L'assureur de toute une vie

To: Ms Françoise FLORES
EFRAG Chairman
35 Square de Meeûs
1000 BRUSSELS

From: CNP Assurances

Date: 25 June 2013

Reference: ECO-ACC-13-202

Subject: EFRAG consultation on long-term investing activities business models

Dear Ms Flores, Dear Chairman,

CNP Assurances is pleased to respond to EFRAG public consultation on the need for a specific financial reporting for long-term investing activities business model.

We believe that insurance industry has a long term oriented business model with strong interrelation between investment strategy and liabilities profile. From our point of view, the existing accounting framework is not sufficiently reflecting the link between assets and liabilities.

We understand the IASB efforts to establish appropriate and consistent accounting principles in the ongoing standards projects for insurance contracts and financial assets (IFRS 4 PII and IFRS 9) but we believe those projects do not fully respond to our concerns since accounting mismatches are still arising between assets and liabilities in the current exposure drafts.

Thus, we would welcome the introduction of a new measure to better reflect our business model and to show the interactions between assets and liabilities performance. The latter consists in pooling and managing assets backing insurance liabilities, sharing similar financial and insurance risks in order to fulfil commitments and guarantees sold to policyholders, taking into account all contractual and prudential constraints. This description justifies the proposed wording for the accounting standard presented in our response to question #5.

You will find attached our answers to all the questions you have raised in this consultation.

We hope you will find these comments useful and we would be pleased to provide you with any further information.

Yours sincerely,

Jean-Michel PINTON
Group Accounting Officer

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About CNP Assurances
CNP Assurances is France's leading personal insurer, with net profit of €951 million in 2012. The Group also has operations in other European countries and in Latin America, with a significant presence in Brazil. It has 23 million savings and personal risk policyholders worldwide and 17 million insureds under term creditor insurance contracts.

CNP Assurances's business is to promote confidence in the future by offering products that protect against the risks of everyday life. The Group designs and manages life insurance, pension, term creditor insurance and personal risk insurance products. The products are distributed by partners that have a strong market presence.

In France, CNP Assurances distributes its individual insurance products through La Banque Postale and the Caisses d'Epargne, as well as through its own CNP Trésor network.

In group insurance, CNP Assurances and its international subsidiaries design term creditor insurance products for a large number of financial institutions. They also craft tailor-made pension and employee benefits contracts for local authorities, companies and mutual insurance partners.

Listed on the first market of the Paris Bourse since October 1998, CNP Assurances enjoys the backing of a core group of four major shareholders (Caisse des Dépôts et Consignations, La Banque Postale, Groupe BPCE and the French State) united by a shareholders' agreement.

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?

Our business model, as a life insurance company, is a long-term investing business model: premiums are collected from policyholders over the covered period, and payment of claims is made when the risk occurs or when requested by the policyholder depending on the type of policy (life/longevity protection or long term savings). Those policies have a long duration, well above 8 to 10 years, which can be seen as defining the threshold of long term horizon.

Modelling tools and available databases and assumptions allow predicting the insurance liability profile. Thus, life insurance companies manage their investments of collected premiums together with the insurance liabilities by ensuring a global consistency in assets and liabilities maturity and profile, which results in a long-term investment strategy.

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?

Our long term investing activities are mainly driven by insurance liabilities profile and commitments made to policyholders. Life long term contracts (mainly 'Unit-linked', 'Euro', 'annuities' and 'loan insurance'contracts) represent the vast majority of our insurance portfolio.

These contracts cash-flows are directly linked to the returns of underlying portfolio and involve a close monitoring of the investment strategy by the ALM department, notably:

- For "Unit linked" contracts which require to hold specified assets, no flexibility is given to the company with regard to the investment decisions (except for the initial choice of investment vehicles)
- For "Euro" contracts with profit sharing provisions, investment strategy will aim to maximize the performance of financial assets since the Group risk appetite and prudential requirements are respected.

Investment strategy also takes into consideration the following:

- Liquidity constraints to guarantee company's commitments are respected (considering the liability predictability): a portion of cash and liquid investment is needed.
- Performance constraints to cover as a minimum the guarantees provided in some contracts: investment strategy is built as such that the expected returns exceed the guaranteed amounts.

These constraints drive mostly the asset allocation strategy in order to be in a stand-ready position to manage the guarantees and more generally cash-outflows of contracts (although cash positions are very limited compared to the financial portfolio).

The diversity of insurance products and their options & guarantees implies the need of an adjusted investment strategy in order to optimize the profile and returns of the underlying assets. From an operational point of view, our financial assets are split into different investment portfolios with specific investment guidelines and strategy, each portfolio is backing determined insurance liabilities and the pools of assets & liabilities are followed-up together.

Our trading activities are very limited and only take place in the context of short-term cash or own funds management (thus affecting a marginal portion of portfolios).

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

Our financial portfolio is mainly represented by government and corporate bonds (68% at 31 December 2012) and also equity investments (including financial funds) which represent 21% at 31 December 2012 of our portfolio).

Investments in more "exotic" products can be made since their risk, profile and returns satisfy to our investment policy:

- Structured/covered bonds (index linked bonds, structured rate bonds, option bonds...)
- Securitization products
- Private Equity and Venture capital
- Others (Infrastructure, direct corporate lending...)

Our investment policy is defined in question #4.

When needed, derivatives are purchased to hedge our assets & liabilities and protect their value or expected cash-flows (though hedging accounting is not systematically used to illustrate our hedging strategy).

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?

Long term investment strategy is established on the basis of liabilities profile, constraints and characteristics.

Investment main guidelines and policies are prepared by the investment committee and approved by the executive committee and board of directors. Periodic investment reportings and orientations are presented to those committees in order to ensure transparency of investment decisions and consistency of assets and liabilities management.

