

FRENCH REPUBLIC



The Chairman

Paris, May 9, 2005

Dear Mr President,

It is my distinct honour to present to you and to parliament the report of the Autorité des Marchés Financiers (AMF) for 2004, the AMF's first full year of operations. The AMF was created on 24 November 2003 from the merger of the Commission des Opérations de Bourse (COB), the Conseil des Marchés Financiers (CMF) and the Conseil de Discipline de la Gestion Financière (CDGF).

In 2004, amid sustained world growth driven by buoyant economic activity in the USA and most emerging countries, financial markets pursued the recovery that began in 2003. The pace was moderate, slowing down in mid-year because of uncertainties sparked by the geopolitical situation, the rising oil price, the weakening dollar, and America's twin budget and trade deficits. Ample liquidity, combined with quiescent inflation and memories of the fallout from the 1998-2000 "bubble", encouraged fixed-income investments, thus holding long-term yields and risk premia at historic lows.

French markets followed a similar pattern to that in leading markets elsewhere in the world. Investors continued to display a marked aversion to risk. And companies pursued efforts to restructure, restore margins and shed debt; they placed the emphasis on buying back shares and paying dividends, which benefited their shareholders. Accordingly, net market financing of economic activity was subdued: equity issuance was offset by share buybacks, and bond issuance was sharply lower than in the previous year. In this environment of caution and restraint, markets were only moderately volatile.

Nevertheless, market activity recovered somewhat, not only in terms of new listings (although the largest of these were attributable to privatisations), but also of mergers, restructurings and trading volumes, which rose steeply compared with 2003.

Special mention should be made of France's vibrant asset-management industry. Among the largest in Europe for collective investment schemes, it had €1 trillion under management in 2004; and it continues to modernise and innovate at a remarkable pace.

The AMF experienced a particularly busy year in 2004. It had to map out and implement its organisational structure and operating methods while pursuing its regulatory activities which, naturally, could brook no interruption.

The new organisation became operational in the first few weeks of the year. The Board very quickly found a balanced mode of operation, based on consensus-building and marked by an intense work rate. To help it with the burdensome task of scrutinising inspection and investigation reports, it set up three specialised commissions with a similar composition to its own to decide on follow-up action – whether to dismiss the case, issue a deficiency letter, commence sanction proceedings, or refer the case to the competent authorities.

Furthermore, to improve the technical quality of its general deliberations by giving open-minded consideration to the opinions of market participants at the earliest possible stage, the Board established five consultative commissions, each chaired by two of its members, and a scientific advisory board. This consultative process involves nearly one-hundred experts from all sectors of activity. It entails formal procedures for dialoguing with organisations representing the French financial community and, in some cases, with foreign correspondents. Moreover, it is conducted in close collaboration with the competent State authorities. The Board also laid down its operating rules and a code of conduct applicable to AMF members and staff. It established an audit and remuneration committee, which, based on the report of the Chief Executive, gives particular scrutiny to budget and accounting matters and also to the methods and results of internal control, for which a special department was created in autumn 2004.

The Sanction Commission, divided into two similarly structured sections, finalised its organisation system at end-2003. In view of the Commission's heavy workload, the support its rapporteurs receive from the Legal Affairs Division was entrusted to a dedicated team, which also seeks assistance from members of the high courts.

The organisation of the AMF's departments is based on cross-distribution by area of responsibility (regulation of issuers and disclosures, regulation of market intermediaries and infrastructures) and by function. A Regulation Division with a cross-functional role is tasked with research, international representation and regulatory policy. It also keeps abreast of fast-moving developments in techniques, activities and competitive conditions.

The process of merging teams from institutions with different traditions required painstaking analysis and staff negotiations. The aim was to establish new management rules and to unify not just the diverse contractual situations but also the classification and remuneration system, which is now based mostly on qualifications, merit and incentives; and working conditions, which involved difficult discussions on the issue of worktime.

In sum, the functional goals set during the reforms of August 2003 were achieved in 2004. These were:

- to build a market regulator that is inherently independent because of the diverse origins of its members and the arrangements for appointing them, its operating methods, and the principles of collective responsibility that inform its decisions;
- to give it the operational resources needed to carry out its duties: the Board authorised a first increase in staff numbers to some 360 persons, prompted by the increase in surveillance tasks and the assignment of new responsibilities, notably supervising the marketing of savings products;
- to establish the regulator's technical legitimacy through the multidisciplinary credentials and high-level skills of its members and its position at the heart of the French financial markets.

