

3.13 FRANCE

Three main covered bond issuing structures exist in France today:

- > *Sociétés de Crédit Foncier (SCF)*;
- > *Sociétés de Financement de l'Habitat (SFH)*; and
- > *Caisse de Refinancement de l'Habitat (CRH)*.

While several countries allow ordinary credit institutions to issue covered bonds subject to the segregation of the cover pool in their balance sheet, France requires the set-up of an *ad hoc* company which is a duly licensed specialised credit institution (licensed by the *Autorité de Contrôle Prudentiel et de Résolution (ACPR)*, the French Banking Authority) such as *société de financement de l'habitat* and *société de crédit foncier*, totally distinct from the other entities of the group to which it belongs and exclusively dedicated to the issuance of covered bonds named respectively *obligations de financement de l'habitat* (OHs) and *obligations foncières* (OFs) and the management of the assets backing those issues (the "cover pool").

Caisse de Refinancement de l'Habitat (CRH) is the sole in its category. It is also a duly licensed specialised credit institution which is acting independently and is distinct from the banking groups which are being financed.

All French covered bonds issuers are strictly regulated in order to offer bondholders a very high credit quality and benefit from a legal privilege.

The French covered bonds' legislation and regulation comply with the requirements of article 52(4) of the UCITS Directive. All covered bonds are UCITS compliant and the vast majority [not to say all] are CRR (article 129(1)) compliant.

French covered bonds, which are CRR compliant, have a 10% risk-weighting according to the Standardised Approach in the CRR if benefiting from a rating classified as STEP1.

French covered bonds can be eligible to liquidity buffer under LCR regulation provided they respect specific criteria.

Regulation of *Société de Crédit Foncier* and *Sociétés de Financement de l'Habitat* was substantially strengthened in 2014 by Decree n° 2014-526 dated 23 May 2014 and *Arrêté* dated 26 May 2014. Law n° 2016-1691 dated 9 December 2016 relating to "transparency, fight against corruption and modernisation of economy" (known as the "Sapin II Law") has amended the legal eligibility criteria of SCF's assets to allow SCF to grant secured loans benefiting from a financial guarantee constituted of real estate's loans receivables as it is already the case for the SFH. It constitutes a new step towards the legal convergence of the various French regimes.

A – SOCIETE DE CREDIT FONCIER (SCF)

By Alexis Latour, BNP Paribas and Alcyme Delannoy, CFF

I. FRAMEWORK

The *SCF* is governed by Articles L.513-2 et *seq.* and R.515-2 et *seq.* of the French Monetary and Financial Code (the "Code"). This stringent legal framework is specially designed to protect the holders of the *OFs*. As a credit institution, the *SCF* is also governed by French general banking regulations.

Permission given to *SCF* to conclude secured loans is currently included in the Law n° 2016-1691 dated 9 December 2016 relating to "transparency, fight against corruption and modernisation of economy" (known as the "Sapin II Law"). Indeed, Sapin II Law has amended the legal eligibility criteria of SCF's assets as set out in Articles L.513-3, L.513-5 and L.513-6 of the French Monetary and Financial Code (the "Code").

First and foremost, it allows the *SCF* to grant secured loans benefiting from a financial guarantee constituted of real estate's loans receivables, regardless of the nature of such receivables, professional or otherwise. Actually, as it is currently the case for the *SFH*, the *SCF* structure is in a position to make use of the implementation of the EU "Collateral Directive" 2002/47/EC, as amended, under French law (implemented into the Code under articles L. 211-36 and seq.). The obligations of the borrower under the loan are being fully secured by either a remittance (*remise*), a pledge (*nantissement*) or the transfer by way of security of the full title (*cession en pleine propriété à titre de garantie*) in favour of the *SCF* of the real estate's loans receivables pursuant to Articles L. 211-36 to L. 211-40 of the Code. These provisions allow for a segregation of the real estate's loans receivables and, therefore, it avoids an actual transfer (true sale) of these receivables to the issuer while providing equivalent legal protection. Actually, pursuant to article L.211-38 of the Code, the pledge or the transfer by way of a security shall be enforceable even when the relevant collateral provider is subject to an insolvency proceeding (please revert to paragraph "Framework" concerning the *Sociétés de financement de l'habitat*).

The Sapin II Law has also introduced the removal of the 10% limit referred to in Article L.513-6 of the Code under which *SCF* were allowed to subscribe mortgage promissory notes (*billets à ordre hypothécaires*) governed by Article L.313-42 et seq. of the Code only on the basis that such mortgage promissory notes did not exceed 10 per cent. of *SCF*'s privileged assets.

By replacing the Mortgage Backed Securities with the secured loans, it allows *SCF*, which are holding Residential Mortgage Backed Securities on their assets side, to be compliant with the provisions of article 496 of Regulation (EU) N° 575/2013 of 26 June 2013 on "prudential requirements for credit institutions and investment firms" (known as "CRR") and the provisions of Article R. 513-3 – IV of the Code. Both provisions will take effect from 1st January 2018 onwards and would have had a negative impact on the current prudential preferential treatment on the *obligations foncières* issued by these *SCF* if such substitution of assets had not been implemented.

It is also a new step towards the legal convergence of *SCF* and the *SFH* the European Union is looking forward. It must be noted that, following this reform, in the end, there is no longer major differences between the *SCF* and the *SFH*. Admittedly, the *SCF* may refinance "public exposures" and commercial real estate loans receivables while *SFH* cannot. Moreover, the *SCF* are not allowed to finance guaranteed home loans receivables above a threshold of 35% of the privileged assets of the *SCF* and the guarantor must not belong to the same group as the *SCF* while *SFH* are allowed to refinance such receivables. Broadly, these are the main differences that currently remain between both regimes.

II. STRUCTURE OF THE ISSUER

The *SCF* is a credit institution licensed by the *Autorité de Contrôle Prudentiel et de Résolution (ACPR)*, the French Banking Authority, with a single purpose: to grant or acquire eligible cover assets, as defined by Law, and to finance them by issuing *OFs*, which benefit from a special legal privilege (the "Privilege"). It may also issue or contract other debts benefiting or not from the Privilege.

The *SCF* operates under the close control of the ACPR, which requires it to comply with strict management rules in order to ensure the company's financial security.

Furthermore, and in addition to the nomination of two external statutory auditors as all French credit institutions, the *SCF* is also required to appoint an independent controller, registered as a statutory auditor, (the "Specific Controller") whose mission, beyond the single monitoring of the cover pool, is more globally to ensure that the *SCF* complies with the regulations and especially with the coverage ratio requirement and the assets/liabilities matching.

III. COVER ASSETS

Only eligible assets, restrictively defined by law, are authorised on the balance sheet of the *SCF*. All assets on the balance sheet are part of the cover pool. The eligible assets of a *société de crédit foncier* may only be:

