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RÉPUBLIQUE FRANÇAISE

European Commission's consultation paper on CRD IV

RÉPONSE DU MINISTÈRE DE L'ÉCONOMIE, DE LA BANQUE DE FRANCE ET DU SECRÉTARIAT GÉNÉRAL DE L'AUTORITE DE CONTRÔLE PRUDENTIEL

General Comments:

This document sets out the French response to the European Commission consultation document regarding further possible changes to the Capital Requirements Directive (CRD). This response has conjointly been produced by the French Treasury, the Banque de France and the French supervisory authority in charge of the banking sector (Autorité de Contrôle Prudentiel).

France is committed to build a more resilient banking system thanks to stronger capital and liquidity cushions. However, France will remain cautious about the cumulative impact of reforms proposed by the European Commission on banks' ability to finance efficiently economic growth. Therefore, appropriate measures should be selected and calibrated carefully. France also wants to ensure that measures will not penalize business models which proved to be relatively resilient throughout the financial crisis, such as non-joint stock companies, universal banks and financial conglomerates. Finally, the implementation of the selected measures should take into consideration the speed, nature and extent of the financial and economic recovery in order to avoid impeding economic growth.

Within the overall package of proposed reforms to the CRD, France has identified the following priorities:

Liquidity

France welcomes the proposals to strengthen and harmonize liquidity risk management. Nevertheless, France is deeply concerned by the assumptions proposed by the Commission for the calibration of the new ratios, which may significantly hinder the banking sector's ability to finance the economy. In particular, France warns against a too narrow definition of liquid assets in the liquidity coverage ratio in order: (i) to diversify the sources of liquidity and avoid concentration risk on government bonds, (ii) not to drain the interbank and corporate funding. Therefore, France wants to integrate into liquidity buffers not only cash and qualifying securities from sovereigns and central banks, but all the assets eligible for refinancing by central banks (i.e. certificate of deposits, covered bonds, corporate and financial institution bonds…) as well as equities, under specific rules and ceilings. In addition, France calls for substantial changes in the assumptions of the net stable funding ratio which lead to deny banks their transformation role.

Capital

France welcomes the EU proposals which will strengthen banks' capital on a further harmonized definition. France supports strict criteria to determine eligibility in banks' capital, and especially the focus on loss-absorbency. This common framework though must take into account the specificity of business models, in particular financial conglomerates which cover banking and insurance activities, as long as they comply in fully equivalent terms to the criteria and rules of deductions.

Leverage Ratio

Leverage ratio is a one size-fits-all tool which has strong limits to capture risk. Moreover implementing such a ratio on a global basis would penalize retail or universal banks. Therefore, France strongly opposes any introduction of leverage ratio within the Pillar I of Basel 2. Leverage ratio should only be treated as an undisclosed pillar 2 indicator for supervisors in their dialogue with financial institutions.

Counterparty risk

France is in favor of reinforcing capital charge which is required to cover the counterparty risk and the internal control framework. Nevertheless, the calibration of the counterparty risk charge needs to be adapted in order to reflect appropriately the CVA risk. The quantitative impact study should help find the correct calibration in that respect.

Mitigating pro-cyclicality

France strongly favors changes in accounting rules as the prime procyclicality mitigants. We encourage the IASB to amend its expected cash flow draft in order to make it more countercyclical and less costly to implement and support the BCBS proposal to amend the IASB proposal with respect to forward looking provisioning. On the other hand, France has serious concerns with capital buffers as a means to mitigate the pro-cyclicality of prudential rules. Capital buffers would be redundant with pillar II requirements. Furthermore capital buffers raise serious concerns of implementation, especially as far as shareholders rights are concerned.

SECTION I

Liquidity standards for credit institutions and investment firms

I. <u>Liquidity Coverage Requirement</u>

Question 1: Comments are sought on the concept of the Liquidity Coverage Requirement and its likely impact on institutions' resilience to liquidity risk. Quantitative and qualitative evidence is also sought on the types and severity of liquidity stress experienced by institutions during the financial crisis and – in the light of that evidence – on the appropriateness of the tentative calibration in Annex I. In particular, we would be interested in learning how the pricing of banking products would be affected by this measure.

1. **French authorities fully support the principle of an enhanced and harmonized regulatory liquidity risk framework within EEA.** This new framework should however give room to the use of internal methodologies to abide the new requirements (as it has been put in place in France since the adoption of the Order of 5 may 2009 relative to identification, measurement, management and control of liquidity risk). French authorities' views are that using internal methodologies for supervision of liquidity risk is i) the best incentive for complex banking groups to develop, adapt and improve continuously their internal methodologies for liquidity risk management across their business units or lines and ii) the best way for supervisors to conduct an appropriate liquidity risk control, tailored to each group particularities. On the contrary, relying extensively on standardized ratios for any types of credit institutions is highly likely to be misleading for institutions as well as for supervisors.
2. Considering the Liquidity Coverage Ratio, France has some concerns as regard the current proposal. The stress assumptions are related to both an idiosyncratic stress and market stress. They are not consistent with a market wide stress scenario and appear excessively conservative considering the French banks behaviors during the financial crisis.
3. As regard the denominator of the LCR, <u>the assumptions should be revised down to be consistent with observed facts in the worst crisis experienced in decades:</u>
    - The assumptions on retail deposit run-off (7.5% and 15% or higher) must be reassessed downward in order to take account of the fact that French retail deposits turned out to be remarkably stable during the recent financial crisis;
    - It cannot be assumed that all the liquidity back up lines would be drawn down; Flows out assumptions should be reviewed on the basis of the observed data, for instance in the recent crisis; Thus<u>, in case of systemic crisis, corporates decrease their working capital needs immediately and massively.</u>
    - Most contractual obligations <u>cannot be denied or considered asymmetrically</u>. There is no reason to impose the assumption that committed liquidity lines granted by a bank to other financial institutions would be totally drawn while the bank could not draw on the committed lines granted to it by other financial institutions (0% for the beneficiary bank as an inflow and 100% for the

granting bank as an outflow). In addition, no act of refusal of honouring a commitment was observed during the recent financial crisis.

4. As regard the numerator of the LCR, France suggests that the proposed definition of high quality liquid assets encompass all the assets eligible for refinancing by central bank credit operations. In addition, this definition of liquid assets must be extended to equities, financial institutions deposits and bonds issued by these institutions (with appropriate haircuts) upon condition that these securities are traded in large, deep and active markets characterized by a low level of concentration. As a matter of facts:

    - central bank eligibility is the most objective and tangible criteria for identifying liquid assets in a market wide stress scenario;
    - Conducting monetary policy requires coordinated action of central bankers. This action may be based on a range of tools, among which liquidity pricing or volume management come first; thus, adjusting criteria of assets eligibility or modifying haircuts applied on these assets are only one of them. Therefore, building the definition of high quality liquid assets mostly on the criteria of eligibility for refinancing by central banks is unlikely to create a constrain for the conduct of monetary policy by central banks (in particular, if other categories of assets are included in the liquidity buffer in addition to the assets eligible for refinancing by central banks, –*see below*);
    - liquid assets should also comprise assets whose liquidity has been reality-checked in the most acute liquidity crisis in decades (i.e. certain equities);
    - excluding bonds issued by financial institutions leads to deny the interbank funding; these assets should be included within the liquidity buffer with adequate haircuts;
    - focusing on a too narrow definition may increase market instability or reduce the liquidity of the excluded assets which may be damageable for the economy as a whole; on the contrary, including all assets eligible to central banks in the buffer could have a counter-cyclical effect (enlarged eligibility during stress periods, reduced eligibility otherwise).
    - finally, high quality liquid assets should not be agency rating-dependent in order to avoid the liquidity risk position of the entire banking industry being dependent on rating agencies.

