



DIRECTION DES AFFAIRES EUROPEENNES ET INTERNATIONALES  
DIRECTION FINANCIERE

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### Answer to EFRAG Consultation on Long Term Investment

#### 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?

The identity of Caisse des Dépôts as a long term investor is written into the Law for the Modernization of the Economy (LME): "The Caisse des Dépôts et Consignations is a long-term investor and contributes, consistent with its proprietary interests, to the development of companies." (Article L.518-2 of the French Monetary and Financial Code).

Undoubtedly, its business model can be described as a long-term investing business model in so far as it owns sufficiently stable assets to be able to build an investment strategy based on a long-term horizon.

Long-term financing could indeed be considered as the process of investing or lending with the expectation of holding assets for a long period of time by an investor disposing of sufficiently stable liabilities to be able to do so with a yield.

"Stable liabilities" are the prerequisite of long-term investment. Stable does not necessarily mean "long-term".

For instance, cash deposits such as the Livret A allow CDC to finance investment spanning on more than 20 years....

According to the World Bank (2013 report): "in broad terms, financing long term investments or long term financing can be considered as the process by which the financial system provides the funding to pay for investments that stretch over an extended time period. Investors engaged in long-term financing are generally expected to hold onto the assets for a long time and are less concerned about interim changes in asset prices, focused instead on long-term income growth and/or capital appreciation." But "holding assets for a long period of time" does not boil down to "buy and hold strategy". Obviously long-term investors build strategic allocation consistent with their stable liabilities, but of course implementing this long-term strategy induces them to constantly adjust their portfolio by selling or buying assets. More than the effective holding period of an asset, what is important to take into account is the global investment strategy which accounts for its inclusion in the portfolio.

A way to approximate long term investment business model could be for instance to compute the turn-over of a portfolio. CDC average turn-over of portfolio is around 4% for the last 5 years.

Assets cannot be classified as “long-term” per se: for instance, CDC holds equities which are part of its long-term portfolio; a bank, for instance, could own the very same stocks for trading purposes only. That is why applying measurement rules based on management intent rather than the category of financial instrument is relevant in this matter.

Long-term investing cannot simply be defined on the asset side. More generally speaking, it is really important to define long-term investing as a “business model”: stable assets, multi-annual objectives and constraints, a long-term strategic asset allocation set accordingly. As the OECD puts it in its “Draft High-level Principles on Long-Term Investment Financing by Institutional Investors”, such investors are set with “patient, productive and engaged capital”.

Concerning the economic purpose of this business model, one should be careful not to mistake missions – how important they are – for management objectives: long-term investors are “des investisseurs avisés” (wise investors) which takes into account financial risks and returns when investing.

The Caisse des Dépôts cannot rely on any shareholder to reinforce its equity capital or of providing for its liquidity requirements, if any. It must at all times, therefore, be financially sound enough to withstand crises and cycles without interrupting its missions as a long-term investor, both as a stable shareholder of its subsidiaries and as an investor serving general interest. The economic model of the Caisse des Dépôts is based on a virtuous circle founded on trust: the transformation of short-term resources derived from the mandates exclusively entrusted by the State into long-term uses, as intended by the law and made possible by the trust inspired by financial soundness of the Caisse, must generate results capable of strengthening the equity capital of the Caisse and therefore the confidence that is essential to the conduct of its missions. With the benefit of excellent credit ratings from the credit rating agencies, the Caisse des Dépôts must set itself a financial soundness target that is compatible with its mission as a trusted manager on behalf of third parties and with that level of credit rating, otherwise it will risk undermining the capital of trust that is so essential to its business.

Nevertheless, even though long-term investors such as the CDC pursue financial objectives (defined in terms of risk and returns), they do so with a long-term “patient” perspective so that they generate macroeconomic and social externalities: long-term profit objectives are thus consistent with support to structural policies (e.g. growth through investment) and countercyclical investments.

In this respect, even if long-term investment does support public policies and serve general interest, the “long-term investing business model” cannot be defined as a non-profit one.

**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?**

The long-term investing activities of the CDC derive from the law, which defines the CDC as a long-term investor at the service of public interest and economic development.

They are not driven by the need to back long-term liabilities. As stressed above, the CDC can rely on stable liabilities but have not many long-term commitments to fulfill (except those stemming from the issuance of long-term bonds).

In our balance sheet, we distinguish long-term assets ("actif investisseur") and short-term assets ("actif court terme"). The "actif investisseur" is built to match, more or less, the "passif investisseur" (stable liabilities).

The CDC is involved in trading activities in a really marginal way, just to keep in touch with the markets.

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

In the balance sheet of CDC, investments in subsidiaries, equity investments, private equity, real estate, long-term bonds, long-term loans... are classified into the long-term assets, because of the nature of the instruments, their duration, but also the management intent.

Bank loans, cash management, repurchase agreements... are classified into the short-term assets.

**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 Caisse des Dépôts et Consignations is placed, in the most exceptional manner, under the supervision and guarantee of the legislative authorities. " (Monetary and Financial Code Art. L518-2).

The Supervisory Commission comprising 13 members (including five representatives of the French Parliament, a representative of the State Council, two representatives the Court of Auditors, the Governor of the Bank of France, the Director General of the Treasury and 3 qualified) has to ensure control over major decisions and strategic directions. Since 2003, the Supervisory Commission has a charter which outlines their rights and duties and organizes its relations with management; this regulation also defines the role of the committees created within the Commission to strengthen its capacity for analysis and monitoring: the Accounts Inspection and Risk Assessment Commission, the Savings Funds Commission, the investment committee and the nomination committee.

