EUROPEAN CENTRAL BANK

OPINION OF THE EUROPEAN CENTRAL BANK

of 14 September 2004

at the request of the French Ministry of Economic Affairs, Finance and Industry on a draft decree concerning *fonds communs de créances* (securitisation funds)

(CON/2004/30)

1. On 3 August 2004 the European Central Bank (ECB) received a request from the French Ministry of Economic Affairs, Finance and Industry for an opinion on a draft decree (hereinafter the 'draft decree'[1]) concerning *fonds communs de créances* (FCC), which are French securitisation vehicles. The draft decree takes over and amends Decree No 89-158 on the same subject, and repeals it.

2. The ECB's competence to deliver an opinion is based on the second indent of Article 105(4) of the Treaty establishing the European Community and the sixth indent of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions[2], as the draft decree relates to rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

Preliminary remarks

3. In its recent opinion[3] on a draft Luxembourg law, the ECB pointed out that securitisation is 'an area where considerable progress in integrating European financial markets could still be made notably in terms of the convergence of market practices, instruments and legal rules. (…) Looking beyond the Financial Services Action Plan, the ECB sees merit in a strategy of increased harmonisation in the area of securitisation at EU level'. The Securities Expert Group[4] supported this analysis in its final report of May 2004, stating that 'one of Europe's most innovative and rapidly growing financial market sectors is securitisation, which has developed as an alternative capital markets

1 The draft Decree is to be adopted pursuant to the Law on financial security No 2003-706 of 1 August 2003 that amended Articles L. 214-43, L. 214-44, L. 214-46 and L. 214-48 of the Monetary and Financial Code (hereinafter the 'Code').

2 OJ L 189, 3.7.1998, p. 42.

3 ECB Opinion CON/2004/3 of 4 February 2004 at the request of the Ministry of Finance of the Grand Duchy of Luxembourg on a draft law on securitisation.

4 The Commission chairs this group composed of industry representatives that was established in the framework of the post-Financial Services Action Plan debate.

financing, funding, arbitrage and risk-shifting mechanism'. The Expert Group also considered that: 'while several Member States have taken steps to create a more hospitable environment for securitisation, and many of these initiatives are similar in concept and purpose, (…) more coordination of some aspects of the legal framework applicable to these operations is necessary at EU level, thereby facilitating a more harmonised framework while simultaneously encouraging innovation in securitisation markets across Europe'. The ECB also shares this view.

4. The ECB notes that the Law on financial security of 1 August 2003 (hereinafter the 'Law') introduced substantial changes to the existing French legal framework on securitisation which dates back to 1988. The ECB notes in this respect that, although the French authorities consulted it on an early draft of the Law[5], they did not consult it on those amendments relating to securitisation transactions which Parliament only introduced late in the legislative process. Although the ECB is aware that it is now only being consulted on the draft decree, the provisions of the draft decree are in several respects so closely intertwined with those of the Law that any comments on the draft decree will also apply to related provisions of the Law.

Reform of the French securitisation vehicles

5. The ECB notes from the statement of reasons submitted with the draft decree that the French securitisation market has developed significantly over the past few years. Securitisation transactions have become more and more complex with the result that it has become necessary to adapt French law to changing market requirements. Under the new rules contained in the Law, as implemented by the draft decree, FCCs will be allowed *inter alia* to issue debt instruments; to use credit derivatives in synthetic securitisation transactions; to assign receivables during their life except in cases of liquidation; and to increase the security for some mechanisms, including accounts specifically dedicated to FCCs, in order to reduce costs and to increase the efficiency of these arrangements.

6. The draft decree introduces, as a result of the Law, new rules for FCCs, in particular regarding the composition of FCCs' liabilities. The ECB understands that under current rules, the units issued by FCCs represent co-ownership rights in assets that FCCs have acquired. These units are neither shares nor debt securities and therefore, due to their hybrid legal nature, might be considered unattractive to international investors. One of the main changes introduced by Article L. 214-43 of the Code, as amended by the Law, is that FCCs may now issue negotiable debt securities. The ECB welcomes the opportunity given to French securitisation vehicles to issue such instruments directly, as well as the flexibility under the draft decree as to the type of debt instrument (FCCs may now issue instruments such as notes, bonds or commercial paper – including Euro commercial paper) and as to the law governing the debt instrument (the debt instruments can be issued under French or

