

Overview of the French securitisation market: recent innovations and market trends

Freshfields Bruckhaus Deringer



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Hervé Touraine and Fabrice Grillo

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The French securitisation market has benefited from significant changes over the last few years. It is now a mature market, attractive to French and foreign arrangers and investors but also to originators across Europe. The French securitisation market is still behind some of its European competitors in term of volume, but this situation is balanced by a wide range of transactions and assets. Furthermore, it is recognised as being particularly innovative and on the cutting edge, both in term of structural and legal aspects.

The French market has developed safe legal instruments that are flexible and adapted to the increasing need of industrial and commercial companies to diversify their sources of financing. Apart from this ongoing progress, financial institutions continue to use securitisation as a tool to diversify their risks and to improve their regulatory ratios. 2003 has been a cornerstone of the French securitisation market. Parliament adopted a significant law on August 1, displaying the French authorities' willingness to ensure that the French legal framework remains competitive and to establish the French securitisation vehicle known as *fonds commun de créances* (FCC) as the benchmark for international securitisation programmes.

There are some interesting transactions in the pipeline and 2004 should be the year for:

- an increasing number of international securitisation programmes;
- a wider range of originators, namely mid-size companies and insurance companies; and
- the French market to move from typical ABCP conduit transactions or "AAA/aaa" ABS transactions to non "AAA/aaa" ABS transactions, closer to whole business securitisations.

International securitisation programmes

Several international securitisation programmes have been put in place over the last three years by French originators. Often, these transactions contemplate the assignment of assets originated by a parent company based in France and its subsidiaries located in various European countries and in the US. In many cases, between 12 to 20 sellers and five to eight countries are involved. In a few transactions, actual numbers are much higher. Although trade receivables are the core type of assets for those programmes, real estate assets and consumer loans are also used for international securitisation programmes.

Recent significant transactions include those for Danone, Chargeurs, Alcatel, Michelin, Arcelor, Rhodia, Suez, Alstom, Garonor, Orange and Peugeot.

International programmes are likely to become even more frequent in France and to increase in size and geographical coverage. It is now difficult to obtain an off-balance sheet treatment under International Accounting Standards (IAS) and when such favourable treatment is achieved, the financial analysts and the rating agencies tend not to take account of it in their analysis. As a result, international originators tend to put in place securitisation programmes as a mere financing tool. In order to increase the financial profitability of this tool, they increase the size of the programmes by including a large number of subsidiaries and countries.

It is worth noting that among all these transactions, an FCC is often used, either as an asset purchase vehicle and/or as a financing vehicle. It is likely that this situation will remain and FCCs might become even more visible on the international scene in the near future since a new legislative framework has been designed in order to promote cross-border transactions and to attract non-French players. For example, the new laws and regulations provide that:

- the assignment of receivables is valid and enforceable without any notification or formalities, regardless of the law governing the assigned receivables and the law of the residency of the assigned debtors;
- the custodian of an FCC can be the French branch of a credit institution having its registered office in a member State of the European Economic Area;
- FCCs are entitled to issue bonds and other debt instruments governed by French law or non-French law; and

- the information memorandum relating to the issue of securities by FCCs can be drafted in English provided that the corresponding securities are admitted to trading on a regulated market but are issued without public offering in France.

