June 16, 2009

General investment policy guidelines

1. FRR mission statement

1.1 Established by Act no. 2001-624 dated July 17, 2001, the lawful mission of the FRR is to *"manage the sums that are allocated to it, building up reserves that will be used to contribute to the long-term survival of eligible retirement plans"* (Article L 135-6 of the French Social Security Code). These sums will be set aside and built up until 2020.

The FRR is also responsible for the financial management of a portion of the exceptional, one-off, lump-sum contribution owed to the CNAVTS (*Caisse Nationale d'Assurance Vieillesse des Travailleurs Salariés*) pursuant to the 3rd section of Article 19, Act no. 2004-803, dated August 9, 2004 on public utilities (natural gas and electricity) and public utility providers in the electricity and natural gas industries.

Acting on the basis of proposals submitted to it by the Executive Board, the Supervisory Board of the FRR determines the general guidelines underlying the policy for investing the Fund's assets, compliant with (i) the aim and timeframe for use of the Fund's resources and (ii) the principles of caution and risk diversification (Article L 135-8 of the aforementioned code).

1.2 The Supervisory Board considers that the aim of the investment policy of the Fund is to optimize the return on its investments while also preserving the real (inflation-adjusted) value of the Fund's endowments since inception in the period between 2020 and 2040. The Fund's liabilities are therefore composed of the restitution, in the form of 21 payouts, of the value of the endowments received up to 2020, adjusted for inflation. In addition to this accrued liability, the Fund seeks to generate the best possible outperformance while complying with the principles of caution and risk diversification. To this end, the Board has defined a reference portfolio built around the major asset classes.

In the absence of a public policy decision on the exact timetable and payouts of the FRR to pension schemes that are eligible for funds from 2020 onwards, the Supervisory Board has opted for a central technical scenario pertaining to the Fund's payouts, as it did in 2006, which is vital to ensuring optimized management of its reserves. This scenario is both consistent with the most recent work of the COR (*Conseil d'Orientation des Retraites*), which demonstrates the growing funding requirements of eligible pension schemes (in particular between 2030 and 2040), and is simple, in that it posits a linear payout between 2020 and 2040.

These liabilities will be automatically revised upward if the FRR receives additional endowments or if conditions allow for the locking-in of investment gains.

1.3 In its implementation, the FRR's investment policy is also intended to contribute to the funding of economic actors in general and businesses in particular. This in turn helps to consolidate their prospects for long-term growth and promote lasting wealth creation and job growth. At the same time, it is consistent with certain shared values that promote balanced economic, social and environmental development.

In 2008, the Supervisory Board adopted a responsible investment strategy, which is appended to this decision and which seeks to enable the Fund to honor its commitments as a signatory to the UN's PRI (Principles for Responsible Investment).

2. The FRR's governance principles

Within the framework of rules determined by law and specified by regulatory powers, the Fund's Supervisory and Executive Boards are particularly attached to the belief that its organization and activities should guarantee the following and allow it to fulfill its public interest role and goals:

- The integrity of the institution, i.e., its independence as well as respect for its own particular obligations, in particular those relating to ethics and compliance;
- The professional quality of the expertise the FRR requires to achieve its performance-related objectives, both in-house (its own staff) and in its outside service providers;
- The efficiency of internal and external systems of control;
- The quality of its communication with all stakeholders.

3. The guiding principles of the investment strategy

The Supervisory Board has identified the following five principles as those which underpin its actions:

3.1 Long-term horizon and short- to medium-term risks

The long-term horizon and lack of liquidity constraints are obvious comparative advantages for an investor like the FRR. Thanks to these advantages, the FRR can leverage reversion to the mean phenomena and accordingly seek out higher returns at certain points in the cycle. The existence over the long term of a significant risk premium, available to investors able to assume the risk of holding assets whose volatility may be high or that have limited liquidity, is also one of the reasonable convictions held by the FRR.

These comparative advantages of the FRR condition the expected return that it hopes to bring to the management of the reserves entrusted to its care. They must be combined with two other considerations:

- The FRR's reference portfolio factors in the occurrence of extreme scenarios (through stress testing) and, 95% of the time, the basic risk of not being able to honor the liability obligations indicated above. This obligation being mostly hedged, the investment policy seeks the best return/risk tradeoff.

- Although conservative, the risk and return hypotheses underlying the definition of a reference portfolio can be temporarily called into question by capital market movements. These movements are reflected in higher volatility and short-term risks. In the process of implementing the investment policy, an attempt must be made to constantly identify these shocks and disruptions upstream. In fact, dynamic management of the reference portfolio that takes the identification of short-term risks into account as well as the integration of the optimal entry and exit points over a medium-term timeframe is absolutely vital for coping with uncertainties. An investment policy must be more than a fixed and static allocation among asset classes; it must also be capable of substantial deviation whenever it appears that the real risk underlying an asset class or an entire portfolio has become too high over too long a period or is no longer producing returns.

In this effort to reconcile investment timeframes and risks, the use of tools and models that allow us to quantify the returns, the risks and the correlations of the various asset classes remains indispensable for defining and optimizing an investment policy and managing it dynamically. Data obtained from past performance, even over long periods, do not allow us to represent all of the future scenarios and their related uncertainties. For this reason, it is also important to combine them with more qualitative economic and financial considerations.

