AN OVERVIEW OF BANKING IN FRANCE

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A bank is a credit institution authorized to carry out banking operations. Only banks are authorised to receive sight deposits and term deposits of less than two years from the public

(Article 511-9 of the French Monetary and Financial Code).

In addition to this "official" definition, a bank is a company that operates like any other business. It has employees, customers, shareholders and an obligation to turn a profit....
Banks also play a key role in financing and developing economic activity.
By granting credit from the funds deposited and by providing sophisticated financial services and reliable payment instruments and systems, banks help people achieve their projects, however big or small.

A DYNAMIC SERVICE INDUSTRY

BANKING SECTOR IS STRONG

Over the past few years French banks have been doing very well. There are basically two reasons for this strong performance: the efforts that banks have made to streamline their activities and the strong overall demand for banking products and services.

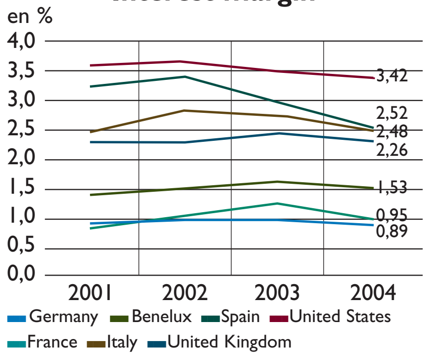
At end 2004, the net profit of the five largest French banking groups totalled 14.1 billion euros, a 32% increase over the previous year. According to the Banque de France, this performance is in line with that of the leading global banks. The return on equity of French banks in 2004 was 12.6%. This was also consistent with the EU 25 average of 12.2%. ROE ranged from 15.5%[1] to 18% for Spanish and UK banks respectively, and stood at 3.9% and 10.6% for German and Italian banks.

> *At end 2004, the combined assets of France's seven largest banking groups totalled 3,327 billion euros, i.e. twice the nation's GDP.*
>
> *Source: Commission bancaire*

1. Growing rapidly

The total consolidated net banking income (NBI) of the five largest French banking groups was 63.4 billion euros in 2004 – an increase of almost 13% on the previous year. This is quite a substantial increase, considering that the average NBI of banks in nine of the largest EU economies[2] was 5.5%.
This may be explained by the growth of the banking industry both abroad and in France, particularly as regards real estate credit. The French banking industry is also particularly strong in specialised financial services and asset management, and French banks have developed a broad range of retail banking products and services.
98% of French households have a bank account (one of the highest levels in Europe) and 36% have accounts in more than one bank.

Interest margin



Source : Banque de France Bulletin, October 2005

The French market for banking services is highly competitive. The increase in lending-related income is mainly the result of greater lending volumes rather than higher interest margins. Lending margins are low for French banks. In 2004, interest margins stood at a mere 0.95% in France, compared to 2.52% in Spain and 3.42% in the United States[3].

1) European Central Bank – "EU banking sector stability".
2) Benelux, France, Germany, Italy, Japan, Spain, Switzerland, United Kingdom and United States.
Source: Banque de France Bulletin, October 2005.
3)Banque de France Bulletin, October 2005

Key terms

Net Banking Income (NBI): *gross income earned by a bank on all banking activities (credit intermediation, market activities, financial engineering services, etc.), before general expenses, depreciation & amortisation, provisions and taxes. NBI is the equivalent of annual revenue for non-financial companies.*

Interest margin: *net interest income as a percentage of average interest-bearing assets (bank deposits, securities and loans).*

2. Controlling risk

Low credit risk cost

In addition to the high volume of business activity, the excellent financial performance of French banks is also the result of their sound risk management, which has reduced their risk cost. In the first half of 2005, the credit risk cost for France's four largest banking groups was only 3.2% of NBI, one of the lowest levels in Europe's seven largest countries. By comparison, the risk cost of the largest British and Italian banks was 10.4% and 6.6% of NBI[1] respectively.

Solid balance sheets

The leading French banking groups have an average solvency ratio of 11.5%, which is considerably higher than the regulatory minimum[2]. This enables French banks to absorb shocks to the economy and smooth out economic cycles, without having to cut back on lending.

3. Restructuring without job loss

The French banking industry has also reorganised and streamlined its activities. According to the CECEI (the Credit Institutions and Investment Firms Committee), there were 24 mergers and 20 acquisitions in the French banking industry in 2004, a figure that is consistent with the trend observed over the past few years. The number of banks has declined from 552 in 1994 to 425 in 2004. Banks have therefore succeeded in restructuring without destroying jobs.

