

# AXA 1H14 conference call transcript

*August 1, 2014*

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This document is the transcript of the 1H14 conference call held on August 1, 2014. The podcast of this presentation is available on <http://www.axa.com/en/investor/resultsreports/earnings/>. In the event of any inconsistency between the transcript and the podcast, the podcast will prevail. In addition, the following transcript is unedited, and statements and figures therein are accordingly in all cases subject to those set forth in AXA's most recently published quarterly or annual results.

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## **Andrew WALLACE-BARNETT, Head of Investor Relations, AXA**

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Good afternoon, everybody and welcome to people here in the room with us in London. Welcome to the people online or on the call. Of course in the room we have here Henri de Castries, Denis Duverne, and Gérald Harlin and without further ado, I'll hand over to Henri.

## **Henri de CASTRIES, Chairman and CEO, AXA**

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Thanks, Andrew. Good afternoon everybody. It's a pleasure to be here once again, especially when it's for commenting what I think are pretty strong results. So, where do we stand? I think you will agree with me that the first half is showing a very strong growth in earnings. It's true for underlying earnings up 11%, it's true for net income up 25%, and it's true for adjusted, which is basis for dividends, up 8%. If you look at the underlying earnings per share, it's up only 6%, not that much because the number of shares has increased, but because there is an adverse foreign exchange effect. If we were to adjust for the Forex, EPS would be up 9%, which we think is a pretty good performance, I mean both 6% and 9% are good performances because as you see they are extremely well aligned with the goals of Ambition AXA.

We have been delivering on the selectivity front, which is one of the pillars of Ambition AXA, some of you had expressed worries at the end of the first quarter on the possible growth on the Life side. We told you at the time that we had some non-repeated exceptionals, or exceptional elements, and that we're pretty confident that we would be positive at the end of the year in terms of APEs. I think this chart is illustrating what we were meaning. There has been a significant acceleration in APEs in the second quarter where we are up 8%, which for the half year is leading to a stability, but with a very strong momentum built in during the second quarter. And this is not to the detriment of the margins, as you see, since margins have improved by two points when compared to last year. So, overall earnings, underlying earnings in Life are up €200 million, which we think is a pretty good achievement.

If you look at the Property & Casualty, first point, portfolios are growing, which we think is something interesting, because it's not the case everywhere and for everybody. Revenues are up 2%. And if you look at the combined ratio, the current year combined ratio is down, which is a good achievement given the fact that the amount of natural catastrophes, especially in Europe and especially because of the hailstorm of the second quarter have not been insignificant and this is an understatement and Denis will elaborate on that. Underlying earnings on the P&C side are up €100 million. So, on the first two pillars, Life & Savings and Property & Casualty, strong growth in earnings.

We have accelerated in the high growth markets and this is reflected in the earnings, which are up double digits, both in Life and P&C. And we were willing to illustrate here

operations which for us are pretty significant, because we think that they have a very large growth potential going forward. By that, I mean our two operations in Mainland China, the joint venture with ICBC, which has become the first foreign venture in China, where APEs are up 21% when compared with last year. €46 million can look – seem to you as being, well, a number not that high, but if you look at the revenues of that venture now, its €900 million for the semester. So it's not a negligible operation. Second point, AXA Tian Ping, which is the most recent acquisition, with the idea that, with the number of cars bought by Chinese people, and with the potential of the Chinese Direct insurance market, it was the right time to do it. Revenues are up 30% when compared with last year, and the amount of direct business has grown from 20% to 30% of the total. So, the plan is working according to what we were expecting.

Cost savings, two elements there. The first one is, we have pocketed €200 million of additional efficiency savings during the first half. Second point, we increased the targets for the end of 2015 by €200 million additional. I will remind you that we started this plan with a goal of €1.5 billion, which we then increased to €1.7 billion. We now bring it to €1.9 billion. Because we think we have the means to reach this number before the end of last year. This does not mean that we are not going to invest in the future because as you know we will have invested approximately €800 million in digital between 2013 and 2015.

What does this all mean? Well, it means that, what you have in front of you is a business model which is performing well in a low-interest rate environment because we have taken management actions to make that happen. The diversification of the business mix is reducing the earnings volatility, and I think this has been underestimated by the market, 70% of group underlying earnings are coming from P&C and Protection & Health. The second point is I think our strong ALM discipline, with less than a year duration gap, is paying off. Third point, we have decreased the sensitivities of the group – or the sensitivity of the group – to low interest rates environment, which doesn't mean that we would not benefit from an increase in rate in the U.S. And I think this point is a point which also has been underestimated by the market, and is now proven right by the earnings of this semester.

So, what does this create going forward? We are pretty confident that we will deliver on the underlying earnings growth targets as defined by the Ambition AXA framework, 5% to 10% over the whole period. We have told you that the goal was to realize €300 million to €500 million of capital gains every year, it's something we confirm. Last but not least, and I know this is a topic of particular interest to some, if not most of you, the dividend. The dividend, I have now to very precisely remember what we have agreed to say with Gérald and Denis, and what we have agreed to say is very, very simple. First point, the key driver of the dividend growth should be the growth in earnings. And as you see, earnings have been growing strongly in the first half. Adjusted earnings will remain the basis for the growth of the dividend. Second point, we have a payout range for the dividend, which is 40% to 50% of the adjusted earnings. We are not

going to change the range, but we are going to very respectfully make you observe that we are at the very bottom of the range. And that I've never said that we would forever stick to the bottom. Full stop. Denis?

### **Denis DUVERNE, Deputy CEO, AXA**

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Good afternoon. I thought that Henri was in such a great shape that he would do the whole presentation himself. So, moving back to the financial objectives of Ambition AXA, again, we are in-line and I'm on slide A11. Underlying earnings per share at €1.08, so we are confirming that we have compound annual growth rate of 6% so far. Nothing to say on the free cash flow at the half year, but we are in-line with the objective. Adjusted return on equity was for the first half at 16.8%, above the range of 13% to 15%. And debt gearing was, like at the end of last year, at 24% well within the range of – the new range of 23% to 25% that we have announced at the beginning of the year, our previous guidance being 25%.

