

ALTERNATIVE FINANCING: CREATING THE NEW GENERATION OF "FINANCING" FUNDS

On 4 October, the French government issued the ordinance N°2017-1432 (the "**Ordinance**"). The Ordinance contains diverse provisions that aim to improve the legal framework applicable to French securitisation and debt funds. It constitutes also a new step in the liberalisation of France's banking monopoly rules.

NEW ENTITIES: SPECIALISED FINANCE ORGANISATIONS

The Ordinance first establishes a new category of collective investment scheme, namely "finance organisations" (*organismes de financement* or "**OF**"). OF include the existing securitisation organisations (*organismes de titrisation* or "**OT**") and the newly created "specialised finance organisations" (*organismes de financement spécialisés* or "**OFS**").

An OFS may be established either as a fund with no distinct legal personality (called "*fonds de financement spécialisé*", "**FFS**"), or as a limited liability company in the form of a *société anonyme* or a *société par actions simplifiée* (called "*société de financement spécialisé*", "**SFS**").

FFS and SFS share common features. In particular, they may both be structured as umbrella vehicles with segregated compartments and must be managed by a management company, which may be either a portfolio management company (*société de gestion de portefeuille*) authorised by the French regulator (*Autorité des Marchés Financiers*) ("**AMF**") or a management company incorporated in another EU member State authorised by the relevant competent authority to manage Alternative Investment Funds ("**AIFs**").

An OFS is an AIF and is fully subject to AIFMD. Such characterisation aims to make it easier for investors to understand this vehicle, and should facilitate marketing securities issued by it within the European Union. Further, an OFS (but not an OT) may be granted the "ELTIF" label created by EU Regulation N°2015/760 on European long-term investment funds.

The purpose of an OFS is:

- to invest, directly or indirectly, in one or several assets; and
- to finance such investment by issuing units, shares or debt securities, entering into derivative contracts, borrowing or other resources, debts or engagements.

Key issues

- Creation of the specialised finance organisation, which is a new form of AIF.
- Categorises finance organisations into securitisation organisations and specialised finance organisations.
- Liberalises France's banking monopoly rules to permit direct lending by certain types of finance organisations (including those which are not ELTIF) and the purchase of certain receivables by foreign entities.
- The general legal regime applicable to finance organisations has been improved and modernised.

The assets in which an OFS may invest are very broadly defined by the Ordinance and include any financial instrument (including share capital and quasi equity instruments), receivables and more generally those assets as defined in Article L214-154 of the *Code Monétaire et Financier* (the "**Financial Code**") which are eligible to be invested in by specialised professional funds (*fonds professionnels spécialisés*). There is no requirement for risk diversification in relation to the assets.

The issue of debt securities by an OFS will be regulated by a decree that has not yet been published. An OFS may issue different categories of units or shares and the securities issued may give rise to different rights as to capital and interest, as described in the constitutional documents of the OFS and subject to the conditions set out in the AMF general regulation. However, the Ordinance states that the credit risk associated with the holding of such securities shall not give rise to any "tranching" or subordination, which distinguishes an OFS from securitisation SPVs.

The investment restrictions that apply to French professional funds also apply to an OFS. Only limited categories of investors (being mainly professional investors) may subscribe for units, shares and debt securities issued by an OFS.

An OFS can only incur engagements or exposure to losses in a net maximum amount that, after taking into account any hedging arrangements, does not exceed the value of its assets together with any uncalled commitments to subscribe to the OFS (e.g. no leverage).

NEW EXEMPTIONS TO FRENCH BANKING MONOPOLY RULES

The Ordinance introduces new exemptions to the French banking monopoly rules (which in general prohibit persons other than credit institutions from carrying out credit transactions in France on a habitual basis):

- both an OT and an OFS may carry out lending activities, subject, however, to certain restrictions. With respect to an OT, the Ordinance confirms the reform introduced by law n°2016-1691, which permitted the granting of loans to "non financial undertakings". A pending decree will set out those limitations in more detail. Similar restrictions apply to an OFS, unless such OFS is an ELTIF (in which case it can provide loans in accordance with the terms of EU Regulation n°2015/760). The lending limitations applicable to OT and OFS (other than ELTIFs) will be set out in a pending decree;
- when an OT or an OFS has purchased or has undertaken to purchase future receivables that will arise from making funds available to a borrower (other than a consumer), the OT or OFS will be entitled to agree with the seller that the loans will be made directly by the OT or OFS to the borrower. If the borrower agrees, the seller shall cease to have any lending commitment with respect to such future drawings. This rule, which is not subject to the limitations relating to direct lending by an OF as mentioned above, should facilitate the financing of greenfield projects or capital expenditure facilities by an OF and limit negative carry concerns; and
- the Ordinance creates a further exemption which permits assignments and transfers to non-French institutions of unmatured receivables resulting from credit transactions entered into by certain financial institutions, unless the debtor of such receivable is an individual acting for a non-professional purpose. To fall within the exemption, the corporate purpose or activity of

the non-French institution must be similar to that of certain categories of persons listed in the Financial Code (including credit institutions, financing companies and securitisation organisations, collective investment schemes or pension funds). This new exemption should facilitate the purchase of loan receivables by CLOs and other foreign securitisation entities or debt funds.

