# Titrisation in France

By Eric Remus

SECURITISATION in France has been introduced from above, as an initiative by the State, rather than from below by the market as in the U.K. But if, once, French banks dreamt that this was a glittering gift from the Government, they have now realised the complexity of arranging a securitised transaction and have had to fight with various problems simultaneously: collection of historical data on individual loans, structuring of cash flows, rating, credit enhancement, legal documentation and identification of investors to name a few. The difficulties are gradually being solved and already there has been one issue; others are almost ready to be launched.

*The legal and regulatory framework*

The law, dated 23 December 1988, established the Fonds Commun de Créances (FCC). As its sole purpose, it purchases a pool of loans from a credit institution and issues units representing the interest in the loans purchased. The FCC is created at the initiative of a bank and of a management company (Société de Gestion).

Although the whole process is monitored by the issuing bank, legally the management company plays a crucial role in the life of the FCC. The management company applies to the Commission des Opérations de Bourse (COB — the French SEC) for an authorisation to issue the FCC. COB monitors the issue of the units to the investors, manages the financial flows from the Bank to the investors, is responsible for all information obligations whether to the public or the authorities and represents the FCC in any legal action.

To isolate the management company from the issuing bank, the COB has decided that the issuing bank cannot hold more than 33% of the management company, the rest of the capital being placed by the issuing bank into friendly independent hands.

There are a number of characteristics which have evolved out of a market requirement elsewhere and have been made a legal obligation in France.

- The rating: each FCC has to be rated and the Ministry of Finance has authorised three rating agencies (Moody's and Standard & Poor's and a French agency, ADEF). The rating agency will issue a rating and a document of evaluation which will be part of the application to the COB.
- The decree says that the investors cannot bear the insolvency risk and to make sure that the issuers would not forget any credit enhancement solutions, it lists the various possibilities: third party guarantees whether from a bank or an insurance company; senior/junior structures; and over-collateralisation.
- Only loans made by financial institutions can be acquired by the FCC. This is quite important as it keeps a number of potentially securitisable assets out of the scope of securitisation, leasing transactions and corporate trade receivables.
- No more than 5% of an FCC's units can be placed into unit trusts/mutual funds managed by the issuing bank. This is intended to avoid self-securitisation and to have securitisation develop into a real market. Unfortunately, this is counter-balanced by a decision from the Bank of France which allows the issuing bank to invest in any subordinated bonds which an FCC may issue. Hence a bank may in fact end up investing more than 5% of its own securitisation.
- A legal requirement which is specific to France is that the FCC cannot borrow. This was made with the laudable intent to protect investors and to make sure that the FCC does not assume any new obligation, but in practice creates a significant constraint.

*The securitisable assets*

At the end of 1988, loans in France totalled FF4,669 billion. Of this total, medium- and long-term loans to companies accounted for FF1,673 billion, mortgage loans for FF1,685 billion, short-term loans to companies for FF1,004 billion and consumer loans for FF307 billion.

The first securitisation issues will come from loans to individuals, whether mortgage loans or consumer loans. For securitisation to really take off in France, mortgage loans will have to be securitised. However, we know that most of the early issues will concern consumer loans whether automobile or personal loans, except for one mortgage loan transaction I am aware of.

Why? There are a number of factors which make securitising mortgage loans difficult at an early stage.

Over two-thirds of the total is made of up of loans at subsidised rates in one form or another which cannot really be securitised and even in the free market loan category, which has the fastest growth, the rates at which most loans were made do not really leave room for a profitable securitisation. This will change but it is the present situation.

It is helpful to say a few words on the mortgage market in France. First, mortgages are very safe assets and final losses remain at an extremely low level of 0.2-0.3%. For their protection, lenders take either a mortgage on the property (in 90% of cases) or obtain a guarantee from a surety bond company (Société de

Caution Mutuelle) the largest of which in France is Crédit Logement, a subsidiary of Crédit Foncier de France.

This system offers a sound protection to the lending bank and a flexible tool for the borrower who does not have to go through the cumbersome and costly process of registering a mortgage and cancelling it when the property is sold. Most loans are repayment loans with terms of between 10 and 20 years, 15 years being the norm granted on a fixed-rate basis.