Now looking at the underlying earnings in more details. You can see that the underlying earnings have grown by 11%. That we have growth in each of our business segments with the exception of Asset Management, which is at -4%, but would have been at 11% if we take into account the disposal of AXA Private Equity, which took place in the fall of last year.

Moving to the next slide and you have here a waterfall of the underlying earnings comparing the first half of 2014 to the first half of 2013. You see that we have a very substantial increase in our Life earnings, €198 million. And this is taking into account the minus €30 million of lower contribution in the U.S. coming from the loss of the MONY assets, €105 million in P&C as a result of the improved investment yield and increase in premium. International Insurance also positive. You see that we have more holding expenses with further investments in the brand and digital. And we have adverse effects of Forex, which is largely coming from the depreciation of the Japanese Yen.

Adjusted earnings up 8%. We have both slightly lower capital gains, €439 million compared to €555 million last year, but also much lower impairment of €91 million and that gives us the adjusted earnings of €3.1 billion. So the net contribution of capital gains is slightly lower than last year.

Net income up 25%. This is related to the change in fair value of derivatives, both fixed income derivatives and Forex derivatives. We had a negative last year coming from the increase in interest rates. We have a positive this semester coming from the decline in interest rates and the slight negative on Forex coming from the Japanese yen. We have lower exceptional and discontinued operations, but still some negative coming from Hungary. We have lower integration and restructuring costs. Last year we had a significant cost coming from the restructuring of our real estate footprint at

AllianceBernstein, we don't have this this year, and we have a similar level of intangible amortization, in total plus 25%, that's €3.008 billion.

Moving to the Life & Savings part, first on the new business, new business was down 1% in mature markets, this is largely related to the fact that in the Q1 we had one – I mean, we had two things: in Switzerland, we have reduced the volume of group pension new business in the first half of this year. Last year was a big year for Group Life. This year, we have decided to reduce the volume of new business, because this is a business that has relatively high guarantees. And we have also had a very significant one off in terms of health new business coming from the move to the unisex tariff in Germany. Other than that, the momentum that Henri has mentioned in Q2 also applies to the mature markets, the margin has improved one point to 31%. High growth markets, the growth of new business was 7%. It was up 12% in Asia, but we continued to suffer from a decline in Central and Eastern Europe, which is largely related to Poland, where we see the end of the impact of the nationalization of pensions, which has continued to materialize for us this year compared to last year where we still had in the first half some positive contribution on the pension side, which have disappeared at the end of the first half of 2013. Margin has improved from 45% to 48%. We have solid growth in Asia, as I mentioned, with good growth in Hong Kong, in China, in Thailand. In total, flat new business volumes, an improvement of two points of the margin during the first half.

Looking at it from a NBV margin and net flows by business, Protection & Health continued to be the highest margin business at 55% with the continuation of nice net flows at €4.3 billion, and we had a slight decline in production, which is largely related to what I mentioned in Switzerland and Germany. General Account Savings, we saw a rebound of new business of plus 9%, largely related to France. NBV margin at 13%, but still net flows negative at minus €1.5 billion. And finally, Unit-Linked, 29% margin, a growth of APE of 2%, a net flow which is slightly negative at minus €0.1 billion, but this flow has suffered from €1.1 billion coming from the success of our GMxB buyouts in the U.S. which closed in January with the exception of New York, for which we had the authorization later and continued later in the year.

Moving to the next slide, pre-tax underlying earnings by business of +11%. On the protection side, we have a growth of 8% with better claims experience in France, higher fees and revenues, and higher expenses in line with the commercial activity. On the G/A Savings side, we have higher technical margin coming from higher positive prior-year reserve developments, also in France, higher investment margin reflecting lower crediting rates, and slightly lower fees and revenues as the assets come down. Unit-Linked was up 11% with higher management fees in line with higher asset base, and a lower technical margin, which is again mortality in the U.S. on the variable life side.

I'll move now to Property & Casualty, with a growth of revenues of 2%. The growth was 1% in personal lines, with an average price increase of 1.7%. The point to note is

that we had both more than 300,000 net new contracts, as mentioned by Henri, average price increase of 1.7% and only 1% of revenue growth, which means that we have lower average premiums coming from continuation of the financial crisis, and people trending down in terms of the coverage that they ask for. Commercial lines was up 3%, average price increase of 2.2%, revenue growth being driven by tariff increases and volume increases, particularly concentrated on high growth markets.

Looking at the usual slide of A23, where we show the price increases by market, price and volume increases by market, you see that we had still more green than amber on this slide, so we have been able to put in price increases almost everywhere, and we see no price decline at this stage. Pricing trends for the second half are slightly less positive, they remain very positive in France, there are more subdued in the other markets but we don't see significant price declines, with the exception perhaps of Italy on the motor side where we are in the second year of price declines.

On revenues and margins by market, mature markets have revenues up one point and current year combined ratio down by half a point. High growth markets had revenue growth of 5%, lower than usual. Asia was up 8%. Our Mediterranean and Latin American region was up only 4% because of both Turkey and Mexico, which showed less – I mean, Mexico, we have a decline of our exposures because we saw some price competition coming this year and the combined ratio was up 20 basis points from 97.3% to 97.5%, also difficult market condition in Turkey and Mexico. The Gulf has a very good result in term of growth in the MedLA region, and Asia also very good results in terms of growth and profitability. Direct was up 7% and the combined ratio is slightly down by 0.2%. In total, our current year combined ratios continues to improve to 97.1% very close to our target of 97% of our Ambition AXA plan for the current year combined ratio.

