



I-1.20 : The hybrid nature of the French Conseil de Régulation Financière et du Risque Systémique (Council of Financial Regulation and Systemic Risk)

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1) The French Act of October 22, 2010 establishes a *Conseil de Régulation Financière et du Risque Systémique* (Council of Financial Regulation and Systemic Risk), chaired by the Minister of the Economy. It is composed of the Governor of the Bank of France (who is also chairman of the *Autorité de Contrôle Prudentiel* (Prudential Supervision Authority), its Vice-President, and the Presidents of the *Autorité des Marchés Financiers* (Financial Markets Authority) and the *Autorité des Normes Comptables* (Authority of Accounting Standards), and three other competent individuals¹.

2) The Council's tasks are ensuring cooperation between the institutions they represent, analyzing systemic risks in the sector and on financial markets, and facilitating the elaboration of rules applicable to these sectors. The Board may perform hearings of financial market operators. It presents an annual report to Parliament, which is made public.

3) At first glance, this new body appears to be of little importance because it has neither rule-making power, nor authority to sanction or conduct settlement agreements. But it can be extremely important, de facto. This could be due to the fact that it will be the place where regulation is compounded, meaning that it will comprise the entire market, both the supervision of operators' behavior, and the prudential, meaning oversight of operators' internal organization (I). Moreover, within this curious structure where independent regulators are chaired by a member of the executive branch, the lessons of the crisis have led us to backtrack by openly merging politics and regulation (II).

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I) The link between Regulatory and Prudential

4) Despite the universalizing approach of economists, regulation is like Law in that it expresses the Mind of a Nation. Thus, a French- or German-inclined mind would conceive it like a French garden, where a separate institution is devised for each separate task, considering that any overlap is a systemic defect. Thus and for example, it was often considered that supervision and internal requirements for operators (the prudential) were tasks for central banks; whereas market behaviors fell upon regulatory authorities, which regulated using the concept that operators are "black boxes". The *summa divisio* between the prudential and the regulatory, which justified the distinction between central bank and financial regulator, is based on the simple idea of a distinction between inside and outside, between structure and behavior.

5) But this *summa divisio*, if not exact, is at least very fragile. Indeed, if financial institutions are subject to prudential norms, financial ratios, accounting standards, specific corporate governance rules, it is because their behavior is crucial in that they are the principal market intermediaries, and their solvency is essential to prevent systemic risk. Therefore, problems within a financial institution create problems on financial markets. Similarly, chain reactions on markets provoke cataclysms, and cause operators to fail, because they depend on an atmosphere of confidence.

6) Institutional consequences had to be drawn from this porosity between the internal and the external in companies involved on financial markets. France did this, and well before the 2008 financial crisis. Indeed, the *Loi de sécurité financière* (Financial Security Act) of August 1, 2003 created the *Haut Conseil du Commissariat aux Comptes* (High Council of Statutory Auditors). The idea was that the auditors, who inform managers and shareholders, provide information to the market at the same time, whenever the company issues financial instruments on the market, because there is no difference between the market, investors, and shareholders. We also note that in the ruling of the Court of Appeal of Paris on March 7, 2000, *KPMG*, the court held that despite a lack of explicit statute, the financial regulator was empowered to condemn a statutory auditor who had certified an inaccurate document, because the auditor had provided the market with false information.

7) Therefore, we are entering an English garden, in which the edges of the hedgerows run into one another higgledy-piggledy. Indeed, one of the multiple causes of the financial crisis was the excessive segmentation of jurisdiction between different regulators, on different levels and with different aptitudes. The main idea of the law is to create a new regulatory body, which does not replace any existing body, but rather oversees them and is a mix of a regulatory authority in the

strict sense, and a prudential authority, since what we today call macro prudential overlaps market regulation.

8) Thus, a commentary on the law could simply take the form of a gloss of the new body's name: The *Conseil de Régulation Financière et du Risque Systémique* (Council of Financial Regulation and Systemic Risk).

9) In one single body are combined both financial regulation, and the prevention of systemic risks. This is reflected by the presence on the same board of the *Banque de France*, a prudential authority that has strong disciplinary authority over financial operators, holding them accountable for their internal organization, and a financial regulator exercising strong supervisory and disciplinary powers, requiring operators to account for their behavior.

10) The issue is best understood from a temporal perspective. Indeed, the Council may meet "as needed" (Article L 331-2 of the *Code Monétaire et Financier* - Monetary and Financial Code), which is to say at any time. There is thus a permanent *monitoring* of the sector by the Council, which, regardless of the various authorities' respective responsibilities, ensures their cooperation, exchange of information, sector analysis, assessment of systemic risk, and facilitates the development of rules, including accounting standards.

11) We fully appreciate this double level of activity: on one level, there is a whole permanent system of peaceful monitoring and regulation, in order to prevent systemic risks and based on information; whereas on another level, it is always possible to react to an emergency "as needed".

12) Indeed, we note that statute allows the *Autorité des marchés financiers* (AMF — French Financial Markets Authority), through a new wording of Article L 421-16 of the *Code Monétaire et Financier* (Monetary and Financial Code) "in exceptional circumstances, threatening the stability of the financial system," the president of the *Autorité des Marchés Financiers* (the Financial Markets Authority) or his representative to restrict the terms of trade of financial

instruments for a period of up to 15 days, an extension by up to 3 months can be decided on by the board. In addition, the Minister may take such a decision on proposition by the President of the *AMF*.

