DIRECTION FINANCIERE
DIRECTION FINANCEMENT & INVESTISSEMENTS

Re. : EFRAG's Public Consultation
"Is there a need for specific financial reporting for long-term investing activities business models?"

Paris, 25 June 2013,

Dear Sir or Madam,

We would like to thank EFRAG for inviting us to submit our comments on the consultation regarding the need for specific financial reporting for long-term investing activities business models.

Our answers to the questionnaire are attached thereafter.

Should you wish to discuss our comments further, please feel free to contact us.

Yours sincerely,

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Paris, 25 June 2013

EDF submission to EFRAG's Public Consultation

"Is there a need for specific financial reporting for long-term investing activities business models?"

Question 1 – Would you describe your (or one of your) business model(s) as a long-term investing business model? Please explain. If so, what is its economic purpose?

EDF Group is a world leader in electricity, covering all activities: generation (from nuclear to renewables), networks, sales and trading. It is an international group with roots in Europe and long-term partnerships and cooperation agreements in high-growth countries. Outside Europe, EDF Group also has stakes in CENG, a nuclear generation company based in Baltimore, USA.

In France, the French law of June 28, 2006 obliges EDF Group, and indeed all French nuclear operators, to secure financing of long-term obligations, specifically the decommissioning of nuclear power plants and the long-term management of radioactive waste. EDF Group long-term nuclear liabilities have a present value of €20 billion as of end 2012. Their duration ranges between 20 and 30 years, with cash outflows running over many decades.

The law mandates that nuclear operators constitute dedicated assets, whose value shall at least equal that of the long-term liabilities, starting mid-2016 (under conditions met by EDF Group). The degree of security and liquidity of such assets must be sufficient to fit their purpose. The eligible assets are strictly defined by law and can include both financial assets and tangible assets such as buildings.

EDF Group has progressively built up a portfolio of dedicated assets since 1999 and already reached full-funding since early this year. A long-term management strategy is applied for these dedicated assets in accordance with a strategic allocation defined by

EDF Group's Board of Directors and reviewed and approved by the State at regular intervals.

Most of the dedicated assets take the form of internationally diversified equity securities, bonds and shares of mutual funds, partially hedged against currency risk. They are currently held and managed directly by EDF Group and recorded as such in its financial statements. They are therefore carried in the balance sheet at fair value as a component of available-for-sale financial assets, in compliance with IAS 39.

Therefore, EDF Group is a long-term investor, in assets whose primary goal is to cover future cash outflows that will range over many decades. More immediate constraints include the need of: 1. maintaining a funding ratio above 100% starting mid-2016, hence the need of managing asset-liability risks, and 2. ensuring that assets expected return exceeds the liability discount rate with a high level of confidence, hence the need of sustained performance.

EDF Group also has specific financing terms for long-term nuclear obligations in the UK and the U.S.

In the U.K., EDF Energy reports long-term nuclear obligations in liabilities in the form of provisions amounting to €8,402 million at 31 December 2012. In the assets, EDF Group reports receivables corresponding to the amounts payable under the restructuring agreements by the NLF, (Nuclear Liabilities Fund), and by the British Government, for an amount of €6,920 million at 31 December 2012.

In the U.S., CENG has to decommission its three nuclear power plants when they cease operations. NRC (Nuclear Regulatory Commission)-approved funding options provide for the establishment of external investment trust funds reserved for each unit, to cover its decommissioning obligations. These trust funds are currently invested in debt and equity instruments, classified as AFS financial assets.

Question 2 – What are your long-term investing activities driven by (e.g. the need to back long-term liabilities)? What is the nature of your long-term commitments? How do you distinguish between assets held to back long-term liabilities and other assets? Are you also involved in trading activities? If so, to what extent and for what purpose?

EDF Group long-term investing activities are driven by the need to back long-term liabilities, as explained above.

In France, dedicated assets are held separately from other EDF Group assets, as mandated by law, and are described in a specific note of the financial statements. They are managed under a specific governance (Board of Directors, with a specialized Nuclear Commitments Monitoring Committee; Nuclear Commitments Financial Expertise Committee including external experts; Strategic Committee of Dedicated Assets chaired by the Finance Corporate Executive Director; Operational Management Committee). They follow a long-term management strategy, structured along strategic and tactical levels:

- Strategic asset allocation, submitted to Board approval, is based on asset-liability analyses carried out to define the most appropriate target portfolio for financing long-term nuclear liabilities. A benchmark index is set for performance monitoring and risk control of financial assets (excluding tangible assets).

- Tactical asset allocation is defined on a monthly basis based on economic and financial outlook for each market and geographical area, and a review of market appreciation in different markets and market segments.

As part of the tactical asset allocation activity, a moderate amount of portfolio rotation is performed. The goal of such reallocations is not to generate short-term profit but rather to rebalance the portfolio in line with the strategic allocation and with the tactical appreciation of market segments.

EDF Group's dedicated assets currently consist of diversified bonds and equity investments, 50% of shares in RTE (an affiliate operating in power transportation network), and CSPE receivable[1].