Recent mergers

1999: *BNP - Paribas*

1999: *Crédit Mutuel - CIC*

1999: *Banques Populaires - Natexis*

2000: *HSBC - CCF*

2003: *Crédit Agricole - Crédit Lyonnais*

2003: *Caisse d'Epargne - and the French subsidiary of the Italian group San Paolo IMI*

2004: *Caisse d'Epargne - compagnie financière Eulia and CDC Ixis*

CONTRIBUTING TO GROWTH

According to INSEE (the French statistics bureau), banking activity accounted for 3.1% of value added in France in 2004. This was more than the automobile industry (1.1%), the farming and food-processing industries (1.9%) and the energy industry (2.3%). On December 30, 2005, of the 10 largest market capitalisations on the Paris stock market three were banking groups.

1. Creating jobs

Today, France's banks employ some 400,000 people, indirect employment excluded. By comparison, the automobile industry employed 230,000 in 2004 and the energy sector 200,000, according to INSEE. This makes banks one of the largest private-sector employers in many regions. To meet its growing needs, the banking sector has been recruiting heavily, with a hiring rate of almost 10% in 2004. Therefore, despite the large number of people who have retired and who will continue to do so (over a third of bank employees were aged 50 and over in 2004) banks have been net creators of jobs over the past few years. The aggregate bank payroll rose 0.5% in 2004, after increases of 1.1% and 3.3% in 2002 and 2001 respectively.
Banks are also hiring a lot of young people (over two-thirds of new recruits are under 30) and a high proportion of people with college educations. According to an AFB employment survey, at end

1) Banque de France Bulletin, October 2005
2) Commission Bancaire

December 2004, 48% of new recruits had two to three years of college education.

2. *Investing in training*

Banking is one of the industries that provides the most training to its employees. Although large companies in France must spend at least 1.6% of their payrolls on training, banks spend an average of 4%. According to an AFB survey, 75% of salaried bank employees received training in 2003.
French banks are strong believers in work-study programmes. In 2004, banks employed almost 3,500 people under "professionnalisation" or apprenticeship contracts. Not only do such programmes enable these employees to earn a two-year or higher level college degree, they are also often offered a permanent labour contract.

GLOBAL DYNAMISM

1. *Establishing an international presence*

French banking groups are expanding their international operations. At end 2003, French credit institutions operated 913 offices in 83 countries. Large French banking groups obtained 15.7% of their assets within the European Union. Although a respectable figure, this is not as much as some groups in Europe's smallest countries. According to the Commission Bancaire, this is because these banks have reached the limits of their small domestic markets and have invested massively abroad.
Furthermore , France is one of the few countries to have penetrated the US banking market, along with the United Kingdom, Germany and Holland.

2. *World-class players*

Three French banks with a combined market capitalisation of 131 billion euros at end September 2005, rank among the world's twenty largest banking groups by that measure[1]. In terms of capital, five French banks were among the global top 25 in 2004[2]. Only the United States has as many banks that are this big.

