The Ongoing Revolution of the Insurance Business Model

Bear Stearns International Conference

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From warehousing risks ...

- Insurance business model based on **warehousing risks :**
  - Risks taken from policyholders
  - Risks pooled and **borne by the insurers**
  - Traditional **reinsurance programs**
- Requiring **large diversification** and good underwriting
- Requiring a relatively **large amount of capital**, not always efficiently used

The Old World

- Focus on product returns without properly measuring risk/volatility
- Management of assets independent from management of liabilities
- Accounting rules far from “marked-to-market”
- Few rated companies
- Few institutional investors

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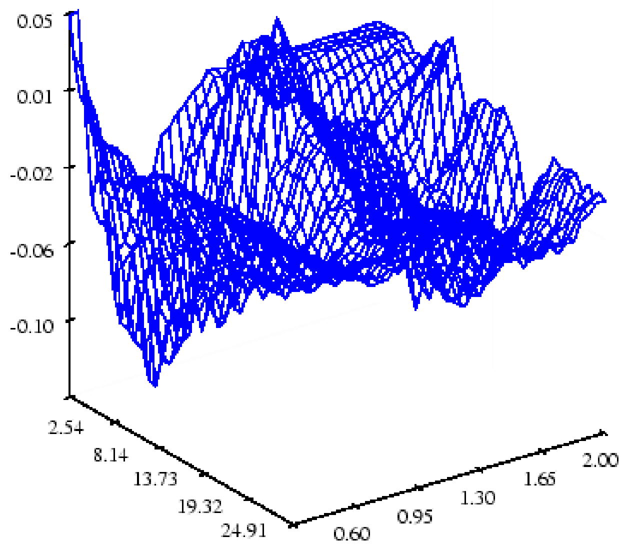
... to understanding, restructuring and transferring risks (1/2)

- Business model evolving towards **management & intermediation of risks :**
  - Risks taken from policyholders
  - Risks pooled and **structured by the insurers**
  - Risks externalized through **reinsurance programs & financial markets**
- Requiring **efficient diversification**
- Requiring **moderate amount of capital** with appropriate capital management

The New World

- Focus on products' risks / value
- Integrated assets / liabilities management
- Accounting rules closer to "marked-to-market"
- Many rated companies
- More institutional investors



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... to understanding, restructuring and transferring risks (2/2)

- **Risks can be insured = Risks can be securitized**

- **Market risks** being more dynamically managed through the use of suitable hedges (bought or built) :
  - UL with guarantees
  - General Account embedded options

- **Insurance risks** being externalized through :
  - Financial markets
  - Reinsurance markets

- **Other risks** still being kept and borne by insurers :
  - Scale (mutualisation of risks)
  - Requirement of a specific expertise
  - Prohibitive market prices

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AXA acts as a pioneer in dynamic hedging…

- **Securitization** and **dynamic asset management** are the new tools for risk management and capital management, aiming to :
  - Improve capital utilization in the insurance industry
  - Add transparency and liquidity to liabilities

- **Dynamic hedging of UL with guarantees :**
  - Enabled through a global platform (AXA Life Europe)
  - Used across the Group
  - Fostering product innovation & giving a competitive advantage

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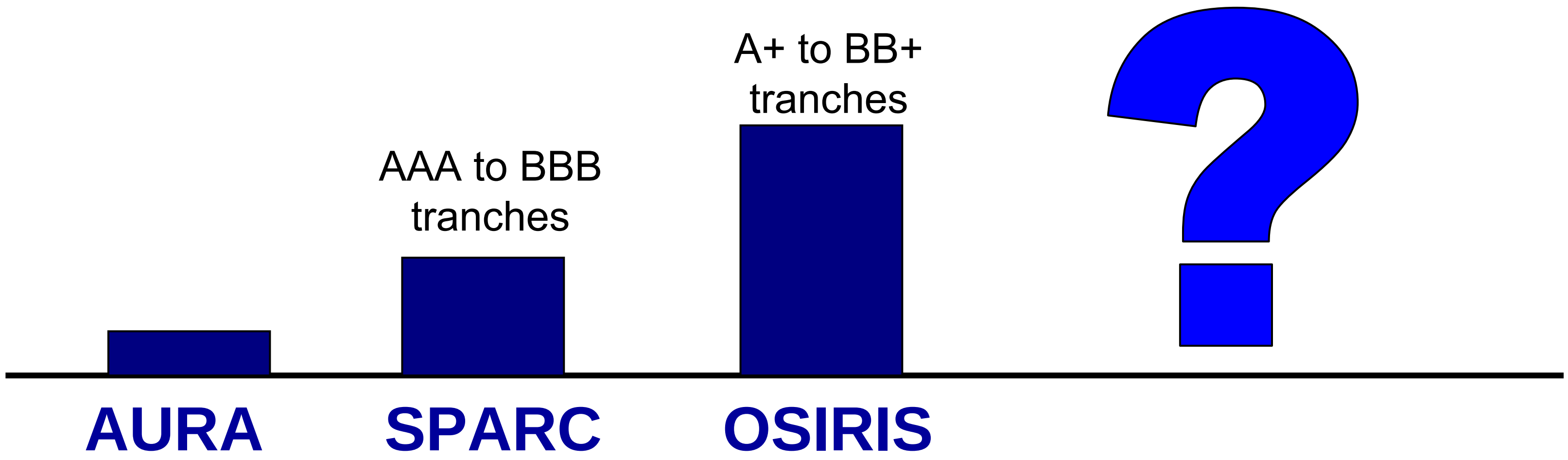
… and insurance-linked securities (1/2)

