

**Report/ratio with the Prime Minister
concerning the lesson to be drawn from the events recently occurred with
General company**

Mister the Prime Minister,

You asked me, Friday January 25, to give you a report/ratio treating of the course of the events relating to the loss of 4,9 billion euros on operations of market occurred with the General Company and presenting the first lesson to be drawn some.

You will find below the brief replies to your request, centered on four aspects:

- course of the facts;
- the management of the situation by the controlling authorities;
- the behavior of the system of audit internal bank;
- first tracks of reflexion to reinforce the safety of the operations of market.

This report/ratio was drawn up on the basis of indication of the governor of the Bank of France, chair banking Commission, and Authority of the financial markets, as well as other public information available to the date of January 31, 2008 and in particular the “explanatory note concerning the exceptional fraud” diffused by the General Company on January 27, 2008 as well as the hearing of the governor of the Bank of France, President of the banking Commission, and the President of the Authority of the Financial Markets before the Committee of supply of the Senate, January 30, 2008.

Neither these elements, nor the analyses and conclusions which are the fruit, were subjected to contradictory examination. Under these conditions, this report/ratio could not give an exhaustive sight of the events, and its analyses and conclusions are likely evolutions. This consideration all the more deserves to be stressed that certain facts evoked in this report/ratio are the subject of legal information led by two examining magistrates of the Court of Bankruptcy of Paris, of an investigation of the Authority of the financial markets on the market of the title and the financial information delivered by the General Company and of an investigation of the banking Commission on the operation of the internal audit at the General Company. In the state of these various investigations in progress, this noncontradictory report/ratio does not have any vocation to evoke, nor with more strong reason to be established, of the culpabilities or the responsibilities, whereas the presumption of innocence prevails, for the benefit for each actor of these events.

1 Course of the facts

The operations having led to a loss of approximately 4,9 billion € for the General Company on its activities market on own account would have been the fact of only one operator; at this stage, no known element results in cancelling this report. This operator had an activity of abitrage on derived actions (warrants): this activity consists in managing in parallel two wallets of size and composition close relations, one having to make it possible to cover the other. Of

this fact, the generated risk but also the released net income is supposed being weak compared to rough engagements resulting from the wallets.

In fact, the operator in question would have taken directional positions not - authorized on contracts in the long term on indices actions Europeans, covered by fictitious operations, which masked the increase in the position and the Nets risk of the bank. He would have proceeded by repeating the following diagram:

- seizure of an operation covering the real position;
- cancellation of this operation before it is not detected because of a control, that it does not give place to confirmation or call for additional cover, then seized by a new operation.

He would thus have carried out a very active management of his wallets, while seeking to mask the profits and the losses.

1.1 These fictitious operations would have started in 2005

- The operator would have carried out irregular operations **since 2005**, but punctually and for relatively weak amounts;
- **during 2006**, these operations would have remained marginal;
- **since 2007**, the clear positions would have increased to very strongly reach in the current of the year a notional amount of about 30 billion €;
- **in November 2007**, the clearing house Eurex would have questioned the General Company on the strategy followed by the operator in question;
- **at the beginning of January 2008**, the real positions reached up to 50 billion € gross value on indices future EUROSTOXX (30 billion €), DAX (18 billion €) and FTSE (2 billion €).

1.2 Once the assembly discovered by the teams of control and made available of the direction of the bank, the positions were débouclées very quickly

- **Friday January 18**, an abnormally high operation with a broker updated by the *middle-office* in the previous days appears sufficiently doubtful so that the direct hierarchy of the operator concerned then the direction of the bank are prevented; an internal team of checking is made up at the end of the evening;
- **saturdays January 19**, after interrogation of the operator and checking near the establishment indicated by the operator like his counterpart, the direction would have obtained to confirmation of the fictitious character of many operations related to the wallet of the aforesaid operator;
- **Sunday January 20 at the beginning of afternoon**, the extent of the exposure is identified; following that:
 - Daniel Bouton, Chairman of the board of the General Company, informs of the situation the Committee of the accounts, already convened this day to examine the estimate of the results 2007; he indicates his intention of déboucler to him

the position as soon as possible like deferring any communication on this situation and results of the bank until the result of the débouclage;

- it warns in parallel the Governor of the Bank of France, President of the banking Commission;
- it warns the secretary-general of the Authority of the financial markets little before the board meeting;
- it finally indicates to the Board of directors, convened with 18h30 also to examine the estimate of the results 2007, which it will not be possible to communicate in the immediate future on these results because of possible substantial losses on the activities of market.