- > Secured loans which, in accordance with Article L.513-3 of the Code include loans which are secured by a first-ranking mortgage over an eligible real estate or by other real estate security interests that are equivalent to a first-ranking mortgage or loans that are guaranteed by a credit institution, financing company (*société de financement*) or an insurance company with a shareholder's equity of at least €12 million and which does not belong to the same group as the relevant SCF according to Article L. 233- 16 of the French Commercial Code. The property must be located in France or in any other Member State of the EU, EE or in a State benefiting from the highest level of credit assessment given by an external rating agency recognised by the ACPR;
- > Grants to any credit institution loans guaranteed by the remittance (*remise*), the transfer (*cession*) or the pledge (*nantissement*) of receivables pursuant to and in accordance with the provisions of Articles L.211-36 to L.211-40 or Articles L.313-23 to L.313-35 of the Code, regardless of the nature of such receivables, professional or otherwise, provided that they satisfy the eligibility criteria set out in Article L.513-3 of the Code.
- > Exposures to public entities which, in accordance with Article L.513-4 of the Code include, *inter alia*, exposures to public entities such as states, central banks, local authorities or state-owned entities located within the EEA, in a Member State of the EU, in the United States of America, Switzerland, Japan, Canada, Australia or New Zealand, or if not located in those jurisdictions, such public entities must comply with specific limits and level of credit assessment given by an external rating agency recognised by the ACPR;
- > Units or notes (other than subordinated units or subordinated notes) issued by French *organismes de titrisation*, which are French securitisation vehicles, or other similar vehicles governed by the laws of a Member State of the European Union or EEA, the United States of America, Switzerland, Japan, Canada, Australia or New Zealand, the assets of which shall comprise at least 90%, subject to certain exclusions, of receivables similar to secured loans or exposures to public entities complying with the criteria defined in Articles L.513-3 and L.513-4 of the French Monetary and Financial Code or other assets benefiting from the same level of guarantees as loans and exposures referred to in Articles L.513-3 and L.513-4 of the Code; such units or notes must benefit from the highest level of credit assessment assigned by an external rating agency recognised by ACPR; the similar vehicle shall be governed by the laws of a Member State of the EU or EEA if the assets are composed of loans or exposures referred to in Article L.513-3 of the Code; and such units or notes are refinanced within a limit of 10 per cent. of the nominal amount of the *obligations foncières* and other liabilities benefiting from the Privilege;
- > Mortgage promissory notes (*billets à ordre hypothécaires*) governed by Article L.313-42 et seq. of the Code provided that the receivables refinanced by such mortgage promissory notes satisfy the conditions set out in Article L.513-3 of the Code (being specified that the 10% limit under which SCF can only subscribe mortgage promissory notes provided that such mortgage promissory notes do not exceed 10 per cent. of SCF's assets has been removed by the Sapin II Law); and/or
- > Substitution assets (*valeurs de remplacement*), under certain liquidity and maturity conditions and provided that their aggregate value is up to a maximum amount of 15% of the outstanding of the *obligations foncières*.

IV. VALUATION AND LTV CRITERIA

Loans in the cover pool can be financed by OFs and other privileged debt up to the amount of:

- > The remaining principal balance of the loan; or
- > The value of the real estate financed or given as collateral multiplied by the financing coefficient, whichever is lower.

This financing coefficient is equal to:

- > 60% of the value of the financed real estate for guaranteed loans, or of the assets given as collateral for residential mortgages;
- > 80% of the value of the real estate in the case of loans that were granted to individuals either to finance the construction or purchase of a home, or to finance both the acquisition of the undeveloped land and the cost of building the home;
- > 100% of the value of the real estate financed, in the case of loans guaranteed by the *Fonds de garantie à l'accession sociale* (Guaranty Fund for Social Home Accession).

The real estates financed by the loans are valued according to the French mortgage market accepted practice and defined by law (regulation n°99-10).

Real estate valuations must be based on their long-term characteristics. Under banking regulation (Arrêté of the 3rd of November 2014), real estate values are considered as part of the risks of *sociétés de crédit foncier*. The valuations are made by independent experts in compliance with banking regulation.

Regarding valuations methods, different options are available (full valuation, use of statistic methods) that depend on the property use (residential or professional), the loan size and the property value. For statistical methods, the real estate's values are based on the index provided by INSEE (*Institut National de la Statistique et des Études Économiques*) or on the index provided by Notaries (PERVAL).

The real estates are revaluated on an annual basis.

Among his duties, the Specific Controller controls the eligibility, composition and valuation of the assets. The valuation and revaluation methods as well as their results are annually validated by the specific controller and published in the annual reports.

V. ASSET/LIABILITY AND RISK MANAGEMENT

The *SCF* must comply with asset/liabilities rules as required by banking regulations and, in particular, it has to ensure the matching of its assets and liabilities in terms of interest rates and maturities.

Market risks

The *SCF* must manage and hedge market risks on its assets, liabilities and off-balance sheet items: interest rate risks, currency risks, liquidity and maturity mismatches between liabilities and assets. The surveillance of these points is part of the duties of the Specific Controller.

Coverage ratio – overcollateralisation

At all times, the total value of the assets of the *SCF* must be, at least, after weighting, equal to 105% of the liabilities benefiting from the Privilege.

From a regulatory standpoint, the coverage ratio is calculated on the basis of the *SCF* 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;
- > Residential loans guaranteed by a credit institution or an insurance company are weighted 100% if the guarantor qualifies, at least, for the step 2 credit quality assessment, weighted 80% if it qualifies for the step 3 credit quality assessment, and weighted 0% in any other case;
- > Public exposures and replacement assets are weighted 100%; and
- > Senior securities of securitisation vehicles are weighted 100%, 80%, 50% or 0% subject to different criteria (essentially their rating).

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

Maturity mismatch

The remaining weighted average life of the assets of the *SCF* should not exceed that of the covered bonds by more than 18 months. Cover pool assets taken into account are only those that are strictly necessary to satisfy the minimum legal overcollateralisation requirement of 105%. In addition, new issuers and structures in run off might be exempted of this requirement.

Liquidity risk

The *SCF* is required to ensure that its cash needs are constantly covered over a moving period of 180 days. The scope of this obligation will extend to forecasted principal and interest flows involving the *SCF*'s assets, as well as to flows related to its derivative instruments. 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.

The *SCF* is authorised to subscribe to its own *OFs* up to 10% of total privileged liabilities provided that these *OFs* are only used as collateral with the central bank or cancels them within 8 days.

Exposure on the group to which belongs the SCF

Decree N° 2014-526 and *Arrêté* dated 26 May 2014 limits the ability of the *SCF* to hold assets in the form of exposures on entities of the group to which it belongs. In this aim, when these assets exceed 25% of the non-privileged assets of the *SCF*, the difference between the exposure on these entities and the sum of 25% of the non-privileged assets together with the assets received in guarantee, pledged or full property, is deducted from the numerator of the coverage ratio.

General risks

As credit institution on general, the *SCF* is subject to the banking regulation as defined by the *Arrêté* of the 3rd of November 2014 on banks internal control (formerly regulation *CRBF* 97-02). Accordingly, it must, in particular, 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.

VI. TRANSPARENCY

As credit institution and listed company, the *SCF* must publish periodic financial information. In accordance with *Arrêté* of the 3rd of November, it also has to send a detailed annual report on risk management to the *ACPR*.

Moreover, the *SCF* is also required to publish:

- > A quarterly report relating to the nature and the quality of their assets. This report must be published either on the *SCF* website, in the *Bulletin des Annonces Légales Obligatoires*, or in any newspaper enable to publish legal announcements;
- > An annual report describing:
 - (i) the nature and the quality of their assets, the characteristics and breakdown of loans and guarantees, 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 quarterly report, on 31 March, 30 June, 30 September and 31 December of each year relating to:
 - (i) the amount of its coverage ratio and 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 etc.;
 - (ii) the data of the calculation of the coverage of its liquidity needs;
 - (iii) the gap of the average duration between those of its eligible assets and its privileged liabilities;
 - (iv) the valuation of the coverage of the privileged debts until their maturity by the available eligible assets and the estimation of the future new production of these eligible assets on the basis of prudent assumptions.

Besides the French Covered Bond Label Reports (national transparency template), the SCF generally publishes on a quarterly basis the European Covered Bond Label Reports (under the Harmonised Transparency Template format), recently enriched by the additional regulatory requirements in connection with eligibility of the collateral to ECB open market operations.

VII. COVER POOL MONITOR AND BANKING SUPERVISION

The Specific Controller is appointed by the SCF with the agreement of the ACPR. To ensure his independence, the Specific Controller cannot be an employee of either of the SCF's statutory auditors, of the company that controls the SCF, or of any company directly or indirectly controlled by a company that controls the SCF.

The mission of the Specific Controller includes the following verifications:

- > That all assets granted or acquired by the SCF 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 105%;
- > That the SCF 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. He checks the different quarterly indicators before sending to ACPR, and
- > That, in general, the SCF complies with the law and regulations.

The Specific Controller certifies that the SCF complies with the coverage ratio rules on the basis of a quarterly issuance program, and for any issue of privileged debt of an amount equal or above EUR 500 m. These coverage ratio affidavits are required to be stipulated in issuance contracts where the debt benefits from the Privilege. The Specific Controller reports to the ACPR. He attends shareholders' meetings, and may attend Board meetings.

