

## French legislative reform opens up new lending opportunities for alternative investment funds

*Through the creation of a French specific debt fund and by easing lending restrictions currently existing in France, French Ordinance (ordonnance) No. 2017-1432 dated 4 October 2017 attempts to modernize the French legal framework for asset management and alternative financing and to bolster non-bank financing. This Legal Update discusses the details of this new legislation and highlights the main opportunities for French alternative financing going forward.*

### Background

While the European banking sector is continuously facing stronger legal and regulatory constraints, alternative funding continued to gain importance over the last two years in Europe, especially in France. As it stands, French alternative finance overall raised EUR 668 million in 2016, a 112% increase from 2015<sup>1</sup>.

Relevant examples include the introduction into French law of legislation on crowdfunding<sup>2</sup> or intercompany lending<sup>3</sup>. As for lending by investment funds, the European regulation on long-term investment funds (“**ELTIF**”)<sup>4</sup>, which entered into force on 9 December 2015, now allows alternative investment funds benefitting from the ELTIF label to directly provide long-term financing to certain companies across the European Union.

Another milestone has been reached recently with Ordinance No. 2017-1432 published on 4 October 2017 (the “**New Legislation**”), which purports to modernize the legal framework for asset management and financing through investment funds. The New Legislation will enter into force on 3 January 2018 and has been passed pursuant to Law No. 2016-1691<sup>5</sup> that empowered French government to introduce legislation on the following:

- definition of the terms and conditions under which certain alternative investment funds may grant loans to companies (in compliance with the ELTIF regulation);
- strengthening the capabilities of the collective investment funds and their depositaries and managers to finance and refinance investments, projects or risks and to acquire or assign unmatured receivables; and
- clarifying the conditions under which non-banking investors may acquire professional unmatured (loan or other) receivables from credit institutions and financing companies.

### Creation of a new French specific debt fund

The main objective of the New Legislation is to allow for the creation of a new French alternative investment fund dedicated to lending activities. For this purpose, a new specific debt investment fund has been created: the *organisme de financement spécialisé* (specialised financing fund or “**OFS**”). The OFS is regulated under the European legislation on alternative investment funds managers<sup>6</sup> (the “**AIFM Directive**”) and is to be managed by any European AIFMD regulated management company.

Note that (i) the OFS will be considered as a sub-category of *organismes de financement* (financing entities) alongside with the existing French securitization entities (*organismes de titrisation*, “**OT**”) and (ii) the OFS will share many of the features detailed below with the existing French securitization entities.

<sup>1</sup> 2016 Alternative Finance Barometer (Financement Participatif France / KPMG).

<sup>2</sup> Law No. 2014-559 of 30 May 2014 and Decrees No. 2014-1053 of 16 September 2014 and No. 2016-1453 of 28 October 2016.

<sup>3</sup> Law No. 2015-990 of 6 August 2015 and Decree No. 2016-501 of 22 April 2016.

<sup>4</sup> EU Regulation No. 2015/760 of 29 April 2015. French law No. 2015-1786 of 29 December 2015 has introduced the possibility for ELTIFs to grant loans to French companies.

<sup>5</sup> Law No. 2016-1691 on Transparency, Fight Against Corruption And Modernization of Economic Life dated 9 December 2016.

<sup>6</sup> Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011.

## PURPOSE

The OFS will be able to lend directly in France, acquire any loan or other receivable and subscribe to any form of debt instruments. It can also take any form of participation in a lending or financing transaction. In that respect, OFS will likely be very active in the receivables financing area.

To finance its investments or lending activities, OFS (or each compartment thereof – see below) can:

- (i) issue shares, stocks, debt instruments (*titres de créances*), enter into forward/future agreements, subscribe to indebtedness or use any other form of resources, debts or liabilities. Note that these shares, stocks or debt instruments as issued by the OFS may give rise to different rights on capital and interest (so long as no subordination applies to the credit risk entailed by such holding of shares, stocks or debt instruments); the OFS' regulations may provide that the rights/claims of certain of its creditors are subordinated to the rights/claims of its other creditors; and
- (ii) grant or benefit from any type of security interest or guarantee under the conditions provided in their regulations.

Note that the introduction of the OFS under French law constitutes another derogation from the so-called French banking monopoly rules, which restrict the lending into France or the ongoing purchase of French unmatured receivables by anyone other than French licensed or EU passported financial institutions or French securitization vehicles (OTs).

## LEGAL FORM

As well as for the OTs, an OFS can take the form of either (i) a *fonds de financement spécialisé* (“**FFS**”), which is not a legal entity and whose subscribers hold an undivided interest (*copropriété*) in the FFS' assets or (ii) a *société de financement spécialisé* (“**SFS**”), which is a legal entity and may be formed as a corporation (either a *société par actions simplifiée* or a *société anonyme*).

More precisely, OFS are constituted by a French or European management company which is AIFMD regulated and authorized to manage alternative investment funds.

French law further provides that the constitutional documents of the FCT may comprise two or more compartments, wherein assets and liabilities are segregated.

## SIMPLIFIED ASSIGNMENT OF RECEIVABLES

Receivables can be transferred to the OFS by way of a simplified transfer deed (*bordereau de cession*) or by any other means of assignment governed by French law or by any other law. In case the *bordereau* is used, it shall identify the receivables or providing information necessary for the identification of such receivables.

As well as for the OTs, French law further provides that the transfer of receivables to an OFS through a *bordereau* becomes valid between the parties and enforceable against third parties as at the date ascribed on the *bordereau*, whatever the law applicable to the receivables and the law of the state of residence of the debtors and irrespective of the fact that a bankruptcy proceeding (whether governed by French or foreign law) has been initiated against the originator after the transfer.