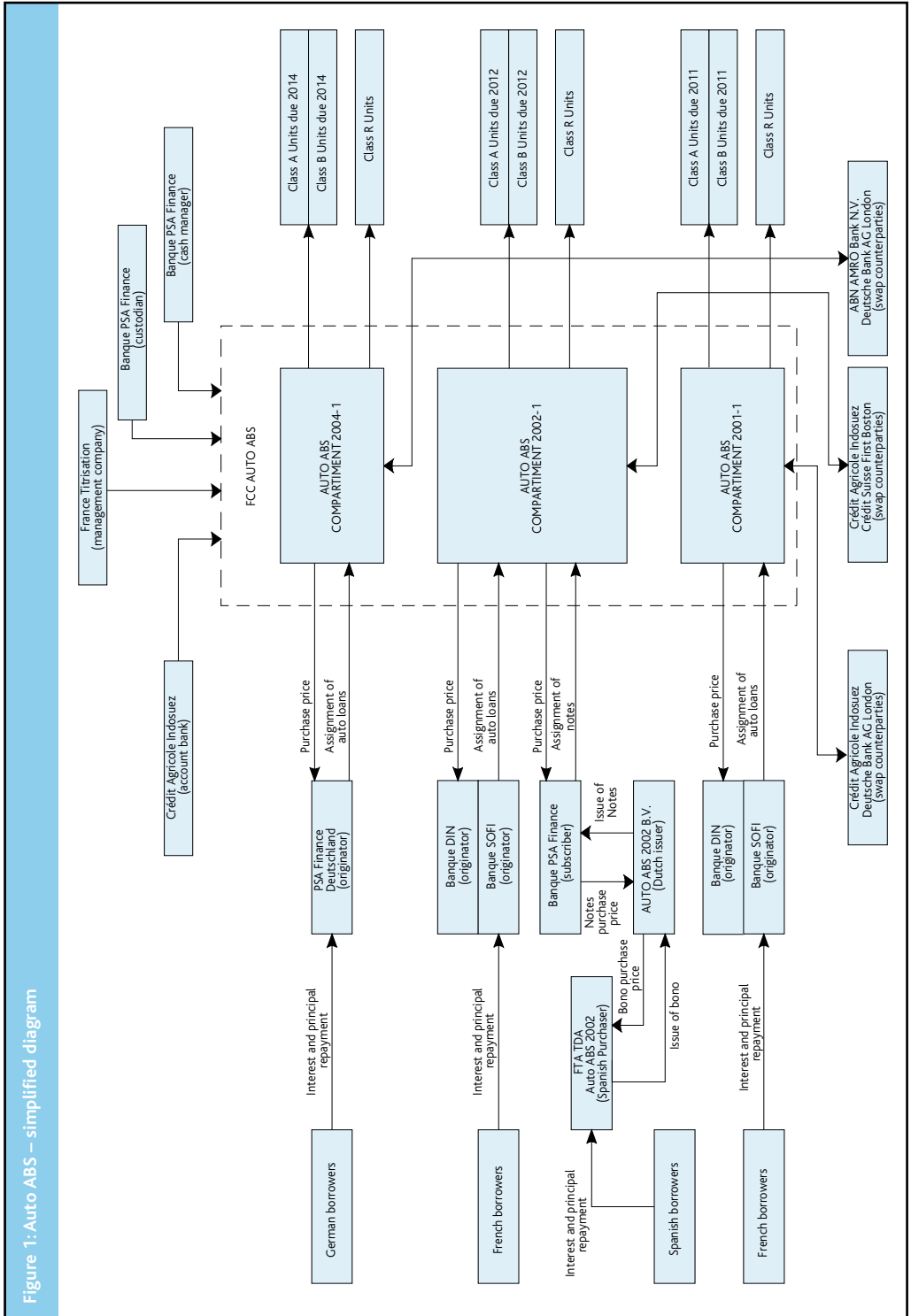
Peugeot offers one of the perfect examples of these trends. In 2001, the group set up an FCC with compartments known as FCCAUTO ABS (see Figure 1), the aim of which is to securitise loan receivables originated by the group in various countries. Since then, Peugeot has created three different compartments which acquired French, Spanish and German assets for an aggregate volume of €3.5 billion. These transactions were arranged by Crédit Agricole Indosuez SA, Deutsche Bank AG London, Credit Suisse First Boston (Europe) Limited and ABN AMRO Bank NV London. They were listed in Paris and Luxembourg and placed within a wide range of international investors.

Mid size companies

For historical reasons, French banks have for a long period of time been the main category of originators in France. Initially, their preferred assets were consumer loans and mortgages. Over the last few years, French banks have been less active in this area and favoured credit derivative transactions rather than cash transactions involving a true sale of assets. On the other hand, commercial and industrial companies have been progressively more active in this market but it remains the domain of large corporates, often rated and/or listed. This fairly static market, as far as originators are concerned, should evolve in 2004.