Question 2: In particular, views would be welcome on whether certain corporate and covered bonds should also be eligible for the buffer (see Annex I) and whether central bank eligibility should be mandatory for the buffer assets?

5. The definition of liquid assets eligible for the numerator must be extended to corporate and covered bonds fulfilling conditions of liquidity (traded in large, deep and active markets characterized by a low level of concentration). The conditions should be defined more simply and qualitatively (and subject to supervisor appraisal) in order to allow some of these securities to be included in the buffer. Requiring banks to hold significant portion of domestic sovereign debt could not be acceptable: concentration on domestic sovereign bonds in banks portfolios may be problematic in the context of a public debt crisis. It is moreover in opposition to the CEBS Guideline 5 ("Guidelines

on Liquidity Buffers and Survival Periods”) stating “They should avoid holding large concentrations of particular assets”

6. Inclusion of equities and bonds issued by financial institutions (with appropriate haircuts) should also be considered (cf. question 1).
7. Even if France supports the inclusion of all the assets eligible for refinancing by central bank credit operations, it suggests that the central bank eligibility is not mandatory for the buffer assets. As a matter of fact, (i) the list of eligible assets is not harmonized amongst jurisdictions et (ii) some assets are not eligible whereas they look highly liquid during periods of stress (e.g. equities).

Question 3: Views are also sought on the possible implications of including various financial instruments in the buffer and of their tentative factors (see Annex I) for the primary and secondary markets in which these products are traded and their participants.

8. The proposed criteria are too specific and should be kept qualitative and subject to supervisor’s assessment (with possible guidance from the CEBS/EBA on the matter). If criteria are imposed for eligibility in terms of intrinsic liquidity characteristics, these must be verifiable. Current proposals related to bid-ask spreads imposed on covered and corporate bonds in the BCBS proposals are not observable to any party and to supervisors in particular

II. <u>Net Stable Funding Requirement</u>

Question 4: Comments are sought on the concept of the Net Stable Funding Requirement and its likely impact on institutions' resilience to liquidity risk. Quantitative and qualitative evidence is also sought on the types and severity of liquidity stress experienced by institutions during the financial crisis and – in the light of that evidence – on the appropriateness of the tentative calibration in Annex II. In particular, we would be interested in learning how the pricing of banking products would be affected by this measure.

9. The objective of the “Net Stable Funding Ratio” (NSFR) proposed is not clear enough, whether it aims at either :
    - Restricting excessive transformation on a going concern basis: in this case, the conception of the ratio will have to be fundamentally revamped as a stress scenario would not be justified;
    - or at ensuring funding capacity of an institution over a one year period in a market-wide stress scenario : in this case, the underlying assumptions should be modified in order to take into account the changes in business model that would necessarily take place over such an extended stress period.
10. <u>Therefore, its conception and possible calibration seems inappropriate :</u>
    - Conception: The stress conditions which are defined to determine the available and required amounts of stable funding over a one-year time horizon are built

on the postulate that banks would not be able to adjust their strategy to the liquidity crisis for a one-year period. The NSFR takes into account neither the ability of banks to react in such a period so as to reduce their maturity mismatches nor the fact that capital markets can run with normal conditions in the case of a firm specific stress scenario.

- Calibration : Setting a minimum threshold of 100% denies the key role played by the banks in reallocating financial resources (using short term resources to finance long term loans), that is their transformation role ;

11. If the calibration of the ratio is not changed, it would have material consequences:

    - Banks would have incentives to reduce the volume of long term loans ;
    - Banks would be forced to finance part of their short-term loans with long-term resources;
    - The NSFR risks favouring securities versus loans. Indeed, for loans granted to corporates, 50% of stable funds are required to cover the amount that will mature within one year. For securities issued by corporate and maturing within the same period, there is not a demand of stable funds.
    - This ratio might induce an increase of interest rates due to the fact that banks would have to raise a huge amount of stable funding –in competition with government bond programs- in order to be in compliance with this ratio ;

12. To sum up, <u>it is necessary to modify the definition of the net stable funding ratio with the following priorities</u>**,** taking also into account the results of the Quantitative Impact Study (QIS):

    - Adjust downward the threshold of 100% in order to preserve the role played by banks in the maturity transformation (for instance 75%); more generally speaking, the threshold of the NSFR must be consistent with the calibration of assumptions for assets and liabilities;
    - Increase the portion of retail deposits (85%) that could be considered stable to a level that is more consistent with historical data; in a market wide stress scenario, flows of deposits are not significant
    - Adjust downward the portion of loans having a residual maturity of less than one year (for instance: 85% to 50% if granted to retail customers and from 50% to 20% if granted to corporate customers) that could be considered stable. Indeed, the crisis showed that companies and individuals tended to delay their investments and reduce their loan requests if they are going through a period of instability; in addition, banks will adjust their business model as explained above;
    - Over a one year horizon, roll over assumptions related to short term funding (funding from interbank markets or repos markets in particular) should be consistent with the ones applied for loans with residual maturity less than one year. Otherwise, short term funding to the whole economy would be penalized (cost increase and decrease in volumes);
    - Reduce the weight of liquid securities (notably equities) for required stable funding assessment (for instance 50% to 20%). Indeed, these securities showed a high level of liquidity during the financial crisis. The ability to repo or sale

these assets imply the assumptions to be reviewed and more detailed by type of equities.

Question 5: Comments are in particular sought on the merits of allowing less than 100% stable funding for commercial lending that has a contractual maturity of less than one year. Is it realistic to assume that lending is reduced under liquidity stress at the expense of risking established client relationships? Does such a differentiation between lending with more and with less than one year maturity set undesirable incentives that could discourage for instance long term funding of non-financial enterprises or encourage investment in marketable securities rather than loans?

13. See our previous answer and the need of clarification on the nature of the ratio (stress ratio or business as usual ratio). The underlying assumptions should be modified in order to take into account the changes in business model that would necessarily take place over such an extended stress period (or the overall calibration if the ratio becomes a structural one, without any stress assumptions). If there is no change in this ratio, the incentives could be counter-productive (less costly to have ABCP maturing within one year than a more than one year debt originated and kept within the balance sheet).
14. Other amendments to the definition of net stable funding ratio should be considered:
    - increase the portion of retail deposits (85%) that could be considered stable to a level that is more consistent with historical data; in a market wide stress scenario, flows of deposits are not significant ;
    - adjust downward the portion of short-term loans (85% if granted to retail customers and 50% if granted to corporate customers) that could be considered stable; indeed, the crisis showed that companies and individuals tended to delay their investments and reduce their loan requests if they are going through a period of instability; in addition, banks will adjust their business model as explained above.
    - reduce the proportion of equities held by banks (50% to 20%), including those registered in the trading book, which is needed to be refinanced in the long term. Indeed, these securities showed a high liquidity during the financial crisis.