- **Monday January 21 at Wednesday January 23, the** existing real position is débouclée on the markets (cf point 1.3.) ; during this period, followed exchanges take place between the General Company, the Bank of France, the secretariat-general of the banking Commission and the MFA;
- **Tuesday January 22,** two representatives of the secretariat-general of the banking Commission discuss with representatives the General Company to obtain explanations on the operations in question and the dysfunctions which would have allowed them, being informed of the rate/rhythm of transfer of the position and to evoke the new issue of capital under consideration by the bank;
- **Wednesday January 23 with 8h, the** Minister for the economy, finances and employment is put at the current of the situation by Daniel Bouton; the same day, after position closure, the Board of directors is again convened to be informed of the situation and his consequences; finally, the Bank of France informs the EDF, the European central Bank then the supervisors of the European host countries of the establishments of the General Company;
- **Thursday January 24 with 8h,** after having asked for the suspension of its stock exchange price, the General Company communicates publicly on the loss of 4,9 billion € on activities market; it also informs on the unit of estimated results 2007; finally, it announces a new issue of capital of 5,5 billion €profiting from a firm catch JP Morgan and Morgan Stanley, who would allow him to change her test of solvency “tier 1” to 8% (after taking into account of the effects of the acquisition of Rosbank);
- **Friday January 25, a** team of the banking Commission begins an inspection at the General Company;
- **Monday January 28, the** secretary-general of the MFA decides to open an investigation (cf point 2.1).

1.3 Conditions of the débouclage of the position on the markets

The identified positions on January 20 were débouclées the 21, January 22 and 23. At the end of these operations, the whole of the positions concerned generated a loss of 4,9 billion €

The General Company published the figures below concerning the volume of its operations of débouclage. Those would thus have reached to the maximum 8,1% of the volumes exchanged on the markets concerned during each day in question.

% of the volumes débouclés on the markets “Indices future “	EUROSTOXX	DAX	FTSE
January 21, 2008	8,1%	7,8%	1,7%
January 22, 2008	6,8%	5,7%	3,1%
January 23, 2008	5,9%	6,1%	0%

EUREX and LIFFE, managers of the markets concerned, would have confirmed with the MFA not to have criticisms to formulate on the operations of the bank during these 3 days. EUREX indicated to the MFA that taking into consideration their particular size, the positions were liquidated in a very professional way.

The débouclage of these positions was done under particularly difficult conditions. Indeed, the financial markets were very disturbed fact in particular uncertainties on the evolution of the American economy, the very high losses related to the American appropriations at the risk announced not the great banking groups and of the degradation of one of the principal insurers *monoline*. These elements made the markets very volatile as of Friday January 18, 2007. This same day, the CAC40 low reached its level since more than one year while passing under the bar of the 5100 points, while Frankfurt was in retreat of 1,34% and the index paneuropéen EUROSTOXX dropped by 1,74%.

The fall continued and worsened on the Asian markets Monday January 21, as of before the opening of the European markets. This day, Tokyo Stock Exchange finished on its level low since October 2005, in fall of 3,86%. Hong Kong yielded 5,5%. The closing of the American markets this same day, after four consecutive meetings of fall, did not contribute to alleviate the tensions. This situation entraîné a strong reaction of the European markets, constrained to absorb very important volumes: in Paris exchanged volumes reached 16,7 billion euros including 8,6 billion on the CAC40.

The two following days, the market trends were contrasted. The lowering of the directing rates of 0,75 pdb by the EDF Tuesday January 22 had an effect limited on very volatile markets always because of persistent concerns as for the evolution of the world economic situation, and in particular of fears on the situation of several insurers *monoline*. The principal European places set out again with the fall Wednesday: Paris and Frankfurt yield more than 4%, London drops of more than 2%.

Any sale of a title on a market has, any thing equalizes in addition, an impact bear on his course. However, in the light of the various elements evoked above, the operations of débouclage in question are not the cause of the very negative and volatile dynamics of the financial markets between the 21 and on January 23, 2008.

2 Application of the stock exchange regulation and management of the situation by

authorities 2.1 Application of the stock exchange regulation

Concerning the positions in question open to the General Company, the management of the rules of information rigorous and was carried out with a view to protection of the markets.