The CEO regularly informs the Supervisory Commission on the implementation of the long-term investment strategy. Each year, the Chief Executive Officer and Chairman of the Supervisory Commission shall submit a report to the Parliament, which includes all the activities of the institution so that members of the Parliament can ensure their compliance with the tasks that have been assigned.

It is crucial to ensure that the Parliament can make the link between the reporting we do on our long-term strategy and the information provided in our financial statements. That is why the report to the Parliament extensively uses data from the annual report. Fortunately, the current accounting system gives us the opportunity to describe properly our long-term activities by allowing us not to use exclusively mark-to-market.

In this respect, for instance, most of our equity investment is classified as “Available for sale”, reflecting the fact that equity selection is based on the assessment of the long-term fundamental value and not on the short-term price volatility anticipations. When equities are sold consistently with our strategic asset allocation, realized gains or losses are recognized through profit and loss, allowing for the CDC to measure its performance as long-term investor.

In the future, IFRS9 should be adapted to take into account the specific characteristics of long-term investments. In addition to fair value through profit and loss and amortized cost, a third accounting portfolio should be dedicated to long-term investments, which are managed on the basis of a business model that does not involve either the realization of short-term capital gains or the collection of cash flows (see below – question 5).

**Question 5: Do you believe the business model described above justifies a specific 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?**

As indicated above questions 1-3 the long-term investments made by the CDC group essentially take the form of long-term financing, acquisition of real estate investment, and investment in equities with a target average detention and long term. On long-term financing, we believe that the accounting principles established by the IFRS 9 project translate our business properly.

Indeed, when these funds do not have leverage attributable to embedded derivatives, which is usually the case with those provided by the CDC Group, the text allows recognition of those assets at amortized cost (amortized cost) cost. The income group finds and a linearized interest income over the term of the financing, which perfectly reflects the business model attached to this type of asset: collection of future cash flows associated with the simple passage of time and these assets are held to maturity.

Concerning the acquisition of real estate investment, we consider again the applicable IFRS (IAS 40) standard is likely to result corresponding to the possession of such asset business model properly.

Indeed, this standard leaves the choice between a recognition at cost or market value for these assets investment. The CDC Group has opted to maintain these assets at cost, because it considered that the accounting principle gave a more accurate picture of the economic model relating to the holding of investment properties over the long term (collection flow rents without foreseeable future sale of the underlying asset).

On equity investments with a mid / long-term detention, we believe, however, that the provisions in the IFRS 9 project are not able to accurately reflect our business model. The IFRS 9 project requires indeed a recognition shares at market value (the spot price for a listed security), and leaves the entity with a choice between:

- A recognition of changes in value through profit and loss
- Or, a recognition of these changes in equity.

In this case, the entity is not permitted to "recycle" later even when the sale really occurs.

In our view, the two options offered in IFRS 9 for the recognition of equities are equivalent to:

- In one case (fair value through profit and loss), denying the very concept of a long-term investor (which would be assimilated as trading from the user's perspective) resulting in undue volatility (see annex A),
- In the other case (fair value through other comprehensive income), denying the possibility for a long-term investor to measure its actual "performance" (assimilation of unrealised and realised results within equity).

In that perspective, we would suggest the retention of a mixed measurement model for the classification of financial instruments, including the following three categories, based on a business model classification criterion:

- Amortized cost category: financial instruments that the entity holds (or issues) for the purpose of collecting (settling) contractual cash-flows.
- Fair value through P&L category: actively traded financial instruments which are held for trading purpose by the entity
- A third category: financial instruments that are held as investments in a medium or long term perspective or that do not meet the definition of either the amortized cost category or the fair value through P&L category.

Financial instruments included in the last category would be measured at the lowest between the acquisition cost and value in use. Reversal of impairment through profit and loss should be allowed.

The concept of "value in use" is already defined by IAS 36 - §6: "value in use is the present value of the future cash flows expected to be derived from an asset"

In our opinion, this definition could be extended to financial assets when the business model applied is to hold these assets for a long period (a minimum commitment of 2 years of holding period for instance could be required).

The position described above is far from isolated. Most of the stakeholders involved in long term investments have expressed strong criticism on the proposed standard. See Annex A. The accounting policies above would not aim to ignore the value of instant market for the assets concerned, and even less to hide users of financial statements the value our current investments. The "fair value" of these assets at the date of the financial statements could also be given in the notes in full transparency.

These accounting rules allow us, however, produce an income statement that truly reflects our business model holder of shares in the long term. We are convinced that the key indicator of the performance measure should not be polluted by short-term fluctuations meaningless, since that is not bound to result in a probable by the creation or destruction of equivalent value.

The proposal (made particularly by EFRAG and EBF) to maintain the current AFS portfolio while modifying the current rules of impairment, including reversal in profit and loss, raises the issue of equity volatility. Also, this solution does not avoid the difficulty of determining when and how to measure the impairment.

Nevertheless, this solution could be an acceptable compromise compared to the IFRS 9 proposal.

IFRS 9, because of its impacts on income statement volatility (see Annexe) and because of the unsuitable option it offers for equity instruments (i.e : recognition of changes in market value in equity without recycling in profit and losses) would be the worst solution for long term investors.

**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.**

As an investor in entities that are involved in long-term investment activities, we need relevant information on the businesses we are invested in: if current prices are relevant for short-term investors who are trading assets, they are of little interest for long-term investors; conversely, long-term investors are looking for information about the way the business is managed and the development strategies that are implemented.

IFRS financial reporting should clearly recognize the importance of the entity's business model. Mark-to-market valuation should be one of the options for accounting, but not the "default" one as long as long-term investment is concerned (see above – question 5).