

# Specific Controller

**The « daily work » of a Specific Controller in France**

**(also called : cover pool monitor ; special inspector ; coverage supervisor, Treuhänder, powiernik etc.)**

Stéphane MASSA  
[massa@fides-audit.fr](mailto:massa@fides-audit.fr)  
Tél +33 (0)6 86 38 68 69

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2- Mission of the Specific Controller

# 1- Characteristics of the legal framework in France

- Privileged debt
  - Covered bonds conferring preferred creditor status
  - Holders of this privileged debt = absolute priority interest (before the State)
- Eligible assets (collateral)
  - First rank mortgage loans
  - Guaranteed home loans
  - Public sector loans
  - Securitisation of the above
- Substitution assets (collateral)
  - Replacement assets up to 15% of the amount of the outstanding covered bonds issued
  - « secure and liquid asset » for which the debtor is a bank rated step 1 or step 2 by a ratings agency

# 1- Characteristics of the legal framework in France

- Over-collateralisation : 102 %
  - But rating agencies require a higher figure than the law
- Liquidity : 6 months
  - Buffer is required to cover, at all times, all cash flows for a period of 6 months
- Investor protection
  - Over-collateralisation
  - Liquidity buffer of 6 months
  - Hedging policy (ALM : Assets & Liabilities Management)

# 1- Characteristics of the legal framework in France

- Issuer of covered bonds = special banks
  - Dedicated legal entity is required :
    - « *SCF : société de crédit foncier* »  
or
    - « *SFH : société de financement de l'habitat* »
  - Their activities are limited by law (sole purpose)
    - to hold eligible assets
    - to issue covered bonds or non-privileged debt

# 1- Characteristics of the legal framework in France

- Transfer of assets
  - Effective transfer to the balance sheet of the issuer of covered bonds is required
    - Covered assets (loans) for SCF « *société de crédit foncier* »
    - Financial guarantees for SFH « *société de financement de l'habitat* »
- Exemption from bankruptcy law
  - In a banking Group, bankruptcy procedure cannot be extended to the SCF.

# 1- Characteristics of the legal framework in France

- Supervision
  - CECEI : Agreement
  - ACP : Banking regulator
  - AMF : Market regulator (financial reporting / investor protection)
  - Specific controller approved by ACP (banking regulator)
  - Two statutory auditors
- UCITS Conformity : Yes
- Risk-weighting according to EU CAD (Capital Adequacy Directive)
  - 10% for SCF « *société de crédit foncier* »
  - 20% for SFH « *société de financement de l'habitat* »
- Rating (M / S&P / F) : Aaa / AAA / AAA

PUBLIC

PRIVATE

CECEI : Comité des Etablissements de Crédit / ACP : Autorité de Contrôle Prudentiel / AMF : Autorité des Marchés Financiers

## 2- Mission of the Specific Controller

- Introduction
- I. Appointment, obligations & responsibilities
- II. Nature & purpose of its mission



## 2- Mission of the Specific Controller

- Introduction
  - 2 different statutory auditors report to shareholders
  - 1 specific controller reports to banking regulator
  - The specific controller produces at least 10 reports a year

## 2- Mission of the Specific Controller

### I. APPOINTMENT, OBLIGATIONS & RESPONSIBILITIES (1/2)

- **Independence**

- Auditing firm listed as a statutory auditor

but

- Not for the issuer, the parent company or any subsidiaries in the Group

- **Duration : 4 years**

- **Agreement**

- special agreement of the French banking regulator given each time for new issuer and for each renewal

- **Professional secrecy**

## 2- Mission of the Specific Controller

### I. APPOINTMENT, OBLIGATIONS & RESPONSIBILITIES (2/2)

- **The specific controller is liable to the company and third parties in respect of negligence committed by him.**
- **In the case of serious issues**
  - **Going concern (doubt about)**  
→ He reports immediately to the banking regulator
  - **Criminal acts (discover)**  
→ He reports immediately to the public prosecutor
  - **Judicial reorganisation / administration**  
→ He makes the « debt declaration » in front of the Court for and on behalf of the holders of the preferred debt.

