

The new French securitisation regime: Creating the ultimate vehicle

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December 2008 will be the 20th anniversary of the French securitisation vehicle known as the *fonds commun de créances* (FCC). For 20 years, the FCC has proved to be a particularly versatile and robust securitisation vehicle. Thanks to timely legislative amendments, it has been seen over the years as the benchmark for European securitisation vehicles. The most recent amendments came into force in June 2008. As a result of the in-depth nature of this latest reform, the French securitisation vehicle (the New Vehicle) is better than ever. The aim of this article is not to detail every new feature of the French legal framework but to highlight the most interesting practical implications of this reform.

Universality of scope of action

The New Vehicle's legal framework is extremely flexible. It can be used in all kinds of circumstances. In particular, there are virtually no limits in relation to:

- the status of the originators and the debtors, which can range from individuals to governmental bodies and can include public entities and corporates registered in France or abroad;
- the nature of the assets securitised, which may include existing or future claims, either performing or non-performing, and which may be governed by French or foreign laws, ranging from classic trade receivables to secured loans and structured assets (mortgages, debt transferable securities, project finance loans, leases, acquisition finance loans, insurance and reinsurance ...);
- the objectives of the transaction, which can be a simple domestic or international financing or refinancings, or a more complex or specific transaction (ECB refinancing, whole business financing, securitisation buy-out, covered bond programme, tax optimisation, accounting/regulatory optimisation, risk transfer ...), and which can take the form of either a cash or a synthetic transaction whereby the New Vehicle may purchase or sell risk;
- the legal status of the New Vehicle, which may be created under the form of a mutual debts fund without legal personality or under the form of a limited liability company. In the first instance, the New Vehicle replaces the former FCC and is called a *fonds commun de titrisation* (FCT). In the second instance, the New Vehicle is known as a *société de titrisation* (securitisation company). In both cases the New Vehicle may include several compartments or cells achieving bankruptcy-proof segregation of assets and liabilities;
- the nature of the financial instruments that can be

issued, which may comprise any type of debt instruments and shares (short, medium or long term notes or bonds, either junior, senior or mezzanine, governed by any laws and denominated in any currencies and featuring any terms and conditions such as extendable maturity notes, partially paid-up bonds and preferred shares) which can be privately or publically placed in all financial markets; and

- the nature of the financial instruments available to manage assets and liabilities, which may include loans, repos, forward financial instruments (interest, currency, credit default and other swaps) and financial guarantees.

International vehicle

Most of the above mentioned features of the New Vehicle were already present in the former FCCs. As a result, FCCs have been very attractive to financial institutions and corporates wishing to set-up international financings involving subsidiaries located in a number of countries.

Although the former FCCs were already very flexible, the New Vehicle benefits from important improvements aimed at further facilitating cross-border transactions, namely:

- the New Vehicle can now be set-up in the form of a limited liability company, which is subject to corporate income tax and should therefore benefit from international double tax treaties.¹ This should extend the territorial scope of action of the New Vehicle and simplify international financings; and
- the New Vehicle is able to purchase assets pursuant to agreements governed by any law chosen by the parties, not just French law.² Therefore, depending on the location of the originators, the assets and the debtors and any

other relevant laws, the New Vehicle will be in a better position to implement cross-border transactions smoothly.

These provisions make the New Vehicle extremely attractive to international securitisation programmes involving European, US, Asian and other originators.

Financing future flows

The New Vehicle is one of the very few vehicles able to purchase future flows in a bankruptcy-proof environment. An assignment of future flows is effective only to the extent that the applicable law i) allows for such assignment, ii) ensures its survival in the event of the bankruptcy of the originator and iii) provides that the underlying commercial agreements from which the future flows derive cannot be terminated in the event of the bankruptcy of the originator. Furthermore, given the fact that bankruptcy proceedings are arenas in which creditors and debtors fight vigorously, it is of chief importance that the law be clear, unambiguous and applicable irrespective of the status of the originator or of the legal nature of the future flows or of the underlying commercial agreements.

Virtually no jurisdiction has legislation satisfying this trilogy of conditions, with the exception of France following the new French reform, which states that:

- the New Vehicle can purchase future receivables, even if at the time of the assignment the underlying commercial agreements have not been performed, the debtors are not identified and the amount and the due date of the receivables have not yet been determined;
- the assignment of such receivables is valid between the seller (originator) and the purchaser (the New Vehicle) and enforceable against third parties (i.e. constitutes a "true sale"), irrespective of the date of creation of the receivables, their maturity date and the potential bankruptcy of the originator occurring after the assignment date; and
- when the future receivables arise from a lease agreement, the underlying lease agreement cannot be terminated on the sole grounds of the bankruptcy of the originator.

As a result, the New Vehicle provides for a clear-cut legal framework ensuring a true sale of future cash flows in all situations, permitting the pre-financing of future flows in the context of ordinary receivables financings, long term contracts securitisations or whole business securitisations.