Question 6: Views are sought on possible implications of inclusion and tentative "availability factors" (see Annex II) pertaining to various sources of stable funding for respective markets and funding suppliers. Would there be any implications of the tentative required degree of coverage for various asset categories for respective bank clients?

15. The stress conditions to determine the available and required amounts of stable funding over a one-year time horizon must take into account the fact that banks would be able to adjust their strategy to the liquidity crisis for a one-year period, so as to reduce their maturity mismatches.
16. It seems difficult to justify that 50% of corporate loans and 85% of retail loans maturing within one year should be funded at a more than one-year term.

III. <u>Completeness of legislative approach</u>

Question 7: Do you agree that all parameters should be transparently set at European level, possibly in the form of Technical Standards by the EBA where parameters need to reflect specific sub-categories of retail deposits?

17. France stands for the adoption of technical standards in order to have transparent and uniform parameters within Europe.

Question 8: In your view, what are the categories of deposits that require a different treatment from that in Annexes I and II and why? Please provide evidence relating to the behaviour of such deposits under stress.

18. Some categories of deposits are subjected to specific rules and tax treatment in France. For instance, the saving account which is called "livret A" and used to provide funding for state-subsidies housing raises a large portion of money owing to tax advantages. Therefore, it requires a different treatment from the others.

IV. <u>Scope of application</u>

Question 9: Comments are sought on the scope of application as set out above and in particular on the criteria referred to in point 17 for both domestic entities and entities located in another Member State.

19. France stresses that these ratios should be applied <u>at the consolidated level</u> for the following reasons:

    - Even through an application at the consolidated level, supervisors have the possibility to tackle the possible funds transfers' restrictions applicable within the banking group. The assessment of possible obstacles and consequent adequate levels of liquidity resources to be maintained locally has to be conducted at the first place by the group and has to be checked and challenged by the supervisors in charge of this banking group.
    - An application at both solo and consolidated levels would be counter-productive: if the ratios (and particularly the LCR) are to be applied at each and every solo level within the group, there will be no need for an application at the consolidated level (since this level would be met by construction); if the (sub)consolidated level is used only to provide the possibility of a waiver for some legal entity, then the scope of this sub-consolidated level should be defined in accordance to the waivers considered.
    - An application at solo level may be appropriate for some institutions that have an autonomous management of their liquidity resources and liquidity risks. Conversely, such a level would not be suitable for entities belonging to banking groups with a centralized liquidity risk management. French authorities' view is that the CRD should not prescribe a specific type of organization among banking groups and should refrain from creating new impediments to liquidity funds transfers. Requiring legal entities to keep

liquidity buffers locally would be a new constraint on liquidity flows within EEA and would hamper financial solidarity within groups, and as a result, financial stability within Europe.

20. For all these reasons, national supervisors in Europe should be allowed to apply solo or sub-consolidated levels only as an exception after having demonstrated that consolidated requirements and supervision (conducted within colleges of supervisors) do not fulfill the objectives of this national supervisor.

Questions 10 & 11: Should entities other than credit institutions and 730K investment firms be subject to stand-alone liquidity standards? Should other entities be included in the scope of consolidated liquidity requirements of a banking group even if not subject to stand-alone liquidity standards (i.e. financial institutions or 50K or 125K investment firms)? Should the standard apply in a modified form to investment firms? Should all 730K investment firms be included in the scope, or are there some that should be exempted?

21. France supports the inclusion of entities which are not subject to stand-alone liquidity standards in the scope of consolidated liquidity requirements of a banking group upon condition that the regulatory perimeter is the same as the perimeter used for solvency ratio calculation.

V. Treatment of intra-group transactions and commitments

Question 12: Comments are sought on the different options and in particular for how they would operate for the treatment of intra-group loans and deposits and for intragroup commitments, respectively. Comments are also sought as to whether there should be a difference made between the liquidity coverage and the net stable funding ratio.

22. All intra-group transactions must be treated symmetrically in order not to create distortions between the entities and for sake of internal consistency.
23. Contractual obligations cannot be considered asymmetrically. There is no reason to impose the assumption that committed liquidity lines granted by a bank to other financial institutions would be totally drawn while the beneficiary bank would not receive any amount from this commitment. If it had been the case, it would have been a default trigger according to the French law. In addition, there was no observable act of refusal to honour a commitment during the recent financial crisis.
24. The treatment of intra-group transactions and commitments must not lead to maintain in a group more liquidity than what it globally needs and to prevent the group from allocating the liquidity in an efficient way in a time of stress.

VI. Supervisory responsibility for branch liquidity

Question 13: Do stakeholders agree with the conclusion that for credit institutions with significant branches or cross-border services in another Member State, liquidity

supervision should be the responsibility of the home Member State, in close collaboration with the host member States? Do you agree that separate liquidity standards at the level of branches could be lifted based on a harmonised standard and uniform reorganisation and winding-up procedures?

25. The branches are included in their headquarters legal entities and home supervisor should be responsible for the supervision of the banking groups (or legal entities), in close collaboration with the host member States.

VII. <u>Monitoring Tools</u>

Question 14: Comments are sought on the merit of using harmonised Monitoring Tools, either in the context of Supervisory Review or as mandatory elements of a supervisory reporting framework for liquidity risk. Comments are also sought on the individual tools listed in Annex III, their quality and possible alternatives or complements.

26. Harmonized monitoring tools could be helpful if they give a real value added to the understanding of the liquidity risk profile of a given institution. That is why France considers the good level of definition for these monitoring tools is the supervisory college. France supports the initiative taken by CEBS to issue an “identity card”, which promotes some key tools (adapted to each banking group : ie, the maturity scale is based on the assumed maturities and not on the contractual ones, which are not necessary relevant : customers deposits are at view but are stickier than that).

27. France is cautious about the publication of such tools. There is a clear risk of mis-understanding by market participants. Indeed raw figures, for example in contractual maturity mismatches, are likely to be misleading if interpreted without an enhanced understanding of the bank specificities and environment (e.g. national specificities, accounting rules…).

Question 15: What could be considered a meaningful approach for monitoring intraday liquidity risk?

28. This question is highly related to the position of the institutions within the settlement and payment systems and is currently contemplated jointly by BCBS and CPSS. Due to the particularity of this issue, France is convinced of the relevance of internal methodologies in this matter.

SECTION II

Definition of Capital

Question 16: What are your views on the prudential appropriateness of eliminating the distinction between upper and lower Tier 2, and of eliminating Tier 3 capital?

29. France supports the European Commission proposal to simplify the capital structure. Eliminating the distinction between UT2 and LT2 has the benefit of clarifying the capital structure of banks. Effectively, as instruments in T2 are meant to absorb losses on a gone concern, it is tantamount to not recognise UT2 any longer. The question arises as to the future status of the outstanding stock of UT2.

30. France also supports the proposal that Tier 3 capital is eliminated. As a matter of fact, Tier 3 is meant to cover market risk only. As banks can cover their market risk by other types of own funds – i.e. T1 and T2, which are of a higher quality, then eliminating Tier 3 capital does not raise major prudential concerns.

