

REFORM OF FRENCH SECURITISATION LAW AND CREATION OF SPECIALISED FINANCING VEHICLES

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Legal Briefings - By **Vincent Hatton**

The reform of the French securitisation legislation announced by the Government throughout the implementation of 'Sapin 2 Law' has been published on 5 October 2017. This reform is coupled with the introduction into French law of specialized financing vehicles and a new reform of the banking monopoly and the Daily assignment. We have listed below the key elements of this reform, which will come into force on 3 January 2018.

1. CREATION OF A NEW CATEGORY OF FINANCING VEHICLES

1.1 Financing vehicles

- The reform introduces a new category of regulated SPV named financing organisms ("**FV**" or OF in French) which will comprise the existing **securitisation vehicles** (*organisme de titrisation*) ("**SV**" or OT in French) and a new form of SFV named **specialised financing vehicles** (*organismes de financement spécialisé*) ("**SFV**" or OFS in French);
- SV and SFV can be set up either as a fund with no legal personality or as a company (*société anonyme* or *société par actions simplifiée*);
- SFV and SV will be governed by **common provisions applicable today only to SV** which will enable them, amongst other things, to (i) be by law bankruptcy remote, (ii)

ensure the validity and the enforceability of their funds allocation rules, waterfalls and limited recourse provisions (including a confirmation of the validity of the flip-clauses), (iii) benefit from dedicated collection account mechanisms which when granted by the servicer, eliminate the risk of commingling and (iv) have separate compartments;

- SFV will by nature fall within the scope of the AIFM directive and will be subject to specific provisions;
- FV will now be set up on the sole initiative of the asset management company or a sponsor within the meaning of CRD (i.e. institution other than the originators of the securitisation and which will manage it) which will transfer the management of the portfolio to a portfolio management company;
- Custodians will no longer be the co-founder of the FV (and cease to bear liability in this respect) and will be designated by the SV;
- Both SFV and SV can benefit from the label *fonds prêt à l'économie* but only SFV can benefit from the "European Long Term Investment Fund" (ELTIF) label.

1.2 Securitisation vehicles - Major changes or factors of differentiation from SFV

1.2.1 **Simplification of the object:** SV are purported to, on the one hand, be exposed to risks, including the insurance risks, and, on the other hand, ensure full funding or coverage under the conditions provided under the law.

1.2.2 Assets

(A) **Risks exposure** by acquisition, subscription or holding of receivables, granting of loans, conclusion of financial futures (derivatives), contracts transferring insurance's risks, guarantees, security or **sub-participation in risk or cash flow**;

(B) Granting of loans to non-financial companies where "the buying out of shares or stocks and the use of leverage are subject to limitation" (the concept of non-financial companies needs further analysis but it should, as for the *fonds de prêt à l'économie (FPE)*, encompass companies belonging to the private sector engaged in commercial, agricultural and/or real estate activity to the exclusion of financial activities);

(C) Possibility to hold securities received by conversion, exchange or repayment of securities giving access to the capital in equity.

1.2.3 Liabilities

(A) Financing or coverage by issuance of debt securities, financial futures (derivatives), **sub-participation in risk or cash flow, or external facilities or other forms of resources, debts or commitments**;

(B) **Tranching remains possible;**

(C) Clumsy drafting and contradiction between several articles of the new legislation, however, it seems that there is no buying-out of securities at the investors' request (except maybe when the SV grants loans).

1.3 Specialised financing vehicles - focus

1.3.1 **Object:** the purpose of SFV is to directly or indirectly invest in eligible assets and to ensure their financing or coverage by issuance of debt in accordance with conditions to be defined in a decree.

1.3.2 Assets

(A) Financial instruments, **receivables**, sub-participations in risk or cash flow, **and similar assets as those in which professional specialised funds can invest** i.e. **any kind of asset** free of any security in which (i) property right is based on registration, notarised deed, or private agreement if its probative value is recognised under French law (wide range of assets), and (ii) its **value** is reliable and **liquid**. SFV should be entitled to subscribe shares (clumsy drafting);

(B) Possibility to grant loans:

(1) to **non-financial companies** where "the buying out of shares or stocks and the use of leverage are subject to limitation";

(2) to eligible non-financial companies in the meaning of the ELTIF Regulation when the SFV is duly authorised to act as ELTIF funds. The ELTIF label would entitle French SFV to, in accordance with EU legislation, provide loans to borrowers located in EU jurisdictions including in jurisdictions equivalent to France which prevent entities that are not credit institutions to lend to and/or purchase unmatured receivables from professionals located in these jurisdictions.

1.3.3 Eligible Liabilities

(A) Shares, stocks, securities (terms and conditions to be defined by Decree), conclusion of financial futures (derivatives), borrowing facilities or **any form of resources, debts or commitments;**

(B) Different categories of shares or stocks and various rights over the capital and option for interest but **no tranching;**

(C) Possibility of requesting the buying out of shares, stocks or securities by their holders.