It is generally accepted that banks tend to be even more conservative than they used to be in financing medium size corporates. This situation is common to most European countries but is sensitive in France to such an extent that it became a real concern to some authorities. Asset-backed financings, such as securitisation, have always been seen as a potential answer to this situation since it concentrates the credit risks on the assets assigned by the corporate and not on the corporate itself. However, recent well-known bankruptcies have highlighted the fact that this approach is somewhat theoretical and that it is difficult to fully eliminate all corporate risk.

In France, one of the major weaknesses of the legal framework in this respect was the lack of protection against commingling risk when the servicer of the



securitised receivables becomes the subject of insolvency proceedings. If the insolvent servicer holds sums for the account of the FCC (or any other receivables purchaser) at the start of the insolvency, the FCC is an unsecured creditor in the servicer's insolvency. In such a case, the claim of the FCC against the servicer competes with the claims of other creditors of the servicer.

In order to address this issue, the August 1 2003 law referred to above introduced a new type of bank account in France. This new type of account is opened in the name of the servicer of the assigned receivables but the sole beneficiary of any sum credited to it is the FCC. Accordingly, all funds credited to this account and corresponding to the collections of the assigned receivables are exclusively allocated to the benefit of the FCC. Furthermore, the other servicer's creditors have no right to seek payment of their claims on such a dedicated bank account, even in the event of the servicer's bankruptcy.

This new legal mechanism will give access to the securitisation market to mid-size companies to whom banks would not have otherwise granted either any financings or only those with a much higher margin. These companies are a new category of originator which, obviously, is extremely large and for which French banks are keen to do business with since a large portion of these potential originators are existing clients of the banks' networks.

Insurance companies

Amongst all potential categories of originators, it is surprising to note that there are almost no insurance companies. This is even more surprising since, in 1988 ie the date of the French securitisation law creating FCCs, the law expressly stated that insurance companies were eligible to use FCC structures.

Nevertheless, only a very few transactions initiated by insurance companies have taken place over the last 15 years. Companies like Axa and Gan have securitised premium receivables but these transactions remain rare in France. This is for a number of reasons. In particular, there is a strong and long-standing practice within the European insurance business whereby insurance companies reduce their risks through reinsurance contracts. In addition, the insurance prudential ratios in France were not very clear as to when and how to structure a securitisation transaction granting a capital relief to the originator. Today, insurance companies face the same issues that financial institutions were facing a few years ago: they need to reduce and diversify their counterpart risk, to gain new means of

financing and new investors and to maintain or improve their prudential ratios.