1) Reuters, cited by Banque de France
2) The Banker, July 2005

II. FRENCH BANKS AND THE ECONOMY

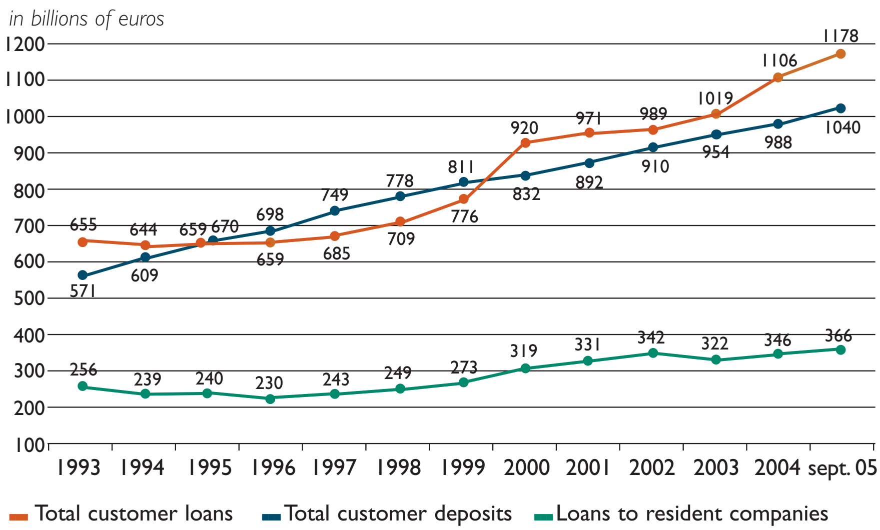
AN ESSENTIAL ROLE

1. *Financing economic activity*

With 1,178 billion euros in loans outstanding at end September 2005, i.e. four times the nation's budget, French banks play a fundamental role in financing economic activity.
They convert savings into credit that is used to finance a wide variety of business projects, sometimes of a particularly complex and risky nature. In providing credit, banks stimulate economic growth over the near-term by facilitating consumer spending and home purchases and over the long-term by enabling companies to invest in the resources they need to develop their business.

According to the Banque de France, credit granted to business enterprises by French credit institutions rose 9% in 2005.

Increase in FBF member bank loans and deposits from 1993 to 2005



■ Supporting consumption

54% of French people know that credit is good for the economy[1]. At end March 2005, French credit institutions had 116 billion euros in outstanding consumer credit. French credit institutions offer consumers attractive interest rates, with 4.45% for a consumer loan of less than one year, compared to an average of 6.62% for the euro area[2]. According to the OEM, which monitors consumer debt, one third of French households were repaying some form of consumer credit in 2004. Half of these consumers could not have purchased what they wanted if they had not obtained credit[1].

What is consumer credit used for?
- ***57% of households use it to purchase a car or motorcycle;***
- ***30% use it to make a substantial purchase for their home (furniture, appliance, TV, etc.)***

Source : OEM, published in May 2005 and based on November 2004 figures.

■ Facilitating home purchase and real estate investment

At end March 2005, credit institutions had granted consumers a total of almost 376 billion euros in real-estate loans. According to the OEM, 29.1% of French households were repaying a real-estate loan in 2004, compared to 28.5% in 2003.

Interest rates on property loans are particularly low in France. In the second quarter of 2005, French consumers could obtain a real estate loan for a term of 10 years or more at an interest rate of only 3.90%, compared with 4.76% in Italy and an average of 4.09% for the euro area[2].

In addition to this, advantageous home-purchase savings plans further facilitate real estate purchase and investment. According to Crédoc, the French banking industry is apparently meeting the needs of French consumers since 84% believe that it is better to own a home than to rent.

50.2% of French households used credit in 2004, compared to 49.7% in 2003.

Source : OEM

■ Helping small and mid-size businesses achieve their goals

Banks play a key role in small-business creation and development. 64% of French SME believe they could not have carried out their projects without bank credit. What is more, banks are apparently doing a good job lending since 60% of French SME consider that a bank loan can be easily obtained, compared to a European average of 46%. Indeed, only 6% of French SME say that they need easier access to credit to develop their business which is the lowest rate in Europe[3].

Credit granted to SME by credit institutions totalled over 353 billion euros at end December 2005. Two thirds of this was granted to very small businesses representing an annual increase of 10%.

Source : Banque de France

2. Advising large companies and supporting them in capital markets

At end December 2005, outstanding loans to large companies totalled 149.4 billion euros. But the relationship between banks and their large corporate customers goes far beyond lending. For example, banks can provide tailored solutions for a broad spectrum of projects, ranging from the restructuring of a family business to going public. They can also provide complex long-term structured financing for major international projects. In 2005, banks assisted with 507 mergers and acquisitions in which the purchaser, the seller or the parent company was French, representing a total of 160 billion dollars[4].

French corporations that issue securities can also draw on the expertise of top-notch financial intermediaries, with skilled teams

1) TNS Sofres survey conducted in October 2004 for the ASF.

2) Source: Eurostat, customer negotiated rate excluding loan charges, Q2 2005.

3) Source: Eurobarometer 174 "SME access to finance", October 2005 (SMEs with 1 to 249 employees).

4) Thomson Financial, M&A Global Financial Advisors Review, Q4 2005.

offering best-in-class financial analysis[1]. In fact, French investment and merchant banks present a certain number of advantages. For example, France has some of the world's largest custodians, capable of offering their clients a full range of services, including: payment and final settlement of transactions, cash management and forex trading. That said, although France offers an abundance of savings solutions, most is invested in products that do not require investment banking expertise, which is why the French financial community is currently examining ways of promoting investment banking in France.