Question 17: Are the criteria proposed for Core Tier 1, non-Core Tier 1 and Tier 2 sufficiently robust and how might they be improved?

31. As a general comment, France agrees with the proposed criteria for Core T1, non Core T1, and Tier 2.

32. France believes that a level-playing field must be ensured at an international level without penalizing European business models that proved to be resilient during the financial crisis, such as non-joint stock companies or financial conglomerates which cover banking and insurance activities. In that respect, France encourages the Commission to take into account the guidance currently developed by CEBS that seeks to clarify the extent to which the specificities of non-joint stock companies can be taken into account in the Core Tier 1.

33. Moreover, France fully supports the view that tax treatment of non-Core tier 1 and Tier 2 instruments should not be a criterion for eligibility for regulatory purposes. The criteria should only aim at focusing on truly loss absorbent instruments in regulatory capital, and not discriminating against instruments that are very robust from a prudential viewpoint, because of tax issues. Furthermore, such criterion would not resolve unlevel-playing field issues as tax rates and regimes vary from one country to another.

34. France has reservations as regards the proposal to exclude minority interests from the common equity component of Tier 1. Since core tier one will become a regulatory ratio, this proposal leads to a situation where a group core tier one ratio integrates 100% of the risk weighted assets of consolidated subsidiaries (denominator) but cannot take into account 100% of consolidated subsidiaries' capital (numerator). There appears to be no good reason for this imbalance in the prudential treatment of the denominator (RWAs) and the numerator (Minority interests) as minority investors do effectively support part of the risks of the subsidiary.

35. This would have a very large impact on the European common market. It would penalize the business model of cross-border groups, especially in the context of the EU single market: local authorities sometimes impose for a group not to take control of 100% of a bank in order to have part of the capital owned by local investors. Independently of such constraint, it can also be a well devised strategy for banks to share the risks associated with investments in foreign markets by bringing along local investors. The proposed deduction will penalize banks in their external growth strategy and/or will change their behaviour in relation to the capitalisation of their subsidiaries.

36. Therefore, France proposes different options for a more balanced treatment:

- The best option would be to exclude RWA supported by minority interests from the denominator of the group core tier one ratio (first best). Thus, the group core tier one ratio on a consolidated basis would reflect in a symmetrical and balanced way both capital and risks taken by the subsidiaries.
- Including minority interests up to a limit in the numerator of the group core tier one ratio is another possibility. There can be instances where the local subsidiary is capitalised well in excess of the Core Tier One ratio of the group measured on a consolidated basis. In this case, one could argue that the Group unduly benefits from this overcapitalisation through the inclusion of minority interests in the Group's regulatory capital. Indeed this "excess capital" is not available to support the risks of the whole group. To prevent this situation, minority interests in subsidiaries could be included only up to the level corresponding to the Tier One ratio of the group. The portion exceeding this threshold would cease to be recognised in Core Tier One capital of the group.

37. FR notes that the Commission's Consultation paper has not put forward any consideration or proposals with regard to the deduction from Core tier 1. FR believes that the Commission should carry out a thorough analysis on this issue.

38. In particular, <u>the full deduction of banks' participations in insurance companies from Core Tier 1 capital would penalize financial conglomerates</u> whilst this integrated business model proved to be resilient to the financial crisis. Double counting of own funds between banks and insurance companies is already addressed under the current regime of the **financial conglomerate Directive (EC 2002/87). Since 2002, this framework** has been operational in European countries and proved to be efficient. This regime should keep on applying since the implementation of the full deduction rule would be redundant with the additional requirements that apply within the supervisory scope of financial conglomerates.

39. France supports the principle of deducting differed tax assets (DTA) from predominant core tier one capital as their value can be affected in periods of economic stress. But full deduction of DTA may raise issue because some DTA derive from differences of tax and accounting rules across jurisdictions. France suggests to assess with the results of the quantitative impact study if the full deduction of DTA is bearable and if not, to examine a limited recognition of DTA in core tier one capital, with an appropriate threshold. Alternatively, DTA deductions could be applied only beyond a certain time horizon.

40. Moreover, the results of the QIS will need to be taken into account when calibrating the deductions. France notes that some adjustments may have heavy impacts for the European common market which could penalize business models of universal banks,

conglomerates and cross-border groups. In a nutshell, FR believes that it is critical to arrive at a more robust and more harmonized definition of capital that is currently the case. This is key to restore confidence in the banking system and to ensure a level playing field between institutions. Depending on its impact, appropriate transitional mechanisms such as deduction in part and / or from tier 1 first and then from Core tier 1 must be devised.

Question 18: In order to ensure the effective loss absorbency of non-Core Tier 1 capital, would it be appropriate under certain circumstances to require the write down of the principal amount of an instrument or its conversion to a Core Tier 1 instrument? To what extent should the trigger for write-down / conversion be determined objectively or at the discretion of an institution or its supervisor?

41. FR considers that non core tier 1 instruments, regardless of their legal form and accounting classification, must be able to effectively absorb losses on a going concern through an appropriate loss absorbency mechanism. The latest financial crisis showed that such instruments failed to absorb losses. Thus, such mechanism will improve the quality of non-Core tier 1 instruments, at least in some countries, compared to the present situation. It will also contribute to create a level playing field between countries.
42. In France, the current practice is that the loss absorption mechanism is triggered by the earlier of (i) a breach of the solvency ratio and (ii) when the supervisor has determined, in view of the deteriorating financial condition of the issuer, that a breach would apply in the near term.

Question 19: Which of the prudential adjustments proposed have the greatest impact? What alternative, robust treatments might be considered and what is their prudential rationale?

43. The prime imperative concerning prudential adjustments is international harmonisation. However, we highlight that it will be imperative to await and analyse carefully the results of the current impact assessments which are conducted at both individual and macroeconomic levels in order to fully understand the impact of all these prudential adjustments. Moreover, the latter must be business model neutral. As a matter of fact, it would not be understandable to apply measures that penalize certain business models, such as joint stock companies, universal banks and financial conglomerates covering banking and insurance activities while they proved to be relatively resilient throughout the financial crisis.

Question 20: Are the proposed requirements in respect of calls for non-Core Tier 1 and Tier 2 sufficiently robust? Would it appropriate to apply in the CRD the same requirements to buy-backs as would apply to the call of such instruments? What restrictions on buy-backs should apply in respect of Core Tier 1 instruments?

44. FR believes that the Commission should not depart from CEBS guidelines on this issue: see para 55 of the Commission document and the CEBS guidelines on article 57(a).

Question 21 : "What are your views on the need for further review of the treatment of unrealized gains? What would be the most appropriate treatment of such gains ?"

45. France agrees that it is appropriate that prudential filters and deductions be made generally in respect of Core Tier 1.

46. France fully agrees with the Commission services that there is a need for further review of the treatment of unrealized gains. In that respect, France is concerned with Level 3 fair value instruments for which gains have been calculated using internal models based on unobservable data. Unrealised gains may not be reliable. They may not be completely and immediately available to absorb losses. Inclusion of such gains directly in equity can raise a problem with regard to the quality criteria that must be met for inclusion in regulatory capital. Therefore there is a need to consider how to deal with the valuation uncertainty of these instruments.