Floating rates are actively being marketed as an answer to the massive prepayments observed in 1986 and 1987 when rates had dropped by more than five percentage points from the level of the early 1980s. One large mortgage specialist lender has indicated that 50% of its new production is floating rate loans. This trend will make securitisation of mortgage loans easier in the future.

By contrast, consumer loans have immediate advantages:

a) Much larger spreads, from 4% to 8%, which leave room to pay for all costs, be generous with the investors, and retain an income for the issuer.
b) It is also felt that their shorter maturity helps in two ways:
   - For the investor who will be more inclined to test securitised paper with a short life.
   - For the issuer himself since in a short period of time he will discover and will have to solve all the problems of a securitised transaction.

*The players*

Who will be the actors among financial institutions? As potential issuers, there are two categories: the large commercial banks on one side and the specialised lenders on the other. Of the largest banks, BNP, Crédit Agricole, Crédit Commercial de France, Crédit Lyonnais and Société Générale are most likely to be early in the market. Commercial banks account for about 80% of mortgage lending and 50% of consumer lending. They operate through decentralised networks.

A major difficulty for them is the collection of sound and complete information on their portfolio and the organisation of systems to process the financial flows from the borrower to the FCC. If they do not have as good a picture of their portfolio as the specialised lenders, their loss experience is estimated to be lower because the loans are part of a global and often close relationship with their customers.

The specialised lenders represent less than 20% of mortgage lending and 50% of consumer lending. There are hundreds of specialised lenders. The largest three (Compagnie Bancaire, Credisuez and Sovac) are part of large financial groups and themselves control several specialised subsidiaries in various fields. Specialist lenders have a more accurate picture of their portfolio than the commercial banks and could thus quite easily structure a securitised issue.

Commercial banks have an interest in securitisation not only for their own balance sheet management but also as a fee-generating service to offer their customers.

Given the number of potential arrangers, both commercial and investment banks, the competition is likely to be quite tough at this end of the market.

What about the investors? Insurance companies, pension funds and corporations do not show a great deal of enthusiasm for the paper and will wait to see the first experiences and the activity on the secondary market.

The most likely investors will therefore be the commercial banks (many of them are hungry for assets) and the unit trusts. France is by far the largest country in Europe for funds managed in unit trusts (SICAVs and FCPs). With the equivalent of ECU 203 billion under management, France represents almost 50% of the European total while Great Britain has a third of this amount (ECU 64 billion) and West Germany a fifth (ECU 43 billion).

Credit enhancement of FCCs is a legal obligation. We now have a number of French insurers ready to participate in the new field of financial risks either as lead-insurers or as risk-takers. They are organising themselves, recruiting new people, generally coming from the banking sector, to understand and analyse the risks of these transactions. At present, only one group, AXA-MIDI, through its reinsurance subsidiary, AMRE, has obtained a rating, an AA+, from Standard and Poor's. Given the intrinsic strength of the three or four largest insurance companies, I am confident that we can structure the desired level of rating for most of them, and I also think that soon they will ask to be rated.

In terms of pricing, we should not be far from the British market levels, maybe slightly higher in the consumer lending area to reflect more the higher administration costs than the higher risk.

On the negative side, unfortunately the Bank of France has recently adopted a position which is quite favourable to senior/junior structures. Banks are allowed to buy back their junior tranche and calculate the required capital by applying the Cooke ratio to this tranche only. This treatment allows banks to free capital while retaining the whole portfolio risk on their balance sheet.

This is quite different from the position of, for example, the Bank of England which, as I understand it, considers in a similar case that no risk has been removed and the required capital should be unchanged. We wonder whether such treatment is consistent with the spirit of the international guidelines set out by the Basle Committee.

The problem it poses to insurance is not so much cost as simplicity which is an irony as one of the major arguments in favour of insurance is precisely simplicity. But the temptation is for banks to say "I am struggling to solve the problems for my first issue; why complicate the whole thing by involving a third party while I am allowed to keep my problems to myself and meet my objective to free some capital." ■

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