BANKS

Banks are value-added service companies. Some 500,000 people are employed by the profession across its various activities, including some 400,000 based in France. 2002 saw progress made in key projects for shaping the prudential, accounting and tax frameworks of the banking and financial service sectors both in France and Europe.

SOLVENCY RATIOS: FINAL STAGE TOWARDS BASEL II

The Basel Committee is due to publish its recommendations in November 2003, while the "Mc Donough" ratio is set to replace the "Cooke" ratio at the end of 2006. Introduced over ten years ago, this ratio is no longer appropriate given the increasing sophistication of banking activities and the progress made in methods developed by banks to assess risk.

The new recommendations should, for the most part, be covered by a European directive applicable to all credit institutions in Europe as of 2006. The aim is to define a regulatory framework common to all banks, enabling a more finely tuned management of risk and greater control.

Still room for improvement

The demands of French banks relate mainly to the system's balance and its implementation at a European level.

In order to improve the balance, it is necessary to:

- clearly define concepts, such as equity capital and provisioning rules;
- reduce certain weightings used in the evaluation of credit risk as regards both the corporate finance portfolio (specialised financing) and the retail portfolio;
- improve the use of risk reduction techniques: securitisations backed by financial guarantees, broader recognition of credit derivatives;
- facilitate the changeover to the more advanced methods recommended by the Basel Committee, notably by basing models on shorter statistical data sets.

At a European level, a directive (CAD III - Capital Adequacy Directive) has been in preparation since the end of 2002. It is very important, for reasons of coherence and fair competition, that this directive transposes the Basel recommendations, not only in terms of content but also timeframe and method of application..

Mobilised banking teams

The Basel Committee is aware of the significant resources required to implement this directive and has set up a working group with this in mind. Close co-ordination between the various regulators will be necessary right up until the practical application stage so as to avoid any distortion of competition.

Moreover, the application of the new solvency ratio has been made more complicated by the simultaneous adoption of new accounting standards, which could affect the (sought-after) stability of bank's equity capital. It is therefore vital to closely co-ordinate the IAS standards and the Basel Committee provisions so that both are underpinned by the same approach to banking activities and their specific characteristics.

French banks have made significant efforts over the past two years to keep to the timetable for implementation: a number of teams have been working on this vast project, which involves the time-consuming formatting of statistical data sets for banks that opt for the internal calculation method. For this reason, banks would like to have a certain degree of flexibility in interpreting the acceptance criteria when adopting advanced methods, particularly when it comes to the length of the statistical sets, notably by taking into account the quality of monitoring procedures, which can be verified by the banking authorities. Lastly, they would like to see current prudential standards stabilised until 2006.

CALCULATING CREDIT RISK

The Basel Committee sets out three methods for calculating capital adequacy requirements in relation to credit risk:

- standard method: the rules are decided by the regulator and draw on external ratings;
- basic internal rating: the default rate is calculated using data collected by the financial institution;
- advanced rating: all calculations are made using the financial institution's statistical sets

Studies are underway to explore the possibility of allowing banks the option of combining different methods according to their portfolios or geographical location.

TAXATION: SOME FRENCH CHARACTERISTICS

Taxation of French banks

French banks are in a unique position in Europe in that, until recently, they have been subject to two tax deductions — a tax on wages and a tax on financial institutions — that can be qualified as unique, given that the same taxes are not payable by other European Union companies or banks.

Although introduced on a temporary basis under the amended finance act of 1982, the Contribution des Institutions Financières – CIF (contribution of financial institutions) were made permanent in January 1985. This tax cannot be deducted from earnings and is calculated as 1% of "general expenses", i.e. primarily payroll expenses. The 2003 finance act is expected to phase out the CIF within three years.

HEAVY TAXATION OF SAVINGS

Savings made by individuals resident in France are subject to four different types of tax:

- all savings are taxed as the unused portion of taxable income;
- financial asset holdings are subject to wealth tax;
- income on savings is generally subject to income tax and/or social security withholding taxes;
- capital transfers (donation or inheritance) are subject to transfer tax, and if a sale is involved, capital gains are taxed when the disposals exceed EUR 7,650.