- **Examples of AXA's innovative Life & P&C insurance-linked securities (ILS) transactions :**
  - AURA Re (2005): 1st P&C Cat bond issued by AXA (€68m)
  - SPARC (2005): 1st securitization of a motor insurance portfolio (€200m)
  - OSIRIS (2006):1st extreme-mortality risk coverage program (€300m issued)



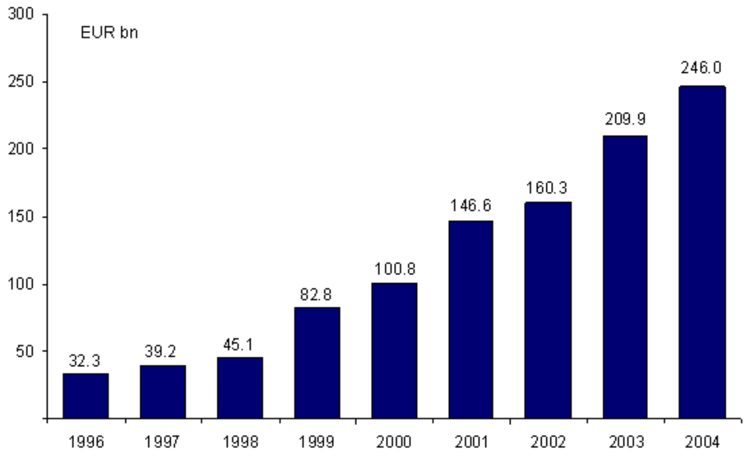
… and insurance-linked securities (2/2)

- Volume of ILS still small in the ABS market, but potential is high

- The **market is expected to expand** rapidly, according to Swiss Re!
  - P&C securities x2 over the past 5 years
  - Life bonds x3
  - Expected growth by 2016: x6 to x15

- Securitization of **new classes of risk:**
  - Credit reinsurance risk (SwissRe,€252m)
  - Liability risk (Oil Casualty Ins/Avalon Re: $405m)

➔ **What's next ?**



Source: Deutsche Bank Securitization Research

European ABS Market

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- Transformation of the insurance business model
- AXA, a pioneer in the transformation of the model
- **Solvency II, an accelerating factor**
- Conclusion

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A new regulatory framework

- **Solvency II is still under development** but the framework is already well established :
  - Benefits of diversification
  - Market consistent approach / total balance sheet approach
  - Risk based capital measure through a one year V@R
  - Recognition of specificity of insurance industry in Pillar 2 (multi year approach, etc.)

- **Latest developments are encouraging** although issues need to be addressed e.g. the coordination of European supervision

- **Solvency II should accelerate the change in the insurance model :**
  - Use of all sorts of risk mitigation techniques
  - Supported by development of cutting edge financial techniques

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Key impacts on AXA

- **For AXA, the new framework will validate strategic decisions** made years ago :
  - Systematic use of cash-flow forecasting models
  - Resistance to short-term shocks
  - Stable & sound equity & corporate bond exposure, commensurate with Group resources
  - Dynamic management of the convexity, in particular through derivatives

➔ Benefits related to our commitments to economic approaches should continue to emerge thanks to our strategy based on :
  - Sound economic principles
  - Diversification
  - Recognized superior risk management practice

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Key impacts on the industry

- **Solvency II** should :
  - Lead to better risk management
  - Provide a **more efficient capital management environment**
- The **industry consensus** is stronger and stronger:
  - CFO Forum EEV principles and Expanded principles for IFRS 2
  - CRO Forum responses to the Solvency 2 CEIOPS calls for advice
- Accounting (**IFRS 2**) & regulatory (**Solvency II**) frameworks should embrace the **same concepts**
- Changes are expected to foster …
  - Transparency
  - Discipline and risk management