Pursuant to Article L.513-23 of the Code, the Specific Controller is liable towards both the SCF and third parties for the prejudicial consequences of any breach or negligence he may have committed in the course of his duties.

The SCF operates under the constant supervision of the ACPR. Its management, its Specific Controller and its Statutory Auditors should be agreed by the ACPR. All the above-mentioned reports should be sent to the ACPR together with the annual report of the Specific Controller and the annual reports of the Statutory Auditors.

VIII. SEGREGATION OF COVER ASSETS AND BANKRUPTCY REMOTENESS OF COVERED BONDS

Cover assets are segregated in the issuing specialised credit institution. Pursuant to Article L.513-11 of the Code, holders of *OFs* and other privileged debts have preferred creditor status and the right to be paid prior to all other creditors who have no rights to the assets of the *SCF* until the claims of preferred creditors have been fully satisfied.

Under the *SCF* legislation (as it is the case for the *SFH* legislation), the holders of the *OF* benefit from the legal privilege over the *SCF's* eligible assets. If the issuer becomes insolvent, the *OF* and other privileged debts are paid 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 the *SCF* law provides for a regime which derogates in many ways from the French insolvency provisions (the same applies for the *SFHs'* programs):

- > **Legal Privilege / No acceleration of covered bonds as a result of insolvency of SFH:** in the event of an insolvency proceeding of the *SCF* (safeguard procedure, judicial reorganisation or liquidation), all claims benefiting from the Privilège¹ (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 *SCF*;
- > **No nullity during the hardening period:** the provisions, allowing an administrator to render certain transactions, entered into during the hardening period (*période suspecte*) null and void are not applicable for the transfer of assets entered into by a *SCF* (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 *SCF*, any contract may be immediately terminated by the *SCF* notwithstanding any legal provisions to the contrary;
- > **No impact of the hardening period:** the common provisions of French bankruptcy law affecting certain transactions, which entered into force during the months prior the insolvency proceedings during the hardening period (*période suspecte*), are not applicable to *SCF*.
- > **No extension of bankruptcy proceedings:** as an exception to the general French bankruptcy Law, bankruptcy proceedings or liquidation of a company holding share capital in a *SCF* cannot be extended to the *SCF*. As a result, the *SCF* enjoys full protection from the risks of default by their parent company or the group to which it belongs.

Recourses

The sums resulting from the eligible assets and derivatives transactions, together with deposits made by the *SCF* with credit institutions, are allocated in priority to the payment of sums due in respect of the *OF*. Until payment in full of such privileged liabilities, no other creditors may take action against the assets of the *SCF*.

BRRD

On 15 May 2014, the Directive 2014/59/EU of the European Parliament and of the Council established a framework for the recovery and resolution of credit institutions and investment firms ("BRRD"). The BRRD provides authorities with a credible set of tools to intervene sufficiently early and quickly in an unsound or failing institution so as to ensure the continuity of the institution's critical financial and economic functions,

¹ Principal and interest of the Covered Bonds benefit from the so called "Privilège" (priority right of payment). As a consequence, and notwithstanding any legal provisions to the contrary, all amounts payable to the issuer in respect of the cover pool and forward financial instruments are allocated in priority to the payments of any sums due in respect of the covered bonds.

while minimising the impact of an institution's failure on the economy and financial system. The implementation of the BRRD into French law has been made by two texts of legislative nature (the Banking Law dated 26 July 2013 and an Ordonnance dated 20 August 2015). Regarding Covered Bonds, the BRRD provides that the relevant resolution authority shall not exercise the write down or conversion powers in relation to secured liabilities including covered bonds and liabilities in the form of financial instruments used for hedging purposes which form an integral part of the cover pool and which according to national law are secured in a way similar to covered bonds, whether they are governed by the law of a Member State or of a third country.

IX. RISK-WEIGHTING AND COMPLIANCE WITH EUROPEAN LEGISLATION

The French covered bonds' legislation and regulation comply with the requirements of article 52(4) of the UCITS Directive. All covered bonds are UCITS compliant and the vast majority [not to say all] are CRR compliant (fulfilling criteria provided in article 129(1)).

OFs which are CRR compliant have a 10% risk-weighting according to the Standardised Approach in the CRR if benefiting from a rating classified as STEP1.

OF can be eligible to liquidity buffer under LCR regulation provided they respect specific criteria.

X. ADDITIONAL INFORMATION

Covered bonds liquidity

The French *SCF*, which issue jumbo *OFs*, have signed together with more than 20 banks a specific standardised market-making agreement, which has become a national agreement.

B – CAISSE DE REFINANCEMENT DE L’HABITAT (CRH)

By Marc Nocart, Caisse de Refinancement de l’Habitat

I. FRAMEWORK

CRH was created in 1985 by French Government as a central agency, in order to develop the housing market in France; it aims at extending long-term funding to the loan retailers (currently French banks) in the specific legal framework of art 13 of law 85-685 of July 1985.

CRH was initially granted an explicit State guarantee, which has been replaced in 1999 by a Law-specific package consisting in an increase of the minimum overcollateralisation rate and a very strong legal privilege upon CRH’s secured loans to banks.

Being the sole agency-type structure currently existing in France, CRH is operating under its dedicated legal framework. CRH received approval to issue bonds under Article 13 of act 1985-695 by letter of 17 September 1985 from the Minister for the Economy, Finance and Budget. CRH approval to operate is restricted to the sole funding, on a secured basis, of portfolios of eligible loans.

The *Caisse de Refinancement de l’Habitat* (previously *Caisse de Refinancement Hypothécaire*) is therefore a specialised credit institution whose sole function is to fund French domestic residential mortgage to individuals granted by the French banking system. CRH’ operations are governed by the provisions of art L. 313-42 to L. 313-49 of Monetary and Financial Code.

CRH issues exclusively covered bonds and lends this market-sourced funding to banks, by strictly mirroring their terms and conditions (interest rate, maturity, currency), in full dedication to its legal mandate.

CRH’s bonds are strictly regulated in order to provide bondholders with a very high credit quality and a strong legal privilege. They are governed by the Article 13 of act 1985-695 of 11 July 1985 as complemented by Article 36 of act 2006-872 of 13 July 2006.

CRH secured loans to banks take the form of mortgage promissory notes issued by the borrowing banks and held by CRH, secured by a pledge of eligible housing loans to individuals. They are governed by Articles L. 313-42 to L. 313-49 of the French Monetary and Financial Code which grant CRH, inter alia, a very strong privilege upon the covered pool.

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. STRUCTURE OF THE ISSUER

Caisse de Refinancement de l’Habitat, a French corporation (*société anonyme*), is a specialised credit institution licensed by virtue of the decision taken on 16 September 1985 by the French Credit Institutions Committee (*Comité des Établissements de Crédit*).

CRH is therefore governed by the provisions of Articles L. 210-1 to L. 228-4 of the French commercial Code and Articles L. 511-1 *et seq.* of the French Monetary and Financial Code.

Its equity belongs to French banks:

> Crédit Mutuel – CIC	35.29%
> Crédit Agricole SA – Crédit Lyonnais	33.64%
> Société Générale – CDN	17.89%
> BNP Paribas	7.64%
> BPCE	5.54%

Every borrower is committed to become a shareholder of CRH, whose equity stake in CRH is proportionated to its weight in CRH's global regulatory weighted loans amount.