France is the only country that levies tax on savings in four successive stages like this. Moreover, in 1997 and 1998, there was a significant increase in taxation on savings and in the complexity of the relevant regulations (for example, withdrawals from personal equity plans and unit-linked life insurance policies). Lastly, the scope of tax deductions on dividends was reduced.

The necessary elimination of the wage tax

Since January 1st 1968, French banks have been subject to a wage tax on their VAT-exempt domestic and European operations (essentially intermediation and stock market activities), which represent on average 70% to 75% of their total activity.

The average tax charge on wages paid by French banks is around 10% of payroll expenses. For the French banking federation as a whole, the cost is around EUR 1.8 billion.

An anachronistic "stock market tax" on reformed financial markets

All stock market buy/sell transactions involving any kind of security on the spot or futures market are subject to a stamp duty called the "stock market tax", which is calculated on a degressive scale. The tax is paid by the person on whose behalf the trade is transacted. This tax penalises French markets and financial intermediaries because the other main financial centres are not subject to this type of taxation. It concerns all transactions carried out by an individual or company resident or established in France and concerning shares listed on the Premier Marché and Second Marché of the Paris Bourse, bonds that are exchangeable or convertible into shares, index-linked or participating bonds and securities listed on the Premier Marché or Second Marché of the Paris Bourse. The elimination of this stock market tax would have a fiscal impact of around EUR 0.3 billion.

AGREEMENT REACHED ON THE FINANCIAL CONGLOMERATES DIRECTIVE

After more than ten years of discussion, the European Union finally approved the directive on the supervision of financial conglomerates in December 2002. The aim is to establish the group-level supervision of financial conglomerates, which until now have only been subject to sector-based, non-homogeneous regulations, notably in terms of differences between banks and insurance companies. This meant that the supervisory authorities were unable to draw on a global framework enabling the evaluation of systemic risk.

The aim of the directive, which will apply to European banks with an equity interest of over 10% in an insurance company (or vice versa), is to improve the exchange of information between the relevant supervisory authorities, the definition of responsibilities and the assessment of risk in each sector.

It notably involves verifying that the conglomerates' equity capital is sufficient to cover the risks and that the same capital is not used twice. The EU discussions essentially revolved around finding a method to ensure that the same equity capital cannot be used twice to hedge risk. In this regard, Brussels proposed the calculation of equity capital ratio at group level.

DIRECTIVE ON "FINANCIAL GUARANTEE CONTRACTS"

The directive on financial guarantee contracts was adopted on June 6th 2002 and is due to be implemented by the member states before December 27th 2003. In France, it will principally apply to collateral in the form of financial instruments, which are broadly used in settlement/delivery and credit transactions.

This directive introduces an EU-wide legal regime for financial guarantees, collateral or the transfer of ownership of cash or securities, including repurchase agreements. If one of the two parties is a financial institution, the other can be an industrial or trading company. The validity and effectiveness against third parties of the guarantee agreement do not require any formal specification. The contract remains valid even if bankruptcy proceedings have been instituted against one of the parties.

The FBF has two observations to make: first, how can the right of the beneficiaries of financial guarantees to effectively use the guarantees as if they were the owner be incorporated into current French law? Second, how does the conflict of law rule stipulated in the directive fit with the provisions of the Hague Convention "concerning the law applicable to certain rights in respect of securities held with an intermediary".

These issues are highlighted in 2003 by the work being carried out to prepare for implementation of the directive in France. The use of guarantees by beneficiaries requires that the following be covered under French law: on the one hand, procedures whereby a person who is not the owner of an asset can nevertheless use it as if they were the owner, and, on the other, the consequences of this use on the rights of the actual beneficiary of the guarantee and those of the party pledging the guarantee. The European Commission is also debating whether to rewrite the conflict of law rule to bring it into line with the provisions of the Hague Convention. The FBF does not agree with this, the main reason being that it may lead to delays in the transposition of a directive that the banking profession is unanimous in considering highly useful.

