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*Banking supervision
And Accounting issues Unit
The Director*

Paris, September 30th 2013

French Banking Federation comments on the Financial Stability Board Consultative document on the principles for an effective risk appetite framework

Dear Sir,

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorized as banks and doing business in France, i.e. more than 390 commercial, cooperative and mutual banks. FBF member banks have more than 38,000 permanent branches in France. They employ 370,000 people in France and around the world, and service 48 million customers. We welcome the FSB intent to specify the Risk Appetite Framework.

We consider that most of principles proposed by the FSB are a step in the right direction. They are already largely implemented by French banks. Nevertheless, some of them need to be more detailed or amended in respect of each bank organization.

You will find in the appendix attached our response to the consultation.

We thank for your consideration and remain at your disposal for any question or additional information you might have.

Yours sincerely,

Jean-Paul Caudal

**Mr Svein ANDRESEN
Secretary General
Secretariat to the Financial
Stability Board (FSB)
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland**

French Banking Federation comments on FSB Consultative document on the Principles for an effective Risk Appetite Framework

We welcome the FSB intent to specify the Risk Appetite Framework.

We consider that most of principles introduced by FSB are already implemented by French Banks (1) Nevertheless, some of them need to be more detailed or amended in respect of each bank organization (2) and the framework should not bind banks to “one size fit all” approach (3).

1- French banking regulation contains most of the proposals introduced by FSB

First of all, Regulation 97-02 of 21st February 1997 relating to internal control in credit institutions and investment firms established a robust policy framework regarding the control system for operations and internal procedures, risk and result measuring systems, risk monitoring and risk control systems, duties of the executive body and of the decision making body.

Many of the principles proposed by FSB are already implemented by French banks in respect of Regulation 97-02. French banks commend the FSB initiative to strengthen the international standards related to internal control and risk management.

For instance, as proposed by the FSB, Regulation 97-02 requires risk analysis and risk measurements systems that are suited to the nature and the volume of credit institutions 'transactions in order to assess the different types of risks, particularly credit risk, market risk, overall interest-rate risk, intermediation risk, settlement risk , liquidity risk and operational risk. In the same line of thinking, FSB proposals introduce an obligation to notify the supervisor and to escalate immediately to the board in case of “unexpected material risk exposures” as required by Regulation 97-02 in its articles 17ter and 38-1, in the event of “significant incidents”.

Furthermore the guidelines regarding risk management adopted by the French banking associations in 2009 extended good practices in risk function, with the appointment of a risk officer.

At last, CRR-CRDIV completed the framework by introducing new rules regarding governance internal control and risk management.

2- Some definitions need to be clarified

Key definitions / Risk capacity :

The FSB proposes a number of definitions with a view of establishing a common framework for supervisors and firms. However, through these definitions, the FSB induces a quite prescriptive approach for the articulation of institutions' Risk Appetite Frameworks. In particular, French banks are reluctant to introduce the concept of "Risk Capacity" in their own approach. It should thus be mentioned that, even though setting definitions may be useful, institutions shall retain some flexibility in the way they will articulate their own framework and in the key elements they wish to use in order to do so.

- forward-looking dimension / stress-testing:

There are several mentions in the consultation document of the need to include "forward looking" components in the Risk Appetite Framework.

However, this idea is not clearly explained and may open the door to various interpretations. It could be understood as an expectation for systematically introducing a stressed version of the risk appetite indicators. Although some institutions may choose to follow some indicators on a stressed basis, we consider that this approach is not necessarily relevant in all instances and could add a layer of complexity which might be detrimental to an effective implementation of the Risk Appetite Framework.

In particular, the forward looking concept introduced in the definition of the Risk Profile appears very unclear, if not self-contradicting.

We would be much more comfortable if the use of stressed analysis would not be presented by the FSB as a compulsory requirement for the Risk Profile indicators.

We would welcome more clarity on the use of stress tests in relation to the risk capacity and risk appetite. In our view, regular stress tests -severe but plausible- are a key component to be considered amongst others in the determination of the risk appetite. Thus, the forward-looking and stressed components are already part of the definition process of the risk appetite and introducing a stressed risk profile would add a layer of complexity of doubtful use.

- Net exposures:

Referring to the proposed definition of the Risk Profile, the FSB mentions "firm's net exposures, after taking into account mitigants". Clarification by FSB of this definition of "net exposures" and "mitigants" would be welcome.

With respect to the recommended use of "net exposure", it also appears that it may be difficult to follow some risk limits indicators on a net basis, and that a "gross" approach may in some instances be relevant (especially at granular levels of analysis).

We concur with the opinion expressed by IIF in its draft answer that "*net computation depends on the kind of risk category that is being referenced.*"

- Reference to "comparison to peers" for setting of risk limits:

We would like to mention the fact that other institutions' indicators do not necessarily have to be taken into account by an institution when setting its own risk limits. Nevertheless markets practices and benchmarks are, of course, useful where appropriated.

- An iterative process

Even if French banks recognize the merits and the benefits for an institution of the RAF approach and of its formalization, it must be underlined that this is a lengthy and time-consuming process. As such, it is expected that supervisors will appreciate the iterative nature of this approach, and will accept that institutions take the necessary time to build, refine and deploy their framework.

