

### **3.10 FRANCE**

By Francis Gleyze, Caisse Centrale du Crédit Immobilier de France,  
Henry Raymond, Caisse de Refinancement de l'Habitat – CRH,  
Cristina Costa, Natixis  
and Boudewijn Dierick, BNP Paribas

The Regulation relating to French covered bond issuers was significantly modified in 2010 and 2011 with the strengthening of the *société de crédit foncier* legal framework and the creation of *sociétés de financement de l'habitat*. Consequently, three main covered bond issuing structures exist today in France:

- > *sociétés de crédit foncier*,
- > *sociétés de financement de l'habitat*,
- > Caisse de Refinancement de l'Habitat.

Further, whilst most structured covered bonds have been converted into the *société de financement de l'habitat* framework, there are also a few general-law based covered bond issuers who have not converted their existing programmes but will no longer issue new covered bonds out of these programmes.

#### **A - SOCIETES DE CREDIT FONCIER**

By Francis Gleyze  
Caisse Centrale du Crédit Immobilier de France

While many States allow ordinary credit institutions to issue covered bond subject to the segregation of the cover pool in their balance sheet, France requires the set-up of an *ad hoc* company, the *société de crédit foncier* totally distinct from the other companies of the group to which it belongs and exclusively dedicated to the issuance of covered bonds named *obligations foncières*.

*Sociétés de crédit foncier* are credit institutions governed by a stringent legal framework designed to protect the holders of the obligations foncières they issue. They operate under the close scrutiny of the *Autorité de Contrôle Prudentiel*, the France's Banking Authority, which requires them to comply with strict management rules in order to ensure control over risks.

#### **I. LEGAL FRAMEWORK**

*Sociétés de crédit foncier* are governed by articles L.515-13 and seq. and R.515- 2 and seq. of the French Monetary and Financial Code (the "Code"). Licensed by the French Banking Authority, they have a single purpose: to grant or acquire eligible assets, as defined by Law, and to finance them by issuing *obligations foncières*, which benefit from a special legal privilege (the "Privilege"). They may also issue or contract other debts benefiting or not from the Privilege.

The legal framework of the *société de crédit foncier* was lastly updated by Law N° 2010-1249 of 22 October 2010 and by Decrees n° 2011-244 dated 4 March 2011 and N° 2001-205 dated 23 February 2011

#### **II. COVER ASSETS**

Only eligible assets, restrictively defined by law, are authorized on the balance sheet of the *sociétés de crédit foncier*. All assets on the balance sheet are part of the cover pool.

Assets eligible to the cover pool are:

- > loans guaranteed by a first-ranking mortgage or by an equivalent guarantee;
- > loans granted to finance real estate and guaranteed by a credit institution or an insurance company with shareholders' equity of at least EUR 12 m and that isn't a member of the group to which belongs the *société de crédit foncier*. The amount of these loans cannot exceed 35% of the assets of the *société de crédit foncier*;
- > public exposures that are totally guaranteed by:
  - > central administrations, central banks, public local entities and their grouping, belonging to a member State of the European Community or party to the European Economic Area, or - under ratings conditions - central administrations and central banks belonging to a non member State of the European Community or to an non adherent to the European Economic Area;
  - > European Community, International Monetary Fund, Bank for international Settlements and multilateral developments banks registered by the French Ministry of Finances;
  - > others public sector entities and multilateral developments banks as more described in Article L.515-15 of the Code;
- > senior securities issued by French securitisation vehicles or equivalent entities subject to the law of a Member State of the European Community or party to the European Economic Area, USA, Switzerland, Japan, Canada, Australia and New Zealand whose assets are composed, at a level of at least 90%, of loans and exposures directly eligible to the cover pool. The assets of the securitisation vehicles or equivalent entities may only consist of mortgage loans or public sector exposures, and under no circumstances, may be backed by assets created by consolidating or repackaging multiple securitisations. To be eligible to the cover pool, the senior securities issued by the securitisation vehicles or similar entity must qualify as a minimum for the credit quality assessment step 1 by a rating agency recognised by the French Banking Authority

Such senior securities cannot exceed 10 % of the nominal amount of the outstanding issue. However, until 31 December 2013, the 10 % limit shall not apply, provided, in accordance with Directive 2010/76/EU (CRD III) of the European Parliament that:

- > the loans carried by the securitisation vehicles were originated by a member of the same consolidated group of which the issuer of the covered bonds is also a member or by an entity affiliated to the same central body to which the issuer of the covered bonds is also affiliated (that common group membership or affiliation to be determined at the time the senior securities are made collateral for covered bonds; and
- > a member of the same consolidated group of which the issuer of the covered bonds is also a member or an entity affiliated to the same central body to which the issuer of the covered bonds is also affiliated retains the whole first loss tranches supporting those senior securities.
- > mortgage promissory notes representing loans that would be otherwise directly eligible to the cover pool and issued in accordance with Articles L.513-42 et seq. of the Code. The mortgage notes may not represent more than 10% of the assets of the *société de crédit foncier*;
- > replacement assets up to 15 % of the amount of the outstanding covered bonds issued by the *société de crédit foncier*. Replacement assets are defined as sufficiently secure and liquid assets: securities, assets and deposits for which the debtor is a credit institution or an investment company

qualifying for the step 1 credit quality assessment (with a maturity up to 100 days for a credit institution or an investment company subject to the law of a Member State of the European Community or party to the European Economic Area and qualifying for the step 2 credit quality assessment).

Loans guaranteed by a first-ranking mortgage or by an equivalent guarantee and loans guaranteed by a credit institution or an insurance company are eligible for privileged debt financing up to a part of the financed or pledged real estate's value. Senior securities of securitisation vehicles are subject to similar rules.

### **III. PRIVILEGE**

Pursuant to article L.515-19 of the Code, holders of obligations foncières and other privileged debts have preferred creditor status and the right to be paid prior to all other creditors who have no rights whatsoever to the assets of the *société de crédit foncier* until the claims of preferred creditors have been satisfied in full.

This legal Privilege which supersedes the ordinary French bankruptcy Law, has the following characteristics.

- > The sums deriving from the loans, exposures, similar debts, securities, financial instruments, after settlement if applicable, and debts resulting from deposits made with credit institutions by the *société de crédit foncier* are allocated in priority to servicing payment of the covered bonds and other privileged debt;
- > the judicial reorganisation or liquidation or amicable settlement of a *société de crédit foncier* does not accelerate the reimbursement of *obligations foncières* and other debt benefiting from the Privilege which continue to be paid at their contractual due dates and with priority over all other debts. Until the holders of privileged debts are fully paid off, no other creditor of the *société de crédit foncier* may avail itself of any right over that company's property and rights;
- > the common provisions of French bankruptcy law affecting certain transactions entered into during the months prior the insolvency proceedings (the *période suspecte*) are not applicable to *sociétés de crédit foncier*.