In total, the P&C earnings, underlying earnings went up 9%. You see on the flowchart on the right side of the slide that we had positive elements in terms of price increases and lower expense ratio. But negative elements in terms of higher claim severity and higher net cat charges of which €241 million for the ELA hailstorm, which hits France, Belgium and Germany in June. In total, our natural catastrophe charge was 1.7% for the half year compared to 0.7% for last year. We have slightly lower positive prior year developments, 1.3 points against 1.8 points, which leads to a stable all year combined ratio at 95.8%. You see a very good performance of our investment income, up 12%. Yield of 4.2%, it would be 4%, if we excluded the exceptional mutual fund dividends in France, which amounted to €67 million and are probably not repeatable across several years.

Moving to Asset Management, we have a good story in Asset Management with net flows of €14 billion against €12 billion last year for the same period, €11 billion at AXA IM, €3 billion at AllianceBernstein. What is notable for AllianceBernstein is that they were negative in the first quarter and they had more than \$8 billion of positive flows in

the second quarter, so we see a sharp rebound at AB. Revenues were up 7% at AXA IM, we have, I mean this growth of 7% takes into account the sale of AXA Private Equity and revenues were up by 3% at AllianceBernstein. In total, the Asset Management earnings went down 4% or +11% excluding AXA Private Equity. The decline was 15% at AXA IM for the reason I have mentioned, it would have been +9% without AXA Private Equity. And we have a growth of 14% at AllianceBernstein. I'll hand over now to Gérald for the balance sheet. And I thank you very much for your attention.

## **Gérald HARLIN, Group CFO, AXA**

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Good afternoon. So let's move to the shareholders' equity. So, shareholders' equity went up from €52.9 billion to €58.9 billion. On the right hand side, as usual, you have the various movements, the key drivers of change. I will comment only the most important one, which is the change in unrealized capital gains, mainly driven by lower interest rates, and the sub debt, plus €0.8 billion corresponding to the €1 billion undated subordinated debt that we issued in May 2014.

Moving now to the debt gearing, the debt gearing is at 24%, the total net debt is more or less stable at €12.4 billion. The debt ratio is at 24%. So within the 23% to 25% range that we updated, that we fixed, before, we were at 25%. Interest cover is improving from 10.2x to 11.0x. And I would like to mention that Moody's and Fitch changed from a negative to a stable outlook. So, that means that we are – that is equivalent of to AA minus stable at Moody's and Fitch and AA plus stable at S&P.

Moving to the economic solvency, the economic solvency ratio went up from 206% to 215%. You have the roll forwards. So this increase is mostly explained by the operating return of 12% for the six months. We have a -3% adjustment coming from the markets and mainly as you can see in the upper right, coming from the decline in the interest rates. So, we are continuing to work with our group supervisor on the validation of our internal models. This includes looking at the latest developments in the Solvency II framework. What I can say is that we don't expect any of these impacts to create an issue for us and for our capital.

Asset-liability management, we have General Account invested assets of €489 billion. The global asset allocation did not change significantly. You can see that our fixed income asset duration remains very long as explained previously by Henri, we manage roughly a one-year duration mismatch, which means that in Life & Savings we are at 7.2 years and in P&C five years. This long duration explains why we have slow yield dilution. We are at 3.7% in Life & Savings, and you have all the – we started in 2010 at 4%. In P&C, same, we are at 4.2%, but excluding these exceptional mutual funds as explained by Denis, would have been at 4%.

This slide is quite interesting. As explained by Henri, we have resilient margin. And here, what you can see on Life first, in the upper part of the slide is that, although we have a progressively declining asset yield, the fact that we have very low average guaranteed rate and on top a declining average guaranteed rate makes that – we have a safe gross margin of 150 bps, which means that we have a resilient investment margin, which was at 79 bps in the first half of this year well within the guidance of 70 bps to 80 bps. As far as P&C are concerned, we have resilient yields, and which makes that – in the end we have a resilient investment income.

Let us focus on the net amount invested during this first half. We invested €22 billion, at an average rate of 2.9% of which the Eurozone is at €3%. Where did we invest? Mostly, of course, it's our business in fixed income, but more in investment grade credit rather than in govies and also in some diversification. And as you can see, most of the investment grade credit is in corporate bond, but some part also in commercial real estate and other loans. I hand over to Henri.

### **Henri de CASTRIES, Chairman and CEO, AXA**

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So, if we sum up, what would we like you to take back from this afternoon's session? Strong increase of earnings across the board in the three big pillars. Top-line growth on track in Life, in P&C and Asset Management. Company is performing well in the low interest rate environment, and we are comfortable that we will deliver on Ambition AXA objectives.

If I look forward, what are the priorities: keep delivering profitable growth, keep accelerating the growth through investments in brands and digital, because we think these are two things we are at a time where the world is changing and investing in brand and digital is susceptible to move market shares. We will maintain a very strong discipline in capital and risk management, and we will offer you an attractive dividend. Having said that, we will move to the questions. Who is going to ask the first one? Well, maybe, we will start from the bottom of the room, go ahead. If you could stand up, say who you are and ask your question.

## **Q&A session**

### **Peter ELIOT, Berenberg**

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Peter Eliot from Berenberg. Probably to start with the dividend question maybe better. I guess on the full year results, you commented that we should probably expect the lower end of the range for the next few years. And you were very careful in your wording earlier. But I would think I managed to pick up a small improvement in the tone. And I was just wondering, if perhaps you could touch on why – the reasons perhaps for that tone increase, whether it was sort of better, very strong half year result or perhaps the facts that fed into that. Secondly, on the APE comment, I guess the one, the surprise for us at the first quarter was the change in strategy in Switzerland and not offering the full solutions. I noticed, in Q2, the Swiss numbers were up quite strongly Q2 on the previous Q2. And I was just wondering if there was any change in that strategy in that country. And then perhaps thirdly, if I may, just on the Mediterranean-Latin American region in P&C, Denis, you gave some figures there and in particular on Mexico and stuff. But, just if I take a headline sort of top view of that, I guess we had some quite significant action in Turkey sort of 12 months to 18 months ago, which hopefully would've sort of improved that result a little bit there. And in Italy, we've had a very profitable market which is sort of improving. I guess I was slightly surprised to see a combined ratio still quite close to 100% with still some additions. So, I was just wondering if there was any more granularity you could give over the different countries within that region.