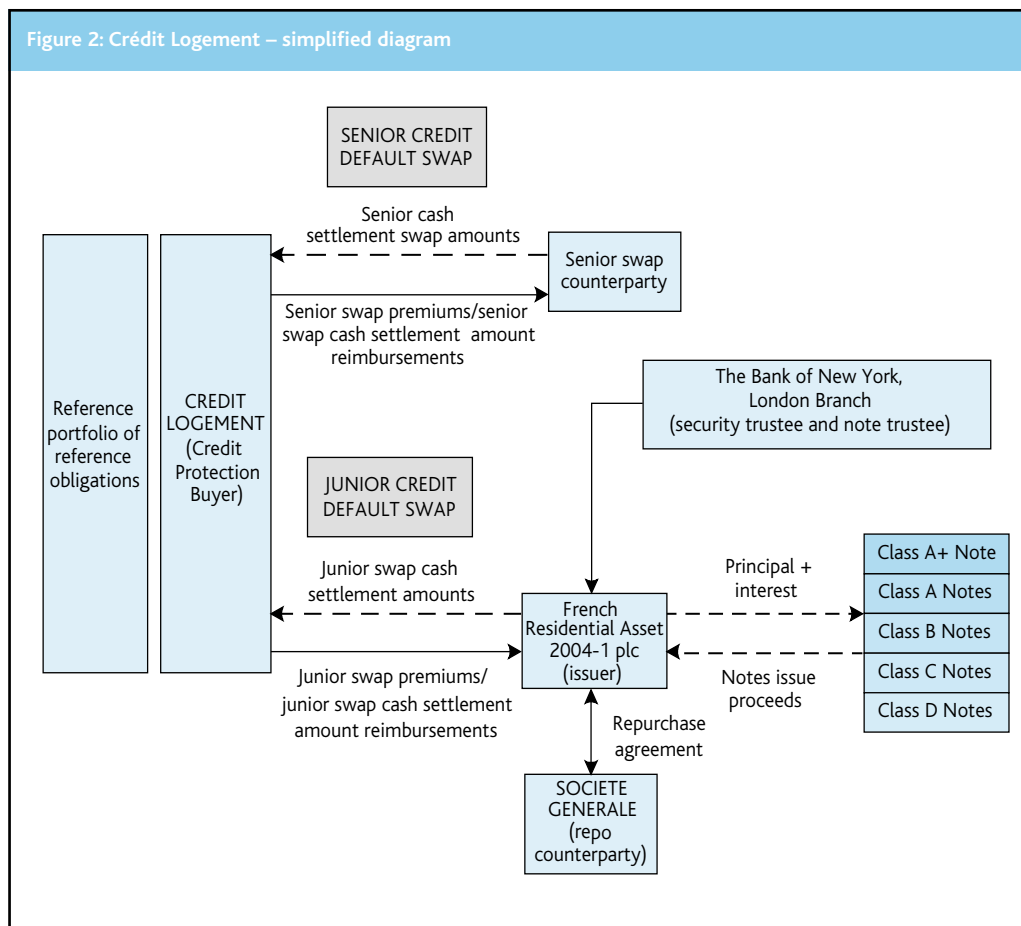
Securitisation is one of the very few financing tools that can satisfy all these concerns. This is why it is likely that insurance companies will be more active in the near future and might become regular originators on the French securitisation market. This approach should be facilitated by recent legislative changes. Until the August 1 2003 law, FCCs did not constitute an adequate tool for the setting up of synthetic securitisations. FCCs are now entitled to enter into swaps and derivatives transactions; this should offer new possibilities to insurance companies since, as is already the case for financial institutions, it is likely that insurance companies will favour synthetic securitisation.

As a significant illustration, this year *Crédit Logement* entered into a synthetic securitisation in order to defease €3.2 billion of credit risks arising from guaranties it delivers to most French credit institutions in the context of mortgages granted by the latter to individuals. Although *Crédit Logement* is a financial institution and this transaction involved an Irish SPV, its activities are substantially that of an insurance company and the FCC structure was seriously considered at the time the transaction was structured and arranged by *Société Générale* (see Figure 2).

It can be reasonably expected that insurance companies will take advantage of the legislative changes in the near future and will seek to defease some of their risks, such as automotive insurance claims, through synthetic transactions using FCC structures.

Whole business securitisation

In practice, securitisation transactions in France tend to be either conduit transactions (ABCP) or "AAA/aaa" asset backed securities transactions (ABS). This is probably due to the fact that French banks managed in the past to obtain a fairly favourable capital adequacy treatment on the liquidity facility agreements they grant to their conduit vehicles. Liquidity agreements for a duration of less than 365 days are normally 0% weighted but some liquidity facility agreements are cleverly worded so that they comprise different elements of risk difficult to isolate. Therefore, it is sometimes difficult to draw a clear distinction between each risk and in particular between the pure market liquidity risk which should be weighted zero per cent and other risks, such as credit risk or commingling risk, which should normally bear a higher weighting percentage but the overall weighting for those