### **IV. BANKRUPTCY REMOTENESS**

As an exception to the general French bankruptcy Law, bankruptcy proceedings or liquidation of a company holding share capital in a *société de crédit foncier* cannot be extended to the *société de crédit foncier*. As a result, *sociétés de crédit foncier* are totally bankruptcy remote and enjoy full protection from the risks of default by their parent company or the group to which they belong.

### **V. COVERAGE RATIO**

The total value of the assets of a *société de crédit foncier* must at all times be greater than the total amount of liabilities benefiting from the Privilege, a condition that makes, initially, for a coverage ratio always greater than 100%, increased to 102% by decree N° 2011-205.

From a regulatory standpoint, the coverage ratio is calculated on the basis of the *société de crédit foncier* accounting data by applying different weights to classes of assets:

- > loans secured by a first-ranking mortgage or by an equivalent guarantee are weighted 100% up to their part eligible for privileged debt financing ;

- > loans guaranteed by a credit institution or an insurance company are weighted 100% if the guarantor qualify, at least, for the step 2 credit quality assessment, weighted 80% if it qualify for the step 3 credit quality assessment, and weighted 0% in any other case ;
- > senior units of securitisation funds are weighted 100% if they are rated at minimum AA- (Fitch and S&P) or Aa3 (Moody's), weighted 50% if they are rated A- (Fitch and S&P) or A3 (Moody's), and weighted 0% below these ratings ;
- > public exposures and replacement assets are weighted 100%.
- > senior securities of securitisation vehicles are weighted 100%, 80%, 50% or 0% subject to different criteria including, essentially, their rating ;

The coverage ratio is reported and published at regular intervals, in accordance with applicable laws and regulations.

## **VI. COVER POOL MONITOR**

*Sociétés de crédit foncier* must appoint a registered auditor, with the agreement of the French banking regulator, to act as a "Specific Controller". To ensure independence, the specific controller may not be an employee of either of the *société de crédit foncier's* independent auditors, of the company that controls the *société de crédit foncier*, or of any company directly or indirectly controlled by a company that controls the *société de crédit foncier*.

The mission of the Specific Controller involves the following verifications:

- > that all assets granted or acquired by the *société de crédit foncier* are eligible to the cover pool, and in the case of mortgage assets, that they are properly valued ;
- > that the coverage ratio is, at any moment, at least, at 102% ;
- > that the *société de crédit foncier* comply with all the limits required by the regulation (i.e. the limit of the loans guaranteed by a credit institution or an insurance company, the limit of the mortgage promissory notes and the limit of the replacement assets) ;
- > that the "congruence", i.e. the adequacy of maturities and interest rates of assets and liabilities, is at a satisfactory level ;
- > and, more generally, that the *société de crédit foncier* complies with the law and regulations.

The Specific Controller certifies that the *société de crédit foncier* complies with coverage ratio rules on the basis of a quarterly issuance program, and for any issue of privileged debt of an amount equal or above 500 million euros. These coverage ratio affidavits are required to stipulate in issuance contracts that the debt benefits from the legal Privilege.

The Specific Controller reports to the French banking regulator. He attends shareholders' meetings, and may attend Board meetings.

Pursuant to article L.515-30, the Specific Controller is liable towards both the *société de crédit foncier* and third parties for the prejudicial consequences of any breach or negligence he may have committed in the course of his duties.

## **VII. ASSET/LIABILITY MANAGEMENT – LIQUIDITY**

*Sociétés de crédit foncier* must manage and hedge market risks on their assets, liabilities and off-balance sheet items: interest rate risks, currency risks, liquidity and maturity mismatch between liabilities and assets. The surveillance of these points is part of the duties of the Specific Controller.

In order to give protection to the hedging system in place, article L.515-18 of the Code provides that financial instruments hedging the assets, *obligations foncières* and other debt benefiting from the Privilege, and financial instruments hedging the overall risk on assets, liabilities and off-balance sheet items, benefit from the Privilege. As a consequence, they are not to be terminated in the event of bankruptcy proceedings or liquidation.

Since Law N° 2010-1249 of 22 October 2010 and Decree N° 2011-205, *sociétés de crédit foncier* are required to ensure that their cash needs are constantly covered over a moving period of 180 days. The scope of this new obligation will extend to forecasted principal and interest flows involving the *sociétés de crédit foncier's* assets, as well as to flows related to its trading of financial futures stipulated in CMF § L.515-18. Cash needs may be covered, if necessary, by replacement securities, assets eligible for Bank of France refinancing, and repurchase agreements with credit institutions that have the highest short-term credit ratings or whose creditworthiness is guaranteed by other credit institutions that have the highest short-term credit ratings.

As credit institutions, they are, more generally, subject to Comité de la Réglementation Bancaire et Financière (CRBF) regulation 97-02 on internal control. Accordingly, they must set up a system for monitoring transactions and internal procedures, a system for handling accounting processes and data processing, as well as risk management and monitoring systems.

## **VIII. ASSET VALUATION**

Among his duties, the Specific Controller controls the eligibility, composition, and valuation of the assets. Real estate valuations must be based on their long-term characteristics. Under banking regulation n° 97-02, property values are considered part of the risks of *sociétés de crédit foncier*. The valuations are made by independent experts in compliance with banking regulation.

## **IX. TRANSPARENCY, ASSET VALUATION**

As credit institutions and listed companies, *sociétés de crédit foncier* must issue periodic financial information and, in accordance with French Regulation 97.02, a report on risk management.

Moreover, *sociétés de crédit foncier* are also required to publish:

- > A quarterly report relating to the nature and the quality of their assets. This report must be published in the *Bulletin des Annonces Légales Obligatoires*, in any newspaper enable to publish legal announcements or on their website ;
- > an annual report describing (i) the nature and the quality of their assets describing the characteristics and breakdown of loans and guaranties, the amount of defaults, the breakdown of receivables by amount and by class of debtors, the proportion of early redemptions, the list and characteristics of senior securitisation securities and RMBSs they hold, the volume and breakdown of replacement securities they hold and (ii) the extent and sensitivity of their interest-rate exposure. This report is published in the *Bulletin des Annonces Légales Obligatoires* after the annual shareholders' General Meeting ;

- > A semi-annual report, at 30 June and 31 December of each year relating to the amount of its coverage ratio, the compliance with the limits they are requested to respect i.e. the 35% limit of guaranteed loans, the 10% limit of mortgage promissory notes, .... This report is certified by the Specific Controller and transmitted to the Banking Authority.

## **X. BANKING SUPERVISION**

*Sociétés de crédit foncier* operate under the constant supervision of the Banking Authority.