### **Henri de CASTRIES, Chairman and CEO, AXA**

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Denis you want take the Switzerland and the Med region?

### **Denis DUVERNE, Deputy CEO, AXA**

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So, Switzerland, there was no change in fact in Q2 compared to Q1, but Switzerland we have both group business and individual business. The group business is quite lumpy as you know. It's a business that is I would say discussed in Q2 and goes on the book Q1 of the following year. So basically, the campaign of 2013 leads to the Q1 figures of 2014. And what happens in the other quarters is essentially individual business. So, we had a very strong individual business in the second quarter, it has nothing to do with this policy change that you refer to on the group side. On MedLA, I'd like to make two comments. First on Turkey, we had a negative surprise in 2012 where we strengthened our reserves quite significantly because of a very dramatic change in bodily injury claims trends with a trebling of the bodily injury awards by the court. And we thought that we had dealt with it once and for all, and this – it emerged that it was not the case because – for two reasons. The courts have continued to, I would say,

change jurisprudence in a way that was more favorable to the claimants. And the claimants can go back 10 years. And we had been a big writer of third-party liability in Turkey with a very high market share. So we continued to have some negative development in 2013 and even early this year. We have increased prices between the fall of 2012 and the spring of 2013 by a total of 50%. The market did follow us last year, but we showed some of our competitors early this year that started to reduce prices. And we have less exposure as a result of that. But our current year combined ratio in Turkey remains quite good. We still have a little bit of negative developments, less so obviously than in the previous years, but our current year combined ratio is good. But the new news for this year is that at this stage, we are slightly losing market share. I don't – the comments that were made on MedLA were focused on the emerging markets side and Italy is not part of that bit of MedLA, Italy is classified in the mature markets. I mentioned Italy as a country where prices have come down. They've come down 6% last year. They are still coming down this year. We were starting from the very strong position, and our position in Italy in terms of combined ratio remains quite solid. So we are not worried about this.

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**Henri de CASTRIES, Chairman and CEO, AXA**

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On your favorite subject. Yes, there is a slight change in tone. Why so? The earnings are strong in the first half. We are confident that we will deliver on Ambition AXA, and the reason for which we were more cautious was the fact that with the number of uncertainties regarding the discussion surrounding Solvency II and SIFI, it was such that we thought it was good and prudent policy to be cautious. The more we come closer to the outcome on Solvency II and to more visibility on what's going on with the SIFI discussion, the more elements we have to adjust our position. So, I've said what I've said, I'm not going to repeat it. But, I'm sure you've noted it. Next question.

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**François BOISSIN, Exane BNP Paribas**

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Thank you. Good afternoon. François Boissin from Exane BNP Paribas. First question, if you could come back to the €100 million negative sensitivity that you have with interest rates, what's the methodology behind that? That's the first question. And second question is, with regards to the GSII legislation, you just mentioned, maybe just an update on where you stand on this one, and how you see your U.S. operations in this context? And just the third question is, with regards to Solvency II, what areas of your internal model are you likely to recalibrate according to new legislation? Thank you.

## **Henri de CASTRIES, Chairman and CEO, AXA**

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Good. These are great questions for Gérald.

## **Gérald HARLIN, Group CFO, AXA**

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Okay.

## **Henri de CASTRIES, Chairman and CEO, AXA**

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I mean, these are his two favorite subjects.

## **Gérald HARLIN, Group CFO, AXA**

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Okay. And €100 million sensitivity, what we did is something quite simple. That means that you noticed that I mentioned that the new investment for the first half was €22 billion. So, roughly we invest let's say €45 billion in new money, of which let's say 80% is in the fixed income. So assuming that we would starting from something around €30 billion, €30 billion invested at minus 100 basis points that makes €300 million, €300 million minus tax, minus PB because a significant part goes to the policyholder make that roughly you had €100 million. What are the areas on which we are working, I would say that first we have the capital on sovereigns, we have the fungibility, we have the volatility adjuster, we have the ultimate forward rate, all these types of elements, you know which are changing, but as I said that means that in the end, we are confident, but for the time being it is not stabilized yet.

## **Denis DUVERNE, Deputy CEO, AXA**

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I'll take the question on GSII, Gérald commented on Solvency II. There's still a lot of unknown, but there is one element that has been clarified, which is the – what is called the basic capital requirement or BCR, where we don't have a final regulation, but we have a draft that has been put out for consultation by the IAIS, International Association of Insurance Supervisors at the beginning of July. And the calibration that's proposed for the BCR is in line with what had been indicated informally by members of the IAIS, which means that for European players, it comes in the area of 70% to 75% of the SCR. So, they have delivered what they had said they would. And so far – I would say, so far so good. It doesn't say anything about, two important topics, which are the quality of capital and what they would say about the quality of capital and the factors that they would take into account for the HLA, which means higher loss absorbency, so the parts of the business that they consider as more

systemic. So, we still have this, I mean, an expectation that we will have more information about this by the end of this year, but I would say, so far so good. Nick, you had a question, I think.

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**Nick HOLMES, Société Générale**

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Nick Holmes of SocGen. Yeah, two questions, please. One is on emerging markets. So I think about 13% of your underlying earnings come from high growth markets at the moment. And I wondered if you could share with us your sense of where this might develop, say, in five years' time or whatever time period you think is appropriate? Second question is looking at expense reduction, your P&C expense ratio has come down to 25.9%, and you've achieved €1.3 billion of cost reductions. I think in P&C, correct me if I'm wrong, but you were targeting €1 billion of expense reduction. And my question is, what effect do you think, well, firstly, where are you with that €1 billion on the P&C side? And then, secondly, if you were to achieve €1 billion, what might that do to your expense ratio, which is currently around about 26%? Thank you.