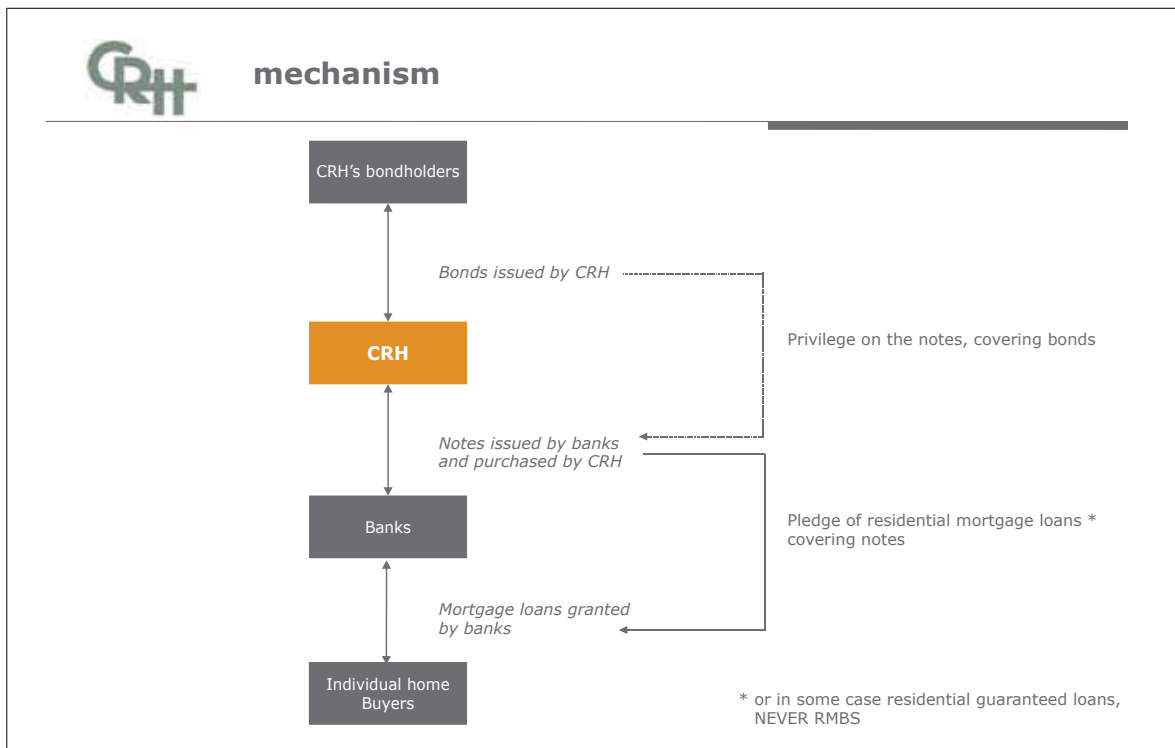
Furthermore:

- > every borrower is committed to supply back up lines to CRH
- > CRH benefits from cross commitments of shareholders to supply cash advances and capital contributions

These shareholders-borrowers are among the best European names. Their global market share is roughly 78% of the French mortgage market.

CRH is not borrowing for itself but for the account of its shareholders; nevertheless, as any fully independent credit institution, it can decline funding a shareholder.

CRH covered bonds are unsubordinated senior secured obligations and rank *pari passu* among themselves benefiting from the legal privilege. No other debt can be either senior or rank even *pari passu* with the covered bonds.



III. COVER ASSETS

CRH's loans to banks (represented by mortgage promissory notes) are secured by the pledge of eligible loans kept in the balance sheets of borrowing banks. These assets are ring-fenced thanks to the legal privilege granted to CRH (and passed impaired to CRH's bondholders in virtue of the privilege granted to the covered bonds holders).

Eligible loans are restricted by Law, and by additional restrictions embedded into CRH internal regulation.

Are eligible to CRH cover pool:

1. Home loans (*prêts à l'habitat*) secured by a first-ranking mortgage
2. Within the limit of 35% of the cover pool, home loans that are guaranteed by a credit institution or an insurance company, with a shareholder's equity of at least €12 million and which does not belong to the same group as the relevant bank according to Article L. 233-16 of the French Commercial Code.
3. Loans guaranteed by the *Fonds de Garantie à l'Accession Sociale à la Propriété* (Guarantee Fund for Social Access to Home Ownership).

These eligibility criteria are supplemented by the following restrictions:

- > The property must be located exclusively in France
- > The loan amount cannot exceed 1.000.000 €
- > The loan residual tenor cannot exceed 25 years

Are NOT eligible in CRH cover pool

- > Securitisation exposures
- > Public assets
- > Replacement assets

The CRH cover pool includes exclusively residential loans complying with the Capital Requirements Regulation (CRR Article 129). Typically, ca. 82% of the pool is secured by first rank mortgages and 18% are guaranteed loans.

The total value of the cover pool must equal:

- > For fixed-rate home loans, at least 125% of the total amount of CRH loans (equal to the total amount of CRH bonds)
- > For floating-rate home loans, at least 150% of the total amount of CRH loans

The collateralisation rate can of course be set at higher levels by additional requests made either by CRH itself or by the rating agencies.

IV. VALUATION AND LTV CRITERIA

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

The properties financed by the loans are valued according to the French mortgage market accepted practice and defined by law (regulation n°99-10).

Regarding valuations methods, different options are available (full valuation, use of statistic methods) that depend on the loan size and the property value.

All buildings financed by eligible loans are the subject of a prudent evaluation that excludes all speculative aspects. It is carried out by the borrowing bank. The valuation is performed taking into account the building's long-term characteristics, normal and local market conditions, the current usage made of the asset and all alternative usages that it might be assigned to.

This valuation must be performed by an independent expert, i.e. a person who is not part of the lending decision-making process.

The valuation of the buildings is re-examined as part of the risk measurement system required of borrowing credit institutions by CRBF Regulation no. 97-02. This examination is performed annually using statistical methods.

For statistical methods, the properties values are based on the index provided by INSEE (*Institut National de la Statistique et des Études Économiques*) or on the index provided by Notaries (PERVAL).

They are revaluated on a quarterly basis.

Loans in the cover pool can be financed up to the lower amount of:

- > The remaining principal balance of the loan; or
- > The value of the real estate financed or given as collateral multiplied by the financing coefficient,

This financing coefficient is equal to the lower of:

- > 60% of the value of the financed real estate for guaranteed loans, or of the assets given as collateral for residential mortgages;
- > 90% of the value of the real estate (provided the overcollateralisation rate is at least equal to 125%) in the case of loans that were granted to individuals either to finance the construction or purchase of a home, or to finance both the acquisition of the undeveloped land and the cost of building the home;
- > 100% of the value of the real estate financed, in the case of loans guaranteed by the *Fonds de garantie à l'accession sociale* (Guaranty Fund for Social Home Accession).

V. ASSET – LIABILITY MANAGEMENT

CRH ALM is extremely simple as it is a perfect pass-through structure.

CRH's debts (covered bonds) and loans (mortgage promissory notes) have exactly the same characteristics. CRH is therefore not exposed to any interest rate, foreign exchange or liquidity risk.

Overcollateralisation:

By law, CRH minimum collateralisation rates are the following:

- > For fixed rates home loans, at least 125% of the total amount of CRH loans (equal to the total amount of CRH bonds)
- > For floating rate home loans, at least 150% of the total amount of CRH loans

The collateralisation rate can of course be set at higher levels by additional requests made either by CRH itself or by the rating agencies.

Liquidity:

According to CRH internal regulation, banks are committed to grant liquidity lines on which CRH can draw upon request.

Maturity mismatch:

According to CRH internal regulation, each bank's cover pool must be congruent with rate and duration of CRH's related covered bond to protect CRH in the case where it becomes owner of the cover pool. Save to achieve it, an extra layer of overcollateralisation is requested from the borrower.

VI. TRANSPARENCY

CRH publishes, on a quarterly basis the European Covered Bond Label Report (under the Harmonised Transparency Template format), recently enriched by the additional regulatory requirements relating to eligibility of the collateral to ECB open market operations.

Due to the new regulation, CRH must disclose (but not publish), on a quarterly basis: i) the overcollateralisation ratio, ii) the gap between the average life of the assets and liabilities and iii) the forecast cover plan regarding the matching between the assets and the liabilities.

Every year, the annual report discloses 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.

VII. COVER POOL MONITOR AND BANKING SUPERVISION

CRH is an independent credit institution which is directly supervised by the ECB, in coordination with the French supervisor ACPR (*Autorité de contrôle prudentiel et de résolution*).

Furthermore, its operations are under a specific supervision of ACPR as a consequence of the provisions of the article L.313-49 of Monetary and Financial Code.

The monitoring of the portfolio is carried out at two levels:

- > Off-site portfolio data processing reported in the monthly list of pools of loans pledged to CRH by the borrowing banks
- > On-site audits (i.e. at the borrowing banks) of the cover pool, based on samplings. 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.

CRH is also subject to audit by its shareholder banks.