It is reassuring to note that our achievements were applauded by the International Monetary Fund, following an assessment mission completed in October 2004.

The securities regulator's activity involves four types of decision: setting standards; taking individual decisions concerning the review or authorisation of corporate financing transactions, products and service providers; policing markets and

practitioners; and sanctioning breaches of laws and regulations.

The first task tackled by the AMF in 2004 was to draft its General Regulation – a major and foundational undertaking. This body of rules, which constitutes a fully fledged “code” of French market regulation, incorporates or updates the regulations laid down by the COB and the CMF. The drafting process began in spring and was conducted in cooperation with industry organisations, which must be congratulated for their highly efficient and thorough contribution. As a result, one year to the day after the AMF was founded, the finance minister was able to approve the General Regulation. It will be regularly updated and expanded to take account of new laws and regulations, developments at EU and domestic levels, and innovations in products, techniques and services.

It is important to note that Europe’s markets are now regulated by a body of highly detailed EU-wide rules devised and adopted between 2001 and 2005 under the Financial Services Action Plan and in accordance with the so-called Lamfalussy Process. During this period, significant progress was made on the construction of the single market, even though the process of national transposition is only just getting underway and the impact of the new rules is still imperceptible. This has resulted in a major legislative and regulatory drive to adapt France’s national system, begun in 2004 and set to continue in 2005 and beyond, and in what may prove to be fundamental changes to our finance industry. The principal directives – on financial instrument markets, market abuse, prospectuses and transparent disclosures by issuers, asset management firms and products, the adoption of international financial reporting standards by some 7,000 listed European companies, and so on – are now in force in all member states or will be implemented in the near future.

In 2004, the AMF’s work programme was determined largely by this major European project, and it will continue to be so in future. Moreover, both the COB and the CMF were heavily involved in this process from the outset. With its international profile enhanced by the merger of these two institutions, the AMF continued to play an active role in the work of European authorities, especially the Committee of European Securities Regulators (CESR).

However, financial market globalisation now extends beyond the confines of Europe, and regulators must therefore take into consideration the work done at international level by bodies such as the International Organisation of Securities Commissions (IOSCO) and the Financial Stability Forum (FSF). Here, too, the AMF is deeply involved on several fronts, helping to set common regulatory standards for markets and to promote international cooperation, without which market surveillance would be unrealistic. As a result, the policy settings adopted at world level derive directly from the progress made in France – at the instigation of the AMF, among others – in the fields of corporate governance and the internal and external control of listed companies. Although this standard-setting activity was heavily influenced by the international environment, the AMF was also involved in some specifically domestic developments. For example, it helped draft a legislative order on securities, prepared the regulatory framework on cold-calling and financial investment advice, and defined accepted market practices for share buybacks by listed companies.

Regarding individual decisions, 2004 saw a pick-up in activity by issuers and the major impact of technological and regulatory developments in the asset management industry.

Mergers and takeover bids increased sharply, both in number and in scale. They included the initial public offerings (IPOs) of PagesJaunes and Snecma, the finalisation of Alcan’s bid for Pechiney, and the acquisition of Aventis by Sanofi-Synthelabo. A number of tender offers resulted in corporate restructurings and, in some cases, a concomitant delisting. The AMF saw to it that the terms offered by bidders were fair. At the same time, it decided that the rules governing independent appraisals, which are often mandatory in such cases, needed updating and it initiated a cross-market work project for that purpose. The outcome of the project will be debated by the Board in the coming months.

Asset management is one of the key strengths of the French finance industry. Responding to changes in European rules and regulations, and amid fierce competition and constant innovation, the AMF devoted much of its energies to the

asset management sector in 2004. It sought to reconcile its remit to protect investors with the need to adapt products and methods. On this point, attention should be drawn to the significant advances made in the fields of alternative investment management and employee savings plans. The substantial progress achieved in the area of employee savings marks a positive trend insofar as the French need to make long-term investments in our country's companies to prepare for their retirement. This is an embryonic effort which, to the greatest possible extent, will demand continued and patient efforts.