Indeed, the rules européennes¹, taken again by the French right, force any transmitter “to carry [as soon as possible] to the knowledge of the public any privileged information”². However, “the transmitter can, under its own responsibility, to differ the publication from privileged information”, since it meets the three following conditions:

- the omission must be justified by the objective not to carry reached to its legitimate interests, in particular “in the event of serious and imminent danger threatening the financial viability of the transmitter”;
- the omission should not be suitable for induce the public in error;
- the transmitter must be able to ensure the confidentiality of privileged information.

Information on the open positions of the General Company is of unquestionably a privileged nature. The carryforward of their disclosure at the market collected Sunday January 20 towards 17h00 an agreement in principle on behalf of the secretary-general of the MFA, approval then by the President of the MFA.

This carryforward appears perfectly justified by the situation of the General Company, since it appeared possible, on the one hand of déboucler the positions in question and to thus remove the exposure to the risk, on the other hand to make safe the realization of a new issue of capital making it possible to reinforce the own capital stocks of the establishment. The opposite solution, namely the immediate communication about the real exposure of the bank to the risks of the markets of derived actions, would have made run a serious risk of loss of confidence of the counterparts of the General Company. This would not have been in conformity with the interest of the company and was likely to blame the stability of the French and international financial systems.

It was appropriate however that the absolute secrecy is respected. The MFA, the Governor of the Bank of France and the secretariat-general of the banking Commission obtained the insurances necessary on this point being the General Company, and adopted themselves an organization enabling them to ensure the respect of the secrecy fully.

Thereafter, Monday January 28, the secretary-general of the MFA decided to open an investigation into the market of the title and the financial information delivered by the General Company. The questions treated by this investigation emanating of an independent authority and into the opportunity of which the government does not have to decide, do not enter the field of this report/ratio.

¹ Directive 2003/6/CE of the European Parliament and the Council of January 28, 2003 on the operations of initiates and handling of market (abuse market)

² Article 223-2 of the general payment of the Authority of the financial markets in particular. Privileged information, as defined in article 621-1 of the same payment, is characterized by three dimensions: it must be precise, confidential, and to be likely to have an influence on the courses if it were revealed.

2.2 Co-operation between authorities and information of the Government

Unrolled facts exposed in the first part shows a good communication between the General Company and the authorities concerned, namely the Bank of France and the Authority of the financial markets. The co-operation between the two authorities was immediate and very close.

The question arises of knowing if, have regard to the exceptional nature of the events, the Government should have been informed before Wednesday January 23 in the morning.

The supervision of the situation concerns many competences and the responsibility for the Bank for France, the banking Commission and the Authority of the financial markets. The independence of these authorities is precisely defined by the law. This does not exclude a co-operation and regular exchanges of information with the State. It is in particular of good practice, in France like abroad, that the Government is fully and quickly associated the management of situations endangering a private financial institution.

In the species, the decisions under consideration by the General Company (débouclage of the open positions and preparation of a new issue of capital guaranteed) brought an important comfort on the maintenance, even the reinforcement, of its solvency and the absolute secrecy was a condition essential with the implementation of these decisions.

Taking into account these elements and of their analysis of the obligations of professional secrecy their incumbent with the concrete cases, the controlling authorities considered that it was preferable not to inform the Government which Wednesday January 23 at the beginning of day.

Have regard to the exceptional character of the situation and the consequences which it could have had on the stability of the financial system, it would undoubtedly have been desirable that the Government was informed before Wednesday January 23, 2008. With the future, it will be convenient to specify the articulation between the controlling authorities and the Government in this type of situation in order to avoid any uncertainty on the methods of information, the times of this information and the rules of absolute confidentiality which are essential. These points could be in particular clarified within the framework of the agreements of management of crisis which are under development at the European level, in accordance with the orientations decided at the time of the Ecofin Council of October 9, 2007.

3 Behavior of the internal system of audit

The present part of this report/ratio only aims at considering, under the same reserves as those expressed in introduction, the elements which appear not to have made it possible to detect the operations mentioned in first part. It does not have as an aim to seek possible charges of responsibilities, nor to identify culpabilities, whereas judicial and administrative enquiries are in hand and that the presumption of innocence prevails; no conclusion could thus of it be drawn from this noncontradictory report/ratio.