VIII. SEGREGATION OF COVER ASSETS AND BANKRUPTCY REMOTENESS OF COVERED BONDS

Under the applicable CRH legislation:

- > CRH is granted a very strong legal privilege (i.e. superseding any other laws, in particular bankruptcy law) over the covered pool. This legal privilege is integrally passed on to covered bond investors, without any impairment or possibility of legal challenge.
- > The holders of CRH covered bonds benefit from the legal privilege over CRH Mortgage Promissory Notes (i.e. the secured loans to banks).

Which means that the entirety of the covered pool cash flows will be passed to bondholders, in accordance with their payment schedule, and have priority over any of CRH's other debts or non-privileged creditors. The sole CRH privileged debts are CRH covered bonds.

In case of a bank's default:

- > CRH becomes the owner of the portfolio of housing loans without any formality, notwithstanding any provision to the contrary.
- > CRH being an independent company from the borrowing banks, bankruptcy proceedings or liquidation of a borrowing bank holding CRH's equity cannot be extended to CRH.

In case of a CRH's default:

- > **No acceleration of covered bonds as a result of insolvency of CRH:** in the event of an insolvency proceeding of CRH (safeguard procedure, judicial reorganization or liquidation), all Covered Bonds 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 CRH;
- > **No nullity during the hardening period:** the provisions allowing an administrator to render certain transactions entered into during the hardening period (*période suspecte*) null and void are not applicable for the transfer of assets entered into by CRH (provided that such transactions are made in accordance with their exclusive legal purpose and without fraud);

Recourses

The sums resulting from the eligible assets, are allocated in priority to the payment of sums due in respect of the Covered Bonds. Until payment in full of such – sole – privileged liabilities, no other creditors may take action against the assets of CRH.

BRRD

On 15 May 2014, the Directive 2014/59/EU of the European Parliament and of the Council established a framework for the recovery and resolution of credit institutions and investment firms ("BRRD"). The BRRD provides authorities with a credible set of tools to intervene sufficiently early and quickly in an unsound or failing institution to ensure the continuity of the institution's critical financial and economic functions, while minimising the impact of an institution's failure on the economy and financial system. The implementation of the BRRD into French law has been made by two texts of legislative nature (the banking law dated 26 July 2013 and an Ordonnance dated 20 August 2015). Regarding Covered Bonds, the BRRD provides that the relevant resolution authority shall not exercise the write down or conversion powers in relation to secured liabilities including covered bonds and liabilities in the form of financial instruments used for hedging purposes which form an integral part of the cover pool and which according to national law are secured in a way similar to covered bonds, whether they are governed by the law of a Member State or of a third country.

IX. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION

CRH's bonds are compliant with the criteria of Article 129(1) CRR and Article 52(4) of the UCITS Directive.¹ They are 10% weighted in standard approach.

Article 129 of CRR defines which assets are eligible as collateral for covered bonds to ensure a lower risk-weighting. French guaranteed home loans (*prêts cautionnés*) are eligible for preferential treatment subject to a number of conditions:

- > The eligible guaranteed home loan provider qualifies for credit quality step 2 or above (i.e. rated minimum A3/A-/A- by Moody's, S&P and Fitch);
- > The portion of each of the loans that is used to meet the requirement for collateralisation of the covered bonds does not represent more than 80% of the value of the corresponding residential property located in France (i.e. guaranteed home loans comply with the 80% LTV limit); and,
- > Where a loan-to-income ratio is limited to 33% when the loan has been granted.

CRH Covered bonds are included in securities accepted for the European Central Bank (ECB) open market operations. They are eligible as Level 1 assets for the Liquidity Coverage Ratio (LCR).

X. ADDITIONAL INFORMATION

CRH belongs to covered bonds world but is very different from other issuers:

- > CRH is a former agency created by French government,
- > CRH is regulated by specific legal framework dedicated to it,
- > CRH is not borrowing for itself but for the account of French Banking system,
- > CRH is a credit institution of full exercise able to refuse to fund a shareholder,
- > CRH benefits from cross commitments of French banks to supply cash advances and capital contributions.

¹ Please click on the following link for further information on the UCITS Directive and the Capital Requirements Regulation (CRR): <https://hyppo.org/ecbc/covered-bonds/>.

C – SOCIÉTÉ DE FINANCEMENT DE L'HABITAT

By Cristina Costa, Société Générale, Alexis Latour, BNP Paribas and Jennifer Levy, Natixis

The *Société de Financement de l'Habitat* (SFH) and the *Société de Crédit Foncier* (SCF) are subject to the same law and regulations (specific controller, coverage ratio, liquidity ratio, etc.) implemented in the French Monetary and Financial Code (the Code). The SFH is dedicated only to granting and refinancing eligible home loans. The segregation of assets is based on the European Collateral Directive which has been transposed into the French Monetary and Financial Code. The *SCF/SFH* framework was last amended on May 2014¹ to increase legal minimum collateralisation to 105% (from 102%) and provide further details on exposure to the sponsor bank, maximum asset liability mismatch and liquidity buffer rules.

Under the *SFH* legislation, the holders of the *Obligations de Financement de l'Habitat* (OH) benefit from a legal privilege granted over the *SFH* programme's assets (according to article L. 513-11 of the Code). If the issuer becomes insolvent, the OHs and other privileged debts are paid in priority and in accordance with their payment schedule, over any of the programme's other debts or non-privileged creditors in relation to the *SFH*'s assets.

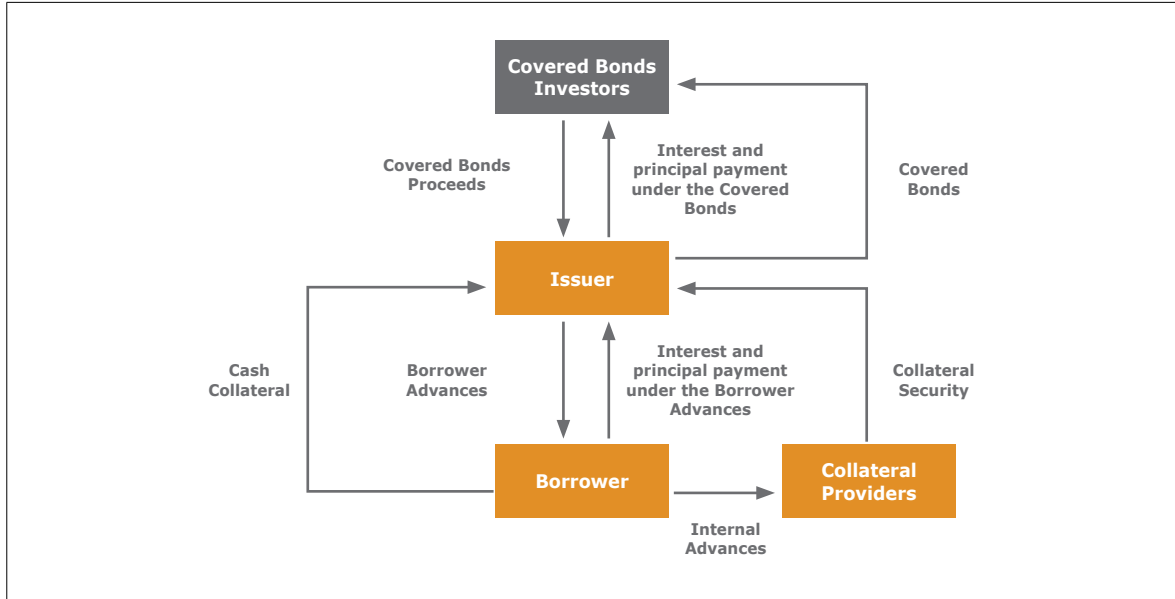
I. FRAMEWORK

The SFH structure makes use of the implementation of the EU Collateral Directive 2002/47/EC, as amended, under French law (implemented into the Code under articles L. 211-36 and seq.), which allows for a segregation through either a remittance (*remise*), a pledge (*nantissement*) or the transfer by way of security of the full title (*cession en pleine propriété à titre de garantie*) of the home loans' receivables without an actual transfer (true sale) of these receivables to the issuer. Pursuant to article L.211-38 of the Code, the transfer by way of security and the pledge shall be enforceable even when the relevant collateral provider is subject to an insolvency proceeding.