- cascading down the RAF to the business lines and legal entities :

We believe the RAF should ideally be established on a group-wide basis, and subsequently developed by business lines OR legal entities on the basis of relevance/materiality to the group's overall operations.

While the risk appetite of business lines should be aligned with the risk appetite statement of the firm, due to the diverse and varying nature of business lines and legal entities, it should not be assumed that risk appetite can be disaggregated and apportioned or allocated in all platforms of risk appetite statements. A clarification that recognizes this is not a precise or automatic process, but a highly qualitative/judgmental process, which involves bottom-up as well as top-down approaches will be very helpful. Indeed, business lines or legal entities should be able to build their risk appetite statement according to their own risk profile. In addition, reinforcing our prior point, the quoted statement above also ignores the diversification that may exist across business lines.

- Third party disclosures:

Owing to the fact that elements of a firm's RAF will include confidential business information, and that external communications are more generally governed, particularly in the United States and other jurisdictions, by securities law requirements, it would be useful to clarify that this Principle does not impose a requirement to disclose confidential information and should be viewed in the context of current applicable rules regarding disclosures.

Besides Pillar III disclosure as introduced by Basle II framework already requires banks to disclose risk related information.

- Qualitative statements to be measured:

The Principles recognize that risk appetite statements should include qualitative statements for risks that are not easy to measure. It further adds that “boundaries or indicators” need to be established to enable monitoring of these risks. The recognition of the relevance of qualitative statements as an important aspect of a risk appetite statement is very welcome. The FSB should further highlight that boundaries of acceptable risk-taking are often qualitative in nature, and in a number of cases, quantitative boundaries would not be possible.

- Robust risk weighting system:

The RAF section of the Principles misses a few key elements. First, it seems to exclude models and systems that contribute to measuring and aggregating risk. This is important because for instance, the lack of a robust risk weighting system in an institution’s credit portfolios in one jurisdiction, could impact risk appetite.

3- The framework should not interfere in the risk management

a. Proportionality

The FSB’s document seems to imply that the RAF should be fully fledged at all business units, legal entities and activities. We think that a complete RAF is relevant at a Group-wide level, and that its elements should be applied to business units **according to a proportionality principle**, taking into account the size of the exposures, their complexity and the materiality of risks. The proportionality principle does not mean a mathematical allocation of limits but what is strictly necessary to hit the group-wide target. This **proportionality principle** should be an overarching one guiding the implementation of the FSB’s recommendation (such a principle plays a similar role in the guidelines for a sound stress-testing framework).

b. Risk limits and risk bands

The FSB’s document adopts a view of risk management through cascading quantitative (and most of the time implicitly saturated) risk limits. This approach is not, in our view, applicable for the following reasons.

Firstly, many risk management tools, while akin to limits, are not quantitative in nature (preferred sectors for origination, underwriting policies, etc.). Some of these tools are specific to a business line or a level of aggregation of exposures, and cannot be consistently “cascaded” upwards or downwards.

Secondly, even quantitative limits are not additive when they apply to risks that are correlated, and the calibration of such correlations is notoriously difficult and susceptible of large moves in times of stress. Thus, defining a consistent set of limits requires expert judgment. We would propose a less mechanical approach and explicitly recognized the role of expert judgment in building a consistent set of risk limits.

Thirdly, the FSB's document adopts a very black-and-white vision of risk limits: either you are within the limit, or you breach it. Actual risk management relies to a set of thresholds defining a band of comfort and alert triggers leading to various actions. Our view is that the document should put less emphasis on limits and more on a consistent set of thresholds leading to appropriate business and risk management information and possibly actions.

Finally, and one of the key points, a limit by itself is usually not sufficient to define a level of risk appetite you are taking. Indeed, the same level of exposure can lead to very different risks in the future according to, in particular, the quality of transactions (rating, securities attached, maturity...).

c. Strategy and Commercial and Financial Control

The proposal could be seen as a reversing in the process of establishing banks strategy. Business lines should state their risk appetite at the first step; subsequently, the risk function assess the key components to objectify the risk appetite of the bank. Finally, the executive committee arbitrates between business lines, financial control and risk function. And ultimately it presents the strategy to the Board of Directors.

In fact, establishing a strategy entails to take into account various factors: the macro-economic environment, overheads and operating costs, HR management, IT evolution and customer needs...Risk appetite is built around all of these factors.

d. Interference of external audit in management

The proposal may not be compatible with the responsibilities of external audit. There could a potential conflict of interest if the external audit is required to validate the RAF, which is a component of the bank strategy.

e. Governance and Commercial law

Considering local practices in governance and commercial law, it should be considered that the degree of implication of stakeholders in the decision making process and the strategy setting varies widely across jurisdiction. French banks would welcome an in depth review of all type of governance structures within international banks. While the FSB proposal does not advocate one specific board structure, it should be clear that in case of a two-tier structure, the board of directors will not be submitted to the same level of expectation.

f. Guidelines for regulators of internationally active banks

We would have expected from the FSB some elements of guidance for internationally active banks and their regulators. Our opinion is that the RAF should be defined at a Group-wide level and under the scrutiny of the Core College of regulators. Host regulators for affiliates can expect to be presented with the part of the RAF that pertains to the local activities, but should not require each affiliate to have its own standalone RAF, since this would go against both the clarity and the efficiency of the Group-wide RAF.