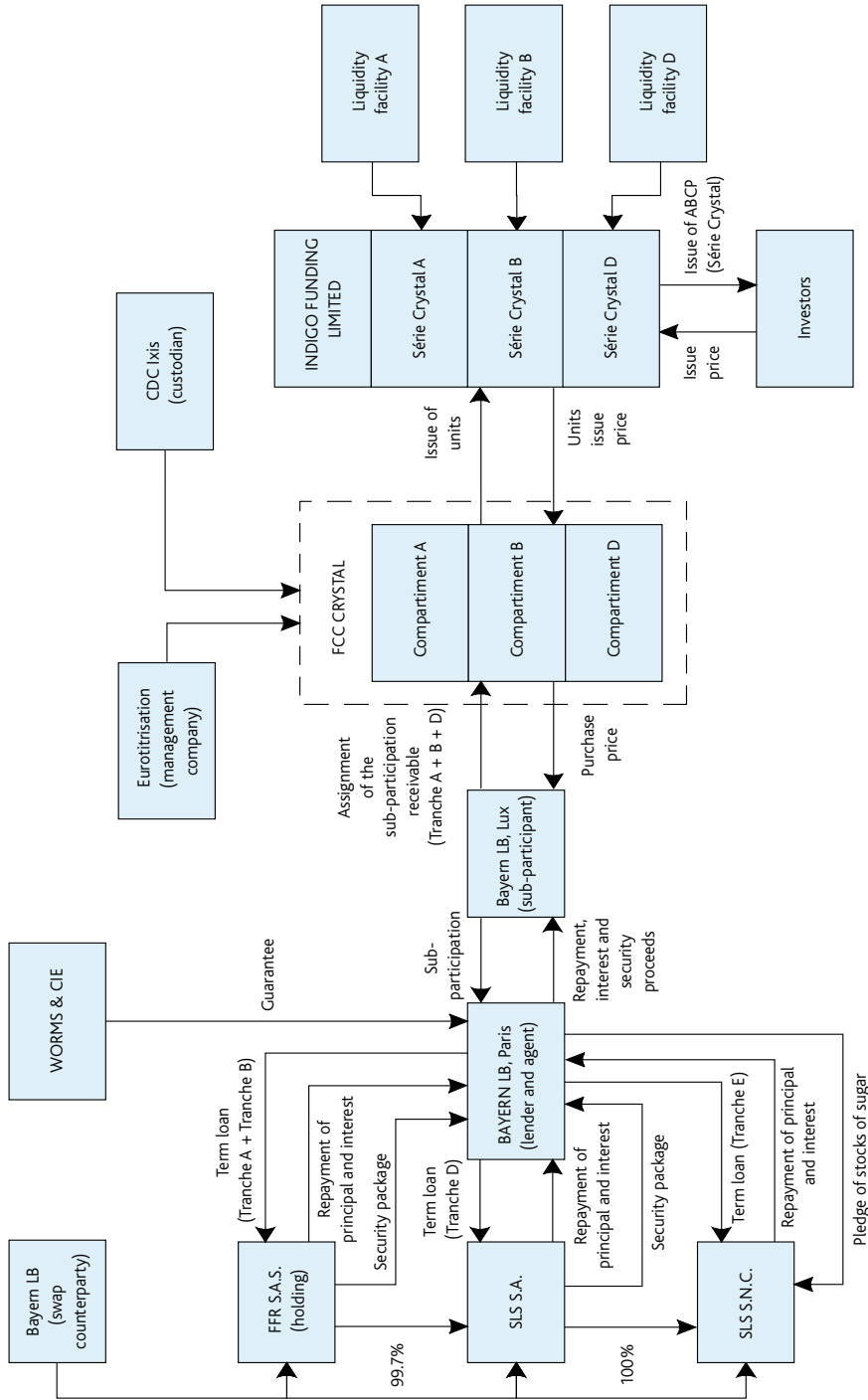
liquidity facility agreements used to be zero per cent. This situation has changed recently and, in the light of both the Basle II regulations and accounting changes, French banks are willing to develop their share of ABS transactions. As for the few industrial and commercial companies which were aiming to launch ABS transactions instead of using conduit vehicles, they used to prefer not to do any deal at all if their transaction was not able to obtain a "AAA/aaa" without the involvement of monolines or other insurers. This situation is also changing and originators are now accepting the fact that launching an ABS transaction which is not rated "AAA/aaa" or which requires a monoline to achieve such ratings is not futile or damaging.