The sponsor bank remits, pledges or transfers collateral to a dedicated subsidiary, which is a regulated French specialised credit institution with limited purpose licensed as a SFH (e.g. issuing covered bonds for the purpose of providing financing to the sponsor bank). The covered bond proceeds are used to fund advances to the respective sponsor bank(s). The covered bonds are secured by the legal privilege over the assets of the issuer (advances to the sponsor bank(s)), which are in turn secured by a pledge over cover assets (i.e. residential home loans), 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 without any formalities to the covered bond issuer.

¹ <http://www.legifrance.gouv.fr/affichTexte.do;jsessionid=?cidTexte=JORFTEXT000028970057&dateTexte=&oldAction=dernierJO&categorieLien=id>, JORF n°0121 du 25 mai 2014.
<http://www.legifrance.gouv.fr/affichTexte.do;jsessionid=?cidTexte=JORFTEXT000028990539&dateTexte=&oldAction=dernierJO&categorieLien=id>, 8551, JORF n°0123 du 28 mai 2014.

FIGURE 1: STRUCTURE OF OBLIGATION DE FINANCEMENT DE L'HABITAT (DUAL STRUCTURE)



Sources: Moody's, Natixis

II. STRUCTURE OF THE ISSUER

The sole purpose of SFH 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 a SFH programme (EMTN), the SFH issues *Obligations de Financement de l'Habitat* (OHs) which are unsubordinated senior secured obligations and rank pari passu among themselves benefiting from the legal privilege.

These specialised credit institutions are usually an affiliate of the sponsor bank. There are currently eight SFH issuers: BNP Paribas Home Loan SFH (99.9% owned by BNP Paribas), BPCE SFH (99.9% owned by BPCE S.A.), Crédit Mutuel Arkea Home Loans SFH (affiliate of the Crédit Mutuel Arkéa group), Crédit Mutuel-CIC Home Loan SFH (a subsidiary of Banque Fédérative du Crédit Mutuel), Crédit Agricole Home Loan SFH (99.9% owned by Crédit Agricole S.A.), HSBC SFH (France) (a subsidiary of HSBC France), La Banque Postale HL SFH and Société Générale SFH (a subsidiary of Société Générale).

III. COVER ASSETS

Pursuant to the SFH Law, the eligible assets of a SFH comprise, inter-alia:

- > Home loans (*prêts à l'habitat*) which include (i) loans 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 sûreté immobilière conférant une garantie au moins équivalente*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 highest level of credit assessment;

² Art. L513-29, II, 2° of the Code.

- > Grant to any credit institution loans guaranteed by the remittance (*remise*), the transfer (*cession*) or the pledge (*nantissement*) of receivables pursuant to and in accordance with the provisions of Articles L.211-36 to L.211-40 or Articles L.313-23 to L.313-35 of the Code, regardless of the nature of such receivables, professional or otherwise, provided that they satisfy the eligibility criteria set out in Article L.513-3 of the Code;
- > Loans guaranteed by the *Fonds de Garantie à l'Accession Sociale à la Propriété* (Guarantee Fund for Social Access to Home Ownership);
- > 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 and (ii) such units or notes benefit from the highest level of credit assessment (*meilleur échelon de qualité de crédit*) promissory notes (*billets à ordre*); and
- > Substitution assets (*valeurs de remplacement*), under certain liquidity and maturity conditions and provided that their aggregate value is up to a maximum amount of 15% of the outstanding covered bonds. The substitution assets of the SFH may include within the 15% limit debt securities (*titres de créances*) issued or guaranteed by public sector entities referred to in paragraph I, 1 to 5, of Article L. 513-4 of the French Monetary and Financial Code (*Code monétaire et financier*);
- > Within the limit of the liquidity buffer, in addition to substitution assets, debt securities (*titres de créances*) issued or guaranteed by a central administration of a Member state of the European Union and cash invested on accounts opened within the books of a central bank of a Member State of the European Union which comply with the criteria listed in 1(a) of Article 416 of the Capital Requirements Regulation n°575/2013 dated 26 June 2013.

Under the SFH Law, cover pool assets comprised of units or notes issued by securitisation 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). ABS/MBS count as collateral within the pool depending on the originator, the rating of the securitisation, and the time at which the securities were acquired by the issuer.

Weightings of ABS/MBS for *Sociétés de Crédit Foncier* and *Sociétés de Financement de l'Habitat*:

If the underlying assets of the ABS/MBS were originated by the group and they were acquired by the issuer after 31 December 2011, the securities count as collateral with the following ratings:

- > 100% as long as they are rated Aaa/AAA;
- > 80% if the rating is between Aa3/AA- and Aa1/AA+;
- > 0% if the rating is below Aa3/AA-.

If the underlying assets of the ABS/MBS were originated by the group and they were acquired by the issuer before 31 December 2011 or after 31 December 2014, the securities count as collateral with the following ratings:

- > 100% as long as they are rated Aaa/AAA;
- > 50% if the rating is between Aa3/AA- and Aa1/AA+;
- > 0% if the rating is below Aa3/AA-.

If the underlying assets of the ABS/MBS were transferred by an institute that is not a member of the same group as the covered bond issuer and they were acquired by the issuer after 31 December 2011 but before 31 December 2017, the securities count as collateral with the following ratings:

- > 100% as long as they are rated Aaa/AAA;
- > 50% if the rating is between Aa3/AA- and Aa1/AA+;
- > 0% if the rating is below Aa3/AA-.

If the underlying assets of the ABS/MBS were transferred by an institute that is not a member of the same group as the covered bond issuer and they were acquired by the issuer before 31 December 2011 but after 31 December 2014, the securities count as collateral with the following ratings:

- > 100% as long as they are rated Aaa/AAA;
- > 0% if the rating is below Aaa/AAA.

N.B. These weightings are also applicable to *Sociétés de Crédit Foncier*.

The SFH regulation applies 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, 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 recognised 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);
- > 0% in all other cases.

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. This valuation is assessed in an annual report by the SFH and certified by the specific controller³.

In order to ensure overcollateralisation (far above the 5% minimum required by law), the SFH programmes also 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 overcollateralisation of at least 8%. However, that being said, all SFH programmes currently exceed the minimum amount due to adjustments to the most recent 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%. 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 5% on the adjusted cover pool balance at all times. When intra-group loans in the cover pool exceed 25% of the issuer's non-privileged liabilities (i.e. typically the issuer's share capital or any subordinated bonds), a portion of such loans will be excluded from the cover pool for the purpose of calculating the overcollateralisation test. This limits the risk that covered bond issuers rely on assets directly exposed to the credit quality of their par-

³ Pursuant to the ACPR regulation CRBF 99-10.

ent or any of their affiliates. For the calculation of this ratio, the SFH must take into account its risk exposure on its sponsor bank up to a limit of 25% of the non-privileged assets.

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. It is no longer possible to cover the existing six-month liquidity gap with intragroup liquidity line.

Liquidity: The SFH framework provides further liquidity means 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.

Maturity mismatch test: the remaining weighted average life (WAL) of assets should not exceed that of the covered bonds by more than 18 months. Cover pool assets included in this test are only those that are strictly necessary to satisfy the minimum legal OC requirement of 105%.

The SFHs must also submit once a year to the regulator a maturity mismatch forecast cover plan, that has to be verified by the specific controller.

The requirements above 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, set-off risk, market risk, etc, as follows:

- > Interest rate and currency risks need to be neutralised (the hedging strategy); subject to certain rating triggers, swaps with suitable counterparties have to be entered to ensure that exposure to market risk is properly hedged;
- > Liquidity is ensured through a pre-maturity test for hard bullet bonds (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 (usually 12m) for soft bullet bonds. Since November 2014, most publicly placed OH have been issued in soft bullet format;
- > 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 bank account holder and swap counterparties.

