

Article Title: ARCHIVE | Legal Criteria: France Amends Securitization Law to Create New Market Opportunities Data: A new French law enacted on Aug. 1, 2003, called "Law on Financial Security"¹, contains several provisions relevant to securitization. These provisions, some of which are subject to ministerial decree, will amend the 1988 securitization law on "fonds communs de créances" (FCCs). (1Law n°2003-706 dated Aug. 1, 2003 "De Sécurité Financière", Journal Officiel dated Aug. 2, 2003, page 13220.) The aim of the provisions is to create a more flexible and secure legal environment for onshore transactions, allowing FCC structures to be used for wider categories of asset-backed financings and attracting new types of global and domestic investors. Standard & Poor's views these changes as a positive move for the French structured finance market. The new legislation comes into force immediately. However, a ministerial decree providing for detailed implementation measures is required on several points. This decree is expected to be published by the end of 2003. Scope of French Securitization Likely to Widen Debt Issues FCCs are traditionally used as purchasing vehicles in commercial and consumer receivable-backed transactions. Until now, the receivables purchased by the FCC could be refinanced only by issuing FCC units², defined as co-ownership rights in the underlying assets. Unit holders are neither equity nor debt holders. This unique feature makes FCC units difficult to market to certain types of investors unless the transaction uses a two-tier structure, with an offshore SPE (often a multi-seller conduit) buying the units to issue more standardized instruments, usually French CP ("billet de trésorie") or European CP. (2To a limited extent, FCCs can also benefit from credit facilities granted by the originator or credit institutions.) Under the new law, FCCs are allowed to issue debt instruments such as notes, bonds, or CP. Direct issues of FCC debt on the domestic and international markets are now possible (subject to any condition laid down in the implementing decree). However, the FCC remains a "co-ownership" of debts ("créances") and as such must also issue units representing these assets. The units can be subordinated in payment order to the senior debt instruments. These subordinated units would be issued as an equivalent to the equity/junior tranches in Anglo-American structures. Standard & Poor's will expect the respective rights of the unit holders and debt holders to be defined precisely in the FCC documentation and for legal opinions to be provided confirming the enforceability of limited recourse and priority of payments provisions. Synthetic CDOs May Become a Feature of French Market Another potentially important change concerns derivative instruments. Under the 1998 FCC regime, the use of derivatives by FCCs has been limited to hedging their own exposures. It is expected that the decree implementing the new law will bring more flexibility in this area. Market participants expect that FCCs will be allowed to act as credit protection sellers and take on the role of swap counterparty and issuer in synthetic CDO transactions. The FCC would purchase collateral debt securities with the proceeds of a credit-linked note issue and sell the collateral to redeem the notes. To the extent that debt securities are a form of receivable, the majority view is that they are eligible as FCC assets. Under the 1998 rules, the restrictions on sales of FCC assets have been an obstacle to the sale of collateral necessary to structure a synthetic CDO structure, but the implementing decree is expected to change this. The precise wording of the decree will be key for this aspect of the reform. Other Improvements and Clarifications The new law contains several measures aimed at improving the level of security in FCC transactions and/or clarifying issues identified by practitioners over the years. Commingling Risk: Dedicated FCC Accounts Unless effective segregation steps are taken, collections standing on the servicer's account — often the originator acting as the FCC's collection agent — are at risk and must be treated as a credit loss if the servicer is subject to insolvency proceedings. This issue of protecting the FCC's cash without interfering with the originator's standard collection procedures has been a persistent weakness of the French system, although many thought that, based on case law, it should be possible to create a sub-account earmarked for the benefit of the securitization vehicle that would withstand the insolvency of the originator/servicer. Under the new law, a third-party beneficiary account system ("compte à affectation spéciale") is now officially recognized, which provides that all sums collected by the servicer on behalf of the FCC may be credited to an account specifically dedicated to the FCC (or the relevant compartment of the FCC in the case of a segregated or "umbrella" FCC) on which the servicer's creditors may not take any enforcement measures, including in the event of bankruptcy proceedings against the servicer. The detailed operation of the dedicated account will be regulated in the implementing decree. Standard & Poor's considers that the legal recognition of dedicated accounts is a very positive step that can only

benefit the FCC market. Where a similar third-party beneficiary account is used in non-FCC structures, Standard & Poor's expects to receive robust legal opinions confirming the enforceability of this mechanism, including through the servicer's insolvency. Enforceability of Receivable Transfers Certain legal aspects of the transfer of receivables to FCCs are clarified by the new law; however, the French Parliament's refusal to insulate the transfer of future receivables from insolvency proceedings is a source of disappointment among market participants.