13) This article is important because it shows clearly that in case of crisis, action must be taken very quickly. Power is therefore given to one single person. But the longer this exception to normal market functioning persists, and the more it is necessary for those who have decided upon it to act collegially, which explains why it is mandatory for the *AMF*'s board to take such decisions, a method of procedural legitimacy. Ultimately, because the exception can last for up to three months, only the Political becomes legitimate in such circumstances, and the Minister must decide, but only upon proposition by the President of the *AMF*, who remains the expert. This politically skilful provision perfectly illustrates the relationship between legal rules, financial temporality, and political principles. Precisely, and this is the second part of our gloss, the *Conseil de la Régulation Financière et du Risque Systémique* (Council of Financial Regulation and Systemic Risk) is chaired by the Minister of the Economy.

14) This seems to have gone largely unnoticed by commentators. Yet, the principle is that regulators are independent from the executive. It has even been considered that this is a fundamental principle of regulatory authorities, or even a constitutional principle. However, three different independent or autonomous authorities are chaired by a Minister, who is accountable to the Prime Minister, which implies a hierarchical relationship.

II) The link between the regulatory and the political

15) Certainly, the new Article L 631-2-1 of the *Code Monétaire et Financier* (Monetary and Financial Code) is careful to emphasize that the functions of the new body are exercised "without prejudice to the respective responsibilities of the institutions represented by its members." Similarly, the duties exercised by the board, namely cooperation, exchange of information, analysis of the sector, systemic risk assessment, and participation in promoting the development of rules, including accounting standards, are not policymaking powers.

16) But we must not be fooled. Indeed, first and foremost, financial regulation, unlike economic regulation, is entirely built on the concept of comprehensive, reliable, and accessible

information. However, this Council will not only ensure information is exchanged between various regulators but it will also provide new information. Indeed, since the law asks the council to analyze the situation of the sector and of financial markets, and to analyze systemic risk by taking into account advice and recommendations from the European Committee on Systemic Risk, this Council will bring information to market, which, in a similar fashion to the European Commission's Sector Inquiries, can be received by operators as new rules, in a milieu where *soft law* is often further-reaching than formal statute.

17) In addition, as shown by the Basel Committee's experience, although this Committee has no formal power, as long as its members are strong, the organization will innervate the financial markets with its ideas, doctrine, and decision through its members. The Basel Committee was very successful at doing this in the banking sector because each member asserted his arguments about the Adoption of the Basel III rules. Although the *Conseil de la Régulation Financière et du Risque Systémique* (Council of Financial Regulation and Systemic Risk) has no evident legal authority, it has the luxury of being composed of (honor to whom honor is due) the Governor of the *Banque de France* (Bank of France), the President of the *AMF*, and the President of the *Autorité des Normes Comptables* (Authority of Accounting Standards), not counting the three other competent persons who can play an important role if they have a solid professional or doctrinal reputation in the sector.

18) However, the law also greatly strengthened the *AMF*'s powers, enabling it to regulate the sale of derivatives and short sales. It furthermore allowed the Authority of Prudential Supervision—chaired by the Governor of the Bank of France, and including the Bank's Vice-President on its board—to establish a board of supervisors to collaborate with other European systemic-risk-prevention organizations.

19) Thereby, the *Conseil de Régulation Financière et du Risque Systémique* (Council of Financial Regulation and Systemic Risk), because of this mixing of various functions, instruments, institutions, and persons, will be de facto very powerful. But, these Presidents of independent or autonomous authorities will be chaired by a minister. We can understand the idea. It is that the 2008 financial crisis came about notably because there was a lack of political power: unable to express a "desire", the markets (which are merely mechanisms or echo chambers of corporate health, anticipatory agents etc.) were as a result unable of stopping the devastating impact of the *subprime* crisis. The will of the State, because it is exogenous to the market, could have been a substitute for the failure of markets to self-discipline. Certainly, the financial regulator and the prudential regulator are part of the State and are internalized in the financial market and

banking sectors, and many argue that they are also responsible, partly because they failed to respond at the right time.

20) This explains, continuing the gloss, why the organization is not called the "Authority on Financial Regulation and Systemic Risk", but rather, takes on the more old-fashioned name of "Council of Financial Regulation and Systemic Risk." It is therefore intended to "advise" the executive on its political mission of autonomously preventing, managing, and ending a systemic financial and banking crisis. We thereby better understand why this body is superimposed on the *Banque de France* (Bank of France), the *AMF* and the *Autorité des Normes Comptables* (Authority of Accounting Standards), as it is of an entirely different nature: it is an expert advisory body to council the Government on its political choices, particularly because the management of a financial crisis requires the injection of huge amounts of public money, which only the State is legitimate to perform.

21) This returns us, nonetheless, to a certain ambiguity. We already had a first taste of this when, on August 3, 2010, the Government created the position of the "Commissioner of State Investments. This job title is surprising because State investments in corporations are managed by the *Agence des participations de l'Etat* (*APE* — Agency for State Investments), whose function is to ensure that the state behaves as a good investor, obtaining a good return on its investments (which, besides, is required by European Union law, requiring States to act according to the model of the informed investor). But, by creating the *Commissaire aux participations de l'Etat* (Commissioner of State holdings), Minister Christine Lagarde stated that the Commissioner will report directly to her and have a "broader and more political mission" meaning that he will use his powers as a shareholder to serve a broader interest, such as the general interest, as was done in the United States, where the outcome of the financial crisis was nationalizations.

22) This Council for financial regulation and systemic risk is a lesson in history. On the one hand, our most solid categories are challenged by the facts, in economics, such crises provide information and challenge existing doctrine. The financial crisis has paved the way for a

distinction between regulatory and prudential, upon the ashes of which the new Council is built. But history is a perpetual renewal, and politics are openly making their return into crucial sectors. Regulation therefore appears even more clearly as the unstable yet constant triangle between law, economics, and political sciences.