VI. TRANSPARENCY

All French SFH issuers publish information on their cover pools and outstanding covered bonds on their website. French issuers generally publish three types of reports (i) French Covered Bond Label Reports (national transparency template) and report on the quality of their assets published on a quarterly basis), (ii) on a quarterly basis also, the European Covered Bond Label Reports (under the Harmonised Transparency Template format), recently enriched by the additional regulatory requirements in connection with eligibility of the collateral to ECB open market operations and (iii) Cover pool investor reports (published on a monthly basis). The SFH must disclose (but not publish), on a quarterly basis (i) the overcollateralisation ratio (ii) the components of the calculation of the liquidity buffer (iii) the gap between the average life of the assets and liabilities and iv) the forecast cover plan regarding the matching between the assets and the liabilities.

4 Article L. 513-15 of the Code.

VII. COVER POOL MONITORING & BANKING SUPERVISION

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 external auditors and are appointed subject to the prior approval of the ACPR. 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 (iii) notify the issuer and the ACPR 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. Furthermore, for every issuance with an amount exceeding EUR 500 m, the specific controller must attest the compliance of the cover ratio on the basis of the quarterly programme of debt issued benefiting from the privilege.

Regulations⁵ published by French regulator ACPR in December 2014 detail further reporting obligations of French covered bond (both SCF and SFH) issuers. The new regulations add detail to the calculation of the maximum 18-month asset-and liability maturity matching tests and the liquidity test. Issuers now have to show how 180-day liquidity needs can be covered on a daily basis, rather than just globally over a six-month period. On a quarterly basis, each CB issuer must now provide to the asset monitor and regulator a 'literary report' designed to increase the transparency, consistency and stability of assumptions, thereby improving the effectiveness of the following legal tests: the minimum 105% OC ratio, the minimum 180-day liquidity, the maximum 18-month average life maturity mismatch and the coverage level.

VIII. SEGREGATION OF COVER ASSETS & BANKRUPTCY REMOTENESS

Cover assets are segregated in the issuing specialised credit institution. Pursuant to Article L.513-11 of the Code, holders of *OHs* and other privileged debts have preferred creditor status and the right to be paid prior to all other creditors who have no rights to the assets of the *SFH* until the claims of preferred creditors have been fully satisfied.

Under the SFH legislation (as is the case for the SCF legislation), the holders of the *OH* benefit from the legal privilege over the SFH programme's eligible assets. If the issuer becomes insolvent, the *OHs* and other privileged debts are paid 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 the SFH law provides for a regime which derogates in many ways from the French insolvency provisions (the same applies for the SCF programmes):

⁵ http://acpr.banque-france.fr/fileadmin/user_upload/acp/publications/registre-officiel/Instruction-2014-I-16-modifiant-2011-I-06-de-l-acpr.pdf and http://acpr.banque-france.fr/fileadmin/user_upload/acp/publications/registre-officiel/Instruction-2014-I-17-de-l-acpr.pdf.

- > **Legal Privilege / 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 Privilège⁶ (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 the hardening period:** the provisions allowing an administrator to render certain transactions entered into during the hardening period (*période suspecte*) null and void are not applicable for the transfer of assets 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 impact of the hardening period:** the common provisions of French bankruptcy law affecting certain transactions, which entered into force during the months prior the insolvency proceedings during the hardening period (*période suspecte*), are not applicable to SFH.
- > **No extension of bankruptcy proceedings:** as an exception to the general French bankruptcy Law, bankruptcy proceedings or liquidation of a company holding share capital in a SFH cannot be extended to the SFH. As a result, the SFH enjoys full protection from the risks of default by their parent company or the group to which it belongs.

Recourses

The sums resulting from the eligible assets and derivatives transactions, together with deposits made by the SFH with credit institutions, are allocated in priority to the payment of sums due in respect of the OH. Until payment in full of such privileged liabilities, no other creditors may take action against the assets of the SFH.

In case the assets of the SFH are constituted by loans secured by the remittance, the transfer or the pledge of the receivables arising from the home loans (the "Secured Loans") if upon enforcement of the financial guarantee, in the unlikely event when after their sales and/or disposals, there are still unpaid amounts due under the Secured Loans by the borrower, the SFH will still have a recourse against the borrower for this remainder. This recourse is based on the provisions of article 1892 of the French civil code concerning "consumption Loan" (*prêt de consommation*). In addition to the recourse against the SFH's cover pool, it ensures a recourse on the remaining assets of the borrower ranking as unsecured and unsubordinated debts.

BRRD

On 15 May 2014, the Directive 2014/59/EU of the European Parliament and of the Council established a framework for the recovery and resolution of credit institutions and investment firms ("BRRD"). The BRRD provides authorities with a credible set of tools to intervene sufficiently early and quickly in an unsound or failing institution so as to ensure the continuity of the institution's critical financial and economic functions, while minimising the impact of an institution's failure on the economy and financial system. The implementation of the BRRD into French law has been made by two texts of legislative nature (the banking law dated 26 July 2013 and an Ordonnance dated 20 August 2015). Regarding Covered Bonds, the BRRD provides that the relevant resolution authority shall not exercise the write down or conversion powers in relation to secured liabilities including covered bonds and liabilities in the form of financial instruments used for hedging purposes

⁶ Principal and interest of the Covered Bonds benefit from the so called "Privilège" (priority right of payment). As a consequence, and notwithstanding any legal provisions to the contrary, all amounts payable to the issuer in respect of the cover pool and forward financial instruments are allocated in priority to the payments of any sums due in respect of the covered bonds.

which form an integral part of the cover pool and which according to national law are secured in a way similar to covered bonds, whether they are governed by the law of a Member State or of a third country.

IX. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION

The SFH meet the requirements of Article 52(4) of the UCITS directive.

Article 129 of CRR defines which assets are eligible as collateral for covered bonds to ensure a lower risk-weighting.⁷ French guaranteed home loans (*prêts cautionnés*) are eligible for preferential treatment subject to a number of conditions:

- > the eligible guaranteed home loan provider qualifies for credit quality step 2 or above (i.e. rated minimum A3/A-/A- by Moody's, S&P and Fitch);
- > the portion of each of the loans that is used to meet the requirement for collateralization of the covered bonds does not represent more than 80% of the value of the corresponding residential property located in France (i.e. guaranteed home loans comply with the 80% LTV limit); and,
- > where a loan-to-income ratio is limited to 33% when the loan has been granted.

As recommended by the EBA, these guaranteed home loans could be subject to an additional requirement that the law governing the covered bonds should not preclude the administrator of the cover pool from creating mortgages over the loans included in the cover pool where the guarantee has ceased to exist following the issuer's default.

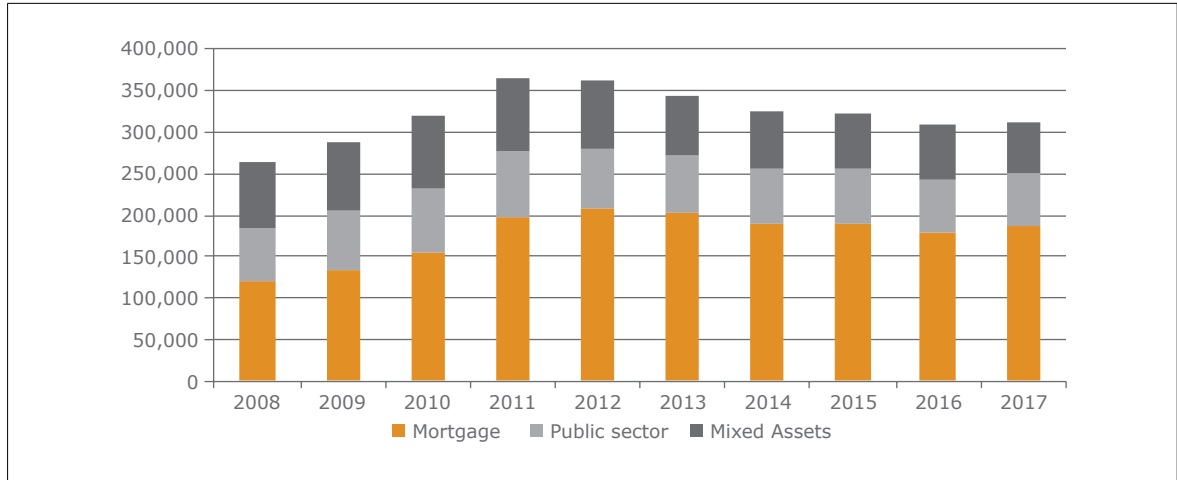
In France and abroad, French OH currently have a 10% risk-weighting under the CRD IV Standard Approach. French OH are also eligible as Level 1 assets to the Liquidity Coverage Ratio (LCR).