3. Putting savings to work

The wide variety of savings products that French banks offer – with a broad spectrum of liquidity, guarantee and risk options – has encouraged a large proportion of French households to invest their savings. Eighty-three percent have a tax-exempt savings account, while 59% have invested in a life insurance policy, the second most popular savings vehicle. After these come home-purchase savings accounts (41%), securities (24%) and employee savings plans (17%)[2].

At end March 2005, French banks managed 271 billion euros in consumer and business deposits in current accounts, and 556 billion euros in special tax-exempt savings accounts ("Livrets", Codevi, LEP, PEL, and PEP). Long-term savings accounts (PEP and PEL) represented 43% of this amount.

1) Accenture study commissioned by the FBF the AFEI: "Investment banking in Paris: Creating the conditions for a collective dynamic", November 2005.

2) INSEE, "Patrimoine, quand les ménages prennent de l'assurance", May 2005.

Savings: French specialities

As in other European countries, the savings rate in France is high, at almost 16%. However, some specific aspects of French savings are worthy of note:

- *If social payment transfers in kind (which are a form of consumption) are included in disposable income, the French savings rate falls three percent due to the considerable weight of France's social security and educational services.*

- *The high level of government deficits - In all countries a strong correlation between household savings and government deficits can be seen, since, according to the Ricardian equivalence, consumers expect taxes to be increased to pay for deficits.*

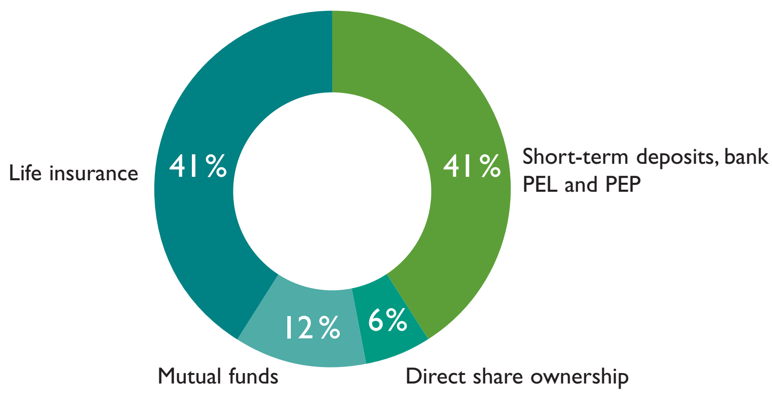
- *Due to the lack of pension funds compared with other countries, the French have invested heavily in life insurance savings products.*

All forms of savings are not created equal in terms of their economic efficiency, the main factor determining their impact on growth being the term of the savings instrument and the purpose for which savings are used. Economically speaking, savings are only useful when they pave the way for future consumption and are invested in productive assets.

By converting savings into credit, banks put them to use in the economy. To promote longer-term savings in higher risk endeavours, the government must clearly make this its policy and provide the necessary means.

Household savings in 2004

Source: Banque de France, cited in the Delmas-Marsalet report



4. Facilitating transactions

Bank payment systems and instruments play a key role in enabling economic transactions between consumers, retailers and large companies, and thereby contribute to economic growth.

In 2005, banks handled over 11.2 billion interbank non-cash payment transactions.

Banks have also set up special systems for large-volume requirements, such as for the cash management of a large industrial group, or the payment of an exceptionally large contract. This is because the slightest delay in the completion of a major deal or a debtor's default may have serious consequences.

With such systems, banks handle about 430 billion euros a day. In fact, the amount of money exchanged through national interbank systems in just four days exceeds France's annual GDP.

Banking services available any time and anywhere

■ 98% of French households have a bank account. This is one of the highest rates in Europe. Even the lowest-income consumers have access to day-to-day banking services.

■ There were 26,370 bank branches in France in 2004. Banks opened an additional 581 branches in one year.

■ There were 43,700 ATMs at end 2004. These machines require considerable investment to keep them properly maintained and ensure security, since their cash is usually replenished once a week, and even once a day in heavy-traffic areas.

■ Half of French Internet users visit their bank's web site and nine out of 10 say they are satisfied with their banks online services.
(Ireq 2005).

■ At 130 euros a year, or about 11 euros a month, fees for banking services in France are lower than the European average of 145 euros[1]. This average price covers all banking resources, "packages", payment instruments, payment incidents, overdrafts and revolving loans.
The revenue from these services is used to pay employee salaries, finance innovation and invest in the new technologies required to provide online services, increase transaction security, etc.