47. However France believes that the review of the treatment of unrealized gains should be based on the final IFRS 9 as adopted in the EU and should take into account the final decision of the Basel Committee on the new definition of own funds. This review should also be coupled with an impact assessment.

48. Considering the potentially negative consequences on banks' capital structure of the removal of the prudential filter on unrealized losses, some appropriate transitional measures should be considered.

Question 22: We would welcome comments on the appropriateness of reviewing the use of going concern Tier-1 capital for large exposures purposes. In this context, would it be necessary to review the basis of identification of large exposures (10% own funds) and the large exposures limit (25% own funds)?

49. FR believes that it is too early to undertake such review. First, the large exposures regime has just been revised and strengthened as part of the CRD II. Firms need some stability in the prudential rules they apply. Second, it is a far more reaching review than just reviewing the denominator: one should also think of changing the level of the numerator as well.

Question 23: What is your view of the purpose of contingent capital? What forms and triggers would be most appropriate?

50. Contingent capital is a very new instrument, very complex and its purpose is not yet clear. One should bear in mind that the financial crisis has shown that capital instruments must be simple and understandable so that the markets can have a clear grasp of the quantity and quality of own funds and a clear view on the real financial solvency situation of the bank. Contingent capital does not go into the direction of 'simplicity'. Moreover, the use of contingent capital, which is considered as debt instruments until it converts, and as such, can be found in pensions funds for instance, could have a far-reaching impact on retail markets. If the role of 'contingent capital' were to be discussed, the following basic conditions must be considered upfront : (i) before conversion, the instruments cannot be counted as regulatory own funds, nor needless to say, as equity; (ii) the trigger must be activated independently of the bank and of the supervisor, in order to make it automatic and certain.

Question 24: How should the grandfathering requirements under CRD II interact with those for the new requirements? To what extent should the grandfathering provisions of

CRD II be amended to bring them into line with those of the new capital requirements under CRD IV?

51. Suitable arrangements should be found out to manage the transitory period and the entering into force of the new standards. They should be decided on the basis of the current QIS and macro impact assessment currently conducted by the Basel Committee. This should also be devised to ensure that, in full compliance with the G20 decision, the measures are phased-in in such a way as to not impede financial and economic recovery

Section III

Leverage ratio

Question 25: What should be the objective of a leverage ratio?

52. France believes that the leverage ratio must not be a mandatory element of the CRD. Replacing a risk-based measure whose principle is right (even if some incentives have to be and are in the process of being corrected) with a blunt measure, less sophisticated but equally binding must be avoided absolutely. If it was the case, all the work done internally to enhance risk management capacities may receive less attention because of the necessity to fulfill a cruder constraint.

53. Having two such different tools (a risk based ratio and a leverage ratio) for only one objective is not consistent. Therefore, France wants: (i) to keep this type of new measure as a pillar 2 instrument within the Basel II framework in order to foster a bilateral dialogue between a bank and its supervisor and (ii) to limit disclosure requirements about the leverage ratio, to avoid any confusion.

Question 26: Which element of going concern capital do you consider would be a more appropriate basis for the leverage ratio? What is you rationale for this view?

54. France believes that the definition of capital should be consistent with the one used for the risk based capital requirements. The Tier 1 capital constitutes in our view the most appropriate capital measure for the leverage ratio as it encompasses all going concern loss-absorbing capital. It is also important to ensure a symmetric treatment of capital and exposures by deducting assets that are deducted from both capital and exposures.

Questions 27 & 28: What is your view on the proposed options for capturing the overall extent of an institution's derivatives business in the denominator of the leverage ratio? What is your view of the proposed approach to capturing leverage arising from credit derivatives?

55. Regarding the treatment of derivatives exposures, France believes that they should be integrated at a value more relevant than the accounting value. As a matter of fact, the latter is generally very low compared to the risks taken. The current exposure method of Basel II should be used instead of the mark-to-market value. Finally, the notional amount should be taken for credit derivatives that are similar in economic substance to guarantees.

Question 29: How could the design of the leverage ratio ensure that it would act as an effective constraint only in benign economic conditions?

56. The design of the leverage ratio must take into consideration the following items:

- highly liquid assets should be excluded from the total exposures measurement for calculating this leverage ratio because the leverage ratio may provide disincentives for banks to hold highly liquid assets while the LCR ratio forces them to do so.
- Interbank exposures should be excluded from the total assets: Although a lot of efforts have been made to rebuild confidence in the interbank market, the inclusion of interbank exposures in the total of assets may provide disincentives for banks to use this means of funding, which will become costlier.
- the accounting value for the treatment of securitization does not appear relevant given the current differences in the accounting systems related to de-recognition aspect. It would not ensure a comparability of the supplementary measure at international level and not appropriately take into account the leverage entailed by securitized exposures that are de-recognised from the accounting statements;
- any off balance sheet items, such as commitments, undrawn credit facilities, guarantees should be included in the leverage ratio with a 100% conversion factor. Off balance-sheet exposures should not be ignored for an appropriate measure of leverage because such these exposures entail a high credit risk.

Question 30: What would be the appropriate calibration of a leverage ratio?

57. The appropriate calibration of a leverage ratio will be devised based on the results of the current impact assessments. However, whatever these results are, the leverage ratio must not become the binding constraint which should undermine the effectiveness of risk-based Basel II ratio. Finally, as a general principle, the calibration should be adjusted by any change in other accounting framework to ensure international comparability. An institutional framework to ensure that these adjustments will be made in a consistent manner at the international level should be established upfront.

SECTION IV

Counterparty credit risk

Question 31 : Views are sought on the suggested approach regarding the improved measurement or revised metric to better address counterparty credit risk. With respect to suggestion to incorporate - as an interim measure - a simple capital add-on by means of calculating the loan-equivalent CVA charge, views are sought on the implications of using VaR models for these purposes instead.

58. <u>France is broadly in favour of incorporating a capital add-on to better cover the credit valuation adjustment risk.</u> As a matter of facts, during the crisis, the latter was a greater source of losses for French banking institutions owing to the deterioration in the credit quality of institutions' counterparty. However, France believes that further work would be useful to try to find an alternative to the bond-equivalent measure proposed to design such capital add-on which may be a too rough proxy for CVA risk.
59. In addition, it is important for European Commission Services to ensure that these proposals will not doubly penalize institutions which would have to cover their CVA risk whereas they are currently required to deduct CVA from their P&L in order to cover their counterparty risk regulatory expected losses. Indeed, in case of counterparty's default, the CVAs are used to offset part or totality of the loss. CVA treatment should probably be aligned with prudential treatment which is applied to credit loss provisions in order to avoid any double counting. This issue need to be covered in the directive.
60. Using VaR models for the CVA charge is an appropriate long term objectives. But currently there is not sufficient evidence that VaR models used for calculating CVA capital charges would be robust enough for prudential purposes. So an interim measure, such as the one proposed, is therefore warranted upon condition that former comments are taken into account.
61. Finally, the market risk charge calibration will likely need to be very significantly adapted to appropriately reflect the CVA risk. The quantitative impact study should help find the correct calibration in that respect.