Their management, their Specific Controller and their Independent Auditors should be agreed by the Banking Authority.

All the above mentioned reports should be sent to the Banking Authority together with the annual report of the Specific Controller and the report of the annual reports of the Independent Auditors.

## **XI. COVERED BONDS LIQUIDITY**

The French *sociétés de crédit foncier* which issue jumbo *obligations foncières* have together signed with 23 banks a specific standardised market-making agreement, which has become a national agreement.

## **XII. RISK- WEIGHTING AND COMPLIANCE WITH EUROPEAN LEGISLATION**

*Obligations foncières* comply with the requirements of article 52 par. 4 UCITS directive, and with the CRD directive, Appendix VI, Part 1, Paragraph 65 a) to f).

Consequently, and subject to local regulations, the banking risk - weighting is 10% according to European solvency criteria.

## **B - BONDS ISSUED BY CAISSE DE REFINANCEMENT DE L'HABITAT (CRH)**

By Henry Raymond, Caisse de Refinancement de l'Habitat

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### **I. LEGAL FRAMEWORK**

CRH was created in 1985 by French Government with State explicit guarantee as a central agency in order to refinance French banks in the specific legal framework of art 13 of law 85-685 of July 1985.

Up to SFEF 's creation in October 2008, no other agency of that type was created in France. Since January 1st, 2010, CRH is appointed to control debt' service and collateral administration of SFEF.

Today, instead of State guarantee, the French law gives to CRH's bondholders a very strong privilege on CRH's secured loans to banks.

The Caisse de Refinancement de l'Habitat (previously Caisse de Refinancement Hypothécaire) is a specialized credit institution of which the sole function is to fund French banks housing loans to individuals.

CRH issues bonds and lends the borrowed amount to banks in the same conditions of rate and duration.

CRH loans take the form of promissory notes issued by the borrowing banks and held by CRH.

CRH's bonds are strictly regulated in order to offer bondholders a very high credit quality and benefit from a legal privilege.

They are governed by the article 13 of act 1985-695 of July 11, 1985 as complemented by article 36 of act 2006-872 of July 13, 2006.

CRH received approval to issue bonds under article 13 of act 1985-695 by letter of September 17, 1985 from the Minister for the Economy, Finance and Budget.

CRH's operations are governed by the provisions of art L. 313-42 to L. 313-49 of Monetary and Financial Code. CRH's loans to banks, i. e. notes held by CRH, are covered by the pledge of housing loans to individuals. In the case of a borrowing bank default, CRH becomes owner of the portfolio of housing loans without any formality notwithstanding any provision to the contrary.

## **II. COVER ASSETS**

Eligible loans are only home loans to individuals defined by law: first-ranking mortgages or guaranteed loans.

Guaranteed loans are loans granted to finance real estate with the guarantee of a credit institution or an insurance company (the total amount of these loans cannot exceed 35% of the covering portfolio).

The geographical area for eligible loans is the European Economic Area in the law but "de facto" only France and Overseas territories.

No replacement assets are allowed. RMBS and other loans are not eligible.

## **III. PRIVILEGE**

Pursuant to article 13 of act 1985-695 (complemented), when the guarantee of the French government is not accorded (this guarantee is no longer granted), the sums or amounts generated by the promissory notes are allocated, as a matter of priority and under all circumstances, to the payment of the interest and principal on CRH bonds.

The provisions of Book VI of the French commercial code, or those governing all legal or equivalent amicable proceedings engaged on the basis of foreign laws, do not constitute an obstacle to the application of these provisions.

These provisions give to CRH's bondholders a preferred creditor status and the right to be paid prior to other creditors.

## **IV. BANKRUPTCY REMOTENESS**

CRH is a company independent from borrowing banks. Bankruptcy proceedings or liquidation of a borrowing bank, holding CRH's equity, cannot be extended to CRH.

## **V. COVERAGE RATIO**

In compliance with article 13 of act 1985-695, the only aim of CRH is to issue bonds to fund banks mortgage loans. Then, CRH's debt amount and CRH's loans to Banks (represented by notes) must be equal.

According to the provisions of the law and of article R. 313-21 of Monetary and Financial code, CRH's statutes dictate that the covering portfolio amount (compound of home loans to individuals pledged to cover CRH's loans to banks) must exceed 125% of the amount of notes held by CRH, and then must exceed 125% of CRH's bonds.

## **VI. COVER POOL MONITOR**

CRH is an independent credit institution that doesn't borrow for its own account but for the account of banks and doesn't charge any fee or interest margin on its refinancing transactions.

CRH regularly achieves, based on sampling, audits on the cover pool, carried out at the borrowing banks. If necessary, CRH asks borrowing banks to increase the cover pool to compensate for the shortfall identified or to pay back CRH by delivering CRH's bonds.

## **VII. BANKING SUPERVISION**

As a credit institution, CRH is under the general supervision of the French banking authority *Autorité de contrôle prudentiel*. Furthermore, its operations are under a specific supervision of *Autorité de contrôle prudentiel* because of the provisions of the article L. 313-49 of Monetary and Financial Code.

CRH is also subject to audit by its shareholder banks.

## **VIII. ASSET - LIABILITY MANAGEMENT**

As explained above, CRH's debts and loans (represented by notes) have exactly the same characteristics. CRH is not submitted to an interest rate risk. CRH is not affected by early repayment of loans included in the portfolio.

According to CRH internal regulation, the cover pool must be congruent with rate and duration of CRH's debt to protect CRH in the case where it becomes owner of the cover pool.

## **IX. TRANSPARENCY, ASSET VALUATIONS AND LOAN TO VALUE**

Every year, the annual report publishes the size of the cover pool. This report confirms the characteristics (nature and quality) of home loans pledged and that CRH is not exposed to interest rate risk.

The rules for real estate valuations are the same as those of *sociétés de crédit foncier*.

Loan to value must not exceed 80% (de facto 90% because of the over-sizing of the covering portfolio by 25%).