⁷ Please click on the following link for further information on the UCITS Directive and the Capital Requirements Regulation (CRR): <https://hypos.org/ecbc/covered-bonds/>.

FIGURE 2: COMPARISON OF FRENCH COVERED BONDS

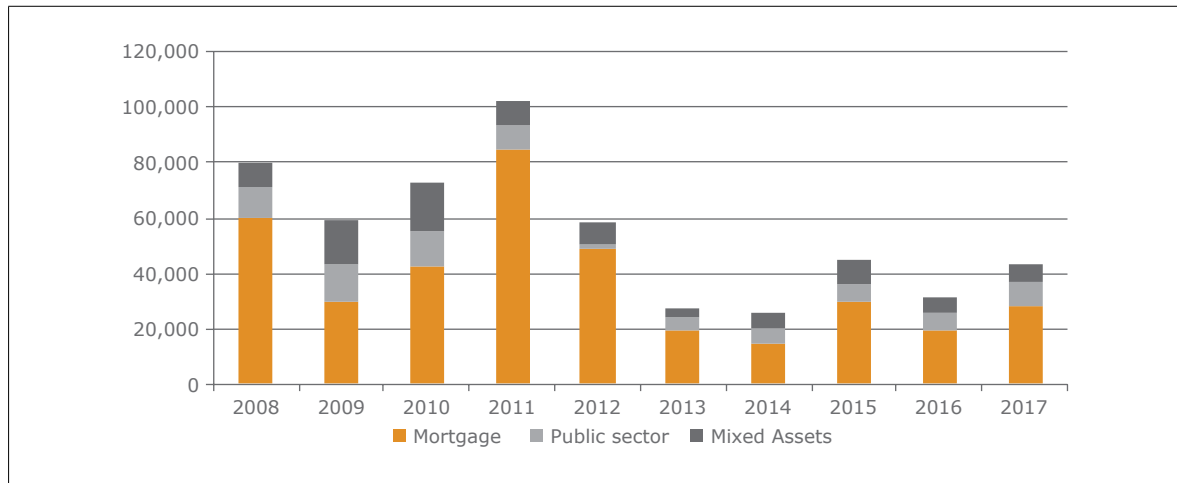
	Obligation de Financement de l'Habitat	Obligations Foncières	Caisse de Refinancement de l'Habitat
Legal Framework	Articles L. 513-2 to L. 513-33, and R. 513-1 to R. 513-21 of the French Monetary and Financial Code, Regulations n°99-10 dated 9/07/1999 as subsequently amended (last amendment 23/02/2011)	Articles L. 313-42 to L. 313-49, L. 513-3, and R. 313-20 to R. 313-25-1 of the French Monetary and Financial Code, article 13 of Law n°85-695 of 11 July 1985	
Issuer	Duly licensed specialised credit institutions		
Eligible cover pools	<ul style="list-style-type: none"> > Residential home without limitation for guaranteed home loans and residential mortgages (commercial real estate loans are not eligible) > Securitization of the above (subject to specific rules and criteria) 	<ul style="list-style-type: none"> > First-rank residential mortgage loans > First-rank commercial mortgage loans > State-guaranteed real-estate loans > Third party guaranteed real estate loans (max. 35% of total assets) > Mortgage promissory notes > Public sector loans, bonds and leasing > Securitization of the above (subject to specific rules and criteria) 	<ul style="list-style-type: none"> > First rank residential mortgage loans > State guaranteed mortgage loans > Third party guaranteed real estate loans (max. 35% of total assets) > No securitisation tranches, no RMBS > No loans with duration over 25 years > No loans with unit amount over €1M
Collateralisation	105%	105%	125%
Legal Privilege		Yes	
LTV ratio	<ul style="list-style-type: none"> > First-rank residential mortgage loans and guaranteed home loans: max. 80% LTV > State-guaranteed real-estate loans: max. 100% LTV 	<ul style="list-style-type: none"> > First-rank residential mortgage loans and guaranteed home loans: max. 80% LTV > First-rank commercial mortgage loans: max. 60% LTV > State-guaranteed real-estate loans: max. 100% LTV 	<ul style="list-style-type: none"> > Residential mortgage loans: max 80% LTV, max 90 % LTV if overcollateralisation of 25% > State guaranteed mortgage loans: max 100% LTV
Substitution assets	Max. 15% of total OH/OF and other privileged resources		Non eligible
Liquidity	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.		
Investor protection	Overcollateralisation, 180-day liquidity needs coverage and ability to repo own issuances, controlled ALM, limited difference between the weighted average life of assets and covered bonds		Overcollateralisation, full recourse to the participating banks in case of collateral shortfall
Issue's structure/Transfer of assets	True sale of cover assets or loans secured by financial guarantees (articles L.211-38 and seq French Monetary & Financial Code – transposition of "Collateral" Directive)	True sale of cover assets; loans secured by financial guarantees (possible for "public exposures" and, since December 2016, for real estate loans receivables) governed by Articles L.211-38 and seq French Monetary & Financial Code – transposition of "Collateral" Directives); Mortgage promissory notes	Mortgage promissory notes exclusively secured by eligible cover pools
Supervision	French Banking Sector Regulatory Authority (Autorité de Contrôle Prudentiel et de Résolution or ACPR) – one specific controller – two statutory auditors – French Financial markets regulator (Autorité des Marchés Financiers or AMF) for listed covered bonds on Paris Euronext		European Central Bank – two statutory auditors – French Financial markets regulator (Autorité des Marchés Financiers or AMF) for listed covered bonds on Paris Euronext
UCITS Compliant	Yes	Yes	
CRR (article 129(1)) compliant	Yes (except if stated otherwise)		
Eligibility to liquidity buffer under LCR	Yes		
Risk-weighting according to EU Credit institutions	10%		

> FIGURE 3: COVERED BONDS OUTSTANDING, 2008-2017, EUR M



Source: EMF-ECBC

> FIGURE 4: COVERED BONDS ISSUANCE, 2008-2017, EUR M



Source: EMF-ECBC

Issuers: AXA Bank Europe (SCF); BNP Paribas Public Sector (SCF); BNP Paribas Home Loan (SFH); BPCE (SFH); Banques Populaires Covered Bonds (BP CB); Caisse Française de Financement Local (CAFFIL); CIF Euromortgage; Compagnie de Financement Foncier (CFF); Crédit Agricole Public Sector (SCF); Crédit Agricole Home Loan (SFH); Crédit Mutuel – CIC Home Loan (SFH); Crédit Mutuel Arkéa Public Sector (SCF); Crédit Mutuel Arkéa Home Loans (SFH); Caisse de Refinancement de l'Habitat (CRH); GE Money Bank (SCF); HSBC (SFH); La Banque Postale Home Loan (SFH); Société Générale (SCF); Société Générale (SFH).

ECBC Covered Bond Comparative Database: http://ecbc.eu/framework/21/Caisse_de_Refinancement_de_l%27Habitat_-_CRH, http://ecbc.eu/framework/71/General_Law_Based_CBs, http://ecbc.eu/framework/73/Obligations_Fonci%C3%A8res_-_OF, http://ecbc.eu/framework/90/Obligations_%C3%A0_l%27Habitat_-_OH.



COVERED BOND LABEL: AXA Bank Europe SCF (1 pool), BNP Paribas (2 pools), BPCE SFH (1 pool), Compagnie de Financement Foncier (1 pool), Crédit Mutuel – CIC Home Loan SFH (1 pool), HSBC SFH (1 pool), Société Générale (2 pools), Crédit Agricole (2 pools), Caisse de Refinancement de l'Habitat (1 pool), Caisse Française de Financement Local (1 pool), Arkéa (2 pools), La Banque Postale Home Loan SFH (1 pool), CIF Euromortgage (1 pool).