5 ECB Opinion CON/2002/32 of 18 December 2002 at the request of the French Minister of Economy, Finance and Industry on a draft law on financial security.

any foreign law). The ECB understands that this new provision is intended to enlarge the investor base and to avoid setting up a two-tier structure for securitisation transactions involving the subscription of units by a repackaging special purpose vehicle. The statement of reasons notes that the draft decree does not affect the legal regime applying to any bonds that FCCs may issue to the extent that the general rules applying to bonds do not apply, since FCCs do not have legal personality. The ECB understands that a specific regime for bonds issued by FCCs would have to be governed by law and that the draft decree simply refers to the FCC regulations governing the conditions under which the FCC may issue debt instruments[6].

7. Article 9 of Decree 89-158 provides that coverage of the debts acquired by the FCC against the risk of default by debtors may be obtained *inter alia* by issuing specific units bearing the risk of default of the acquired debts. Article 5(1) of the draft decree maintains this rule according to which only qualified investors are entitled to subscribe for or acquire such risk-bearing units in FCCs for the purpose of achieving their management objectives. The ECB notes however that the draft decree no longer expressly refers to the distinction between FCC units (*parts ordinaires*) and FCC subordinated units (*parts spécifiques*). The ECB questions whether the wording of Article 5(1) of the draft decree clarifies sufficiently that only qualified investors are entitled to subscribe for units having the same degree of subordination as *parts spécifiques*.

Synthetic securitisation and credit derivatives

8. Another innovation of the Law and the draft decree is the use of securitisation as a risk transfer technique by allowing FCCs to enter into credit derivatives transactions, as either buyers or sellers of credit protection. The ECB notes the introduction into French legislation of these new arrangements developed by the financial markets, following the recent Decrees of November 2003 implementing the UCITS Directive[7] and defining in particular the rules applying in case of recourse to credit derivatives by UCITS. The draft decree determines the conditions under which an FCC, or the compartments of an FCC, may enter into derivatives contracts. To that end, Article 1 of the draft decree defines the FCC's management objectives which consist of acquiring receivables or bearing the credit risk relating to one or more reference entities of any kind. The ECB notes from Article 19 of the draft decree that the FCC's management company will have to comply with certain specific requirements where the FCC regulations provide for recourse to credit derivatives. In particular, these requirements will be further detailed in the *Règlement Général de l'AMF* (General Regulation of the French Financial Markets Authority (AMF)[8], hereinafter the 'AMF's General Regulation') and taken into account when granting a licence to the management company.

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6 As regards negotiable debt securities issued under French law (*titres de créance négociables* -TCN), the ECB understands that the general rules of issuance will also apply to FCCs.

7 Decree No 89-623 of 6 September 1989; Decree adopted pursuant to Law No 88-1201 of 23 December 1988 *relative aux organismes de placement collectif en valeurs mobilières et portant création des fonds communs de créances* (Decree on undertakings for collective investment in transferable securities and creating securitisation funds).

8 See the AMF's draft General Regulation of 30 July 2004.

The ECB would suggest, in line with the practice for the other provisions of the draft decree, that the FCC regulations should determine the conditions under which the FCC may have recourse to credit derivatives and, in particular, bear a credit risk.

Reducing commingling risk

9. Article 22 of the draft decree further specifies the mechanism of the account specifically dedicated to an FCC to which sums recovered with respect to assigned receivables may be credited, as described in the third paragraph of Article L. 214-46 of the Code. The ECB understands from this mechanism that the account distinguishes the *titulaire facial* (apparent holder) and the actual beneficiary or creditor of any sum credited to such account. Any sums on such an account neither form part of the servicer's assets nor can they be targeted by the servicer's creditors, regardless of the fact that the servicer is the subject of insolvency proceedings. The ECB notes in this respect that Article 22 of the draft decree further specifies the respective obligations of the parties to a securitisation transaction where a specifically dedicated account is created, and in particular those of the credit institution holding such an account. The ECB understands that this new mechanism will reduce commingling risk and thereby improve investor protection.