## 2- Mission of the Specific Controller

### II. NATURE AND PURPOSE OF ITS MISSION

#### Contents

- 1. Frequency reports
- 2. Eligible assets
- 3. Compliance with specific rules
  - 3.1 Coverage ratio
  - 3.2 Other limits
  - 3.3 Liquidity
- 4. Hedging policy / ALM
- 5. Real estate valuation
- 6. Data audit

## 2- Mission of the Specific Controller

- 1. Frequency and nature of its reports :
  - 4 quarterly reports based on the quarterly issuance programme : data is based on the forecast for 3 months,
  - 1 report based on every issuance of 500 million euros or more,
  - 2 half-yearly reports based on the compliance with the cover ratio and limits (data is based on audited financial statements). These reports are sent to the banking regulator,
  - 1 annual report on the real estate valuation method,
  - 1 annual Data audit report,
  - 1 annual report to the banking regulator too. This is a long form report and we have to disclose our conclusions on the compliance of the issuer with the specific rules.



## 2- Mission of the Specific Controller

- **II. NATURE AND PURPOSE OF ITS MISSION**
- **2. Eligible assets**

We have to check that all contributions comply with the legal status of the issuer.

These contributions are all eligible assets bought by the issuer.

- Loans guaranteed by a first rank mortgage (residential and commercial loans)
  - Loans granted to finance real estate and guaranteed by a credit institution (a bank) or an insurance company ;
  - Public bodies exposures (loans to or guaranteed by a public body),
  - Senior securities
  - Mortgage promissory notes
  - Replacement assets that need to be secure and liquid
- **Comment :**
    - An issuer can only hold eligible assets
    - No other activities are allowed :
      - For example, issuers cannot buy equity investment or receive deposits and savings.

## 2- Mission of the Specific Controller

- **II. NATURE AND PURPOSE OF ITS MISSION**

- **3. Compliance with specific rules**

- **3.1 Coverage ratio**

The coverage ratio must, at all times, be a minimum of 102%

- Numerator of the coverage ratio is eligible assets
- Denominator is Bonds issued under legal privilege

- **3.2 Other limits**

Other limits are required by regulation, for instance :

- Replacement assets cannot exceed 15% of the amount of the outstanding covered bonds
- Loans guaranteed by a bank or insurance company cannot exceed 35 % of the total assets of the issuer
- Mortgage promissory note cannot exceed 10% of the total assets of the issuer.

- **3.3 Liquidity**

To ensure the liquidity of the issuer, cash needs to be constantly covered over a moving period of 6 months.

## 2- Mission of the Specific Controller

### • II. NATURE AND PURPOSE OF ITS MISSION

#### • 4. Hedging policy

- The mission of the specific controller involves verifying that the adequacy of maturities and interest rates of assets and liabilities is at a satisfactory level.
- A satisfactory level means that the issuer's operations (assets and liabilities) have to be hedged in order to avoid a serious risk for investors.
- In France, the balance sheet of an issuer is very simple indeed :
  - Covered bonds versus eligible assets.
  - For covered bonds, the hedging is done one to one at the same time as the issuance.
  - For the assets, the hedging is done by tranche of maturity and interest.



## 2- Mission of the Specific Controller

### • **II. NATURE AND PURPOSE OF ITS MISSION**

#### • **5. Real estate valuation**

- Property value is a part of the risk of a covered bonds issuer. So the valuation has to be made in compliance with banking regulation.
- Real estate valuations must be done on a conservative basis without any element of speculation.
- The initial appraisals are made by an independent expert if the operation is over 600 000 euros. Otherwise the initial appraisals are made at cost.
- For present value of the property, and for home loan only, the appraisals are made using a statistical method.
- The work of the specific controller is to verify the validity of the process of the appraisal.

## 2- Mission of the Specific Controller

- **II. NATURE AND PURPOSE OF ITS MISSION**
- **6. Data audit**
- Every year, the specific controller makes a random selection of 400 loans from among the complete cover pool.
- For this sample of 400 loans, the specific controller checks all original documents in order to ensure that the loan complies with regulations.
- That means that the specific controller checks the original loan contract, the mortgage, the initial appraisal of the property and the IT system of the issuer.

## 2- Mission of the Specific Controller

- **II. NATURE AND PURPOSE OF ITS MISSION**
- **6. Data audit approach**
- ✓ Eligibility
  - ✓ Loans guaranteed by 1st rank mortgage ; type of guarantor ;
  - ✓ Loans granted to finance real estate ; public exposure ;
  - ✓ Type of assets included in the securitisation.
- ✓ Transfer of :
  - ✓ Cover assets
  - ✓ Financial guarantee
- ✓ Real estate assessment
  - ✓ Initial assessment (when the loan is granted)
  - ✓ Actual assessment (actual index ; conservative principle)
- ✓ Complete loan documentation
  - ✓ Notarial deed
  - ✓ Loan agreement
  - ✓ Insurance certificate (covering damage to the property)

Specific controller = Creator of confidence



# BANKRUPTCY REMOTE



AP Photo