1) Source: study by Mercer Oliver Wyman in July 2004

Ensuring a favourable environment for French banks

France's banking industry is fundamental to its economic growth. Banks enable a wide variety of personal and business projects ranging from car purchases to bridge construction. They are also major employers and invest heavily in training their staff. It is therefore in France's interest to preserve a strong banking system capable of providing high value-added products and services.
A simulation by Accenture shows that the 25,000 investment and merchant banking jobs in France account for 3.2 billion euros (1%) of the government's revenues.

1. Strong profits will be necessary to stand up to European competition

The successful takeover of the UK bank Abbey National by the Spanish bank Santander Central Hispano in 2004 has revived the prospect of large-scale cross-border mergers in Europe. According to the CECEI there were four cross-border mergers in the banking sector in 2004. Many market observers predict an increase in cross-border deals in 2006, particularly in the banking industry, due to strong cash flows, low market volatility and low interest rates in the euro area. Given this situation, the entire business community and large corporations in particular must be able to count on the support of world-class banks.

2. Preventing taxes and regulations from causing competitive distortions

For French banks to maintain their ranking across Europe and around the world and continue to contribute to economic development, they must be able to compete with other European and global banks on a level playing field. To achieve this, the taxes levied exclusively on French banks should be eliminated. France's wage tax, for example, costs the French banking industry about 1.8 billion euros each year - quite a burden for an industry that continues to create jobs and employs a large proportion of highly skilled people.

It is also essential that European banking and financial markets be harmonised in a fair and pragmatic manner, particularly in such areas as consumer credit. Proper transposition of European legislation into national law is just as important. No competitive distortions resulting from regulatory and enforcement discrepancies between the member states must be allowed. For example, for the Markets in Financial Instruments Directive (MiFID), the European Commission will issue implementation measures in 2006. The member states must then transpose these rules into their national laws by February 2007 for them to take effect in November 2007.

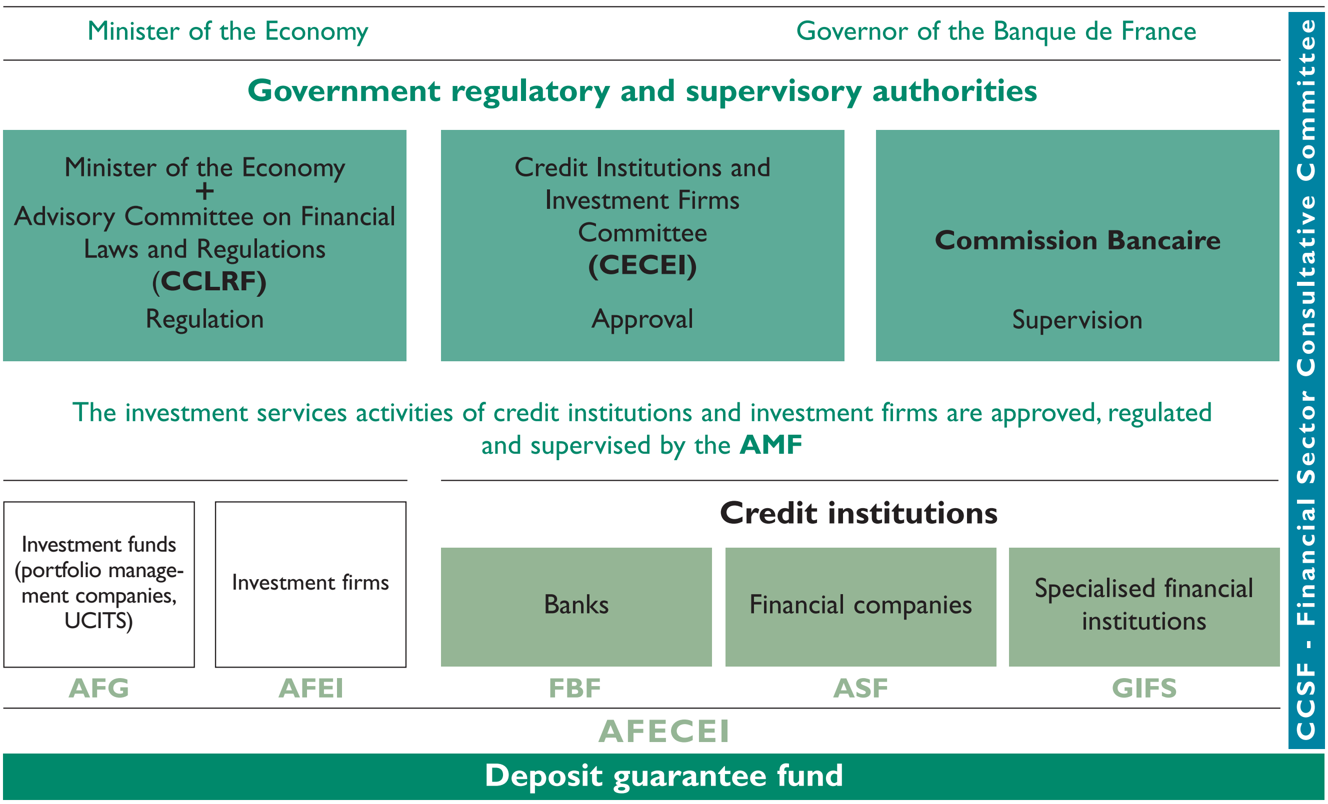
Transposition of EU directives has very important implications.