## **X. CRH BONDS LIQUIDITY**

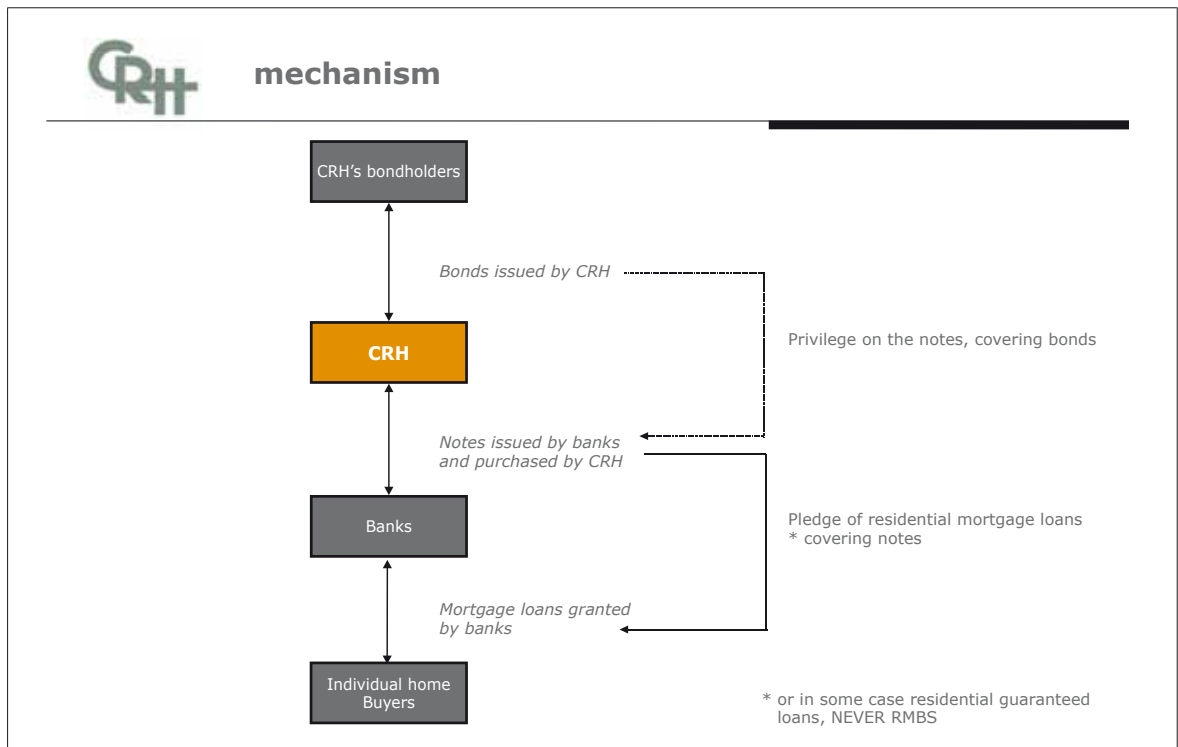
The size of CRH's bonds outstanding is very important. They are very liquid, listed on MTS and several banks are market makers for them. The average full CRH debt turnover ratio is very high. Two of CRH issues have a size of 5 euro billion.

## **XI. RISK - WEIGHTING AND COMPLIANCE WITH EUROPEAN LEGISLATION**

CRH's debt has been rated AAA and Aaa (senior unsecured) by Fitch and Moody's since 1999.

CRH's bonds are compliant with criteria of article 52 par. 4 UCITS directive and with the Capital Requirements Directive (CRD) requirements. They are 10% weighted in standard approach.

They are included in securities accepted for the European Central Bank (E.C.B.) open market operations.



## C - OBLIGATIONS DE FINANCEMENT DE L'HABITAT

By Cristina Costa, Natixis and  
Boudewijn Dierick, BNP Paribas

The enactment of Law n°2010-1249 dated 22 October 2010 on the banking and financial regulation and of the Decree n° 2011-205 dated 23 February 2011, set up the new status of Société de Financement de l'Habitat (SFH). The SFH legislation is intended to give a specific legislative framework to French structured covered bonds backed by residential mortgages and is very similar to the existing 'Société de Crédit Foncier' (SCF) framework. The SFH and SCF are now based on the same legal framework.

Under the SFH legislation, the holders of the Obligations de Financement de l'Habitat (OH) benefit from the privilege granted to these bonds over the SFH program's assets. If the issuer becomes insolvent, the OHs and other privileged debts pay in accordance with their payment schedule, and have priority over any of the program's other debts or non-privileged creditors in relation to the SFH's assets.

According to the SFH law a credit institution licensed as a finance company by the French supervisor (*Autorité de Contrôle Prudentiel*) may, if it satisfies articles L.515-34 and L.515-35 of the Monetary and Financial Code, opt for the status of a home financing company (*Société de Financement de l'Habitat*). Once the supervisor has granted authorisation to operate as an SFH, all covered bonds and equivalent instruments issued by the credit institution prior to its transformation into a SFH shall be converted automatically into Obligations de Financement de l'Habitat, and benefit from the statutory privilege.

At the time of writing, almost all French common-law based covered bond issuers have transferred their status to SFH. Since the enactment of the SFH law, a total of EUR 10 bn Obligations de Financement de l'Habitat have been issued in Euro Jumbo format.

## **I. FRAMEWORK**

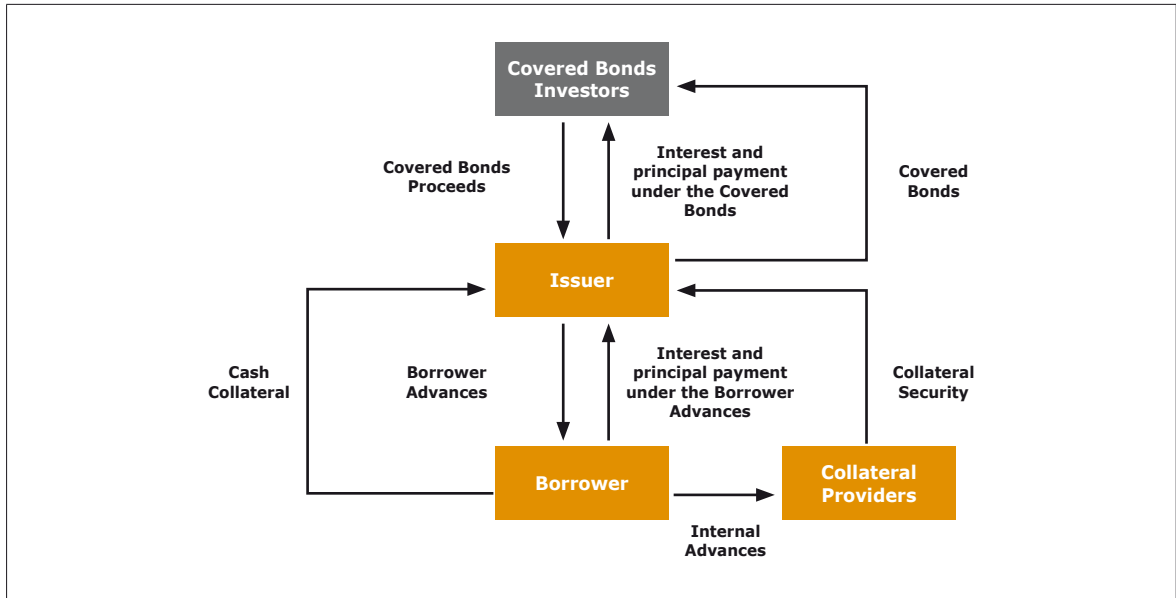
Obligations de Financement de l'Habitat (OH) make use of the implementation of the EU Collateral Directive 2002/47/EC in French law, which allows for a segregation of the assets without an actual transfer of assets to the issuer. This directive was implemented into the French Code Monétaire et Financier (Article L. 211-38 of January 8, 2009). Pursuant to the article L.211-38 of the French Monetary Code, the pledges shall be enforceable even when the relevant collateral provider is subject to an insolvency proceeding.

