Kevin Keenan
Company Secretary

Phone: *61 3 8688 3978*
Fax: *61 3 9614 5298*

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Australian Securities Exchange
Company Announcements Office
20 Bridge Street
SYDNEY NSW 2000

Dear Sir/Madam

AXA Asia Pacific Holdings Limited

Please find attached a speech by Andrew Penn, CEO AXA Asia Pacific Holdings Limited to the American Chamber of Commerce entitled *Financial services in an unpredictable world.*

Yours sincerely

Kevin Keenan
Company Secretary

Andrew Penn

Speech to the American Chamber of Commerce

Thursday 22 July 2010

Financial services in an unpredictable world

Introduction

Thank you Gavin for that kind introduction.

Good afternoon ladies and gentleman and thank you for the opportunity to speak with you here today. Thank you Ray and the American Chamber of Commerce and their sponsors, Salesforce Software.

The topic of my talk today is financial services in an unpredictable world. Whilst we picked this topic some months ago world events since only go to support this is exactly the nature of the world in which we live today.

As Nassim Taleb, the author of the Black Swan recently observed, it is worth reflecting on the fragility of systems that possess the illusion of stability.

Taleb's point is that human nature tends to lead us to overestimate the stability of our systems particularly when they are going well, leading us to conclude they are more predictable than they really are.

Today I want to look at the global financial services industry, the impact of recent events and the political or regulatory response to these against this background of unpredictability. I will make the point that the fundamental drivers of financial services will ensure this sector enjoys strong growth for the foreseeable future notwithstanding the dramatic events it has experienced over the last three years. This is particularly the case in this part of the world.

Let me start therefore with some comments on the Global Financial Crisis. An event that amazingly dates back almost three years now to when credit markets started to falter in August of 2007.

According to Taleb, Black Swan events are those with the following three attributes:-

- They lie outside the realm of regular expectations
- They carry an extreme impact; and
- Human nature makes us concoct explanations for their occurrence after the fact.

The Global Financial Crisis certainly meets these criteria.

It was an event that was outside the realm of regular experiences. Many have commented that the magnitude of the event is comparable only to the Great depression.

Whether or not this is true, it was certainly extreme because it also had an extreme impact.

The US, UK and Continental Europe bore the brunt of this. Household names from traditional retail banks such as Northern Rock in the UK, to large investment banks like Lehman Bros. and the world's largest insurer AIG were all essentially bankrupted by the crises.

Merrill Lynch was forced into the hands of Bank of America following US$55 billion of sub prime related losses whilst Citibank only survived with the Government guaranteeing US$300 billion of its liabilities and providing US$20 billion in capital. Indeed I am sure all in the room will remember the total Troubled Asset Relief Programme, or TARP package introduced in the US in October 2008 which was estimated to total US$700 billion.

Since the beginning of the crisis there has been more than US$1.5 trillion in financial institution write downs. In the US, the loss ratio on all consumer loans topped more than 16 percent.

Spanish banks are estimated to have repossessed real estate assets totalling €59 billion and German banks are estimated to record US$261 billion in write downs.

A number of companies are still in the process of restructuring and refinancing to repair their balance sheets. ING has announced it will sell its global insurance assets to enable it to repay the Dutch

Government the 10 billion Euro rescue package it received. Dai ichi has recently listed in Japan to enable it to access new capital and of course AIG announced its intention to list its Asian assets to repay the US Fed.

In an illustration of the unpredictability of these things, AIG subsequently changed strategy to sell its Asian businesses to Prudential of the UK for US$35 billion. Pru's shareholders baulked at that price and the latest proposal is to list again albeit under some controversy with the AIG Chairman resigning last week.

The third attribute of Black Swan events is that human nature makes us want an explanation for what caused them, in the case, the Global Financial Crisis after the event, even to the point of concocting one. For me the message in the Black Swan analogy is that whilst striving to learn from the experience it is important we do not fall into the trap of retrospective distortion and post rationalisation.

It seems to me that the area that most significantly lay at the genesis of the crisis is the lax provision of credit in the 15 years leading up to it. Up to that point the developed world, including

Australia, had been on a credit fuelled consumption boom. We had been gorging on our homes and futures. The proportion of household debt to household income had more than doubled in the 15 years to 2007.

In turn this fuelled economic growth and therefore governments enjoyed the benefits of growing tax revenues with which to fund increasing fiscal budgets. As is usually the case in economic cycles a bubble is created and it is the bursting of that bubble that marks the start of the crisis.

Clearly in this situation whilst too much credit lay at the heart of the Global Financial Crisis, it was the explosion in growth of the sub prime mortgage market in the US that brought it to its head. To put this in perspective, total new loans to the sub prime sector were running at around US$30 billion a year for most of the 1990s. This increased to US$130 billion by 2000 and US$625 billion by 2005.

More problematically, by the mid 2000's almost 80 percent of these loans were being recycled and sold to institutions rated as

AAA debt instruments via the CDO market. Indeed in 2005 alone there was more than half a trillion dollars in new CDOs issued.

This could clearly not last forever, debt has to be repaid, individuals and companies have to deleverage. Globally there is nearly US$5 trillion of bank debt due to mature in the coming 36 months.

Also governments need to curb fiscal spending against a background of falling tax revenues and to fund the US$2 trillion in fiscal stimulus injected into economies globally over the last 18 months. That stimulus worked and the recovery that we experienced in the second half of 2009 and early part of 2010 was due to it.