THE MEN AND WOMEN OF THE BANKING SECTOR

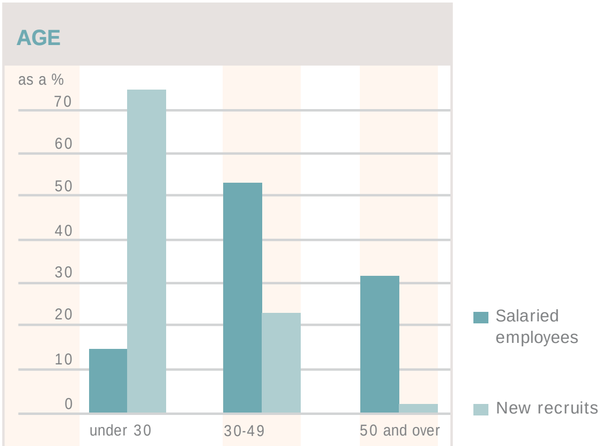
Banks are value-added service companies and, as such, the men and women that work for them represent their biggest assets. Consequently, banks dedicate significant resources to training: 4% of their payroll.

Banks expect to see major changes over the next few years both as a result of natural demographic changes in the sector (over one-third of employees will be 60 by 2010) and a continual process of technical innovation which is transforming their day-to-day working practices and their businesses.

Recruitment and headcount*

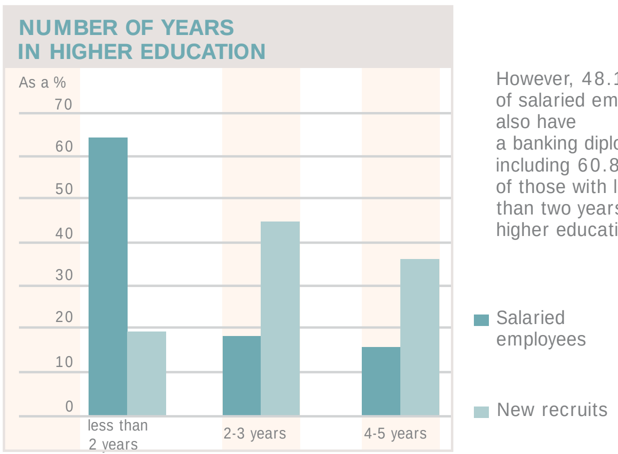
Recruitment of young people…

Almost three-quarters of those recruited are under 30

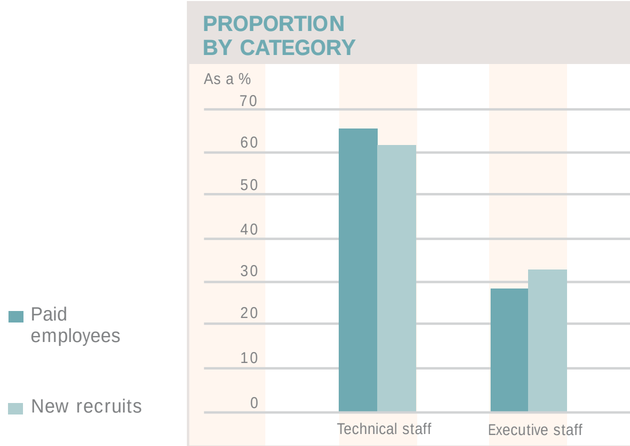


…with higher qualifications…

Among new staff, the proportion of those recruited with less than 2 years' higher education is falling sharply in favour of those with 4-5 years and, in particular, 2-3 years of higher education

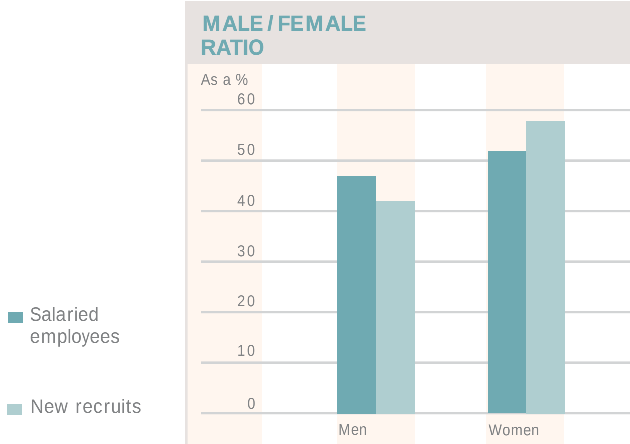


However, 48.1% of salaried employees also have a banking diploma, including 60.8% of those with less than two years' higher education