These dedicated assets are structured and managed according to a strategic allocation defined by the Board of Directors. They are financially sequestered and all proceeds (interest income, dividends, gains/losses on disposals) are reinvested within the portfolio, following the objective of funding the long-term liabilities.

The financial portfolio (bonds and equities) of the dedicated assets are presented as AFS assets.

As a result, for accounting purposes, this portfolio is evaluated as a whole, all funds combined, treating the cash flows generated as a group of financial assets. This ensures consistency with the specificities of the dedicated asset portfolio, in particular the legal association with the liability and the distant timing of significant payments.

In view of the specific financial characteristics of the portfolio, the Group has exercised judgment in determining whether indicators of impairment appropriate to the structure of the portfolio should be taken into consideration. EDF Group thus takes a 5 year period as the basis for assessment of prolonged decline compared to historical value and considers impairment of assets to be significant when the value is 40% or more below the portfolio's historical value.

Question 3 – What are the different types of assets you invest in?

The majority of EDF Group dedicated assets is made of a financial portfolio, whose strategic allocation is balanced between equities and bonds. Tactical asset allocation aims for diversification by segment (geographic, by nature or typology of issuers), and by style, capitalization and investment process. EDF Group opted for an investment structure mainly via open-ended mutual funds, to which are added a number of reserved funds or mandates.

[1] The Contribution to the Public Electricity Service is a contribution set by the State and collected directly from the end-user of electricity to compensate for certain public service charges borne by EDF.

Besides, EDF Group has been pursuing for several years a goal of diversification into tangible assets, first by introducing half of the shares of its power transportation network affiliate RTE at the end of 2010, and more recently by reviewing the strategic asset allocation to incorporate other tangible assets: infrastructure (including RTE shares), private equity and real estate.

Question 4 – How is your long-term investment strategy established and how do you report on it, for both transparency and stewardship perspectives? How do you ensure that your current or potential shareholders can make the link between how you report your investment long-term strategy and the information provided in your financial statements? Could such a link be improved? How?

The long-term investment strategy is established based on asset-liability analyses comparing various candidate allocations on a risk-return diagram. Risk and return measures are defined with an asset-liability perspective, i.e. in terms of expected funding ratio and risk of asset-liability shortfall, over a chosen mid to long-term time horizon. These analyses are presented to the relevant committees (Strategic Committee of Dedicated Assets; Nuclear Commitments Financial Expertise Committee including external experts; Nuclear Commitments Monitoring Committee including State representatives) before submission of the strategic allocation to Board approval.

In the financial statements, specific notes present the nuclear liabilities and the dedicated assets. The “Operating and financial review”, also part of EDF Group publicly available Reference Document, provides the detailed composition of dedicated assets (providing both net book value and fair value), as well as realized performance (of the portfolio and of its strategic benchmark, whose composition is disclosed) and risk measures (volatility, sensitivity of the bond portfolio, stress test).

Question 5 – Do you believe the business model described above justifies a specific financial reporting treatment? If so, what should it be? Please explain how it brings relevant information to investors. Are there circumstances in which you would argue that fair value is not an appropriate measure? What other measurement attribute would you suggest and why (i.e. where a measurement basis in existing IFRS does not properly reflect the business model as described by you)? How should measurement uncertainty be dealt with in a 'long-term investment activities' business model?

The company's investing activities into dedicated assets being completely driven by the objective of funding long-term liabilities, it is of paramount importance that some symmetry be maintained in the reporting of assets and liabilities. P&L impacts from long-term liabilities may be large and unpredictable when adopting spot discount rate valuation; this is unrelated to the long-term nature of the engagements and blurs the financial reporting, hence should in our view be avoided. Symmetrically, fair value changes in assets dedicated to hedging those liabilities, should impact the balance sheet but not the P&L.

Besides, since all assets are managed as a whole and have complementing contributions to the aggregate risk-return characteristics of the portfolio, the possibility must be maintained to give all assets the same accounting treatment.

Specifically, as per IFRS 9 phase I relating to classification and measurement, imposing distinct treatments for debt and equity, would ruin the economic rationale of having risks offsetting each other, which has been the basis of prudent investment for decades. Similarly, introducing discrepancies between direct investments and mutual funds would have devastating consequences on how portfolios are built.

Therefore we suggest letting open the possibility, for assets managed with a view to financing long-term liabilities, to have a global model/portfolio including :

- identical treatment for debt instruments and equity investments and other specific dedicated assets;

- identical treatment for investments performed directly or via mutual funds;

- fair value changes recognized in Other Comprehensive Income rather than in Profit and Loss;

- interest income, dividends and gains on disposals recognized in Profit and Loss, as revenues of the year, rather than in OCI (to reduce the gap with the treatment of liabilities whose financial discounting expenses have a negative P&L impact);

- impairment tests run at the global portfolio level rather than on a line-by-line basis.

Question 6 – If you are an investor in entities that are involved in long-term investment activities, what is the information that is the most relevant to you?

How does IFRS financial reporting contribute to those needs today? Please explain.

NA