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**Henri de CASTRIES, Chairman and CEO, AXA**

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On the first part of your question and I will ask Denis or Gérald to take the second one. On the first part of your question, the – remember, I mean back in 2007, I think, the amount of earnings coming from the emerging markets was around 5%, being at 13% is already a significant growth. What we expect, of course, is to have it continued to grow double-digit. There are some of these businesses which are in their infancy phase. It is going to take some time. If you take the Chinese P&C business, as an example, because we invest heavily in it, I mean it's profitable this half year, it's better than what we were expecting because, in fact, we were expecting to have some losses because we're investing in the development of the business, to create portfolio value and to create volume. But over time, I would say that it's not unreasonable to have a target of above 20%. 20%, 25% of the earnings coming from the emerging markets in the foreseeable future before a change in the decade. On the second question, Gérald, do you want on the P&C expenses?

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**Gérald HARLIN, Group CFO, AXA**

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On the P&C expenses, I would say that, roughly, we are two-thirds of the objective of €1 billion, which means that just for you to make it clear, it's €0.3 billion, it represents roughly 1% of combined ratio. That give you the flavor of what it could mean.

**Henri de CASTRIES, Chairman and CEO, AXA**

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Yeah, Farooq?

**Farooq HANIF, Citi**

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Hi, there. Just actually, you didn't answer part of Nick's question which is, how much is left of the expenses in P&C? So that's question one. Question two is you also gave a range of remittance ratio a long time ago, and then I believe the sense was that that was also stuck at a fairly low level because you're rebuilding capital value. Now we're in a better environment. Are there initiatives that you think will make that appreciably better, because I know that some of your competitors are looking at this and very focused on it? That's question 1B...

**Henri de CASTRIES, Chairman and CEO, AXA**

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It's good to hear. I mean if you go to 5C, it's going to be a very long question. Go ahead.

**Farooq HANIF, Citi**

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And the other question is if U.S. interest rates ever go up, long-term yields, if they went up by 100 basis points or it went up 200 basis points, what's the IFRS earnings impact both sort of immediately and then after two years or three years. Thanks.

**Gérald HARLIN, Group CFO, AXA**

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Yes, on the – first on the remittance ratio, I would say that...

**Denis DUVERNE, Deputy CEO, AXA**

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I understand that Farooq wants the end of the answer. So my understanding is that Gérald has given the end of the answer, which is – since we have realized two-thirds, there is still one-third coming.

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**Gérald HARLIN, Group CFO, AXA**

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Yes, I'm sorry. It was – it is for me. But – and roughly speaking, I'm sorry Farooq. Roughly speaking, I said that it could be roughly one point, that's the answer. And on the remittance ratio, I would say we were at 75% last year. We are doing all what we can in order to improve this ratio. What we can expect is so long as, I would say, the U.S. are improving – you can see that the contribution from the U.S. significantly improved – we could have some reimbursements of debt coming from the U.S. so that could be a plus compared with what we did last year. Your last question was on the IFRS impact?

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**Farooq HANIF, Citi**

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Yes

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**Denis DUVERNE, Deputy CEO, AXA**

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So one additional point is that in Continental Europe, we – on the Life side, we see all the regulators taking into account lower interest rates in Europe to push for an increasing statutory reserves with a reduction of the discount rate. So this is a headwind that we have on the Life side in Europe. We have – I mean we'll try to compensate that, as Gérald said, with other measures, but we have this headwind coming from the Continental European supervisors on the Life side.

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**Henri de CASTRIES, Chairman and CEO, AXA**

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The last part of the question was on the increase in interest rates in the U.S., if it becomes very significant and its IFRS impact?

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**Gérald HARLIN, Group CFO, AXA**

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Of course, in the U.S., we have this – I would say, first of all, if rates are going up in the U.S. that means that we will have less reserves because the options will be less in the money and there will be an improvement. It's difficult for me to give you a precise measurement of what it would mean but look at the difference that we have today, we still have, I would say – I believe that it would be €100 million roughly, we had €100 million of pre-tax, pre-DAC of impact when we have a rise of roughly 100 basis points, but you have to take into account the fact that if rates are going up immediately we amortize more DACs so the impact would be, let's say, roughly 40% of this. I can't give you a more precise estimate but that's roughly what I have in mind.

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**Denis DUVERNE, Deputy CEO, AXA**

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And we have also a positive impact of an increase of the short-end of the curve on the U.S. because here, we would get positive carry that we had assumed in the reserve initially and that we don't have. So we would benefit from an increase in short-term interest rates on top of the benefit that we get on the long end of the curve.

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**Farooq HANIF, Citi**

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But did you feel that your reserves are too high? It doesn't happen immediately but...

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**Gérald HARLIN, Group CFO, AXA**

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No, no. Let's be cautious on that side, what you're referring to is the fact that at the end of 2012, we decided to increase our reserves corresponding to the policyholder behavior. Nothing tells me that if rates would go up by 100 basis points or 200 basis points, we would have to decrease these reserves. It would depend effectively on the behavior of policyholders and nothing tells me that they would have a different behavior. So, let's remain cautious on that side. What I described previously was merely a technical factor coming from the fact that we would benefit, in fact, from higher level of interest rates.

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**Henri de CASTRIES, Chairman and CEO, AXA**

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Next question? Jon?

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**Jon HOCKING, Morgan Stanley**

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Jon Hocking from Morgan Stanley. I have got three questions, please. Just to come back to the comments on capital and dividend. If I sort of remember right here what you said at the full year: absent earnings, you basically said the macro environment is pretty tricky. There was uncertainties around Solvency II and there was uncertainties around SIFI buffers and global capital. If we sort of unpack where we are now that the global macro is facing tougher both politically and also with interest rates with yields coming down. On the SIFI side of things, we have some collateral BCR, but we're still nowhere near to know now where the HLA will end up. So implicitly, are you saying that Solvency II has ended up in a better place vis-à-vis what you're expecting that seems to be only piece which has changed? That's sort of the first question. The second question, on acquisition costs, the extra €200 million, I wonder if you could break down where you think that's going to come from and whether there is any sort of

local impact on growth. And then just finally, when do you think we're going to get internal model approval from your lead regulator?