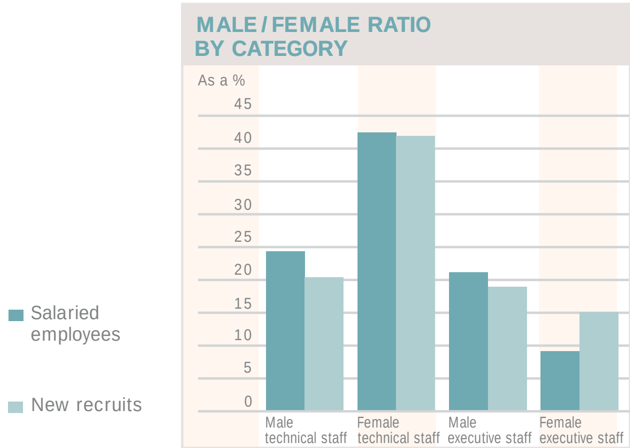
…more executive staff…

Among the new recruits, the proportion of technical staff is declining in relation to executive staff



…more women…

The majority of new recruits are women. They represent an even higher proportion in this category than in terms of the full workforce.



…more female executive staff…

The disparity between men and women is narrowing among newly recruited executive staff

…more retail banking employees

The retail banking activity accounts for nearly two-thirds of total employees

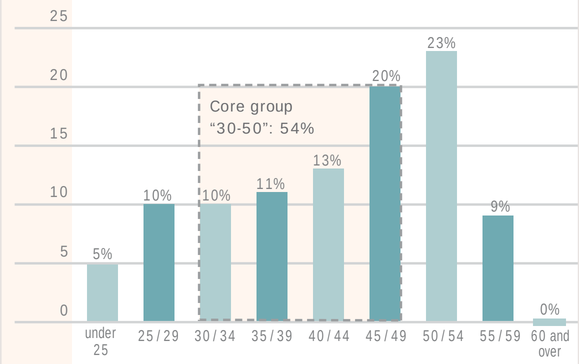
*These figures are taken from a survey of AFB banks and Banque Populaire.

The demographic "shock"

The demographic changes that are making themselves felt across all of French society between 2000 and 2010 are considerably more marked in the banking industry than in other sectors: over this period, it is estimated that some 130,000 people will turn 60. The 30-50 age group, which currently represents the core of French banking staff, is set to become proportionally smaller. This should lead to a greater presence of senior staff in banks, given the foreseeable increase in the number of working years and a massive influx of young staff in a highly competitive environment.

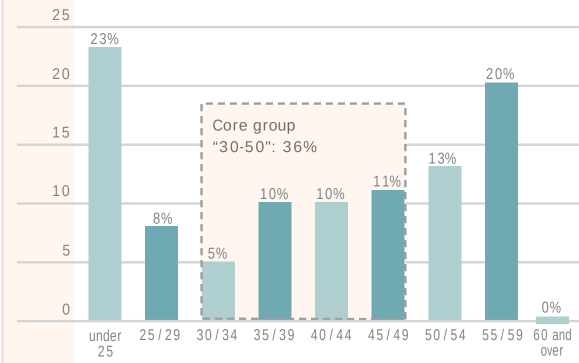
BREAKDOWN OF STAFF BY AGE GROUP

As a % of total staff at the end of 2001



BREAKDOWN OF STAFF BY AGE GROUP (linear forecast)

As a % of total staff at the end of 2010



Renewed emphasis on training

Banks have always invested in training and notably for new recruits. The profession runs several professional qualification programmes (specialised technical qualifications, vocational training certificates, ITB (Technical Institute for Banking Studies) courses). More recently, it has developed work/study training (vocational training, job skill and apprenticeship contracts).

