AXA Asia Pacific Holdings Strategy Briefing 2007

North – Risk management strategy

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Agenda

Ambition 2012 Strategic Imperative 4

Regain our leading position in financial protection and *bring our risk management skills to wealth management*.

- Risks to be managed
- Consistent and systematic approach to risk management
- Management of the key risks
- Dynamic hedging

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Risks to be managed

Market risk

- Risk of:
  - fall in equity markets (delta)
  - fall in interest rates (rho)
  - increase in volatility (vega)

Basis risk

- Risk of mismatch between market indices used for hedging and actual investment funds
- Risk of lack of derivatives to match investments

Client behaviour risk

- Risk of adverse client behaviour:
  - contributions, withdrawals, lapses
  - dynamic / rational behaviour
  - asset allocation

A consistent and systematic risk management approach to product design and pricing, ensures risks are minimised and well managed

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Consistent and systematic approach to risk management

A ‘five step hierarchy of risk management tools’ has been established to ensure risks are minimised and well managed

From the top down, these are:

- product design (avoid, reduce and control risks)
- dynamic hedging (transfer risk)
- pricing for risk (retain risk)
- establishment of risk-based capital to absorb residual risks (retain risks)
- monitoring of risks and potential management action (control risks)

This approach has allowed us to ensure we address risks associated with the product in a consistent and systematic manner

AXA retains the risks that can be managed and receives appropriate reward in terms of earnings

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Management of the key risks

The risks are minimised through effective pricing, product design, dynamic hedging and monitoring client behaviour, risks being priced for profit and closely monitored. We retain the right to reprice the guarantee

Market risk

- Risk of:
  - fall in equity markets (delta)
  - fall in interest rates (rho)
  - increase in volatility (vega)

Managed through product design and dynamic hedging

Basis risk

- Risk of mismatch between market indices used for hedging and actual investment funds
- Risk of lack of derivatives to match investments

Mitigated through choice of funds provided and monitoring

Client behaviour risk

- Risk of adverse behaviour:
  - contributions, withdrawals, lapses
  - dynamic / rational behaviour
  - asset allocation

Managed through product design, pricing and on-going monitoring

Residual risks are priced for profit

Dynamic hedging - strategy

Unlike traditional capital guaranteed products, where guarantees are managed using asset / liability strategies and participating bonus rate mechanisms, market risk is managed using dynamic hedging

This consists of:

- establishing a portfolio of derivatives that exhibit the same sensitivities as the value of the guarantee to changes in the market
- continually rebalancing the portfolio to ensure that hedging remains effective

This leads to much of the risk being passed to the capital markets and reduced capital requirements for AXA APH

A robust hedging strategy and capability has been built, leveraging off the global expertise provided by the AXA Group

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Dynamic hedging - example

A client has an account balance and a protected balance of 100 and is invested in equities.

The value of the guarantee is determined by projecting the product forward under a wide range of economic conditions. Under this example, we establish that a 10% fall in equities will increase the value of the guarantee by 1. This is less than the 10% fall in equities as:

- the client will not be able to access the full value of the protected balance for some years
- in the meantime, markets can recover, or the client may lapse

To construct a hedge, we sell a future on the Sydney futures exchange, agreeing to deliver equities that are currently worth 10, in return, receiving 10 in cash.

If the market falls by 10%, in our example:

- client account balance = 100 – 10 = 90, falling 10%, with the protected balance remaining at 100
- the *futures contract is now worth 1,* because it allows us to deliver equities that are *now* worth 9, but we still receive cash of 10. This offsets the increase in the value of the guarantee