Debtors Outside France Under French conflicts of law rules, in an international assignment of claims, the enforceability of the assignment against third parties is governed by the law of the domicile of the debtor. The 1980 Rome Convention, which applies to these matters in Europe, provides that the law of the underlying debt governs vis-à-vis the underlying debtor but does not address the case of other third parties, notably the seller's creditors. If the law of the domicile of the debtor requires notification formalities, the seller's creditors could claim in a French court that the sale has no effect on them if the relevant formalities were not carried out. The new law solves this issue in FCC transactions by specifying that the transfer of the receivables to the FCC is enforceable against all parties on the transfer date irrespective of the law governing the receivables or the jurisdiction of the underlying debtor (the same clarification is made for Dailly³ assignments). However, it should be noted that French law is not competent to regulate this question at the local enforcement level: if enforcement steps must be taken in the country of the underlying debtor, only the local court applying its own conflict of law rules will be competent to decide if formalities were required.

(3The Dailly law on the transfer of receivables to credit institutions is Law n°81-1 of Jan. 2, 1981 and is named after Senator Dailly. A "Dailly assignment " is used to refer to a transfer under that law.) Transfer of Security Interests and Ancillary Rights The new law confirms — for the avoidance of doubt more than anything else — that the delivery of the transfer instrument transfers automatically to the FCC all security interests and ancillary rights pertaining to the receivables. The new law also specifies that FCCs have the capacity to own assets as a result of security enforcement (e.g., real property).

Missed Opportunity for Future Receivables Future receivables are transferable under French law but it is doubtful that the transfer would survive the seller's insolvency since the French Supreme Court held on April 26, 2000 that collections from receivables under ongoing contracts (such as contracts for services) sold before the originator's insolvency nevertheless belonged to the bankruptcy estate. An amendment designed to overrule this decision for FCCs and Dailly assignments was rejected by the French Parliament pending a more global reform of bankruptcy law. The current legal uncertainties on true sale of future receivables⁴ represent a serious obstacle for assets such as lease receivables and so the hesitation of the French parliament is disappointing. However, Standard & Poor's notes that there are other issues raised by the securitization of future flows in the event that the seller becomes insolvent, primarily the continuation or rejection of ongoing executory contracts, which under French law is an exclusive prerogative of the insolvency administrator. (4The present legal position is confused by more recent Supreme Court cases allowing creditors to attach future receivables in the hands of an insolvent debtor, which contradicts the April 2000 decision.)

Limited Recourse Among Creditors of FCC Compartments The FCC law was amended in 1999 to allow the creation of an umbrella FCC comprising several distinct compartments with separate assets and liabilities. The new law improves the drafting of these provisions to eliminate certain ambiguities. It is now clearly stated that the assets of a compartment can only be used to pay the debts of that compartment and consist only of the claims and receivables pertaining to that compartment.

European Custodians Allowed Before the reform, only credit institutions having their registered office in France could act as FCC custodians. In line with European regulations, the new law provides that the custodian may also be the French branch of a credit institution located in the European economic area. The law also confirms that an FCC custodian is entitled to subcontract custody of the receivables (such as title documents) to the originator or the servicer.

A Move in the Right Direction Since first introduced in 1988, the FCC structure has already gone through three main reforms. However, the French market contributed only €12 billion of issuance in 2002 out of a total of €202 billion for the European structured finance market. France ranks sixth in Europe by volume of issuance, behind the U.K., Italy, Germany, The Netherlands, and Spain. Clearly, the French market is not in line with the potential size of the assets that could be securitized. A clearer recognition among originators of the benefits of securitization as a financing technique might go some way to mitigate concerns and uncertainties surrounding international accounting standards or

regulatory changes. This should stimulate the market with, for example, more corporates willing to securitize for funding purposes. Standard & Poor's does not expect this technical reform to produce a dramatic market boost by itself, but the improvement of the legal framework can only facilitate and broaden the use of FCC structures, with invigorating effects on the French market's volumes. Contact E-Mail Addresses solange_fougere@standardandpoors.com ian_bell@standardandpoors.com nicolas_malaterre@standardandpoors.com StructuredFinanceEurope@standardandpoors.com