PROFESSIONAL BANKING QUALIFICATIONS: CHANGE IN NUMBER OF STUDENTS [1]

IFB (Banking Training Institute)	2001	2002
Specialised technical qualification	12 212	8 589
"Individual" vocational training certificate	852	1 743
"Professional" vocational training certificate	-	277
ITB (Technical Institute for Banking Studies)		
Old system	1 549	413
New system	1 347	2 087

WORK / STUDY TRAINING: CHANGE IN NUMBER OF CONTRACTS [2]

Year	Total	Vocational training contracts	Job skill contracts	Work experience contracts
1996	823	463	360	0
1997	909	437	472	0
1998	1 282	465	814	3
1999	1 913	870	1 040	3
2000	2 643	1 184	1 457	2
2001	2 900	1 352	1 544	4
2002	2 521	1 142	1 376	3

[1] In France

[2] Source: OPCA - Banks

BANKING ACTIVITY IN 2002

Results of FBF banks in 2001 and 2002

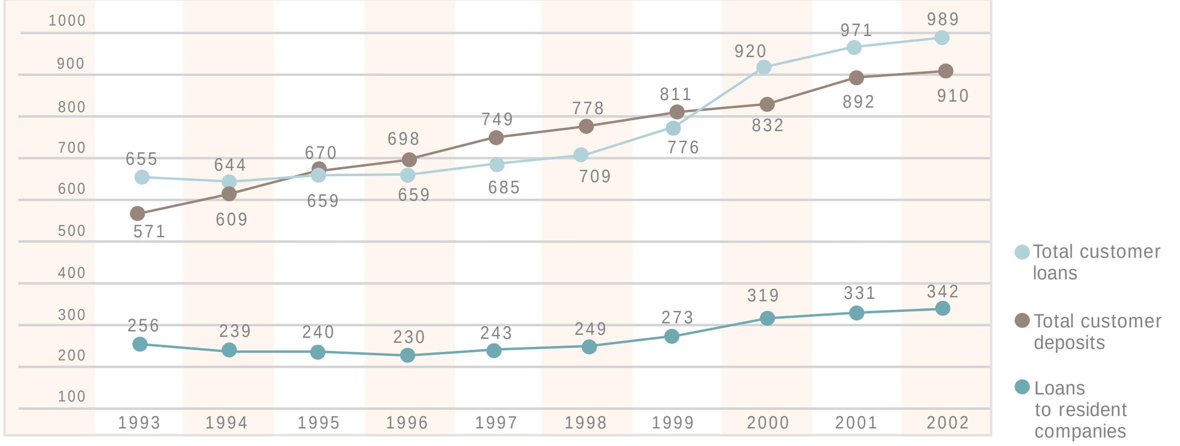
in millions of euros

FBF banks	2001	2002	Change
Net banking income	56,924	61,044	7,2%
Gross operating income	17,431	20,439	17,3%
Net income	14,016	14,912	6,4%

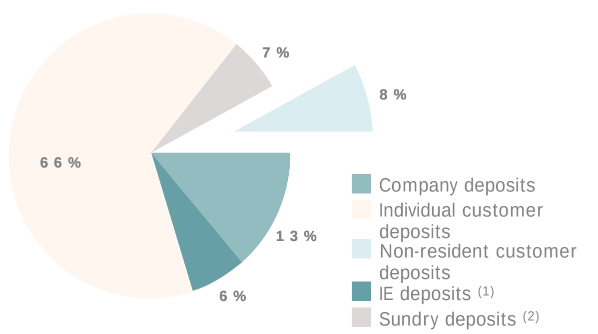
Source: French Banking Commission

Change in deposits and loans held with FBF banks between 1993 and 2002

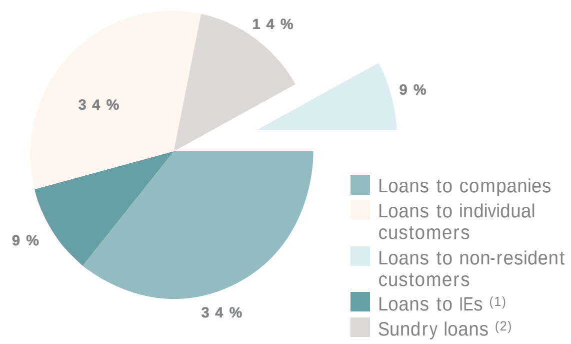
OUTSTANDING IN BILLIONS OF EUROS



Breakdown of deposits at FBF banks in 2002



Breakdown of loans at FBF banks in 2002



(1) Individual entrepreneurs

(2) Insurance companies, administrative bodies, financial clients, etc.