In addition, the delivery of the *bordereau* entails the immediate transfer to the OFS of all related security and ancillary rights attached to the receivables, including real estate mortgages (*hypothèques*) or receivables already transferred to the originator under a “Daily” assignment, without any further formalities.

Note that OFS (as well as OTs – see below) can be direct assignees under the simplified “Daily” assignments (*cession de créances professionnelles*) provided for in articles L. 313-23 *et seq.* of French monetary and financial code when lending to their counterparts.

Finally, (i) to the extent receivables relate to on-going (leasing or other) agreements, any assignment thereof to an OFS (as well as OTs – see below) shall continue to be effective notwithstanding any bankruptcy affecting the assignor of such receivables and (ii) OFS can substitute existing lenders or financiers in the funding of existing leasing or financing agreements.

## EFFECTIVE PROTECTION AGAINST BANKRUPTCY ISSUES

Again, as for the OTs, the OFS will benefit from a strong and legally effective protection against any bankruptcy and its related claw-back issue.

The acquisition or assignment of receivables and the creation of any security interest or guarantee to the benefit of the OFS shall remain effective notwithstanding (i) any payment stop date (*cessation des paiements*) of the assignor or grantor at the time of such acquisition, assignment or creation or (ii) any potential opening of any bankruptcy or insolvency

proceeding mentioned in Book VI of the French commercial code or any equivalent insolvency proceeding (on the basis of a foreign law) opened against such assignor following the said acquisition, assignment or creation of security interest or guarantee.

Moreover, the New Legislation reiterates that French bankruptcy law (under Book VI of the French commercial code) is not applicable to OFS (and OTs either).

#### OTHER FEATURES

- (i) dedicated collection accounts: the OFS' management company (or any servicing entity in charge of handling collections) may agree that the OFS' collections are credited to a "dedicated collection account" opened for the benefit of the OFS. By virtue of French law, creditors of the assignor (or of the servicer) cannot enforce their claims against it, even in the event of opening of any French or foreign bankruptcy or insolvency proceeding (meaning also that any bankruptcy affecting the assignor or the servicer shall not result in a termination of the dedicated collection account agreement). The same applies to OTs.
- (ii) servicing: to the extent receivables are transferred to the OFS, the collection of these receivables is carried out either by (i) the assignor, (ii) any third party servicer contractually appointed before the relevant assignment to carry out such servicing, or (iii) the OFS' management company or any other person contractually appointed and delegated by the management company for that purpose. In such a case, each debtor is informed of this change.

More generally, the OFS' management company is in charge of managing and servicing any other asset acquired or transmitted to the OFS, unless any other third party is contractually appointed and delegated by the management company for that purpose.

To avoid any legal and regulatory debate as to such potential servicing delegations (notably for special servicers to be appointed for OFS or OTs in a distressed scenario), the New Legislation makes it clear that the provisions of (i) the French monetary and financial code, (ii) the French civil enforcement procedure code (as relating to debt collection on behalf of third parties) and (iii) as relevant, those provisions relating to payment services, shall not apply to any such delegated servicing activities.

## Modernization of the legal regime applicable to French OTs

In addition to the above, the New Legislation attempts to modernize the legal regime applicable to OTs:

- OTs can be established and managed by a "sponsor" within the meaning of EU Regulation No 575/2013 of 26 June 2013, where that sponsor can, in turn, delegate the management of the organization to a dedicated management company.
- Rules applicable to custodians of OTs are also clarified and expanded. In particular, the respective responsibilities of the OT's management company and custodian, as well as the related duties and liabilities of the custodian, has been spelled out in more details. Note these provisions will affect existing and future OTs and will enter into force on 1 January 2019.
- The New Legislation reiterates that OTs can grant loans to companies under the ELTIF conditions (if the OT received the ELTIF label) or can grant loans to non-financial companies (under the conditions that be further defined by secondary legislation).

## Introduction of supplemental exceptions to the French banking monopoly

As mentioned above, France has banking monopoly rules which restrict the making of credit transactions (*i.e.*, lending and ongoing purchase of French unmatured receivables) into France by anyone other than a French licensed or EU passported financial institution or a French *organisme de financement* (financing entity) – see above.

In order to further ease the refinancing of French lending or receivables financing transactions and to ensure that French law is now compliant with the European ELTIF regulation, the New Legislation has introduced the following supplemental exceptions to the French banking monopoly:

- Financing institutions or investment funds authorized to lend in France and holding unmatured loan or other professional receivables (other than receivables owed by consumers) will be allowed to assign them directly:
  - (i) as before, to French licensed or EU passported financial institutions; but also to

- (ii) foreign institutions or entities having activities and a corporate purpose similar to those which are authorized to lend in France pursuant to Article L. 511-6 of the French monetary and financial code, *i.e.*, foreign financial institutions or foreign non-banking financial investors (acting through debt or other investment funds).

This should greatly facilitate the participation by French financial entities or institutions to international financing transactions such as syndications, CLO transactions, as well as pan-European trade receivables financing transactions.

- Certain alternative investment funds, mainly OTs, OFS or other professional funds (*fonds professionnels spécialisés* such as FCPIs for instance), which are authorized to lend in France, are also allowed to benefit from the simplified and legally robust “Daily” assignments of receivables when lending to French borrowers.

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## Conclusion

Creation of the OFS, reform of OTs, additional exceptions to the French banking monopoly for refinancing purposes, greater benefit of the “Daily” mechanics; as the New Legislation pursues to the on-going trend towards the shrinkage of the French banking monopoly restrictions, consequences should be twofold for the financial industry: greater lending or refinancing opportunities for French or European investment funds but also an increased competition between French or international financial institutions.

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