

EURO-PP, an alternative to bank funding for mid-market companies

For several years, the diversification of funding sources has become a crucial challenge for French and European mid-market companies.

In this context, private placements in the form of bonds or loans, known as the “Euro-PP” market, have grown significantly in France and in Europe, thereby offering companies an alternative to bank funding.

The financing of small and medium-sized businesses (SMBs)^[1] and so-called *entreprises de taille intermédiaire* (mid-market companies or hereinafter “ETIs”)^[2] is a crucial challenge for the French economy. The long-lasting economic crisis that these companies have been facing for several years has made it difficult for many of them to access to medium/long-term financing sources.

With ever stricter requirements imposed on financial institutions in terms of prudential ratios, it has become essential to diversify funding sources to complement traditional bank lending.

Yet, in 2013, SMBs/ETIs still quasi-exclusively relied on bank financing as it accounted for more than 90% of their funding sources (690 billion euros, including 413 billion for SMBs and 274 billion for ETIs)^[3].

However, the financial crisis has showed the limits of the traditional business funding system that is structured around bank lending; first, under the impulse of SMBs/ETIs that now seek solutions that are more tailored to their needs, in particular with respect to the diversification of funding sources, cost-control and longer maturities to reduce the risk of refinancing; and secondly, under the pressure of institutional investors that, in a low rate environment, are looking for more attractive yields, and also insurers that, contrary to their American or Japanese counterparts, have so far played only a small part in the direct funding of SMBs/ETIs.

As such, over the past few years, “alternative” funding solutions emerged to enable ETIs and large SMBs to

diversify their sources of funding without relying on banks.

Among these solutions, the **access to loans and bonds through the European Private Placements market** (*Euro-PP*) has emerged and developed in France since 2012. This attracts more and more French businesses that had so far no access to the standard bond market and institutional investors.

The Euro-PP, a new funding source for mid-market companies

The Euro-PP is a medium or long-term financing instrument by which institutional investors lend money to a listed or non-listed issuer.

There exist several formats of Euro-PP that meet the various needs of investors and issuers. As such, the Euro-PP can take the form of a **bond issue**, a **loan**, or a combination of both.

The Euro-PP is to be held by until maturity (generally between 3 and 7 years) by the investors that are primarily insurers, private insurance institutions or specialized credit funds. An arranger, generally a bank, is also involved to set up the transaction. The loan format may involve a minority co-investment by the arranger-bank.

While every non-bank investor may subscribe for bonds without infringing the French banking monopoly, only a limited number may invest in a loan, i.e. banking institutions and insurance companies that may - following Decree n°2013-717 of August 2, 2013 - subscribe directly for unlisted bonds issued by commercial companies and invest in loans, under certain conditions.

A rapidly evolving market

The first company to launch a Euro PP was Bonduelle in 2012, with a 145 million euros issue. Since then, the number of transactions is clearly on an upward curve (55 deals recorded in 2014, as opposed to 21 in 2012), with a decline in the average size of the (60 million euros in 2014, as opposed to 152 million euros in 2012).

Since 2012, more than 10 billion euros were raised through this type of financing, primarily in favor of ETIs. Public authorities expect encouraging ETIs to diversify their funding sources will foster the preservation and development of bank lending to the benefit of SMBs.

Towards a standardization of the Euro-PP market

Since March 2014, the Euro-PP market is regulated by a set of rules set forth in the **Charter for Euro-PP** drafted by the Euro-PP working group under the auspice of the French Central Bank, the French Treasury and the Paris IDF Chamber of Commerce and Industry.

Its objective: To provide a non-binding framework of best practices to be applied by the various actors (issuers, intermediaries and investors), including the definition of the key phases and timetable, the standardization of the terms and conditions of reference (such as financial and non-financial covenants, change of control,

specific limitations on the grant of security interests - negative pledge, terms and conditions of early repayment).

By endorsing the Charter, the various federations and associations (in particular, the *Association Française des Marchés Financiers* (French Financial Markets Association), the *Association Française des Trésoriers d'entreprises* (French Association of Corporate Treasurers), the *Mouvement des Entreprises de France* (Movement of French businesses) and the *Fédération Bancaire Française* (French Banking Federation) are committed to promote it to their members.

The process launched in 2014 with the publication of the Charter further developed as early as January 2015 with the **preparation of model contracts** (contracts for loan format and bond format, governed by French law and available in French and in English) in order to create market benchmarks, with the **common principle** of *pari passu* rank with the existing debt with the same characteristics (generally a banking debt), **differences** resulting primarily from the profile of the borrower/issuer and the specificities of the transaction.

It should be noted that in practice the principle of equality between creditors laid down by the Charter is not without raising difficulties wherever the existing lenders benefit from security interests. The borrower/issuer must then try to convince the new investors to "share" the security interests and its legal counsels must find satisfactory legal arrangements for all its lenders.

Towards the emergence of a European reference standard for Euro-PP

On February 11, 2015, the International Capital Market Association (ICMA) published a European best practice Guide - largely based on the French Euro-PP Charter - in order to create a Pan-European private placement market for corporate debt (PEPP).

Just like the Euro-PP market, the PEPP market aims at broadening the base of European investors by attracting new institutional investors, increasing medium- and long-term funding, and promoting an intermediate market between the bank loan and debt capital market.

Knowing that €2.7 trillion of debt will need to be refinanced by mid-sized companies between now and 2018 (according to a research by Standard & Poor's), the Euro-PP and PEPP markets have a significant growth potential.

[1] The category of small- and medium-businesses (SMEs) is made up of companies that employ fewer than 250 people and have an annual turnover of less than 50 million euro or a balance sheet total not exceeding 43 million euros.

[2] An *entreprise de taille intermédiaire* (ETI) is a company with between 250 and 4999 employees, and a turnover which does not exceed 1.5 billion euros or a balance sheet total which does not exceed 2 billion euros.



[3] Information provided by the report issued under the auspice of Paris EUROPLACE in March 2014 “Financement en dette des PME/ETI” (Debt Financing of SMBs/ETIs).

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