A USEFUL IMPROVEMENT OF THE CURRENT LEGAL FRAMEWORK

The Ordinance also improves the legal framework applicable to an OT (and now more generally to both categories of OF). In particular:

- The simplified method of assignment and pledge of receivables under the *Loi Dailly*¹ is now available to an OF, which can benefit from an outright transfer or assignment by way of security or pledge of receivables effected pursuant to such provisions. Until the Ordinance, only credit institutions and financing companies could benefit from this mechanism.
- In order to facilitate the securitisation or financing of portfolios of lease receivables, the Ordinance provides that lease contracts assigned to an OF shall continue notwithstanding any transfer of the underlying leased assets in insolvency proceedings of the originator (e.g. under a *plan de cession*).
- Significant limitations to general insolvency rules have been introduced by the Ordinance with respect to an OF:
 - (i) no transfer of receivables or grant of a security interest made in favour of an OF by a French entity may be set aside in an insolvency of the grantor, even if they were granted during the hardening period (*période suspecte*);
 - (ii) the provisions allowing an insolvency officer to request the nullification of certain contracts entered into during such hardening period, if the counterparty had actual knowledge of the insolvent situation of a company, is also disapplied by the Ordinance with respect to an OF; and
 - (iii) the Financial Code now expressly mentions that the priorities of payments applicable to the allocation of sums received by an OF are binding upon the holders of securities and other creditors of the OF which have accepted such rules, notwithstanding the opening of insolvency proceedings in relation to such creditors.
- In relation to servicing the receivables purchased by an OF, the Ordinance now provides that: (i) such servicing may be carried out directly by the management company of the OF; and (ii) the collection mandate may be set out in the contract from which the purchased receivables arise. Such rules should facilitate the collection of loan receivables by debt funds established as OF.
- The Ordinance expressly contemplates the introduction of majority voting rules for holders of securities issued by an OF. Decisions taken using such voting rules will be binding on the holders of securities issued by the OF and any other creditors which have accepted them.

¹ Articles 313-23 *et seq.* of the Financial Code.

- The purpose of any OT is to be exposed to risks. The Ordinance provides that such exposure may in particular result from the entry into of guarantees or sub-participation agreements. This new rule opens up new opportunities.
- The Ordinance reforms the regime applicable to the custodian of an OT and aligns such regime with those applicable to other AIFs. For an OT in the form of a fund (an *FCT*), the custodian shall cease to be a co-founder of such FCT (which will be established solely by the management company or a sponsor) and the custodian will be designated separately by the FCT. As a result, custodians will no longer take responsibility for prospectuses for securities issued by an OT.

GRANDFATHERING RULES

The Ordinance comes into force on 3 January 2018, except with respect to certain provisions (being mainly the provisions relating to the new regime applicable to the custodian of an OT) which will come into force on 1 January 2019.

Every OT existing as at 5 October 2017 is required to appoint a custodian in compliance with the new legal regime before 1 January 2019.

COMPARISON TABLE

Securitisation organisations (OT) vs specialised finance organisations (OFS)

	OT	OFS
AIF	<i>Yes, but not subject to AIFMD regime (unless meeting certain criteria)</i>	Yes
Legal form	<i>Fund or company</i>	<i>Fund or company</i>
Possibility to create compartments	Yes	Yes
Eligibility to ELTIF label	No	Yes
Eligibility to "Fonds de prêts à l'économie" (FPE) label	Yes	Yes
Regulatory approval	No	No
Management Company	<i>Licensed by AMF</i>	<i>Licensed by AMF or passported EU management company licensed to manage AIFs</i>
Repurchase of units / shares by the fund	No	<i>Depends on constitutive documents, which may allow repurchase of units / shares by the fund</i>
Ability to grant loans	<i>Yes, but subject to limitations to be set out in pending decree</i>	<i>Yes, but subject to limitations to be set out in pending decree. OFS which are ELTIF may lend under the ELTIF regime</i>
Possible "tranching" of credit risk by issue of different securities	Yes	<i>No credit risk subordination but may issue securities with different rights as to capital and income</i>
Ability to issue debt instruments	Yes	Yes
Regulatory restrictions on borrowings	No	No
Portfolio diversification rules	<i>Not applicable</i>	<i>Not applicable</i>

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