The regulation of market infrastructures required particular vigilance on the part of the AMF. Oversight of Euronext Paris is now performed in a spirit of close cooperation and trust with our fellow regulators in the Netherlands, Belgium, Portugal and the United Kingdom. Naturally, much attention was focused on the onset of competition with Deutsche Börse for a tie-up with the London Stock Exchange. Moreover, Euronext pursued its efforts to improve service quality and attract new companies to its markets. This is a matter of cardinal importance, since the number of firms listed in France has plummeted in recent years. Accordingly, the AMF approved the reform of Euronext's listing arrangements and the creation of Eurolist, and it adapted its rules to permit the launch of a new type of market, Alternext, aimed at medium-sized growth companies.

Similarly, the AMF plays a prominent part in work on post-trade infrastructures, that is to say, securities settlement and custody. Progress in this area, which raises awkward industrial and technical problems, will to some extent determine the competitiveness of Europe's financial industry.

Aside from its technical characteristics, a financial market's prosperity, dynamism and efficiency hinge on the confidence of its participants and on the robustness and integrity of its operating procedures. The creation of the AMF was not inspired solely by operational considerations; it was also a response to the crisis of confidence triggered by the bursting of the bubble and the unearthing of scandals that hit all the world's major markets. The new regulator therefore had a duty to show its determination to closely monitor and severely punish anyone guilty of market misconduct. This was the case in the AMF's first year of activity, with numerous inspections and investigations, frequent recourse to the highly effective procedure of court injunctions, and the imposition of financial penalties by the Sanction Commission. On average, these fines were much higher than in previous years, a reflection of greater severity and evidence that the AMF's new organisation is functioning in line with expectations.

However – and this is true for enforcement as a whole – market discipline is hampered by unwieldy procedures, while the scale of the sanctions and the timeframes for dealing with cases are not always suited to real-life market conditions. One welcome reform would be to introduce a transparent settlement process into the French system, along the lines of those used by our key partners, and to couple it with a sharp increase in the size of certain penalties.

The AMF's core mission of investor protection does not depend solely on regulation and discipline. It also relies on the three-pronged process of mediation, information and education in all developed financial centres. Heir to a long tradition of mediating for and informing the general public, the AMF has further improved its much-appreciated services in this area.

Be that as it may, investor education is a weakness in France, where the economic and financial culture is still underdeveloped. The AMF has initiated a market-wide review of this vitally important issue and will shortly unveil ambitious proposals for a long-term programme aimed at all levels of French society.

In conclusion, the AMF's actions must be viewed in a broader perspective, namely the development of France's financial markets.

The AMF will certainly not forget the lessons learned from the market crises, even though memories of those events may be fading. It has a duty to safeguard investments, ensure disclosure quality, and protect orderly markets. To that end, it recently initiated fresh market-wide work programmes on issues such as independent investment research, voting at shareholder general meetings, and corporate internal control. It also called for, and welcomed, the launch by the finance minister of a working group to address the transposal of the Takeover Directive, as well as the important cross-sector mission to study the marketing of financial products.

The AMF is also concerned with the development of Paris as a financial centre. In this respect, the significant progress made by our financial market system in recent years must be singled out for praise. Our financial centre certainly plays a leadership role in continental Europe and is a major asset for our economy. Its success naturally stems from its modern and technically sophisticated systems, its reputation for security and integrity, and the energy and enthusiasm of the people who work there.

But competition is already fierce and will intensify as the European and international markets become more closely integrated. It is therefore vital to pursue the effort to expand our market's domestic base as well as its depth and liquidity, which underpin its appeal. The action taken by the public authorities in this sphere must be organised around two complementary strands that rely on legal and fiscal stimuli: encouraging the most dynamic companies to list on the stock exchange in order to improve their terms of financing, and encouraging the French to invest their long-term savings in equities, so as to involve them in the activities and development of their corporate sector, either individually or through collective investment mechanisms.

It remains for me to pay tribute to the dedication and exceptional skills of the AMF's staff, under the outstanding leadership of Chief Executive Gérard Rameix, and to thank my colleagues on the Board and the Sanction Commission for their personal commitment and for ensuring that our collegiate process works so remarkably well.

Yours truly,



Michel Prada