Question 32 : Stakeholders are invited to express views on whether the use of own estimates of Alpha should continue to be permitted subject to supervisory approval and indicate any evidence in support of those views.

62. France supports the proposal to enable banks to keep using their own estimates of alpha given that this use is subject to supervisory approval and given that the proposal would suggest strengthening requirements for the supervisory review of these estimates. However, France insists that CEBS is entrusted with the elaboration of guidelines in order to harmonize supervisory practices across European Union and avoid regulatory arbitrages.

Question 33: Views are sought on the suggested approach regarding the multiplier for the asset value correlation for large financial institutions, and in particular on the appropriate level of the proposed multiplier and the respective asset size threshold. In addition,

comments are sought on the appropriate definitions for regulated and unregulated financial intermediaries.

63. France supports the application of a multiplier for the asset value correlation. However, France is not in favour of increasing it more for large financial institutions because the asset size threshold may lead to a cliff effect. Furthermore, the calibration of this multiplier needs to be more demonstrated and be computed on the basis of data reflecting the variety of jurisdictions.
64. It should be investigated whether a higher multiplier should not be applied to the AVC of unregulated financial intermediaries.

Question 35 : Views are sought on the suggested approach regarding central counterparties and on the appropriate level of the risk weights to be applied to collateral and mark to market exposures to CCPs (on the assumptions that the CCP is run to defined strict standards) and to exposures arising from guarantee fund contributions.

65. France supports the suggested approach regarding central counterparties (CCP) which would reinforce the incentive for institutions to use these entities for OTC derivates. Therefore, France is in favour of assigning a very small (zero percent for instance) risk weight to counterparty collateral and mark-to-market exposures to CCPs that meet the enhanced standards and which use by the bank satisfies the banking supervision. France also believes that other exposures arising from guarantee fund contributions would require a capital charge that is higher than the current effective capital requirement of zero. Nevertheless, the calibration of all these respective risk weights needs to be informed by the quantitative impact study.

Question 36: Views are sought on the risk management elements that should be addressed in the strong standards for CCPs to be used for regulatory capital purposes discussed above. Furthermore, stakeholders are invited to express their views whether the respective strong standards for CCPs to be used for regulatory capital purposes should be the same as the enhanced CPSS-IOSCO standards

66. France is fully in favour of ensuring that a CCP has in place strong risk management procedures due to the fact that a CCP may concentrate a lot of risks. Therefore, a CCP should be subject to the requirements proposed in the European Commission’s consultation paper regarding risk management, exposures monitoring, back-testing exercises, financial resources and stress testing. In addition, France strongly wants that a CCP is subject to strong requirements regarding its liquidity risk management. This should include the risk of access to central bank money. We therefore fully support the Eurosystem location policy regarding CCPs and insist that CCPs should be located in the currency area of the instruments it clears in order to secure unfettered access to central bank liquidity. Given their systemic importance, CCPs should be able to cope with any kind of liquidity shock. Finally, Prudential and CPSS-IOSCO standards should be the same.

Question 37: Views are sought on the suggested approach regarding enhanced counterparty credit risk management requirements. Do the above proposed changes to the counterparty credit risk framework (in general, i.e. not only related to stress testing and backtesting) address fully the observed weaknesses in the area of risk measurement and management of the counterparty credit risk exposures (both bilateral and exposures to CCPs)?

67. The crisis revealed a number of shortcomings in the current risk management of counterparty credit risk. France believes that the current framework does not ensure that institutions have set up efficient collateral management process, make enough stress testing and back testing and give attention to the wrong-way risk. Therefore, the proposed measures in order to enhance the counterparty risk framework should be appropriate to address most of the weaknesses which were identified by the Basel Committee upon condition that all the previous comments made by French authorities are taken into account. Particularly, liquidity risk needs to be subject to further work.

SECTION V

Countercyclical measures

Question 38: The commission services invite stakeholders to perform a comparative assessment of the three different methods (i.e. ECF, incurred loss and IRB expected loss if it could be used for financial reporting) for credit loss provisioning form 2002 onwards based on their own data.

68. We are not in a position to provide such quantitative assessment.

Question 39: "Views are sought on the suggested IRB based approach with respect to the through the cycle provisioning for expected losses as outlined above."

69. It is worth recalling that the new impairment model should provide a proper answer to the weaknesses highlighted by the financial turmoil as regards the current incurred loss model. The current incurred loss model is highly pro-cyclical, since allowances can only be booked when a specific credit risk event is materialized. From a general point of view, we welcome the effort made by the IASB to set up an expected loss provisioning model allowing an earlier recognition of credit risk in the accounts.
70. However, how the expected cash flow model will address pro-cyclicality concerns will depend both on the IASB's final design of the model and the capabilities of firms to accurately assess expected credit losses over the life of the loans. The IASB proposal also raises operational difficulties that are currently discussed in dedicated expert group.
71. In that context, we see the merits of the work done by the Commission to provide constructive input to the debate on provisioning. The proposal to leverage off the data and processes of the Basel II framework may represent a valuable solution in order to address operational and financial stability concerns.
72. However, we caution against a potential conflict between this proposal and the ongoing work undertaken by the IASB to enhance loan loss provisioning accounting standards. As stated in paragraph 133 of the Commission's consultation paper, in April 2009 the G20 recommended that the IASB should work in co-operation with the Basel Committee of Banking Supervisors on improving the accounting standards (IAS39) for loan loss provisioning. The Basel Committee is currently discussing with the IASB and banks on an alternative simplified proposal that aims to address supervisory concerns and operational challenges. We fully support the Basel Committee proposal since it better integrates expected loss estimation processes with bank risk management systems, draws from information used for Basel II purposes, improves the quality of the expected loss estimates while reducing undue burden on banks and is less procyclical than the IASB proposal.
73. In this context, the importance of keeping close connection between prudential rules and accounting standards should be reminded and therefore we think that the Commission should wait for the outcome of the ongoing work between the IASB and the Basel Committee before taking any further decision.

Questions 40 & 44: Do you agree with the proposed dual structure of the capital buffers? In particular, we would welcome your views on the effectiveness of the conservation buffer and the counter-cyclical buffer, separately and taken together, in terms of enhancing the resilience of banking sector going into economic downturn and ensuring the flow of bank credit to the "real economy" throughout economic cycle. What are the relative merits and drawbacks of capital buffers versus through-the-cycle provisioning for expected losses with respect to minimizing procyclical effects of current EU banking regulation?

74. It is generally admitted that the prudential rules increase the pro-cyclicality of the financial system, especially in economic upturn. Some historical data reveal the pro-cyclical behavior of capital requirements due to the fact that banks deplete their own funds in economic upturns instead of rebuilding them. This depletion in own funds may reflect the willingness of banks to take advantage of investment opportunities in recovery periods. Such behavior may leave the banking sector vulnerable to negative shocks. However, France believes that accounting standards are more pro-cyclical factors than prudential rules. Therefore, changes in accounting regime, especially by implementing countercyclical loan loss provisioning must have priority over any prudential rules reform. Consequently, France has strong reservations about the proposed dual structure of the capital buffers the purpose of which is the mitigation of prudential rules pro-cyclicality. In addition, France believes that the current prudential rules allow the national supervisors to apply measures according to the pillar 2 of the Basel II framework in order to dampen the capital requirement pro-cyclicality. Nevertheless, efforts should be made to make prudential rules less pro-cyclical, in particular efforts which aim at imposing through-the-cycle risk measures in the calculation of capital requirements.
75. Finally, any measure which aims at requiring banks to hold an additional buffer or buffers that can be drawn down in times of stress may be ineffective due to the fact that the latest financial crisis demonstrated that banks were incited not to draw down on their buffers under pressure from investors.