The real position not - authorized would have been dissimulated in particular by the following fictitious operations:

- purchases or sales of titles or warrants at starting date shifted, operations which are usually confirmed only a few days before the date of value;

- transactions on future with a counterpart known as “pending” (on standby of designation), which do not go down in the systems from ^{the back-office}³;
- *forwards* with an internal counterpart with the group, which does not give place to call for additional cover;
- *forwards* with an external, technical counterpart used at the time of the end of the financial year 2007, accompanied by a falsified pre-confirmation, with the aim of avoid interrogations on countable variations intra-group.

3.1 Organization of the internal audit and points of control of the positions and operations

The General Company stresses that the operator in question would have been particularly well armed to carry out operations not - authorized because it had as a preliminary worked with ^{the middle-office}⁴ and thus knew well the check procedures.

The Governor of the Bank of France estimated, during his hearing by the Committee of supply of the Senate on January 30, 2008, that the first known elements let think that the system of audit internal General Company had not functioned as it would have owed and than those which had functioned had not always been the subject of a suitable follow-up. The investigation diligente by the banking Commission will make it possible to establish the possible insufficiencies of the internal audit of the General Company. It could be interested in particular in the elements of audit internal below likely to have been determining taking into account in particular the information communicated by the company:

- monitoring of incur nominal operators (in opposition to the monitoring of the clear positions who reveals by definition only one risk of limited market);
- follow-up of flows of treasury (calls and payments of margins, deposits, results carried out);
- thorough exploitation of the requests for information which to the bank the clearing house Eurex in November 2007 would have addressed;
- follow-up of cancellations and modifications of transactions coming from only one operator;
- confirmation of the operations with the whole of the counterparts;
- respect of the “wall of China” between *face* and *back office* and transversalité of the organization of the *middle-office* and the *back-office*;
- safety of the information processing systems and protection of the access codes;
- atypical condition monitoring (absence of vacation for example).

³ Unit support managing the information systems and ensuring the accounting of the operations in particular

⁴ Unit in charge of the follow-up of the risks and the control of the operations

3.2 Controls carried out before by the banking Commission

The supervision of a group of the importance of the General Company leads the banking Commission to diligenter each year of many missions of inspection. It examines the head office indeed as well as subsidiary companies, various branches of industry of the group (banks of detail, banks of financing and investment, financings specialized) and the various risks to which it is exposed (solvency, liquidity, internal device inspecting and risk management, device of fight against bleaching in particular).

The Governor of the Bank of France indicated, during his hearing by the Committee of supply of the senate, January 30, 2008, that the General Company, over the period 2006-2007, had been the object of 17 inspections, which related in particular to the riskiest sectors, and on the passage to the prudential standards Basle II which intervened on January 1, 2008. These controls led to recommendations of the banking commission, which recommended the reinforcement of the teams and the means dedicated to the counterparts. In March 2007, a letter of framing in this direction was addressed to the chairman of the General Company as well as a letter of continuation. The latter related to the structured derivatives specifically actions, but these recommendations, centered on an objective of security, take on a more general range, aiming at the whole of the financial instruments, in particular the future ones.

The General Company indicated that it had immediately after the discovery of the positions of the operator set up of the specific check procedures and correct measurements. Beyond these specific measurements, the General Company decided to launch additional controls in order to reinforce the internal system of audit.

The first 4 tracks of reflexion to reinforce the control of the operations of market

The events occurred at the General Company must certainly encourage the whole of the Place, establishments and authorities, with a careful thought, in order to release the best practices and the rules likely to reinforce the operational safety of the operations of market. This process could undoubtedly lead to an evolution of the regulation relating to the internal audit. For this reason, one can stress that the French texts on the matter already were frequently adapted to take account of the changes of banking.

Moreover, to take account of the speed of these evolutions, some of the best identified practices would undoubtedly gain with being diffused by the banking Commission, without being for as much built-in in a normative text. In addition the actors of markets should draw the immediate conclusions from the situation here in question without awaiting a possible change of the texts.

From this point of view, the following tracks of reflexion would particularly deserve to be examined. They have in particular as an aim to take into account, beyond the systems and procedures, the importance of the personal elements when it acts as in this case preventing and detecting abnormal or unusual behaviors being able to generate operational risks.

4.1 To reinforce the devices intern of control of the establishments

Several points of control should be more systematically examined by the establishments being operations of market. Many of these practices are certainly already in force but it is a question of being ensured of their implementation systematic:

- The follow-up of engagements is focused today on the net values of the positions, who allow to evaluate the risk of incurred market; a reinforced attention would have also to be granted to the rough notional amounts, which reflect the degree of engagement of the establishment;
- the track of audit should be actually guaranteed for each transaction of each operator;
- the anomalies and errors of treatment of the operations as well as cancellations of operations should be rigorously listed and analyzed;
- The confirmations of operations should be always checked by procedures of reconciliation, with the internal counterparts with a group, on the one hand, and with the external counterparts of the group, on the other hand;
- the terms and conditions of the operations tied with the external counterparts should be very precisely documented.

