scope of assets deemed to be liquid;
- the adaptation of the French regulatory framework for all of the institutions that are currently credit institutions according to our national definition but which will lose this status under the new European definition, which is much more restrictive;
- the overhaul of the banking crisis resolution mechanism, with the French mechanism – in anticipation of the forthcoming European projects – not having been updated to integrate the more powerful crisis management instruments resulting from the G20 guidelines;

- the deliberations, in both the European and French frameworks, about better organisation of banking activities and of the relationships between investment banking and retail banking.

The ACP will ensure that there is coherence between these different initiatives so as to avoid any unanticipated negative impacts.

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Before handing over to Jean-Philippe Thierry, I would like to stress that, although the difficult macroeconomic context persists, I remain confident about the robustness of the French financial sector. It has the necessary fundamentals to actively participate in the financing of the economy and in particular of SMEs and VSEs, whose activity is mainly financed by bank lending. The return of growth in France and the health of the financial sector depend on this.

It is a fact that rigorous risk management in each institution is indispensable to ensure financial stability. These past few years have also shown the full scope of the role of the supervisory authorities and have proved that the interventionist nature of their activities is a crucial element that regulation, however exacting, cannot replace.

The forthcoming developments in prudential regulation in the banking and insurance sectors will only be fully effective if the efforts made by the institutions in 2011 to prepare and adapt are followed through. One of the ACP's main tasks in 2012 will be to help them to do this.