Question 41: Which elements should be subject to distribution restrictions for both elements of the proposed capital buffers and why?

76. France believes that it is not appropriate to impose distribution restrictions as the regulatory own funds continue to be depleted. As a matter of fact, the link between risk-taking and distributions of dividends is not demonstrated. In addition, current rules have already allowed authorities to impose distribution restrictions when the level of regulatory own funds approaches the minimum capital requirements.

Question 42: What is the appropriate timing – following the breach of capital buffer targets – for the restriction to capital distributions to start? Should the time limits for reaching capital buffer targets be determined by supervisors on a case-by-case basis or harmonized across EU?

77. France believes that it is not possible to determine either the speed to which the appropriate capital buffers should be built up nor the level at which the buffer should be at any moment. As a matter of fact, no rule is sufficiently robust in all circumstances to warn supervisors that capital buffers are above or under the target from which capital buffers should be built up or depleted.

Question 43: What is the most suitable macro variable (or group of variables) that may be used in the counter-cyclical buffer to measure the dynamics of macro-level risks pertinent to the banking sector activities?

78. France is sceptical on tying a capital buffer to macro-economic variable, such as credit index: when the variable reveals strong economic conditions, banks would be required to build buffers which would be depleted in economic downturn. In addition, France is sceptical about the ability of a variable capital buffer to cushion against cycles throughout various and diverging economies.

Question 45: Do you consider that it would be too early to fully assess the cyclicality of the minimum capital requirement?

79. France is in favour of assessing of the cyclicality of the minimum capital requirement even if France believes that accounting standards are more pro-cyclical factors than prudential rules.

SECTION VI

Systemically important financial institutions

Question 46: What is your view of the most appropriate means of measuring and addressing systemic importance?

80. The assessment of whether a financial institution, a market or an instrument is systemically important should carefully balance between the need for objective criteria and the need for flexibility in identifying systemic entities.

- Regarding objective criteria, we agree that the crisis demonstrates that the size of individual firms is not the central issue: most failing banks were not among the biggest banks of their countries, while some large banks proved to be resilient thanks to diversification effects. Institutions which are not systemic *per se* may become systemic as a herd when they take identical risks and move together as part of a larger group (origination of subprime mortgages, use of securitisation and re-securitisation techniques). We should put the emphasis on factors such as interconnectedness and substitutability but also on the activities which are the most likely to generate systemic risk such as securitization or OTC trading.

- We agree with the Commission's view on the need to adopt a flexible view on identifying systemically important institutions: not attaching ourselves to the legal form, while still taking fully into account fundamental differences in risk between financial sectors. It is the same need for flexibility which militates against the establishment of a list of systemic institutions. In order to avoid threshold effects, we should beware of determining ex ante whether a firm is systemic or not at one point in time. A list could indeed turn out to be counterproductive by increasing moral hazard and encouraging regulatory arbitrage. It would also largely fail to recognise that systemic risks depends also on geographical considerations (i.e. global, European, national.

81. By the same token, the multi-dimensional nature of systemic risk may be addressed by a package of prudential measures :

- First, we have very significant reservations as regard capital or liquidity surcharges for systemically important banks; should a capital surcharge be established, it should play only as a temporary measure within the pillar 2 supervisory assessment.

- The crisis demonstrated that liquidity management issues were often at the origin of some banking failures. In addition to the new liquidity rules currently defined, systemic institutions could be required to develop advanced internal approaches of liquidity in order to improve the understanding of their liquidity risk. Those approaches should be subject to approval by supervisors and examination through supervisory colleges.

- In the same vein, tougher large exposures rules for systemically important banks may be considered, since an unexpected default of a single counterparty might result in the failure of a financial institution and, via contagion, lead to a wider systemic crisis. In particular, one should consider whether it is appropriate or not that any credit institution, whatever its systemic nature, may incur an exposure to a client or group of connected clients up to 25% of its regulatory capital. Generalising large exposures regime would enable to address the “too-interconnected-to-fail” issue, not adequately captured in liquidity or capital requirements. In addition, it would be consistent with a continuum approach, as it would be implemented in proportion of their level of capital.

- Furthermore, enhancement to firm-wide risk management and corporate governance of systemically important banks should be also considered. It is notably important to better align incentives between stakeholders and management.

82. As an alternative or a complement to stricter prudential measures, other ways to reduce systemic risk could be envisaged :

- A systemic risk levy targeted on financial activities that give rise to negative externalities on the basis of the “polluter pays” principle should be further considered, while taking into account the impact of the regulatory reform package currently under discussion. To be effective in mitigating systemic risk, a levy must apply to all financial institutions, whether they are regulated or not. In order to ensure a level playing field, the purpose, scope, basis and rate of this levy should be set and approved at international level. The levy must be implemented in such a way as to avoid competitive distortion among the various banking and financial systems. It should be levied at consolidated level of taxable entities, taking into account supervisory responsibilities. The sole purpose of the levy being to reduce negative externalities, it should offer no benefits in return and not be mistaken with an insurance mechanism. We absolutely have to avoid situations in which payment of taxes or levies is understood as a de facto bailout policy insurance.

- Governments need effective resolution tools for dealing with distressed financial institutions and halting the propagation of systemic risk. More specifically, authorities must be granted enhanced powers required to re-organise a group that has fallen into distress, bypassing if need be the normal bankruptcy proceedings and general legal principles governing shareholder rights. These powers should be harmonised, both globally and at European level. Although the idea of establishing a large-scale resolution fund should be dismissed, the capacity of deposit guarantee funds for preventive intervention must be strengthened. The European Union must also promote the creation of a European legal framework to facilitate intra-group asset transfers and the harmonisation of bankruptcy laws for financial institutions.

83. We agree to be cautious as regards policy options aiming at reducing systemic risk via imposing a certain style of corporate structures, or restricting banks’ business activities. We should beware of their unintended consequences, ending in punishing business models which have proved to be resilient during the crisis. The issue is less to assess whether a bank is too big, or too complex a priori, than to determine whether it is well risk-managed enough, through strengthened supervision.

- The definition of resolution arrangements for systemically important banks in advance, so called “living wills”, could have far-ranging consequences on the way banks conduct their business, not necessarily beneficial to financial stability. Their proposed use by supervisors in a "pre-emptive way", imposing ex ante simplification of banks' organisation in view of their potential liquidation is problematic. It takes discontinuity and dismantling of the organisation as a starting point, whereas the link between simplified banking structures on the one hand, and financial stability on the other, is not obvious. The crisis showed that complexity, no more than size, is not in itself central in the "too-big-to-fail" issue. We should rather promote in-depth contingency planning, regularly updated and reviewed, for the information of the supervisor.