A bank pledges or assigns collateral to a subsidiary, which is a regulated French credit institution with limited purpose (e.g. issuing covered bonds for the purpose of providing financing to the sponsor bank). The covered bonds proceeds are used to fund advances to the respective sponsor bank(s). The covered bonds are secured by the privilege over the cover assets, which are in turn secured by a pledge over cover assets which remain on the sponsor bank's balance sheet (and/or on the balance sheets of the respective subsidiaries, affiliates or group member banks). Upon a borrower enforcement notice (for example in case of default of the sponsor bank), the respective cover assets, including underlying securities, will be transferred to the covered bond issuer.

There are two types of structures of a SFH:

- > Dual structure (structure used by all issuers until now):
  - > Cover asset pool remains on the balance sheet of the sponsor bank
  - > Cover assets and covered bonds are on different balance sheets;
  - > Transfer of assets following insolvency of the participating bank
- > Single structure:
  - > Cover assets are on the balance sheet of the issuer
  - > Cover assets and covered bonds are on the same balance sheet
  - > The parent company (=lending institution) transfers loans to the issuer of covered bonds.

## STRUCTURE OF OBLIGATION DE FINANCEMENT DE L'HABITAT



Sources: Moody's, Natixis

## II. STRUCTURE OF THE ISSUER

Société de Financement de l'Habitat (SFH), or home financing companies, are credit institutions licensed as a finance company by the French Autorité de Contrôle Prudentiel. The sole purpose of home financing companies is to grant or to finance home loans and to hold securities or instruments under the conditions set out by the law and financial regulations. Under an SFH program, the issuer issues "Obligations de Financement de l'Habitat (OHs) which are unsubordinated senior secured obligations and rank pari passu among themselves.

These specialised credit institutions are usually an affiliate of the sponsor bank, with limited purpose. There are currently seven SFH issuers:

### New SFH issuers:

- > BPCE SFH: is a licensed financial institution (99.9% owned by BPCE S.A.) regulated by the Autorité de Contrôle Prudentiel (ACP). The issuer was initially incorporated on 26 December 2007, but BPCE S.A. confirmed that it was a dormant entity until its conversion into SFH. The programme will replace both GCE Covered Bonds and BP Covered Bonds as the preferred funding tool of the Groupe BPCE.

### Converted SFH issuers:

- > BNP Paribas Home Loan SFH: received its Société de Financement de l'Habitat (SFH) license on June 15, 2011. The issuer is a French limited-purpose credit institution which is 99.9%-owned by BNP Paribas.
- > Crédit Mutuel Arkea Home Loans SFH (previously Crédit Mutuel Arkéa Covered Bonds): received its SFH agreement on April 1, 2011. The issuer is a special affiliate of the Crédit Mutuel Arkéa group

and has been licensed by the French banking regulator for the purpose of making Borrower Loans and issuing Covered Bonds.

- > Cédit Mutuel-CIC Home Loan SFH (previously CM-CIC Covered Bonds): received its SFH agreement on March 28, 2011. The issuer is a subsidiary of Banque Fédérative du Crédit Mutuel and licensed as a credit institution with limited and exclusive purpose.
- > Crédit Agricole Home Loan SFH (previously Crédit Agricole Covered Bonds): received its SFH agreement on April 5, 2011. The issuer is a licensed financial institution (99.9% owned by Crédit Agricole S.A.) regulated by the Autorité de Contrôle Prudentiel.
- > HSBC SFH (France) (formerly HSBC Covered Bonds (France)): received the SFH agreement on March 28, 2011. The issuer is a licensed financial institution regulated by the Autorité de Contrôle Prudentiel.
- > Société Générale SFH: was initially incorporated on 21 February 2003 (although not as an SFH, like for BPCE SFH). Following enactment of the SFH Law, the issuer opted for the SFH regime. The issuer is a subsidiary of Société Générale, licensed as a credit institution with limited and exclusive purpose by the French ACP. The issuer was a dormant entity until its conversion into an SFH.

### **III. COVER ASSETS**

Pursuant to SFH Law, the eligible assets of a Société de Financement de l'Habitat comprise, inter-alia:

- > home loans (prêts à l'habitat) which include (i) loans which are secured by a first-ranking mortgage or other real estate security interests that are equivalent to a first-ranking mortgage (*hypothèque de premier rang ou une sureté immobilière conférant une garantie au moins équivalente, Art. L515-35, II, 2°*) or (ii) loans that are guaranteed by a credit institution or an insurance company (*cautionnement consenti par un établissement de crédit ou une entreprise d'assurance*). The property must be located in France or in any other Member State of the European Union or the European Economic Area ("EEA") or in a State benefiting from the best credit level rating.
- > Loans guaranteed by the Fonds de Garantie à l'Accession Sociale à la Propriété (*Guarantee Fund for Social Access to Home Ownership*)
- > loans secured by the remittance, the transfer or the pledge of the receivables arising from the home loans referred to above,
- > units or notes (other than subordinated units or subordinated notes) issued by French securitisation vehicles, or other similar vehicles governed by the laws of a Member State of the EU or the EEA if (i) their assets comprise at least 90% of secured loans or other receivables benefiting from the same level of guarantees; (ii) such units or notes benefit from the highest level of credit assessment ("*meilleur échelon de qualité de crédit*") and (iii) the similar vehicles are governed by the laws of a Member State of the European Union or EEA.
- > promissory note (*billets à ordre*), and
- > substitution assets, under certain conditions provided by SFH Law (their aggregate value can make up to a maximum of 15% of the cover pool).

Under the SFH Law, cover pool assets comprised of units or notes issued by securitization vehicles (*organismes de titrisation*) are only eligible to support covered bond issuance if they are rated Aa3/AA- or above (100% eligible) or A3/A- or above (50% eligible).

The Sociétés de Financement de l'Habitat are not allowed to make any other investments, except investments in securities which are sufficiently secure and liquid to be held as so-called substitution assets.

Under SFH Law, each issuer has to appoint a Specific Controller, who is responsible for verifying key aspects of the issuer, in particular the extent of the collateral for the covered bonds. He is independent from both the issuer and the sponsor bank. When home loans granted or financed by the SFH are backed by a guarantee from a credit institution or an insurance company falling within the scope of consolidation (as defined in article L.233-16 of the French commercial code) as the SFH (i.e. in-house guarantor), the specific controller shall be entitled to carry out all controls on documents or on-site to determine whether the methods used to evaluate risk by that credit institution or that insurance company are appropriate.

