

## France Ring-Fences Proprietary Trading Activities

### Summary of the Separation Aspects of the French Banking Reform of July 27, 2013

July 30, 2013

On July 27, 2013<sup>1</sup>, new legislation was promulgated in France aimed at the ring-fencing and regulation of certain banking activities. In particular, the reform:

- addresses the separation of lending activities and retail financial services from proprietary trading activities; and
- introduces a strengthened supervisory framework, including, critically, bail-in and other resolution powers<sup>2</sup>.

The reform requires large French banks<sup>3</sup> to operate proprietary trading activities in dedicated non-banking affiliates, separated from financing activities and customer services in order to reduce the risks incurred by depositors.

Commentators have observed that the separation would have a minimal impact on the majority of French banks, given the limited nature of the ring-fenced activities, which are substantially narrower than what would have been required by the US Volcker Rule, the EU Liikanen report or the UK Vickers report.

#### Separation of Activities that Contribute to Funding the Economy from Proprietary Trading Activities

Under the reform, banks are required to ring-fence the following activities into a special purpose (non-banking) subsidiary (“**SPS**”):

- Financial instruments trading activities conducted by the bank for its own account – subject to fairly broad exceptions set out below; and
- Operations conducted by the bank for its own account with leveraged UCITS and other funds. The type of risk addressed by this provision will be specified in implementing regulations to be issued by the Government.

The SPS must be strictly separated from the rest of the banking group and must comply with specific requirements:

- The SPS must comply with prudential requirements on a stand-alone basis<sup>4</sup>;
- The SPS cannot collect insured deposits (*dépôts garantis*) nor offer payment services to customers whose deposits are insured;
- The SPS is required to have a business name and managers different from the banking group in order to avoid any confusion;

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<sup>1</sup> The French banking reform dated July 27, 2013 was adopted by the French Parliament on July 18, 2013.

<sup>2</sup> A summary of the recovery and resolution aspects of this banking reform is available in our Client Memorandum *France Implements Bail-In* available [here](#).

<sup>3</sup> The ring-fencing aspects of the French banking reform apply to banks and other credit institutions, financial holding companies or mixed financial companies, whose activities in financial instruments exceed thresholds to be set by the Government.

<sup>4</sup> The parent of the SPS must comply with prudential requirements on a consolidated basis, excluding the SPS.

- The participation of parent banks in any share capital increase of the SPS requires the prior approval of the ACPR<sup>5</sup>; and
- The French State (or any public entity controlled by the French State) cannot take a stake in, or otherwise provide financing or funding to, a SPS in connection with the implementation of a resolution measure.

Under the terms of the reform, the transfer of the segregated activities into the SPS will occur by operation of law, without the need for any formality or third-party consents. No termination or acceleration of ongoing contracts related to the transferred activities can be triggered based solely on such transfer.

### Exceptions to the Ring-Fencing of Trading Activities

The French banking reform establishes a more limited separation of activities than contemplated by the US Volcker Rule, the EU Liikanen report or the UK Vickers report as banks continue to be able to carry on a broad range of principal trading activities, market making and hedging activities.

In particular, the non-SPS entities in the banking group will be allowed to continue to conduct a broad range of own-account activities, including:

- Provision of hedging or other investment services to customers, where the expected yield for the bank results from the payment for services provided to the clients and the “*sound and prudent management of the risks associated with such services*”;
- Hedging transactions for the banks’ own account, where the instruments used for hedging transactions are economically related to the risks identified;
- Clearing of financial instruments;
- Market making (*tenue de marché*) activities, where the bank is a party to transactions on financial instruments (i) that consist of the simultaneous communication of firm purchase and sale quotes of comparable size and competitive prices, with the result of providing liquidity on a regular and continuous basis to the markets; or (ii) that are required, in the ordinary course of business, to complete purchase or sale orders of clients or to respond to clients’ request to buy or sell<sup>6</sup>; *provided that* the French Minister of economy and finance, after consulting with the ACPR, may set thresholds, applicable to either all financial institutions or one particular institution, above which market making activities will have to be segregated into the SPS;
- Sound and prudent management of the banking group’s cash flows and financial transactions within the banking group;
- Long-term investment in securities; and
- Investment in securities issued by entities of the bank’s group.

### Timing and Implementation Deadline

- The French banking reform is now in force, except those measures which require the publication of some implementing regulation (Government decree or other text). No firm timetable has been set yet for publication.
- Furthermore, the new law sets two implementation deadlines specific to the ring-fencing of proprietary trading activities:
  - ✓ By July 1, 2014: Banks must identify the activities to be transferred to the SPS; and

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<sup>5</sup> The French banking regulator (ACP) is being renamed ACPR, standing for *Autorité de Contrôle Prudentiel “et de Résolution”*.

<sup>6</sup> The ACPR will strictly monitor and supervise the market making activities.

- ✓ By July 1, 2015: Banks must complete the actual transfer of these activities.
- As a follow-up step to the entry into force of the French banking reform, the Government must report to the Parliament by December 31, 2014, including as to:
  - ✓ The impact of the French banking reform on the competitiveness of the French banking sector with respect to the US and EU banks; and
  - ✓ The effect of the law on the size and nature of SPS' operations.

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If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

<b>Andrés V. Gil</b>	<b>+33 1 56 59 36 30</b>	<a href="mailto:andres.gil@davispolk.com">andres.gil@davispolk.com</a>
<b>Natacha Marty</b>	<b>+33 1 56 59 36 11</b>	<a href="mailto:natacha.marty@davispolk.com">natacha.marty@davispolk.com</a>
<b>Jacques Naquet-Radiguet</b>	<b>+33 1 56 59 36 20</b>	<a href="mailto:jacques.naquet@davispolk.com">jacques.naquet@davispolk.com</a>
<b>Christophe Perchet</b>	<b>+33 1 56 59 36 50</b>	<a href="mailto:christophe.perchet@davispolk.com">christophe.perchet@davispolk.com</a>
<b>Arnaud Pérès</b>	<b>+33 1 56 59 36 60</b>	<a href="mailto:arnaud.peres@davispolk.com">arnaud.peres@davispolk.com</a>
<b>Margaret E. Tahyar</b>	<b>+1 212 450 4379</b>	<a href="mailto:margaret.tahyar@davispolk.com">margaret.tahyar@davispolk.com</a>
<b>Georges Terrier</b>	<b>+33 1 56 59 36 80</b>	<a href="mailto:georges.terrier@davispolk.com">georges.terrier@davispolk.com</a>
<b>Juliette Loget</b>	<b>+33 1 56 59 36 21</b>	<a href="mailto:juliette.loget@davispolk.com">juliette.loget@davispolk.com</a>

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