3.2 Diversification

The conventional approach to the diversification of investments and related risks is also a necessary component of practice. However, by itself it is not an adequate response to the most extreme scenarios, under which the correlation-de-correlation hypotheses cease to function.

3.3 The performance of the reference portfolio, i.e., the tradeoff for its exposure to market risks, constitutes the bulk of its expected long-term return or yield. This is why the task of defining and managing this portfolio and its related risks falls ultimately to the governing bodies of the Fund. Sources of outperformance can be found, in particular through the use of active management styles that seek to explore market inefficiencies and bring in an element of de-correlation with respect to trends in the markets.

3.4 For any long-term, public investor like the FRR, the investment policy must take into account environmental, social and good governance criteria. Doing so offers a way of fully factoring in the risks and opportunities that are associated with the companies in which the FRR is or could be invested. These criteria may in fact have a significant impact on valuation. The analysis of the sustainable development strategies (environmental and social) of businesses, as well as of their positive or negative impacts on the community and the risks they could expose the FRR to in terms of image, is also necessary. The discussions underway on the impact of environmental issues on the investment policy of the FRR and, in particular its long-term asset allocation, will be pursued.

3.5. To define and manage the FRR's reference portfolio and seek out sources of outperformance, **the Supervisory and Executive Boards must take steps to mobilize the best possible talents, inside the Fund as well as outside, and must also ensure that systems of information and control are effective.** The costs incurred in this pursuit are investments defined on the basis of performance objectives net of fees. They are benchmarked to those of comparable institutions.

With regard to the selection of external expertise, the FRR is aware of and attentive to the need to ensure that mandates awarded to external experts in asset management respect the necessary alignment of their interests, practices and behaviors with the Fund's own needs—for financial stability, professional integrity and the long-term efficiency of their investment processes.

4. The FRR's reference portfolio and its dynamic management

The reference portfolio is that which offers the FRR the best prospects of return while limiting the risk of not being able to honor its liabilities. It is determined on the basis of new long-term risk and return hypotheses, which remain conservative while also drawing lessons from the recent crisis. It takes into account the occurrence of extreme scenarios through stress testing. The Supervisory Board examined the short- and long-term risks related to the most pessimistic scenarios for the value of the Fund and considers that these risks can be assumed. Naturally, these risks will be re-examined regularly within the context of the dynamic management of the reference portfolio.

The Supervisory Board has opted for the following reference portfolio, which it believes will enable the FRR to both honor the liabilities indicated above [1] and provide an expected annualized return in the years ahead that is estimated today to be 6.3%.

Reference portfolio (long-term target)	
Equities	45%
Real estate	5%
Commodities	5%
Fixed-rate bonds	25%
Indexed bonds	20%

The Supervisory Board offers the following precisions to the table above:

4.1 These five major asset classes can be recombined with respect to the FRR's hedging target for its liabilities – these are fixed-income assets – as well as with respect to the expected return with higher volatility: equities, commodities and real estate.[2]

4.2 The nature of the specific investment vehicle for each class (listed or private) shall be determined by the Executive Board based on the advantages and drawbacks that are also specific to each (return, risk, diversification, liquidity, cost, etc.).

4.3 The actual asset allocation of the Fund is intended to deviate from the reference portfolio of the FRR, in particular if the risk or expected return parameters deviate substantially from the long-term assumptions.

Accordingly, the relative percentage of assets in the reference portfolio that exhibit higher volatility (equities, real estate, commodities, so-called performance assets) and bonds will evolve within a range of fluctuation whose magnitude is determined by the Supervisory Board.

The positioning of this range with respect to the percentage mentioned in the reference portfolio should also evolve over time as a function of two factors: the assessment of the investment results based on the long-term performance trend that the FRR seeks to achieve and the cyclical nature of the capital markets. The upper and lower thresholds of the range of fluctuation are therefore mobile.

Within this range of fluctuation, any future decisions with respect to rebalancing, reducing or increasing performance assets from one period to the next or within a given period by the Executive Board after the Supervisory' Board's Investment Strategy Committee.

4.4 The optimal diversification (by sector, market capitalization, credit rating, etc.) shall be determined by the Executive Board acting within the confines of the Fund's prudential rules. The percentage of investments in equities and fixed-rate instruments made within the Eurozone will target 60% of each of the assets considered. The forex risk related to investments outside the Eurozone will be 90% hedged.

[1] Considering the endowments received and a conservative estimate of future endowments limited to a percentage of the social contribution tax levied on personal wealth, the FRR's accrued liabilities today are equal to 21 annual payouts of 2.3 billion euros (at 2008 constant rates) between 2020 and 2040.

[2] At this stage in the FRR4s investments in infrastructures as an asset class, they are included in the broader equity compartment of this reference portfolio.

4.5 Other than the major asset classes represented in the reference portfolio, the FRR may make investments in other asset classes considered to be innovative in some respect. The framework shall be determined by the Conseil at a later date. The relevance of the exposure to these new assets or management processes will continue to be assessed by reference to the benchmark portfolio.

4.6 Annually, the Supervisory Board reviews the implementation of the reference portfolio. In the course of this review, the Board examines the main parameters and adjusts them as needed. It reviews the magnitude of the range of fluctuation as well as its upper and lower thresholds, and makes a decision as to whether or not it is time to consolidate all or some of the Fund's gains.