The new framework changes the treatment of guaranteed housing loans. In particular, the new regulation will apply a haircut to in-house guarantors: i.e. if the guarantor is a group institution, only 80% of the loan may be included. In addition, a rating criterion/trigger has been introduced. If the credit rating is in the BBB region (i.e. below A-), the rate of inclusion drops to 80% for external guarantors and 60% for internal guarantors. If the rating of the guarantor is non-investment grade, the guarantee will no longer be recognized and the guaranteed loans may not be included in the cover pool. For more information please refer to the box below.

#### **Weighting of guaranteed home loans for *Sociétés de Financement de l'Habitat*:**

When the home loan guarantor is not part of the same consolidation scope as the SFH or the SCF, the weighting is as follows:

- > 100% when the home loan guarantor has at least the second highest level awarded by a rating agency ( $\geq$ A3/A-/A- by Moody's/S&P/Fitch);
- > 80% when the home loan guarantor has at least the third highest level of quality awarded by a rating agency ( $\geq$ Baa3/BBB-/BBB- by Moody's/S&P/Fitch);
- > 0% in all other cases.

When the home loan guarantor is part of the same consolidation scope as the SFH, the guaranteed home loans are weighted as follows:

- > 80% when the home loan guarantor has at least the second highest level of quality awarded by a rating agency ( $\geq$ A3/A-/A- by Moody's/S&P/Fitch);
- > 60% when the home loan guarantor has at least the third highest level of quality awarded by a rating agency ( $\geq$ Baa3/BBB-/BBB- by Moody's/S&P/Fitch).

#### **IV. VALUATION AND LTV CRITERIA**

The properties are valued according to the French mortgage market accepted practice. The property values are indexed to the French INSEE (*Institut National de la Statistique et des Etudes Economiques*) or PERVAL (Notaries) house price index on a quarterly basis. In most programmes, price decreases are fully reflected in the revaluation, while in the case of price increases, a 20% haircut is applied even though this is not required by law.

In order to ensure overcollateralization (above the 2% minimum required by law) compatible with the triple-A rating objective, the CB programmes include a dynamic Asset Coverage Test (ACT) that requires the balance of the mortgages in the collateral pool to significantly exceed the balance of the outstanding covered bonds. The minimum level of OC will depend on the credit quality of the mortgages in the cover pool as assessed by the rating agencies. For all the existing programmes the maximum asset percentage applied in the ACT is 92.5%, which translates into a minimum overcollateralization of 8.1%. However, that being said all programmes currently exceed the minimum amount due to adjustments to the rating agency methodologies.

When calculating the appropriate loan balance within the asset coverage test (ACT), higher LTV loans are included in the pool, but loan amounts exceeding the respective cap do not get any value in the ACT. For all programmes, the LTV ratio of the mortgage loans cannot be more than 100% (however, the portion that is above 80% will be disregarded in the ACT). In addition, the ACT gives no value to the loans in arrears or defaults.

## **V. ASSET-LIABILITY MANAGEMENT**

Overcollateralisation: By law, the SFH framework must maintain a nominal overcollateralisation ratio of 2% on the adjusted cover pool balance at all times.

Liquidity buffer: Also by law, the SFH framework requires the SFH to cover, at all times, its treasury needs over a period of 180 days, taking into account the forecasted flows of principal and interest on its assets and net flows related to derivative financial instruments.

Liquidity: The SFH framework provides further liquidity by allowing, as a last-recourse funding option, the SFH to subscribe to its own privileged covered bonds – up to 10% of total privileged liabilities – provided that the SFH uses these OH as collateral with the central bank or cancels them within 8 days.

The above requirements are also applicable to SCF.

In addition to the requirements specified by the SFH Law, all French OH programmes include a number of safeguards to hedge interest rate and currency risk, refinancing risk, commingling risk, market risk, etc as follows:

- > Interest rate and currency risks need to be neutralised (the hedging strategy);
- > Liquidity is ensured through a pre-maturity test (designed to ensure that sufficient cash is available to repay the covered bonds in full, on the original maturity date in the event of the sponsor bank's insolvency) and possible maturity extension;
- > Subject to certain rating triggers, swaps with suitable counterparties have to be entered to ensure that exposure to market risk is properly hedged.
- > Cash flow adequacy is secured through the asset-coverage test and the contractual obligation to neutralise any exposure to interest rate and currency risk.
- > Commingling risk is mitigated by the hedging strategy and the Collection Loss Reserve Amount.
- > Minimum rating requirements in place for the various third parties that support the transaction, including the swap counterparties.

## **VI. COVER POOL MONITOR & BANKING SUPERVISION**

The issuer is a regulated French credit institution, which is subject to regulation, supervision and examination by the French regulator (*Autorité de Contrôle Prudentiel*). The issuing bank is responsible for the monthly pool monitoring, with the asset coverage test calculation being checked by an independent Asset Monitor (and by the specific controller – some SFH do not have both): under the terms of the asset monitor agreement, the asset monitor tests the calculation of the asset coverage test annually. In case of non-compliance with the asset coverage test or in case the senior unsecured rating of the sponsor bank drops below a predefined trigger rating level, the test has to be performed on a monthly basis. In addition, rating agencies are involved in the programme and re-affirm the ratings of the program upon a pre-defined issuance volume. They also monitor the amount of overcollateralisation required to maintain the triple-A ratings.

Under SFH Law, each issuer has to appoint a Specific Controller (*Contrôleur Spécifique*), and a Substitute Specific Controller (*Contrôleur Spécifique Suppléant*), who are selected from an official list of auditors and are appointed subject to the approval of the ACP. Their role is (i) to ensure that the Issuer complies with the SFH Law (in particular, by verifying the quality and the eligibility of the assets and the cover ratios the Issuer has to comply with), (ii) monitor the balance between the Issuer's assets and liabilities in terms of rates and maturity (cash flow adequacy) and notifies the Issuer and the ACP if he considers such balance to be unsatisfactory. The Specific Controller remains liable, both as regards the Issuer and third parties, for any loss suffered by them which results from any misconduct or negligence arising in the performance of its duties. The Specific Controller verifies key financial aspects of the activities of the Issuer, in particular the extent of the collateral for the Covered Bonds. He is independent from both the Issuer and the Sponsor Bank.