10. As regards the responsibilities of the depository ensuring the safe custody of an FCC's assets, Article L. 214-48 II of the Code provides that it acts as the depositary of the cash ('*trésorerie*'). This concept does not appear in the draft decree which refers instead to the concept of cash holdings ('*liquidités*') including deposits, debt securities, UCITS units and FCC units[9]. Article 17(3) of the draft decree also provides that an FCC may only commit itself through repurchase transactions by paying within the liquidity limits it holds at the time of payment. Doubts could arise as to whether the 'liquidity' in Article 17(3) means the same as the cash holdings defined in Article 4 of the draft decree. The ECB therefore suggests using the same terminology consistently in the draft decree in the interests of clarity.

11. According to Article L. 214-48 of the Code, as amended by the Law, FCCs must entrust their assets to the custody of a credit institution established in France. The ECB notes that this provision includes French branches of credit institutions established in the European Economic Area and welcomes this clarification.

International assignments of receivables and applicable law

12. Conflict of law issues which may affect the validity or enforceability of international assignments of receivables are an increasing concern in the context of international securitisation transactions. Under Article 12 of the Rome Convention 80/934/EEC of 19 June 1980 on the law applicable to

9 Article 2(2) and Article 4 of the draft decree.

contractual obligations[10], the enforceability of a receivables assignment against a debtor is governed by the law of the assigned receivable. However, the Rome Convention does not provide any clear-cut solution with respect to the enforceability of an assignment of a receivable against other third parties. As a result, national legislators have recently taken steps to address this issue in their domestic legal frameworks. In this context, the relevant provision of French law applying to FCCs (but also to *sociétés de crédit foncier* and Dailly assignments) provides that an assignment of receivables 'shall take effect between the parties and bind third parties on the date stated on the note on delivery ("*acte de cession de créances*"), regardless of the date of creation, maturity or payment of the receivables, without any further formality being required, and regardless of the law governing the assigned receivables and the law of the country of residence of the assigned debtors'[11]. At the international level, on 12 December 2001 the General Assembly of the United Nations meeting in New York adopted the Convention on the assignment of receivables in international trade (hereinafter the 'UN Convention') which may contribute to harmonising these conflicts of laws rules[12]. The explanatory note to the UN Convention by the UNCITRAL Secretariat states that it is intended to remove the legal uncertainty surrounding a number of issues arising in the context of important receivables financing transactions, including *inter alia* asset-based lending and securitisation[13]. In addition, under the UN Convention, the law where the assignor has its place of business governs the enforceability of a receivable's assignment against third party creditors. As already mentioned in Opinion CON/2004/3, the ECB hopes that the solutions adopted and/or examined at international level will lead to an increased harmonisation of the rules applying in this area at EU level and reduce legal uncertainty and inefficiency in the context of cross-border commercial and financial transactions.

Protection of investors

13. As does Decree No 89-158, the draft decree often refers to the concept of 'level of security offered to holders of units and debt instruments'. Furthermore, Article 24 of the draft decree imposes an obligation on the body recognised by the Minister of Economy (presumably a rating agency within the meaning of Article L. 544-4 of the Code) to ensure monitoring of the level of security offered by the units and debt securities issued by FCCs and that the conclusions of this monitoring are regularly made publicly available. The ECB considers that it could be useful to further clarify this concept of level of security offered to holders of units and debt instruments either in the draft decree itself or in the FCC regulations[14]. The ECB also understands that some of these disclosure provisions date back to Decree No 89-158 and will be further detailed in the framework of the

10 OJ L 266, 9.10.1980, p. 1.

11 Paragraph 8 of Article L. 214-43 of the Code.

12 This UN Convention is not yet into force.

13 United Nations Convention on the Assignment of Receivables in International Trade, UN, New York, 2004, explanatory note, p. 28.

14 See, for instance, Articles 11, 13, 18 of the draft decree.

AMF's General Regulation[15]. The ECB suggests making this documentation as well as the FCC regulations publicly available at a central access point, for instance, on the FCC management company's website. Furthermore, the draft decree needs to be compatible with the specific disclosure rules for the different types of instruments issued by FCCs (units, debt instruments, commercial paper, etc.), and also with the new general disclosure requirements applying to the issuance of asset-backed securities contained in the implementing rules of the Prospectus Directive[16].

