Briefing note October 2014

'Financing companies': a new domestic status for credit and lending business in France

Since 1st October, French non-deposit taking credit institutions do no longer qualify as credit institutions under the French legislation. Now, they shall instead be 'financing companies', a new status created by Ordinance no. 2013-544 of 27 June 2013. For those who did not elect for such status before that date, the new 'specialised' credit institution status is though available, provided that they pursue a deposit-taking business. This briefing note explains the main features of both statuses.

Regulatory background: definition mismatch

Since the French banking law of 1984 which implemented the first banking consolidation directive 77/780/CEE (the "**BCD**"), the French definition of 'credit institutions' has been broader than the equivalent definition under European law. Whereas the two components of the business of a credit institution (*i.e.* the receiving of deposits and the granting of credit) are considered as alternatives under French law, these components are considered to be cumulative under the EU legislation. This situation has remained in place until Regulation (EU) 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms ("**CRR**") replaced the capital requirement directive 2006/48/EC, which had itself recast the BCD and its successor directives.

The definition of 'credit institutions' (which has not changed since the BCD) is now contained in CRR which took effect on 1st January this year.

As CRR is a legal instrument which is directly effective in EU Member States (including France) without further national implementation (contrary to EU directives), French national law has been required to align its definition of credit institutions with that of CRR.

This is the purpose of ordinance no. 2013-544 of 27 June 2013, which entered into force on 1st January 2014 (the "**Ordinance**").

The consequence of this change to the French legal definition is that former 'financial companies' (*sociétés financières*), which were a type of non-deposit taking credit institution (*e.g.* factoring companies, property finance lease institutions, certain consumer credit institutions, *etc.*), do no longer qualify as credit institutions under CRR. Similarly 'specialised financial institutions' (*institutions financières spécialisées* or 'IFS'), which were another type of credit institution, also do no longer qualify.

The Ordinance has therefore abolished the status of financial companies (as well as that of IFS), which had become inconsistent with CRR, and introduced into French law two new regulatory statuses:

- 'financing companies' (*sociétés de financement*), being a brand new domestic regulatory status; and

- 'specialised credit institutions' (*établissements de crédit spécialisés*), which are credit institutions (within the meaning of CRR) pursuing a specialised credit business.

Former financial companies and IFS had the opportunity to opt for either status until 1st October 2014. This opt-out period has now lapsed, and any financial company which has not elected for the financing company status shall by default be characterised as a specialised credit institution.

Financing companies

Financing companies are defined as '*legal persons that are not credit institutions whose regular professional activity is to perform credit transactions in accordance with the conditions set out in their authorisation*'.

Financing companies are entitled to grant credit but not to collect deposits or other repayable funds from the public (this restriction does not prohibit them from taking collateral). The French legislation provides for certain categories of specialised institutions to qualify as financing companies by their very nature, namely: financial lease companies (*sociétés de crédit-bail*) and mutual guarantee companies (*sociétés de caution mutuelle*).

As a matter of principle, financing companies share the same features as credit institutions as far as their credit and lending business is concerned. Among other things, in practical terms:

- they can extend any form of loans (*e.g.* term loans, revolving credit facilities, *etc.*), grant guarantees, discount receivables or pursue any factoring business, *etc.* This means, in particular, that they can validly participate in loan syndications and lend like any other regular bank in France, without breaching the French banking monopoly rules;
- they are eligible assignees under the Dailly law (art. L. 313-23 *et seq.* of the French *Code monétaire et financier* (the "**Financial Code**")), which means that they can originate PPP or project financings using this form of cash flow transfers. In addition, they can act as primary lenders in real estate finance transactions secured by an assignment of rental proceeds and, more generally, they can discount receivables (*e.g.* under a borrowing base facility) under the same instrument; and
- they qualify for the financial netting and collateral safe harbour provided by art. L. 211-36 *et seq.* of the Financial Code (*i.e.* those French law provisions which have implemented the Collateral Directive) (the "**Financial Netting Regime**"), which means that close-out netting and financial collateral enforcement are fully effective in an insolvency scenario when financing companies act as counterparties to derivative transactions (or more generally to finance transactions if the other counterparty also qualifies for the Financial Netting Regime).

However, financing companies may only provide payment services or investment services, or issue and manage electronic money if they have obtained the relevant authorisation.

Furthermore, financing companies do not benefit from the European passport granted to credit institutions (unlike the latter, they cannot carry out their business in another EU Member State where such business is regulated without first obtaining a license). However, as they qualify as 'financial institutions' under CRR (art. 4(1)(26) thereof), but provided they are at least 90% owned by one or several credit institutions and their liabilities are jointly and severally guaranteed by such credit institutions, financing companies may exercise the European passport granted to financial institutions meeting the above criteria. As a result, financing companies which are not part of a banking group cannot be granted an EU passport under the EU banking legislation.

On the liabilities side, financing companies are more limited in their access to capital market liquidity. Financing companies may issue negotiable debt securities, provided that such securities are not characterised as 'repayable funds received from the public'.

Debt instruments will be so characterised if they cumulatively show the following features:

- they are senior obligations of the issuer;
- they are not exclusively offered to qualified investors and persons providing client portfolio management services (*e.g.* they are offered to the public); and
- their denomination is below euro 100,000 (except for French money market instruments, *i.e.* BTs, CDs and BMTNs).