## **VII. SEGREGATION OF COVER ASSETS & BANKRUPTCY REMOTENESS**

Like the SCF law, the SFH Law provides for a regime which derogates in many ways from the French legal provisions relating to insolvency proceedings. Under the SFH legislation, the holders of the Obligations de Financement de l'Habitat benefit from the privilege granted to these bonds over the SFH programme's eligible assets. If the issuer becomes insolvent, the OHs and other privileged debts pay in accordance with their payment schedule, and have priority over any of the programme's other debts or non-privileged creditors in relation to the programme's assets. All privileged debts rank *pari passu*.

The Issuer may be subject to insolvency but SFH law provides for a regime which deviates in many ways from the French insolvency provisions:

- > Privilège / No acceleration of covered bonds as a result of insolvency of SFH: in the event of an insolvency proceeding of the SFH (safeguard procedure, judicial reorganisation or liquidation), all claims benefiting from the Privilège (including interest) must be paid on their due dates and in preference to all other claims. Until payment in full of all such preferred claims, no other creditors may take any action against the assets of the SFH.
- > No nullity during hardening period: the provisions allowing an administration to render certain transactions entered into during the hardening period (*période suspecte*) null and void are not applicable for transactions entered into by a SFH (provided that such transactions are made in accordance with their exclusive legal purpose and without fraud).

- > Option to terminate ongoing contracts with insolvent counterparties: in case of the opening of any insolvency procedure against the credit institution which is acting as manager and servicer of the SFH, any contract may be immediately terminated by the SFH notwithstanding any legal provisions to the contrary.
- > No Consolidation: SFH law precludes the extension of any insolvency procedure in respect of the SFH's shareholders to the SFH itself.

### **VIII. RISK-WEIGHTING AND COMPLIANCE WITH EUROPEAN LEGISLATION**

In France and abroad, French Obligations de Financement de l'Habitat have a 20% risk-weighting under the CRD Standard Approach. This is because of the amount of guaranteed home loans exceeds 35% in existing SFH.

### **D - STRUCTURED COVERED BONDS**

By Cristina Costa, Natixis and  
Boudewijn Dierick, BNP Paribas

The first French structured covered bond programme was issued in November 2006. This route was chosen to use the bank's collateral more efficiently, than the established legal framework for Obligations Foncières. In particular, the cap on guaranteed housing loans had been a major obstacle, given that more than 50% of the bank's housing loans and circa two thirds of its new origination are secured by guarantees. As of end-2010 there were seven active issuers in the market.

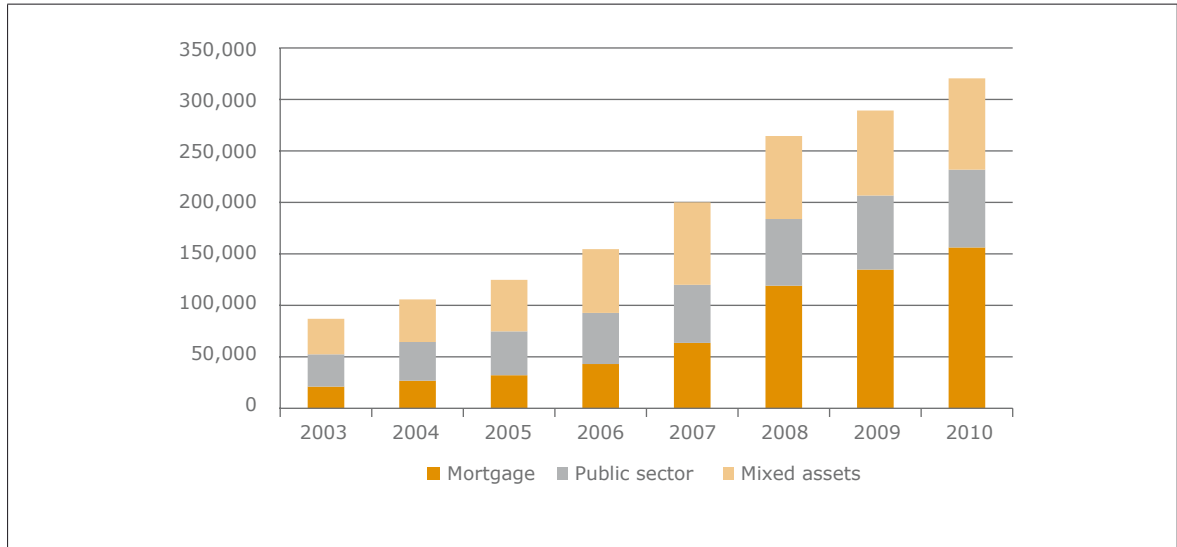
Following the enactment of the Law n°2010-1249 dated October 22nd, 2010 on the banking and financial regulation and its implementing Decree n° 2011-205 dated February 23rd, 2011, the SFH law came into being. The new legislation aims to provide a legislative framework for French residential mortgage-backed structure covered bonds.

According to the SFH law (please refer to section C. of this chapter for more information) a credit institution licensed as a finance company by the French supervisor (*Autorité de Contrôle Prudentiel*) may opt for the status of Société de Financement de l'Habitat. Once the supervisor has granted authorisation to operate as a Société de Financement de l'Habitat, all covered bonds and equivalent instruments issued by the credit institution prior to its transformation into a SFH shall be transferred automatically into Obligations de Financement de l'Habitat.

At the time of writing, almost all French common-law based covered bond issuers have transferred their status to SFH. The only two remaining issuers are Banques Populaires Covered Bonds and GCE Covered Bonds, which will remain French common-based covered bond issuers but will not longer issue (the BPCE Group will issue Obligations de Financement de l'Habitat via BPCE SFH). What follows is an abridged version of the French structured covered bond chapter.

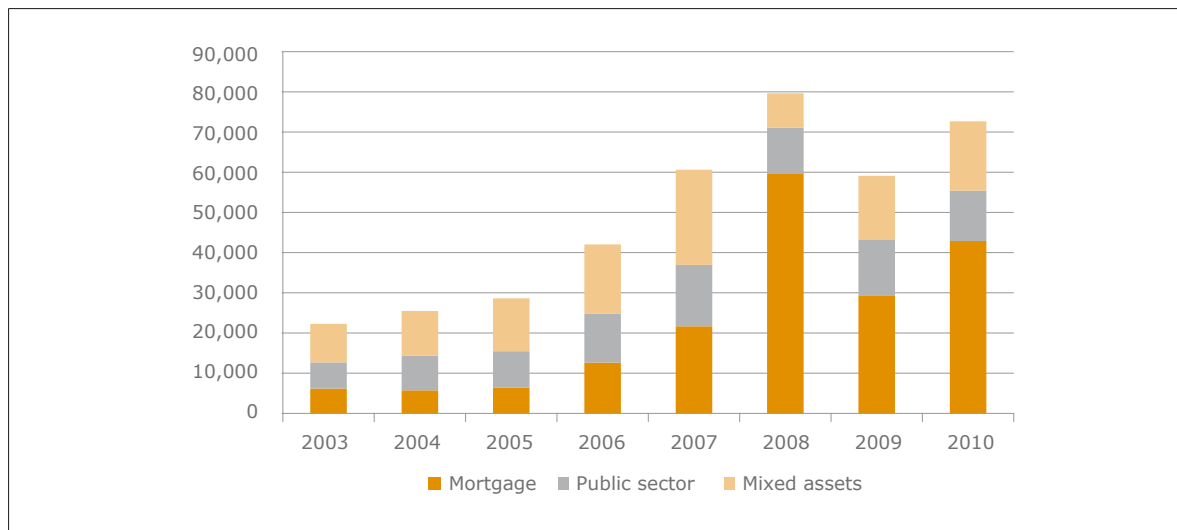
**Please refer to the 2010 edition of the Fact Book for the full version of this chapter.**