Statistics reporting

14. The regular and timely collection of accurate and reliable statistical data on securitisation vehicles and securitisation more generally across Europe is important for monetary policy purposes. Work is currently under way to improve euro area statistics on securitisation. In general, in carrying out its statistical tasks, the ECB identifies reporting agents using a combination of criteria based on EU law and national regulatory provisions, including supervisory agreements or tax provisions. In this context, the ECB notes that Article L. 214-45 of the Code imposes an obligation on FCCs to communicate to the Banque de France any information required for the preparation of monetary statistics. Article 25 of the draft decree specifies that the information referred to in Article L. 214–45 of the Code will be communicated to the Banque de France by the FCC's management company. The ECB welcomes these provisions assuming that the concept of monetary statistics is covered by the definition in the Decision No 02-01 of 22 May 2002 of the Governor of the Banque de France concerning the collection of statistical data by the Banque de France for monetary policy purposes, which comprises all types of data, also on a security-by-security basis, required by the Banque de France for the fulfilment of the statistical obligations imposed by the ECB.

Use of asset-backed securities as collateral for Eurosystem credit operations

15. Pursuant to Article 18.1 of the Statute of the European System of Central Banks and of the European Central Bank, all Eurosystem credit operations (i.e. liquidity-providing operations) have to be based on adequate collateral. As mentioned in Opinion CON/2004/3, asset-backed securities may be accepted as collateral for Eurosystem monetary policy and intraday credit operations provided they fulfil the eligibility criteria laid down in the General Documentation on monetary policy instruments and procedures of the Eurosystem[17]. It should be noted however that the General

15 See in this respect the Information Report of the French Senate on the application of the Law of 1 August 2003 on financial security by Mr P. Marini of 27 July 2004.

16 Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements, OJ L 149, 30.4. 2004, p. 1.

17 For risk control purposes, they belong to liquidity category IV for tier one assets. Guideline ECB/2003/16 of 1 December 2003 amending Guideline ECB/2000/7 on monetary policy instruments and procedures of the Eurosystem, OJ L 69, 8.3.2004, p. 1.

Documentation provides that 'debt instruments affording rights to the principal and/or the interest that are subordinated to the rights of holders of other debt instruments of the same issuer (or, within a structured issue, subordinated to other tranches of the same issue) are excluded from tier one'[18].

16. Article 14 of the draft decree provides that the FCC regulations will stipulate the priority rules among the various categories of units, debt securities and loans regarding the amounts received by an FCC and that the units issued by an FCC will be repaid only after discharge of the FCC's other creditors. The ECB understands from this provision that the holders of FCC units will bear in priority the risk of default by debtors. Most of these units issued by FCCs might therefore constitute 'quasi-equity' units, i.e. subordinated units traditionally subscribed for by the originator or a third party[19]. This provision would not however preclude subordination mechanisms and 'waterfall' structures within the respective categories of units or debt instruments issued by an FCC. Therefore, based on the current wording of Article 14 of the draft decree, FCC units would no longer meet the criteria to be eligible for collateral purposes where an FCC, or the relevant compartment, issues debt instruments. Equally, debt instruments issued by an FCC may not be eligible as collateral if subordinated to other instruments related to the same FCC or compartment.

17. The ECB confirms that it has no objection to the competent national authorities making this opinion publicly available at their discretion. This opinion will be published on the ECB's website six months after the date of its adoption.

Done at Frankfurt am Main, 14 September 2004.

[*signed*]

The President of the ECB

Jean-Claude TRICHET

18 Guideline ECB/2003/16, Chapter 6. Eligible assets, 6.2. Tier one assets. The Eurosystem accepts a wide range of assets to underlie its operations. A distinction is made, essentially for purposes internal to the Eurosystem, between two categories of eligible assets: 'tier one' and 'tier two' respectively. Tier one consists of marketable debt instruments fulfilling uniform euro area-wide eligibility criteria specified by the ECB. Tier two consists of additional assets, marketable and non-marketable, which are of particular importance for national financial markets and banking systems and for which eligibility criteria are established by the national central banks, subject to ECB approval. In May 2004, however, the Governing Council of the ECB approved the gradual introduction of a single list in the collateral framework of the Eurosystem (see press release of 10 May 2004) to replace the current two-tier system of eligible collateral.

19 As a result of the on-going reform, FCCs will be composed at any time of a minimum number of two units representing the FCC's assets.