Therefore, a financing company is entitled to issue bonds, provided that such bonds do not have at least one of the above features. For example, a financing company is entitled to issue:

- senior bonds under a private placement (provided such private placement does not merely consist in placing the

securities within a 'restricted circle of investors' within the meaning of directive 2010/73/EU (the "Prospectus directive");

- subordinated bonds or hybrid instruments under a public offer; or
- bonds (whether senior, subordinated or hybrid) under a public offer or a private placement, provided that their minimum denomination is euro 100,000 or above.

Finally, financing companies are not eligible to the Euro-system liquidity.

In terms of prudential status, financing companies are subject to substantially the same prudential requirements as credit institutions (*i.e.* the Basel II framework, supplemented by Basel III), notably regarding regulatory capital and large exposure rules, though watered-down to take into account that they do not have a deposit-taking business (see ministerial order dated 23 December 2013 which sets out the standalone prudential regime of financing companies). This means that financing companies escape from the LCR and NSFR obligations (but they are however subject to the French liquidity coefficient rules). Furthermore, they are not subject to the leverage ratio.

One may also note that, because financing companies are not credit institutions, their insolvency is not subject to the provisions of the bank winding-up directive 2001/24/EC (the "**Bank WUD**"), subject however to the BRRD which provides otherwise under certain conditions (see below).

The insolvency of a financing company is instead governed by the provision of the EU insolvency regulation 1346/2000 (the "**EU Insolvency Regulation**"). This insolvency regime applies by default to insolvent undertakings which are not regulated as (among other things) credit institutions, meaning in particular that the following provisions (which are Bank WUD specific exceptions to the law governing the insolvency proceeding – the so-called '*lex concursus*') do not apply:

- *netting agreement (art. 25)*: according to which netting arrangements are solely governed by the contractual law elected by the parties to govern the agreement (*e.g.*, with respect to an ISDA Master Agreement, English or New York law);
- *repo transactions (art. 26)*: which provides for the same rule with respect to repurchase transactions.

Most of the time, this will not raise issues to the extent that, *firstly*, the Financial Netting Regime applies, which provides for an equivalent protection in an insolvency scenario, and, *secondly*, the following provisions are, amongst others, in common with the EU Insolvency Regulation:

- *third party rights in rem*: under which the rights of a secured creditor over a pledged asset located outside the home country of the pledgor are not affected by the latter's insolvency; and
- *set off*: under which, notwithstanding a party's insolvency, the other party may set off its claim against its debt towards the insolvent party if the law governing such debt allows for such set off to take place.

Also, financing companies do not fall within the scope of the provisions of the French resolution law enacted on 23 July 2013 (the "**French Resolution Law**"). However, as they qualify as 'financial institutions' under CRR, they may be subject to resolution measures under the provisions of directive 2014/59/EU on bank recovery and resolution (the "**BRRD**"). In such case, the provisions of the Bank WUD would then also apply (art. 117(1) of the BRRD).

Specialised credit institutions

Specialised credit institution is a new status which is a sub-type of 'credit institution' within the meaning of CRR.

As such, specialised credit institutions are required to receive deposits or other repayable funds from the public.

Although this status remains open to any credit institution wishing to pursue a specialised financing business, it has more particularly been created to enable French regulatory covered bond issuers (being *sociétés de crédit foncier* (*SCF*) and *sociétés de financement à l'habitat* (*SFH*)) to maintain their credit institution status for their covered bonds to qualify under CRR and the Euro-system regulations.

Specialised credit institutions are fully subject to all of the requirements applicable to credit institutions generally, including the licensing, prudential and corporate governance requirements, subject to the specific rules governing SCFs and SFHs. They fall within the scope of the Bank WUD, the French Resolution Law and the BRRD.

A table distinguishing financing companies from credit institutions (including specialised credit institutions) is set out on next page.

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Comparative Table

Main features of credit institutions (including specialised credit institutions) and financing companies

	Credit institutions (including specialised credit institutions)	**Financing companies**
Activities		
Credit and lending services	Yes	Yes
'Dailly' assignment	**Yes**	**Yes**
Deposit-taking services	Yes	**No** (but taking collateral is permitted)
Payment services	Yes	**No** (unless they obtain a specific license)
E-money	Yes	**No** (unless they obtain a specific license)
Ancillary services	Yes (within the 10% limit rule)	Yes (within the 10% limit rule)
European passport	**Yes**	**No** (unless they are part of a banking group, subject to certain conditions)
Refinancing		
Issue of debt securities	**Yes**	**Yes** (with restrictions: no public offer of senior notes with a denomination below euro 100,000)
Access to Eurosystem liquidity	Yes	**No**
Regulatory capital requirements		
Minimum share capital	Euro 5 million	Euro 1.1 or 2.2 million
Solvency ratios (Basel III)	Yes	Yes
Large exposure	Yes	Yes
LCR	**Yes**	**No**
NSFR	**Yes**	**No**
Leverage ratio	**Yes**	**No**

	Credit institutions (including specialised credit institutions)	Financing companies
Insolvency and resolution		
ACPR's consent required to open an insolvency proceeding	Yes	Yes
Bank WUD	**Yes**	**No** (unless resolution measures under BRRD apply)
EU Insolvency Regulation	**No**	**Yes**
Financial Netting Regime	**Yes**	**Yes**
French Resolution Law	Yes	**No**
BRRD	**Yes**	**Yes**

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