  …contributing to higher/less volatile ROEs and leading to more attractive insurance stock valuations

➔ Solvency II might **give Europe** a great opportunity to have **a competitive advantage** compared to other insurance markets in the world

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Focus on asset / liability management (1/2)

- **Strategic asset allocation target ➔** maximization of the economic value under the constraints of:
  - (Economic) risk taking capacity
  - Solvency capital requirements
  - Rating requirements
  - Accounting requirements (IFRS)

- Solvency II aligns economic and solvency constraints leading to a **simplified ALM**

- Immediate penalty (capital) of risks to bring **more disciplined approach**

- The **capital relief associated with risk mitigation** will encourage :
  - Larger use of derivatives
  - Larger use of broader investment class

- **For investors**, Solvency II should translate into t**he multiplication of financial instruments backed by new risks** (mass risks like motor, peak risks like cat bonds, structural risks like longevity, etc.)

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Focus on asset / liability management (2/2)

- **AXA is managing actively** its interest rate risk exposure:
  - duration gap
  - convexity gap (mainly through swaptions)

Dec 2005	Assets Duration (yrs)	Liabilities Duration (yrs)	Duration Gap (yrs)	Convexity Gap (bps)
Life - Euro Zone	7,5	9,1	1,6	**103**
Life - Total	7,2	8,2	1,0	**94**
Life & P&C - Total	7,0	7,9	**0,9**	
Dec 2006 (inc. Winterthur)	**Assets** **Duration** (yrs)	**Liabilities** **Duration** (yrs)	**Duration** **Gap** (yrs)	**Convexity** **Gap** (bps)
Life - Euro Zone	7,9	8,8	0,9	**56**
Life - Total	7,4	7,9	0,5	**79**
Life & P&C - Total	7,2	7,7	**0,5**	

Reduction in duration gap and in convexity gap

- Reduction in duration gap will lead to reduction in regulatory capital requirements under Solvency II

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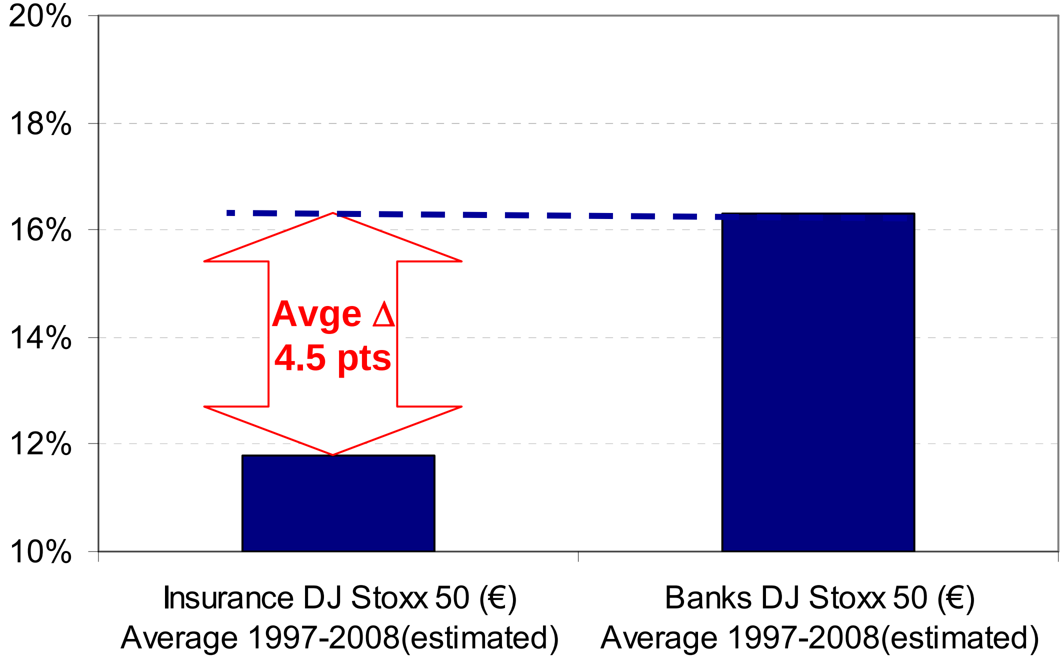
Benefits of our commitment to economic approaches should continue to emerge

- Coming years should confirm and reinforce the appropriateness of AXA's business and capital management strategies
- Attractiveness of insurance industry as an asset class expected to increase

Insurance and Bank RoE



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