&gt; FIGURE 1: COVERED BONDS OUTSTANDING, 2003-2010, EUR M



Source: EMF/ECBC

&gt; FIGURE 2: COVERED BONDS ISSUANCE, 2003-2010, EUR M



Source: EMF/ECBC

Note: For CFF, the mortgage and public sector assets are put in the same pool. As such, the cover pool acts as global coverage for privileged liabilities, i.e. no specific asset is linked to a specific bond issue. Therefore, CFF Covered Bonds are under the "mixed assets" category.

**Issuers:**

- > **CRH** : Caisse de Refinancement de l'Habitat
- > **Obligations Foncières** : AXA Bank Europe SCF, BNP Paribas Public Sector SCF, Cie Financement Foncières (CFF), CIF EuroMortgage, Credit Foncier et Communal d'Alsace et Lorraine (CFCAL), Dexia Municipal Agency, General Electric SCF, Société Générale SCF
- > **Obligations à l'Habitat** : BNP Paribas Home Loan SFH, BPCE SFH, Crédit Agricole Home Loan SFH, Crédit Mutuel Arkéa Home Loans SFH, Credit Mutuel-CIC Home Loan SFH, HSBC SFH (France), Société Générale SFH
- > General Law Based CBs: Banques Populaires Covered Bonds, Groupe Caisse d'Épargne Covered Bond.

COMPARISON OF FRENCH COVERED BONDS

	Obligation de Financement de l'Habitat	Obligations Foncières
<b>Legal Framework</b>	French Monetary and Financial Code, Articles L.515-15 to L.515-38, Decree no. 2011-205 of 23 February 2011 and the Banking and Financial Regulation Act no. 2010-1249 of 22 October 2010	French Monetary and Financial Code, Articles L.515-13 to L.515-33, regulation no. 99-10 of 9 July 1999. Amended by the Decree no. 2011-205 of 23 February 2011, Banking and Financial Regulation Act no. 1249 of 22 October 2010
<b>Eligible assets</b>	<ul style="list-style-type: none"> <li>- Residential home without limitation for guaranteed home loans</li> <li>- Securitization of the above (subject to specific rules and criteria)</li> </ul>	<ul style="list-style-type: none"> <li>- First-rank residential mortgage loans</li> <li>- First-rank commercial mortgage loans</li> <li>- State-guaranteed real-estate loans</li> <li>- Third party guaranteed real estate loans (max. 35% of total assets)</li> <li>- Public sector loans, bonds and leasing</li> <li>- Securitization of the above</li> </ul>
<b>Overcollateralisation</b>	2%	
<b>LTV ratio</b>	<ul style="list-style-type: none"> <li>- First-rank residential mortgage loans and guaranteed home loans: max. 80% LTV</li> <li>- State-guaranteed real-estate loans: max. 100% LTV</li> </ul>	<ul style="list-style-type: none"> <li>- First-rank residential mortgage loans and guaranteed home loans: max. 80% LTV</li> <li>- First-rank commercial mortgage loans: max. 60% LTV</li> <li>- State-guaranteed real-estate loans: max. 100% LTV</li> </ul>
<b>Substitution assets</b>	Max. 15% of total OF and other privileged resources.	
<b>Liquidity</b>	Requirement to cover all cash flows for a period of 180 days, taking into account all cash flows resulting of future payments on principal and interests on its assets, and cash flows pertaining to term instruments.	
<b>Investor protection</b>	Overcollateralisation, 180-day liquidity needs coverage and ability to repo own issuances, controlled ALM	
<b>Issue's structure/Transfer of assets</b>	Effective transfer of cover assets or financial guarantee	Effective transfer nearly exclusively (financial guarantee for certain public assets)
<b>Supervision</b>	Autorité de contrôle prudentiel (ACP), Comité des Etablissements de Crédit et des Entreprises d'Investissement (CECEI), AMF (Autorité des Marchés Financiers) and specific controller	
<b>UCITS Conformity</b>	Yes	
<b>Risk-weighting according to EU CAD</b>	20%	10%
<b>Rating (M/S&amp;P/F)</b>	Aaa/AAA/AAA	Aaa/AAA/AAA

Source: Natixis, French Monetary and Financial Code, Banking and Financial Regulation Act

French common-law covered bonds	Caisse de refinancement de l'Habitat
Code de Commerce and Code Monétaire et Financier (in particular Art. L.431-7 ff. concerning the bankruptcy remoteness of the cover pool)	Specific legal framework: article 13 of Law n°85-695 of July 11 1985 referring to Code Monétaire et Financier Art L.313-42 to 313-49 and Art L.515-14-1.
<ul style="list-style-type: none"> <li>- First-rank residential mortgage loans or promissory mortgage notes</li> <li>- Real-estate loans guaranteed by a credit institution</li> <li>- Only loans for housing; commercial real estate loans are not eligible.</li> </ul>	<ul style="list-style-type: none"> <li>- First rank residential mortgage loans</li> <li>- State guaranteed mortgage loans</li> <li>- Third party guaranteed real estate loans (max. 35% of total assets)</li> <li>- No securitisation tranches, no RMBS</li> <li>- No loans with duration over 25 years</li> <li>- No loans with unit amount over</li> </ul>
8.11%	25%
LTV ratio: max. 100%	<ul style="list-style-type: none"> <li>- Residential mortgage loans: max 80% LTV, max 90 % LTV if overcollateralisation of 25%</li> <li>- State guaranteed mortgage loans: max 100% LTV</li> </ul>
Max. 20% of total cover pool	Non eligible
Contractual requirements	-
Overcollateralisation, pre-maturity and collection loss reserve tests, hedging strategy	Overcollateralisation, full recourse to the participating banks in case of collateral shortfall
Effective transfer or financial guarantee	Financial guarantee exclusively
ACP, asset monitor and external auditors	ACP and CECEI
No	Yes
20%	10%
Aaa/AAA/AAA	Aaa/-/AAA