If the market rises by 10%, the reverse occurs

As a result, the capital market bears the market risk

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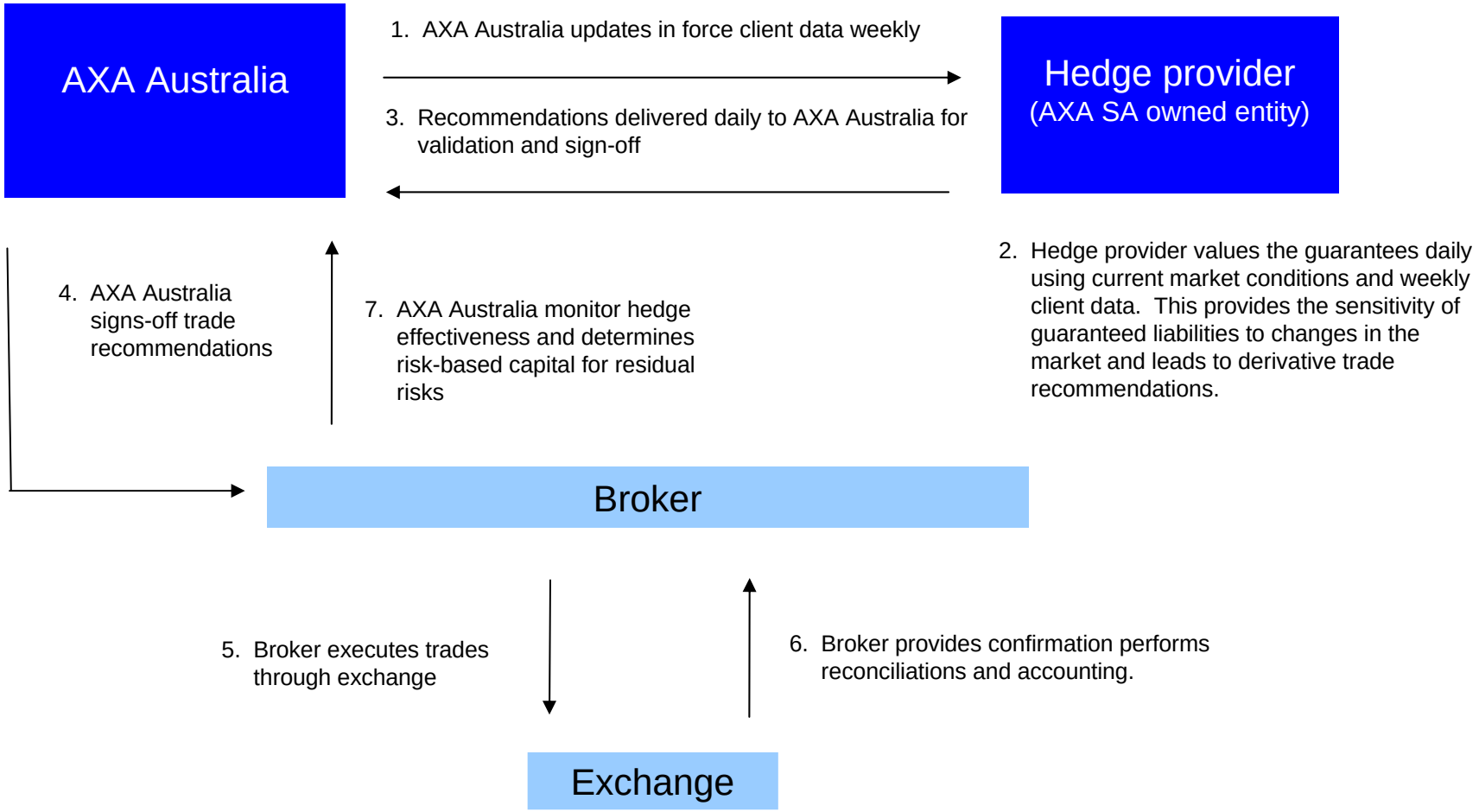
Dynamic hedging - in practice

Hedging market risk requires regular valuations of the guaranteed liability and the derivative positions required. AXA has a tried and tested global hedging capability



Dynamic hedging - in practice

Setting up a hedging infrastructure is costly and requires a specific skill set:

- liability valuations require complex financial projections and computing power
- monitoring the derivative trading requires a dedicated experienced team

This specialist hedging capability is being provided by the AXA Group, who have built a tried and tested global world-wide capability:

- 20 years of successful variable annuity experience in the US at AXA Financial
- guarantees offered since 1996 and now represent 10% of USA retirement funds
- over US$45bn of guaranteed FUM
- capability has been tested in different market conditions through the cycle
- global risk management and hedging capability has been developed in Europe
- similar products launched in France, Germany, Italy, Japan, Spain and the UK

The dynamic hedging program is not easy to replicate and will differentiate AXA in the Australian market. North also has the potential to immunise sales against downturns in equity markets.

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THE AXA "what comes after AXA 6" PLAN.

Q & A

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