Optimizing our ALM strategy and avoiding any economic mismatch between financial investments and insurance engagements are definitely one of the main objectives we aim to achieve and monitored through these periodic reporting

From our point of view, information provided in the financial statements is cross industry and thus not adapted to life insurance specific business model. Nevertheless, the existing link between insurance assets and liabilities is already illustrated, though disclosed in various appendices:

- Effective interest rates at purchase and at balance sheet date
- Carrying amounts of bonds by maturity
- Average remaining life of securities
- Future cash flows from assets
- Payments projections by maturity
- Reconciliation of unit linked assets and liabilities
- Guaranteed yields on insurance and financial liabiliteis

We believe IASB ongoing projects on financial assets (IFRS 9) and insurance contracts (IFRS 4PII) should improve the current accounting framework, as such, one of the key principles that needs to be further developed in the new standards is the important interaction between managing assets and liabilities. The exposure drafts in their current status achieve partially this goal since some accounting mismatches are still arising (see question #5).

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?

We do believe that insurer business model justifies a specific financial reporting treatment to achieve the objective described above. We suggest that the IASB should analyse the interaction between IFRS 9 and IFRS 4 and the effects of applying them simultaneously in the financial information produced by an insurance company. We believe such effects should be anticipated and adjusted if needed to best reflect a long-term business model, far before finalizing the macro hedging project.

From our point of view the most important principles for accounting assets and liabilities under an insurance business model are:

- To avoid accounting mismatches between assets and liabilities effects and limit the volatility of P&L, and;
- To highlight the interactions between assets returns and insurance cash flows.

We understand the relevance of measuring and presenting assets and liabilities at fair value, but we believe the interaction between assets and liabilities is the key point that needs to be reflected in financial position of insurance company.

For participating contracts, we consider that there could be two different scenarios to achieve this goal:

- If assets are measured at amortised cost: liabilities should be measured using a discount rate that corresponds to a current book yield (CBY rate) [1]calculated prospectively on the basis of expected performance and movements of the financial portfolio
- If assets are measured at FV-OCI: liabilities should be measured using a current discount rate and the portion of liabilities change that do not reflect long term movements should be booked in OCI (the liabilities discounting effect booked in P&L should be calculated using the CBY rate described above).

Below are raised our main concerns and key messages on what needs to be further improved in the financial instruments and insurance contracts standard projects in order to prevent spurious volatility due either to accounting mismatches or to the use of improper discount rate for liabilities :

A. IFRS 9:

- We understand the FV-OCI for debt instruments has been introduced by the IASB mainly to address insurers concerns on accounting mismatches arising between assets and liabilities. However, we believe the business model for which this category is eligible should be better adapted to reflect a long-investment business model, and more specifically an insurance company business model.
- We believe an accounting mismatch would arise from the use of FV-OCI for equity investments if recycling is not allowed. Mirroring approach may absorb such mismatch but would add complexity to the follow up and accounting of those instruments.
- The SPPI test (which only vanilla bonds can pass) and the impossibility of bifurcating embedded derivatives would lead to classifying a part of our portfolio to FV-PL (structured bonds, securitization…) even if these are held in the context of our ALM strategy and backing insurance contracts: accountings mismatch will appear and the objective of showing interaction between assets and liabilities will not be achieved.

B. IFRS 4 (Phase II):

- We believe the use of a prospective CBY rate (Current book yield) for accounting liabilities changes in P&L is the most appropriate discounting rate for participating contracts because it enables to discount liabilities at the same rate as return on assets, while effects of market rates should be booked in OCI for assets accounted at FV-OCI.
- We consider that the breakdown of liabilities between three components (Fix Component, Asset dependant and Option value) proposed in the mirroring approach is not appropriate because it's not possible to isolate an "asset dependant" component (because of lapses and discretionary benefits), but we believe the use of a Current Book yield allows to achieve the same objective (matching assets and liabilities performance and capturing effects of options and guarantees in cash flows)
- We believe the recalibration of contractual service margin allows stabilizing gains and losses in case of shocks on the residual duration of contracts accounted according to the insurance contract standard.

If we could suggest and amendment to IFRS 9 wording to resolve the business model issue, our proposal would be the following (changes to current wording highlighted below):

"4.1.2 A financial asset shall be measured at amortised cost if both of the following conditions are met:

(a) The asset is held within a business model whose objective is to hold assets in order to ***mainly*** collect contractual cash flows.

(b) The contractual terms of the financial asset give rise on specified dates to cash flows that are ***mainly*** payments of principal and interest on the principal amount outstanding.

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[1] Please refer to the first part of our study/ field test on IFRS 4 Phase II presented to IASB members on March 11th 2011, and the two following parts of the study we would be pleased to present to you

Paragraphs B4.1.1–B4.1.26 (to be developed) provide guidance on how to apply these conditions.

4.1.2A A financial asset shall be measured at fair value through other comprehensive income if the following two conditions are met:

(i) ***The asset is held in a business in which designated assets are managed globally within a pool backing liabilities – sharing broadly similar risks and managed together as a single pool – which contractual estimated cash flows are matched by the estimated cash flows, either trough collection or sale.***

(ii) The contractual terms of the financial asset give rise on specified dates to cash flows that are ***mainly*** payments of principal and interest on the principal amount outstanding."

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.

Please refer to answer 5. We do not think IFRS financial reporting contributes to those needs today since the interactions between assets and liabilities are limited to the shadow accounting. We believe Insurance liabilities as calculated under local gaap and maintained in IFRS are totally disconnected from the effects of financial assets measurement under IAS 39.