The rules adopted will have a considerable impact on the degree of market transparency, and the transposition of these measures into each member state's law must ensure uniform enforcement to prevent competitive distortions.

III. A HIGHLY REGULATED SECTOR

French banking activities are subject to the French Monetary and Financial code, and all dealings with consumers are subject to the French Consumer Code.

1. Organisation, regulation and supervision of the French banking sector



2. The increasing role of European legislation

Europe makes over 70% of all regulations for the banking industry, covering all markets and activities. For the 1999-2004 FSAP, over 40 European directives were adopted to regulate financial instruments markets, takeover bids, market abuse, distance marketing of financial services, UCITS, the prevention of money laundering and savings taxation.

EU advisory committees help build a unified European banking market

The European Banking Committee (EBC) directly advises the Commission on legislative matters. As for the Committee of European Banking Supervisors (CEBS), it is composed of senior representatives of EU member state banking authorities and central banks.

Banking industry milestones:

1958: *central bank lending restrictions are removed*

1984: *the Bank Act establishes the principle of "universality" and the legal status of "credit institutions" giving them the exclusive right to conduct banking activities*

1988: *an international solvency ratio (the Cooke ratio) is adopted*

1990: *foreign exchange controls are abolished*

1993: *a single European banking market is established*

1999: *a single currency is created*

January 1, 2002: *euro banknotes and coins are introduced*

1999/2004: *first Financial Services Action Plan (FSAP) is launched*

The CEBS serves as a liaison between the Commission and national government authorities and also makes sure that EU measures are correctly and uniformly enforced. The work of the Committee of European Securities Regulators (CESR) in the area of securities is extremely important for the banking sector. This advisory committee is composed of representatives of the national regulatory authorities and of the European Commission. One of its main functions is to assist in determining directive implementation measures.

Key 2004 data for the 7 banking groups that form the FBF's Executive Committee in 2004:

	BNP Paribas	Crédit Agricole SA	Crédit Mutuel	Dexia Crédit Local	Groupe Banque Populaire	Groupe Caisse d'Epargne	Société Générale
NBI (€ bn)	**18,82**	**12,51**	**8,75**	**1,6**	**7,64**	**8,97**	**16,42**
Operating income (€bn)	**6,55**	**3,18**	**2,58**	**1,11**	**2,54**	**2,21**	**4,91**
Net profit, group share (€bn)	**4,66**	**2,20**	**1,49**	**0,70**	**1,06**	**1,78**	**3,12**
ROE* (in%)	**16,8**	**13,6**	**10,6**	**18,63**	**14,1**	**10,8**	**18,9**
Capital (€bn)	**35,02**	**30,81**	**18,2**	**4,32**	**17,2**	**22,7**	**23**
Payroll	**94 892**	**62 001**	**56 760**	**3 199**	**44 509**	**52 800**	**92 000**

** ROE (Return on equity. Ratio of net after-tax profit to shareholder equity)*
Sources: bank press releases and annual reports

FEDERATION
BANCAIRE
FRANCAISE

Exchanging, flowing, circulating, channelling, collecting, distributing, guiding, orienting... all terms that describe the essential characteristics of networks – the theme for the photos in this year's management report.
Where there is no flow there is no life, and where flows are not channelled and controlled there is no direction or policy. Money – that of each person, company or institution – must also flow fluidly if it is to enrich our society, our economy and our individual lives, and controlling and optimising these flows is what the French Banking Federation strives to do each day.

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