**Henri de CASTRIES, Chairman and CEO, AXA**

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I thought you have three questions.

**Jon HOCKING, Morgan Stanley**

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Just capital, acquisition costs and internal model.

**Henri de CASTRIES, Chairman and CEO, AXA**

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Okay. On your first question, don't try to do too much criminology. The – yes, we are more confident about Solvency II. We are also more confident about SIFIs. On the first point, yes, the global environment as far as interest rate is concerned is tougher. On the other hand, it's not improbable that U.S. rates will start to go up and more than anything else if you look at the way the group is behaving in a tougher environment, both in terms of revenues and in terms of earnings, we have some reasons to think that the model is working well.

**Jon HOCKING, Morgan Stanley**

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The extra confidence on the SIFI, where are you getting that confidence from, I think the BCR is landing in a good place...

**Henri de CASTRIES, Chairman and CEO, AXA**

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I'm not telling you that the discussions have come to an end. On BCR, it's reasonable. On the rest, we will see, it's going to be a long process. At this stage of the discussion, we are not saying it's going to be easy, but we think it's not going to be disruptive.

**Jon HOCKING, Morgan Stanley**

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So, the other two questions.

## **Henri de CASTRIES, Chairman and CEO, AXA**

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Yeah, sorry. The two other ones.

## **Denis DUVERNE, Deputy CEO, AXA**

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So, your question on acquisition cost was, where is it going to come from, because we have – I mean it's always the same. We start from the top down ambition, and then we try to reconcile that with a bottom-up plan, and we have very precise bottom-up plans in our various operating units that give us confidence that we will achieve those figures. And you asked for the source of those expense reductions and I believe that's in the slide that Henri has presented, we mentioned on the right side of A7: sales support productivity improvement, marketing efficiency, commissions optimization, which means commission reductions and these are the sources of those €200 million. On the internal model approval, is your third question, where do we stand? I think we stand in a reasonable place. It's a huge and complex process which involves not only the French supervisor, but the supervisors of all the European entities. There is a college of supervisors. They gather on a regular basis. We have meetings with them and they look at the internal model bit by bit. They narrow down the number of questions that they have. We are supposed to file a preapproval in December. We are supposed to file final approval at the end of May. And we believe that we are on track to meet those deadlines, and everyone on the regulatory side seems to work towards those deadlines as well.

## **Andrew CREAN, Autonomous**

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It's Andrew Crean from Autonomous. A slightly fluffy question. The development of digital is presumably, say, you can interact with your customers more and in interacting with your customers more, you would have to be more transparent with them in terms of what you charge them selling products, and that is sort of underpinned, I think, by regulations around the world, including some of the MiFid II stuff. Could you give us a sort of pencil sketch as to which markets you think would be most challenging in terms of greater transparency around distribution cost and sales costs?

## **Henri de CASTRIES, Chairman and CEO, AXA**

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Probably, the mature market, before the emerging ones, which doesn't mean that some of the emerging are not going to be sensitive, but I mean if you look at the consumerism, in this market, in some of the other European countries, these are places where you will have to be more transparent. We don't think it's a – in the long-

term, we don't think it's an issue because we think that if properly handled, digital can enable you to very significantly improve the service you give, making it much more comfortable with the customer and therefore we do not think that this is the major factor in reducing the margin. You will have a portion of the business which will become more transactional. I mean the automobile business, it's clear that for traditional agents, it's going to be a tough life. But if you can rescale them or if they have the proper skills, they will do more of the commercial risks where the market is underequipped. And the consumers will still keep having automobiles and will need to ensure them, and we are pretty well positioned with that business. But I think most of the pressure will come probably in the mature markets first. Denis, would you add to that?

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**Denis DUVERNE, Deputy CEO, AXA**

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We have also some of the markets that could qualify today as high growth like Hong Kong, where we see the regulation changing rapidly, and I mean it will impact us on the Unit-Linked side because traditional products will not be impacted by this transparency initially; it will be an impact that will focus on the Unit-Linked. And there is certainly going to be a market impact of this move through transparent commissions next year. So it's coming in different shapes or forms. I mean you've seen India three years ago that was hit by that with the change in regulation. So, it's – I mean there is – I mean it's not directly connected to digital. So there is clearly a move towards more transparency, more commission disclosure, more disclosure of charges, which is affecting many of our markets gradually and we need to be ready for that. And I believe that at the end, we must be in the side of customers and be in favor of those changes.

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**Andrew CREAN, Autonomous**

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Just as a follow-up then. How do you get ready for that in terms of selling life policies, when you're in such low interest rates world, in terms of actually cutting the charge structure?

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**Denis DUVERNE, Deputy CEO, AXA**

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I mean, you've seen our program of expense reductions of €1.9 billion. This program takes into account the need to reduce the expenses of the business and when we are at the end of our 2015 plan, our next plan will also include a reduction of expenses because we believe that we're in an industry where the charges are excessive and they would need to get closer on the life side to what is happening on the asset management, so we need to continue to reduce our expenses.

## **Ralph HEBGEN, KBW**

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Hi. It's Ralph Hebgen from KBW. Just two things. One is on the U.S. variable annuity book. I wonder whether you can give us some sort of commentary on what the profitability of the legacy VA book might be. Best would be an answer like it contributes so much in underlying earnings but I leave it to you what metric you might wish to choose. And the second question is something which we sort of discussed already. It relates to the regulatory environment in Europe. But specifically to Germany, I wonder whether you can give us a view of how you feel new regulatory legislation in Germany might impact fungibility of capital and cash up-streaming capacity in your group? Thank you.