As a result, there is a slow but tangible move on the French securitisation market from ABCP conduit transactions to ABS transactions and from "AAA/aaa" ABS

transactions to non "AAA/aaa" ABS transactions enhanced by a monoline insurer. These transactions essentially concern corporates whose rating is around investment grade and tend to be structured as whole business securitisation transactions.

Everyone claims to have done the first whole business securitisation in France. Amongst potential winners, the Chargeurs – Wool Finance deal, the Saint Louis Sucre – Crystal deal and the Xerox – Copy First deal are serious candidates and a few other transactions could be seen as challengers. In any case, it is worth noting that each such transaction was set up for a specific reason and that they do not follow a specific market need or trend. This is likely to change since most players in the acquisition finance market in France are now considering the advantages of financing or refinancing their usual business through securitisation. Securitisation offers them many alternative

Figure 3: Saint Louis Sucre – simplified diagram



routes, such as securitising the assets of the operating companies and/or securitising loans made to the operating companies and/or to the holding company. It also permits a reduction of funding costs to the benefit of the purchasers and allows them to follow different strategies, depending on the goal they want to reach: securitisation before, on or after the acquisition.

The Saint-Louis transaction arranged by Bayerische Landesbank Girozentrale, Paris branch is the first (and at present the only) transaction of this type in France and it is seen as the benchmark in this area (see Figure 3). It involved the acquisition and LBO of the Saint-Louis Sucre producer of sugar and the simultaneous securitisation of all acquisition financings which were secured, inter alia, by a pledge over sugar.

Whole business securitisation raises a number of legal issues in France, the main one being:

- the transfer of future flows, which is ineffective in the event of the seller's bankruptcy;
- the enforceability of the security package in bankruptcy proceedings, knowing that the ultimate goal of French bankruptcy law is to protect the bankrupt company and its employees and not the existing creditors;
- the preservation of the corporate benefit of each party in transactions involving multi-parties financings; and
- the need to ensure a neutral tax regime in case of transfer of assets and/or business in complex structured finance transactions.

Nevertheless, some solutions exist and given the opportunities offered by such a substantial market, these transactions will no doubt shortly take off in France.

Freshfields Bruckhaus Deringer

69, Boulevard Haussmann, 75008 Paris, France

Tel +33 1 44 56 44 56

Web www.freshfields.com

Hervé Touraine

Partner

Email herve.touraine@freshfields.com

Hervé Touraine has been a partner of Freshfields Bruckhaus Deringer since 1998. He studied law at the University of Paris II (Maîtrise de droit des affaires et fiscalité ; DESS de droit des affaires et fiscalité). Hervé also completed the ALP at Columbia University, New York. His practice focuses on structured finance and securitisation. In the context of securitisation transactions, Hervé has been working closely, since the introduction of securitisation in France, with various arrangers, originators, rating agencies, monolines insurers and regulatory authorities. Hervé has advised on numerous domestic and international transactions (including many firsts in France and Europe). Hervé has been involved in most recent public securitisations in France advising both French and international clients using domestic and off-shore structures. Besides his French mother tongue, Hervé speaks fluent English.

Fabrice Grillo

Associate

Email fabrice.grillo@freshfields.com

Fabrice Grillo joined Freshfields Bruckhaus Deringer in January 1999 after three years in a major French law firm including one year in its Tokyo office. He studied law at the University of Aix-en-Provence (DESS droit des affaires internationales and Diplôme de Juriste Conseil en Entreprises – DJCE). His main area of practice covers banking, structured finance and capital markets. Fabrice specialises in domestic and cross-border securitisation transactions. He has been involved in a number of innovative transactions including the first securitisation of French non-performing loans, the first transaction using a fonds communs de créances à compartiments (debt mutual fund with compartments), the first securitisation of LBO financing, the first synthetic securitisation of a consumer loan portfolio and the first multi-jurisdictional securitisation of trade receivables. He advises some of the leading European arrangers on their multi-seller conduit transactions. Fabrice also speaks fluent English next to his French mother tongue.

Freshfields Bruckhaus Deringer
www.freshfields.com

69, Boulevard Haussmann, 75008 Paris, France
Tel +33 1 44 56 44 56



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