2. CHANGES TO BE NOTED - STRENGTHS AND WEAKNESSES

2.1 Regarding public transactions

2.1.1 The prospectus will now be prepared under **the sole responsibility of the asset management company or the sponsor (who cannot be the assignor). The Custodian is no longer responsible;**

2.1.2 A document (i) establishing an assessment of the characteristics of the securities to be issued by the FV, the principal assets (*actifs*) and liabilities (*passif*) components and the contracts to be entered into by the FV, and (ii) assessing the risks involved shall be issued by one of the persons named in a list to be set up by the Minister of the Economy upon recommendation of the *Autorité des Marchés Financiers*. The prescribed document is not required for SV which will already be incorporated on 3 January 2018. It is unclear at this stage as to whether the legislator wants to re-introduce into French law an obligation to have the listed bonds rated by at least one rating agency even when the notes are distributed to qualified investors only.

2.2 Regarding any transactions (including where loans are granted by FV)

2.2.1 **Claw-back risk, alignment with the collateral directive regime:** As from the entry into effect of the reform, the assignment of receivables or the creation of security or guarantees to the benefit of an FV will remain valid even if the transaction is made during the hardening period;

2.2.2 **Rent receivables and leasing:** neither the opening of insolvency proceedings (nor its equivalent in a foreign law) against the tenant or the lessor, nor the assignment or the transfer of movables or real property (objects of the contract) in the context of the said insolvency proceedings or on its completion, can challenge the continuation of the lease and the leasing. Thus, the tenant will continue to pay the FV even though the identity of the owner or the lessor has changed;

2.2.3 **When the SV acquires future claims to be made by a fronting bank under a loan, the SV can with the express agreement of the fronting bank and the borrower, make the advance directly to the borrower instead of the fronting bank** (the mechanism of delegation of payment or any advance of payment of the purchase price made to the benefit of the fronting banks created by the practice in green field projects and construction loans that will no longer be necessary);

2.2.4 **The asset management company can now be in charge of the servicing of the assets of the FV;**

2.2.5 Confirmation that the FV can **grant** or **receive** any kind of security or guarantee (in response to foreign investors who - to tick the box - ask for "*secured notes*" that were not necessary under French law as the OF is by law bankruptcy remote);

2.2.6 The validity of the funds allocation rules is confirmed, including in the event of bankruptcy of the FV's counterparty (**flip-clauses are valid under French law**)

2.2.7 The list of Dailly's assignees is extended to SFV. The Dailly assignment is no longer limited to the sole licensed credit institutions. From now on, and notwithstanding any inconsistent legislative or regulatory provision, FV are entitled to benefit directly from the so-called Dailly assignment. FV will benefit from assignment forms (*bordereaux Dailly*) signed after the acquisition of the rent receivables (which is not currently possible) or directly benefit from this specific security interest if it acts as initial lender, as credit institutions are entitled to. FV will also be able to benefit from the acceptance of the assigned debtor.

2.2.8 It is also possible to operate a transfer between compartments of the same FV

2.2.9 Validity of the rules related to the decision-making by the management company as developed by the practice (**investors' consultation**)

2.3 New exemption to banking monopoly

It is now possible for a bank or an FIA (thus including FV) to transfer unmatured receivables arising from loans made to legal entities or professional individuals (thus excluding consumer loans) to "entities or institutions governed by foreign law with **"a similar object and activity"**", licensed credit institutions (*établissement de crédit*), financing companies, *OPCVM* or FIA (including securitisation funds). Reference is only made in the new law to the object and activity of the French transferors (all regulated entities) without requiring the assignee to be a regulated entity itself while the report to the president that has introduced the reform to the government indicates that the reform would be applicable to assignees that are regulated entities.

There will be no longer any need to interpose an FCT between banks acting from France and foreign SPV or debt funds to transfer outside France performing loans booked in France.

2.4 Custodies - what is going to change for securitisation

2.4.1 The custodian will be designated by the FV and will no longer be in charge of the constitution of the FV;

2.4.2 Expansion of the list of eligible custodians: French licensed credit institutions or European institutions with a branch in France (EEA – consequence of Brexit will need to be analysed), or institutions (French or with a branch in France) selected from a list established by the ministry of finance;

2.4.3 To avoid conflicts of interest, the custodian cannot "exercise activities concerning the FV" (SFV are only mentioned in the Ordinance) unless "the custodian has separated the execution of its mission on a functional and hierarchical level": **originators which generally act as servicers of the FCT may no longer be able to assume the role of custodian.** This issue should be analysed in more detail (this reform may prevent the custodian from acting for an FV as account bank, cash manager or hedging bank);

2.4.4 Possibility for the custodian to delegate some of its missions, including assets custody, with possibility to exempt itself from all liabilities subject to strict conditions;

2.4.5 The conditions of exercising the custodian's missions will be provided by the General Regulations of the AMF.

3. COMING INTO FORCE AND GRAND-FATHERING

3.1 The *Ordinance* will come into force on 3 January 2018 except for the provisions in relation to the depositary which will come into force on 1 January 2019;

3.2 **SV created on 5 October 2017 shall designate a custodian which satisfies the new conditions as of 1 October 2019** (we trust it should relate to securitisation funds created between the date of the prescribed Ordinance and the 31st of December 2018 although the Ordinance is silent on this matter);

3.3 It will be possible to convert existing SV into SFV without the necessity of dissolving the SV;

3.4 The new document required for public securitisations where the risk shall be described is not required for public SV which already exist on 3 January 2018 (this may apply also to new sub-funds of existing securitisation funds, possibly...).

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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