## **Gérald HARLIN, Group CFO, AXA**

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Maybe you can go in your booklet. You have the booklet, on page B26 and you have an update on where we are in terms of U.S VA legacy book. And you can notice that we have for the first half a contribution of €123 million slightly up compared to last year. But we had some positive one-off last year. You can notice that anyway the hedge margin is at €-35 million which means that taking the basis risk, the volatility risk, interest rates they've decreased a lot. So that means that we are doing – we have been doing a lot in the last years in order to decrease the basis risk, being much more indexed. The volatility went down. But we have also been managing through options some ways to lock this volatility, so that's it. And you can see that, now we can expect that as far as the variable annuity book is concerned that in the absence of market conditions that would worsen a lot, we are at relatively stable levels now. And what we can expect is at the same time, going to the previous question in case the markets will improve, then of course we will have an improvement and a gradual improvement of the fees. Last but not least, out of the €431 million of Life & Savings underlying earnings for the first half, keep in mind that we improved pre-tax basis with the fees that we extract from the Unit-Linked business - improved by €63 million which is quite substantial. And this is also the benefit of the improvement in the equity market.

## **Henri de CASTRIES, Chairman and CEO, AXA**

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And the first part of your question and Denis will add something if he feels he need. I think you have already given a portion of the answer. On fungibility and on the reaction of the regulators, it's not only in Germany that you see the tendency of regulators to try to put their hands on more capital if they can. It's the case in the U.K., it's the case in Belgium. It's a sort of game before they all jump into the sea of Solvency II. So, they are trying to force the players to increase their local buffers. It is what it is, I don't think it changes the world. It's unpleasant. It's difficult discussions. If it were to persist beyond, it would be a problem. Because it would mean that under the appearance of a

common system, you have very different behaviors. But I think it's a sort of normal regulatory sphere before the introduction of a new system. Denis, do you want to add something specifically on Germany?

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**Denis DUVERNE, Deputy CEO, AXA**

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No. I would say that the German reform was – has some positive aspects and some negative aspects. From a profit standpoint, it's not negative, but from a distribution standpoint, it looks slightly rather negative. So, yes, it's one of the headwinds that I have mentioned.

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**Henri de CASTRIES, Chairman and CEO, AXA**

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Do we have another question in the room – and? Okay, go ahead. And then I'll check if we have a questions... No, we don't. Okay, there is one here.

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**Paul DE'ATH, RBC**

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Thanks. Paul De'Ath from RBC. Just a quick question on Life products. And you mentioned a few times in the release success of the hybrid products kind of general savings and Unit-Linked product and this was also mentioned by one of your peers yesterday as a success story for them. Are these the answers for the issue with Continental Life sales or are they just kind of a way or means to get everyone into Unit-Linked products in the long term as you kind scale back the Guaranteed Savings element and increase Unit-Linked? How do you see this going forward?

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**Henri de CASTRIES, Chairman and CEO, AXA**

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Yeah. I mean, good question. Could be a bit of both. We are in a situation where it is not very rewarding for clients to invest for the long term in General Account product as these products are invested mostly in bonds, even if historically, the performance has been good, and we all know that most of the time small investors when investing, they look into rear mirror. So it's not in their interest to be totally exposed to General Account. So what we try to do, because it's also in our interest to see them buying Unit-Linked, if they don't want to jump 100% to Unit-Linked, they have this sort of hybridation. So I guess the answer is probably, it's a bit of both. Any other questions? Yes. Blair?

## **Blair STEWART, Bank of America Merrill Lynch**

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Thanks very much. Blair Stewart from BofA Merrill. Just picking up on a couple of things. I think it was Allianz who took a reduction to their economic capital to reflect the possibility of sovereign default risk. I just wondered what your comments on that were. And secondly, on expenses, when you get to the end of your Ambition AXA plan, where do you think your expense level would be relative to your peer group? Have you done any benchmarking exercises that you would share? And thirdly, I think one thing you've talked about in the past is the quality of capital. I think that Denis mentioned that the business was still in deleveraging mode. And I guess that was to improve the quality of the capital. And I noticed you prefunded some debt retirements with some Tier 1 hybrid. What was that coming up over the next few years? Just wondered if you can say about anything about the quality of the capital of the company because the quantity of capital looks very strong?

## **Henri de CASTRIES, Chairman and CEO, AXA**

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Okay. I could – Gérald, do you want to take the first and the third part of the question? And, Denis, do you want to take the second one?

## **Gérald HARLIN, Group CFO, AXA**

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About the sovereign default, I could say that we can expect that, nothing is settled yet, but we can expect that for those who will adopt internal models, there will be some capital in front of sovereign, but in front of spread risk and not credit risk. At the same time, we should keep into consideration the fact that there will be some, what we call, the volatility adjuster, that means some mitigation mechanism that will offset at least part of this. The second question – you raised the question about the quality of capital. Yes, you're right, that means that we – what we have been doing is that we have been anticipating the €0.8 billion maturity of the senior debt that will mature in September and we have issued a Tier 1 debt. Why? Because we took the opportunity of very good market conditions. We did it at 215 basis points spread. And at the same time, as you know, we will benefit from the grandfathering over ten years. And if you refer to page A31 that I just presented, you can notice that now all of our debt, which is at €12.4 billion, all our debt is in undated subordinated debt or in subordinated debt. So that is that it's a very high quality debt, and it will qualify for Solvency II.