In addition, it appears determining that the organization of the inspecting devices on the level of the rooms of market allows a total follow-up of the transactions of each operator, in order to be able to determine its profile of activity and to thus identify more easily of the unusual behaviors.

Moreover, of the written terms should systematically precisely define the operations allowed each operator. They would make it possible to make sure that the nature and the amount of the financial instruments used are registered well inside the fixed limits and of the strategy defined by the establishment.

The operations said private should be the subject of an attention reinforced in the field of the derivatives, in particular being the contractual conditions, while resorting as much as possible to the standard contract worked out by the trade associations.

The information systems must be correctly made safe, in order to avoid the intrusions. In particular, the access modes must be the procedure object approved by the leaders.

Lastly, it would be advisable to take care in the rooms of market for a rigorous independence between the *face-office* and the control units, without to call into question the diversity of the possible courses of career in this branch of industry.

4.2 To supplement the regulation on the audit internal concerning the follow-up of the operational risk

The new test of solvency says “Basle 2” makes it possible from now on to assign a cover in own capital stocks with the opérationnel⁵ risk.

The payment of the Committee of the banking and financial regulation n° 97-02 relating to the internal audit could be supplemented in this direction to treat qualitative aspects of this risk, by envisaging for all the establishments the existence of a system of operational risk management duly documented including a cartography of the operational risks by entity and/or line of trade and of the obligations of *reporting* as well to the social bodies at the banking Commission.

4.3 To better identify the fight counters the internal fraud like an element with whole share of the internal audit

The follow-up of the internal risk of fraud could be explicitly integrated in the regulation on the internal audit, within the framework of the operational risk. For this reason, a duty of information of the banking Commission could be instituted in the case of noncompliance with the internal rules exceeding a certain threshold or having certain characteristics, even if no negative consequence appeared.

In addition, the establishments of a certain size or presenting a specific profile of risk could be encouraged to create a department dedicated to this mission.

4.4 To fully imply the direction and the framing of the establishments in the hazard control

The effective reinforcement of the audits internal here considered requires a greater implication of the authorities of governorship of the establishments. In this respect it would be desirable that, taking into account the complexity of the operations carried out, the social bodies set up committees made up partly of personalities independent and dedicated to the monitoring of the risks and internal audit. These committees would examine the results of work of the various dies of audit internal and would prepare the deliberations of the leading authorities of the establishment on these questions.

In parallel, the quality of the systems of internal *reporting* of the establishments should be reinforced, by making sure that transmitted information corresponds well to the needs for the various hierarchical levels or control. These *reportings* should systematically combine a quantitative approach of the risks with a more qualitative judgement, so as to ensure itself in particular of coherence between the nature of the activities, the results which they release and risks that they generate.

⁵The operational risks are those which are not due at the risk of market or credit, but with events of another nature external or interns weighing on the establishment (fire, data-processing breakdown, fraud...)

4.5 To adapt measurements relating to the sanctions applicable to the banking and financial houses

In the field of the pecuniary penalties, the maximum amount that the banking Commission can inflict is 5 million euros to the maximum for the greatest establishments. In comparison not only of the stakes but also with the capital cost in effective systems of internal audit, these amounts are not sufficient. It is thus necessary to raise this quantum substantially.

4.6 To formulate proposals at the international level

Because of strong international integration of the activities of market, it appears very desirable that reflexions of the same order take place on the levels European and international, so that homogeneous standards can apply to the whole of the speakers.

Moreover, certain subjects still insufficiently covered at the international level would deserve specific work. Being the risk of reputation, by not easily quantifiable nature, it would be desirable that the supervisors within the Committee of Basle and Europeans within the European Committee of the banking supervisors specify the requirements of capital stocks own to implement by the establishments taking into consideration these risk.

As regards transparency, it is also proposed to work at the international level with the coherence of the requirements of publication of information (pillar 3) of the new test of solvency "Basle II" with those fixed at the chart of accounts by the standards IFRS, which at this stage do not envisage under information on the financial instruments to make be reproduced elements on the operational risks.