- The debate about systemic firms echoes also concerns about the activities and business models of some institutions. The presumption is that smaller and leaner financial institutions would pose less risk to financial and macroeconomic stability than larger and more diversified ones. Yet, facts suggest this cannot hold as a general lesson from the crisis. Indeed, those banks which suffered most from the crisis were precisely those which were more specialized, such as investment banks. By contrast, large universal banks, reliant on a large deposit base, could withstand the shocks comparatively better. Therefore, restrictions on size or on activities would be equally dangerous. As already mentioned, diversification effects, which imply a certain size, have been a resilience factor during the crisis. Limiting banks' size and/or splitting banking activities will not necessarily prevent systemic risks.

Question 47: How could the Commission services ensure a consistent prudential treatment of systemic importance across financial sectors and markets?

84. It is crucial that supervision fully takes into account the systemic nature of a firm. The crisis has established a broad consensus on the need to submit systemically important banks to enhanced supervisory scrutiny. While the business model of those banks may vary (business organised on a globally integrated basis and/or via separately national banks), their systemic nature calls for enhancing their supervision on a consolidated basis, within supervisory colleges, focusing on capital adequacy, liquidity and governance of the overall group.

SECTION VII

Single rule book

Question 48: In which areas are more stringent general requirements needed given national or other circumstances? Is Pillar 2 a sufficient tool to address specific negative circumstances at credit institutions and if not, how could it be strengthened?

85. France supports a reduction in the number of national options and discretions within the CRD. With the objective of full harmonisation. It is important to make sure that same things are treated the same way by all the banks across the European Union. France has not identified areas where national or market specific circumstances necessitate a more stringent general requirements or stricter rules.

86. France believes that Pillar 2 is a sufficient tool to address particular negative circumstances at individual credit institutions; that is why France supports the Commission's proposal that the European Banking Authority should develop draft technical standards on Pillar 2 in order to harmonize the application of the CRD across Member States.

Question 49: What is your view of the suggested prudential treatment for exposures secured by mortgages on residential property outlined above? What indicators and their respective values do you consider appropriate as possible preconditions for the application of the preferential treatment of exposures secured by mortgages on residential property?

87. First of all, we would like to emphasise the fact that we support the Commission plan to harmonise the prudential treatment across Member States toward a single rule book, and in particular concerning the treatment of exposures secured by either commercial or residential real estate.

88. Regarding more specifically the proposed prudential treatment of exposures secured by real estate property which is outlined in the document, we support the introduction of a "hard test" on losses and development of the national real-estate market when waiving the independence criterion. We agree with the introduction of limits similar to the one presented in Annex VI, Part 1 point 58 - which was initially settled in relation to exposures secured by mortgages on commercial real estate – to the residential real estate, as it will certainly foster the alignment and harmonisation of treatment between commercial and residential real estate. Nevertheless, it is not certain that the ratio has to be the same for the two categories of exposures, since the risk and price dynamics on residential real estate might be different from the those of commercial real estate. That is why we also suggest that the CEBS / EBA explores as much as possible the data that will be provided by European banks in the framework of the EU QIS on this topic and, if necessary proposes a complementary common impact study to determine if the introduction of such thresholds for residential real estate is meaningful given the data and what could be the most appropriated thresholds for exposures secured by real-estate–for instance even in the residential real estate category prime mortgage and buy to let mortgage could have different results-.

89. The indicators and their respective values which are proposed seem relevant for both Loan-to-Value (LTV) and Loan-to-Income (LTI) requirements. As a matter of fact, the French market has a common restrictive practice that banks grant loans with terms such that households should not spend more than one third of their disposable income on servicing their debt. This ratio is also recommended by the household debts commissions for the prevention of over indebtedness. We support the generalisation of maximum LTI ratio of 1/3 (but with a margin of flexibility given to the credit institutions subject to a precise justification and documentation of the exception) as a harmonised treatment. However, we underline that such a requirement should also give some precisions on the calculation of the reference income that is necessary for a harmonized treatment: Is it the income at the time when credit is granted? Is the income updated till the final maturity of the credit (requirement that would be very burdensome for credit institutions)? Is it a ratio including all debts –like the French market practice- or only the mortgage?

90. We also agree with the LTV ratio of 80% as it is already a requirement in the French transposition of the CRD (Order of 20 February 2007), instead of the "substantial margin" actually proposed in the CRD.

Question 50: What is your view of the suggested prudential treatment for exposures secured by mortgages on commercial real estate outlined above? What indicators and their respective values do you consider appropriate as possible preconditions for the application of the preferential treatment of exposures secured by mortgages on commercial real estate? In particular, are additional preconditions needed to ensure the soundness of this treatment? Do you believe that the existing preferential risk weight applied to exposures secured by mortgages on commercial real estate should be increased?

For questions 49 and 50, any qualitative and/or quantitative evidence supporting your arguments would be greatly appreciated.

91. As for residential real estate, we support the introduction of a "hard test" as a general precondition for applying a preferential treatment to exposures secured by mortgages on commercial real estate, as these data could be provided by credit institutions and will reflect the soundness and relevancy of the treatment (article 58 a) and b) of the CRD).

92. However, we think there is no need to amend or increase the existing levels of the LTV and/or mortgage lending value benchmarks, neither to settle additional preconditions to ensure the steadiness of the treatment - in addition to the generalisation of hard test as explained above - since the current prudential treatment is sufficiently sound (article 55 of the CRD).

93. For the same reasons of consistency of the current treatment, we do not believe that the existing preferential risk weight applied to exposures secured by mortgages on commercial real estate should be increased.

Question 51: Should the prudential treatment for exposures secured by mortgages on residential property be different from the prudential treatment for exposures secured by mortgages on commercial real estate? If so, in which areas and why?

94. The alignment of prudential approach (i.e. the introduction of a hard test) between exposures secured by mortgages on residential real estate and commercial real estate make sense, but it is important to take into consideration the fact that the risk on residential real estate –especially the prime mortgage one- might be different from than the risk on commercial real estate. That is why we support the idea of a common framework, by i) inset general “hard test” for both categories, and ii) to introduce new thresholds for residential real estate –possibly with a distinction between buy to let and prime mortgages, but with a specific level to determine in relation with the effective risks stand for this activity.

95. Once again, even more than the alignment of treatment between residential and corporate real estate, the most important issue in our view is the alignment of treatments among the Member States.

Question 52: What is your view of the merits of introducing measures that would help to address real lending throughout the economic cycle? Which measures could be used for such purposes? What is your view about the effectiveness of the possible measures outlined above?

96. The proposed ideas to introduce measures that would help to address real estate lending throughout the economic cycle could be interesting to consider further, but at this stage, seem difficult to implement. First, it will be uneasy to determine a homogeneous, reliable and relevant adjustment factor on a long term basis. Then, the question on how to define a consistent mortgage lending value on a national basis will be a complicated issue to deal with. Moreover, residential and commercial real estate lending can follow different cycles, which does not facilitate the analysis at this point.

97. In our opinion, the LTV and LTI ratios are sufficient effective and potent tools to avoid real estate bubbles, as the resilience of French market has proved.