## **Denis DUVERNE, Deputy CEO, AXA**

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Maybe one additional point here. Some people – some of you have asked whether we expect it to reduce our debt gearing to below the current level. We are mindful in one hand of the quality of capital, but we are also mindful on the other hand of the effect of

the efficiency of capital. And we want to use all the space that is available within Solvency II to have Tier 1 and Tier 2 debt that qualifies for capital, and we don't think it would be good for the shareholders that we end up underusing the ability that we have to have a Tier 1 and Tier 2 debt to fund our capital if it is allowed in Solvency II. So that's something that we are very clear. So we might retire the remainder of the senior debt that we have. We don't intend to reduce the amount of subordinated debt and deeply subordinated debt that we have in our balance sheet. On the expenses versus the benchmark, it's certainly a moving target. When we launched Ambition AXA, we had the ambition to be above the peer group in terms of – I mean better than peer group in terms of expense ratio, but I believe that we are not moving alone. We talked earlier in the discussion about the pressure to reduce expenses, the increase in transparency. So I expect that by 2015, we'll be probably at the benchmark or slightly better, but not so much better, and we believe that we will have to continue to reduce our expense base going forward.

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**Henri de CASTRIES, Chairman and CEO, AXA**

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And so we already know that in the plan, which is going to follow Ambition AXA, you'll have a significant piece devoted to expense reduction. Next question. Oh, three of them, good.

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**François BOISSIN, Exane BNP Paribas**

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Hi, François Boissin again from Exane BNP Paribas. Just a follow-up question on your European strategy in Belgium and CEE. Belgium, it seems you are looking at your – you're losing market share in P&C. Maybe just some elements there, what's going on in Belgium? And in CEE, conditions have become tougher. You've exited from some markets, just how you believe your operations are going to be positioned there, and then just finally, you mentioned the plan following Ambition AXA, so when can we expect an update on the following plan. Thank you very much.

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**Henri de CASTRIES, Chairman and CEO, AXA**

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To the latter part of your question, once Ambition AXA will be over. On CEE, it's clearly, I mean it has been – when we decided to accelerate in the emerging parts of the world, CEE was clearly on the list, if we had to start it again now, we wouldn't put CEE on the list, clearly. We have been disappointed by the evolutions in Hungary, in Romania, Ukraine even if we have a very tiny operation there, and in Poland, with the nationalization of the pension market. If you look at where we are now, we have a stake in RESO which is the second largest Russian P&C company. 36%, we are happy with it. We don't intend to move that, it's a profitable company, it's a good model. It's a risk like any Russian risk, but it's a large market and we think that it's a

reasonable bet on this market. We wouldn't increase the bet, of course, under the current circumstances. Then we remain with operations in Poland and in the Czech Republic and Slovakia. Czech Republic and Slovakia it's a small thing. Poland, it's a significant market, if we could expand our P&C operations, we would certainly try to do it, but it's not going to be – I mean it's clear that Central and Eastern Europe is not going to be a major part of the development going forward. Denis?

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**Denis DUVERNE, Deputy CEO, AXA**

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On Belgium, it is true that we have been losing market share in P&C. We did it in part deliberately because we are not happy with our profitability. And I have to say that we did it very successfully. If you saw our combined ratio in the first half, I believe, that it is just under 90% all your combined ratio. Sorry?

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**Gérald HARLIN, Group CFO, AXA**

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91.5%

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**Denis DUVERNE, Deputy CEO, AXA**

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Okay. 91.5%, sorry. So, we did successfully and we started to regain exposures in automobile insurance in the first half of this year. So I believe that we had to improve the underwriting. We changed our footprint. We were overrepresented in the south of the country, underrepresented in north, we've corrected that. So, it's been a massive turnaround that has been taking place in last three years. We're happy with what – with the results that we have now and we are regaining market share gradually. So there is no fatality there and the Belgian market is a profitable market for us and we intend to hold our role in that market.

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**Farooq HANIF, Citi**

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Thanks. Farooq Hanif from Citi. I've noticed that your cash at the holding has gone up a lot in recent years. We see a lot of drivers behind that, but the number is just historically very, very large, and you have pointed out a lot of debt and you pointed out there maybe you retired senior debts. So I'm thinking in my mind that you have an ideal level of cash basically for qualitatively and if you felt like you have surplus, what's the best use of retiring debt? Buying something, investing, you never seem to talk about that? Thanks.

## **Gérald HARLIN, Group CFO, AXA**

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Yes. So, the point – yes, we have a lot of cash, but a lot of cash explained also by the fact that we have been anticipating the refinancing of debt. Second, your legitimate reaction is to say that it is an underutilization of our cash. No, because when I tell you that we are managing the duration of seven years in Life and five years in P&C, this includes the cash so that means that we have strategies which makes that from time-to-time, first of all, in our business we need to keep some type of cash, we need to be liquid, and at the same time we integrate this in our management of duration, so I think that is not sub-optimization.

## **Denis DUVERNE, Deputy CEO, AXA**

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And we have to have some cash also given the size of our derivatives program both at the holding company and in the VA portfolio.

## **Jon HOCKING, Morgan Stanley**

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It's Jon Hocking from Morgan Stanley. Can I just ask a question on the leverage? You're in the middle of your leverage range 23% to 25%. I just wondered how you think about financial flexibility and leverage. So would you, within that range, be prepared to go above that range or do you think you've got financial flexibility within the range? So just trying to get an understanding for it, if you have an opportunity to raise or retire debt, is there an argument for you to undershoot that range if you think 23% to 25% is the optimal level to be in the run rate.

## **Gérald HARLIN, Group CFO, AXA**

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Let's be clear, we need to have some flexibility because we have ups and downs. So 23% to 25% seems reasonable as a level as explained before by Denis, plus the cost of this debt is pretty cheap because we have been optimizing it and look, we are growing at around 4% before tax. I cannot tell you that we will be at 23.5% on that date and at 20 – 24.5%. So range is fine, don't interpret if we go at 24.5% or 25%, it shouldn't be interpreted, that's in the right range, and the target will remain this way.

## **Henri de CASTRIES, Chairman and CEO, AXA**

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On this note, if they are no additional questions – no additional questions ? – no additional questions on the dividend? So, it's a question that we have been very clear. Okay. So on this note, I suggest, we'd adjourn. We will wish you not only a very good

dividend but also a very good summer. And we look forward to seeing you soon.  
Thank you very much.