Elimination of commingling risk

French law has designed a specific regime, known as the "*compte spécialement affecté*" or CAS, which eliminates commingling risk, making the New Vehicle very attractive to investors. The main features of the CAS

are as follows:

- the CAS is a bank account opened in the name of the servicer but which benefits solely to the New Vehicle, thereby protecting investors from claims of a liquidator or third party creditors;
- the CAS can be created by a simple agreement entered into between the New Vehicle, the servicer of the assets transferred to the New Vehicle and the account bank with which the CAS is opened. As a result, the CAS can be the existing bank account of the servicer to which the payment of the securitised assets are credited and the underlying debtors or creditors are not involved in this process or even made aware of its existence;
- the CAS is flexible enough to absorb non securitised cash flows, to be created at the level of the servicer or at the level of sub-servicers and to allow the servicer to use the available cash as it sees fit; and
- in the event of the bankruptcy of the servicer, the CAS arrangements survive and cannot be terminated by the bankruptcy administrator.

The efficacy of the CAS justifies the use of a New Vehicle in a number of situations, in particular in the context of international securitisation programmes.

Insurance risks transfer

In addition to the significant improvements to the French securitisation legal framework described above, the reform has implemented Directive 2005/68/CE on reinsurance (the Directive). The main objective of the Directive was to introduce a minimum level of harmonised prudential supervision of reinsurers across the European Union, in advance of Solvency 2. However, one of the most interesting provisions of the Directive is the introduction of a 'insurance special purpose vehicle' (ISPV), the purpose of which is to act as a reinsurer, but without having the legal status of a reinsurer and without being subject to the corresponding regulatory constraints.

The creation of the ISPV follows on from the "*European Commission ART Market Study – Final Report*" published on October 2, 2000 which concluded that alternative risk transfer techniques and products such as securitisations provide solutions that would not exist in conventional insurance terms, and that it is to the benefit of the policyholders, together with insurance companies and reinsurance companies, that the latter be able to offer such techniques and products.

The reform allows New Vehicles to acquire or transfer insurance or reinsurance risks in accordance with the following general principles:

- the establishment of an ISPV requires the prior authorisation of the French insurance authority,

namely the *Autorité de contrôle de l'assurance et des mutuelles* (ACAM); bearing in mind that the rules applicable to an ISPV are designed to result in a much lighter and quicker procedure than that applicable to insurance companies;

- the ISPV is neither an insurance nor a reinsurance undertaking. Furthermore, the law expressly states that the agreements entered into by an ISPV do not qualify as insurance contracts. As a result, there is no risk of such agreements being re-characterised as 'insurance contracts', with all of the related regulatory and tax consequences that would flow from characterisation as insurance;
- ISPVs are not subject to minimum solvency margin or capital requirements, other than that their assets must be equal or greater to their liabilities, meaning that i) once the initial funds necessary to cover the ISPVs reinsurance liabilities have been raised in the capital markets, the corresponding proceeds and other assets must remain sufficient throughout the life of the ISPVs to cover the reinsurance risks they bear and ii) the repayment of the capital markets investors is subordinated to the payments due by the ISPVs to the ceding company (or other insurer creditors) in the event of the materialisation of the underlying insured risks; and
- under certain conditions, i) amounts recoverable from the ISPV by the ceding insurer (or other insurance creditor) may be considered as reinsurance or retrocession in calculating the ceding insurer's solvency margin requirements and ii) amounts outstanding from the ISPV may be treated as reducing, or included as assets covering, technical provisions.

In practice, a French ISPV will take the form of the New Vehicle and will therefore be either a FCT or a limited liability securitisation company.

These specific provisions, together with the numerous features of the New Vehicle should constitute competitive advantages for the French ISPV compared to its European counterparts in the development of the alternative reinsurance risk transfer markets.

Bankruptcy remoteness reinforced

The new reform is extremely clear on a number of legal issues which are of major importance to investors in current market conditions. In particular, the new

reform expressly states that:

- the New Vehicle is not subject to bankruptcy laws;
- the rules of allocation and priorities of payment (waterfall) amongst investors in the New Vehicle, together with limited recourse and subordination arrangements, are enforceable against all creditors of the New Vehicle, including in the event of early liquidation;
- each compartment or cell of a New Vehicle is segregated from the others; and
- the liabilities of investors are limited to the value of their investment.

In summary, the New Vehicle is flexible, efficient and safe, and is well-equipped to serve in a variety of situations. In the current market turmoil, its qualities should be valued by originators, financial institutions and investors.

Notes:

¹ As the FCC was a mutual debts fund without legal personality, it was tax transparent and therefore could not benefit from international double tax treaties. In the context of cross-border transactions, it was generally possible to avoid any tax hurdles but with certain countries and asset types, this situation was delicate and could give rise to additional structural complexity.

² The FCC could only purchase assets by virtue of a transfer deed governed by French law. In practice, this was not problematic. French law specifically confirmed that all transfers of assets to FCCs performed in accordance with French law would constitute true sales, irrespective of the location of the debtors and the law applicable to the assigned assets. Nevertheless, in certain transactions, it was necessary to ensure in some jurisdictions that transfer agreements be governed by local laws, thus creating additional delays, formalities and costs.

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