However, this was always going to run out and now countries will have to do the hard yards as we are seeing in southern Europe.

Against this background Australia has fared relatively well. Our banks remained strong throughout the Global Financial Crisis and we did not experience the kind of dire events that characterised that of the U.S. and Europe.

Australia’s positive situation was due to a number of factors, including the healthy balance sheet we had going into the crisis as well as the strength of the financial services industry and the regulatory structure and avoiding the sub prime calamity.

Finally of course, Australia also enjoyed the underpinning of our resources sector in conjunction with the strong growth that has continued in Asia and in particular China. This acted to provide continued economic momentum notwithstanding the crisis happening around us.

One of the opportunities for Australia is to use our proximity to the Asian region to continue to strengthen our economy in areas other than just resources. However, it will be important that we do not create regulatory barriers from us so doing and I will comment more on this in a moment.

Financial deregulation over past decades has provided a major stimulus for growth and the globalisation of the sector. However, the climate has changed and demand for regulatory change to address the perceived failings in our system has inevitably increased.

In Australia one of the most important regulatory responses has already been made in the nationalisation of the regulation of credit, forcing lenders to take a greater responsibility ensuring their customers can afford the loans that they are trying to sell them.

Other changes are occurring in the area of capital where the global trend is to drive up capital requirements for financial services companies through Solvency II for insurance companies and Basel III for banks.

In addition to these trends there are potentially very significant changes in the Financial Services sector. These include the Overhaul of Financial Advice, the increase in the SGC levy and the recently announced Cooper recommendations for superannuation in Australia.

AXA is well positioned to respond to these changes. We run highly professional advice networks which operate at a level consistent with the new fiduciary standards for financial advisers. As of July 1 our business shifted to a full fee for service model. This was a relatively minor move for us as 70 percent of our advisers had already been using fee for service in their practices.

With our wealth.net platform, the benefits of which have been highlighted for all by the ACCC, we are extremely well positioned to respond to the Cooper recommendations with a simple low cost highly automated super solution for individuals and companies.

Whilst we understand the drivers for some of the regulatory changes being contemplated it is also important to be aware that they can have unintended consequences. In relation to Cooper there is one example of this that I would like to comment on.

I understand the logic behind the recommendation to ban the holding of art in self managed super funds however, I don’t agree with it. We need to ensure that we continue to support our development culturally as well as economically. Australia has a talented but fragile visual arts sector and the benefits of protecting this far outweigh the rationale for this specific recommendation.

One of the important issues for Australia, as I will comment on again shortly, is the demographic challenge ahead of us. In fact the Cooper team also recommended that My Super be a whole of life solution. That is a solution providing for both savings pre retirement and income strategies in retirement.

This is a very important issue to address and we recently launched a new innovative product providing both capital protection and a guaranteed income for life within our award winning North range of superannuation solutions. This was also supported by an income generator investment product specifically designed for individuals in retirement.

While the industry will obviously respond to regulatory changes, one of the challenges they present for Australia and Australians is the ongoing uncertainty they create. It is important to balance the need for regulatory change with the need to provide a stable environment that supports confidence to all superannuation members otherwise we will undermine private savings.

So it is clear that the financial services industry is undergoing massive changes both locally and globally. While this has increased global unpredictability in the short term, it is also confirming the central role financial services will play to the long term development of the global economy.

Notwithstanding the changes, the fundamental characteristics that will drive the sector have not changed. It is and will remain one of the strongest growing industries, particularly in our part of the world.

Long term demographics, in conjunction with the fall in investment markets and the short term economic slowdown, means that the need for long term savings has increased not decreased.

The latest intergenerational report issued by the Government projects that the Australian population will increase from 22 million to 36 million over the next 40 years with the proportion greater than the age of 65 almost doubling from 13.5 percent to 23 percent. Or to put it another way there will be less than 3 people working to support each Australian in retirement compared to 5 today.

The impact of the ageing population through the aged pension and health care costs will increase the budget deficit to approximately 4 percent of GDP by 2050. By then the amount of spending on health, the aged pension and aged care will double proportionally from one quarter of government spending today to one half.

However, the demographic changes in Australia seem small when considered in a global context. The world's population is projected to increase from almost 7 billion today to close to 10 billion by 2050. Much of this growth will be in Asia. India's population alone will increase more than 40 percent in the same time to more than 1.6 billion. At the other end of the scale Japan faces the massive challenge of managing a population reduction of more than a quarter by 2050 and a half by the end of the century.

The role of long term private savings is crucial to address these challenges; governments will simply not be able to address them alone. The products we provide and the advice our advisers give is what drives private savings and therefore financial services sits at the heart of the solution.

Likewise governments are not going to be able to fund the safety net life insurance provides. Insurance caters for those unpredictable events that prevent us from enjoying a full working life and therefore generating the income necessary to provide private savings for either us or our families. In all of the markets in which we operate, particularly the developing markets in Asia, but also here in Australia there continues to be significant underinsurance. This is therefore a sector that will continue to grow strongly.

Finally in terms of the drivers of growth in our industry, whilst Asia was not immune from the impacts of the global financial crisis the underlying economic growth projected for the region remains well ahead of the rest of the world. According to the IMF, Asia is expected to grow by 7 percent in both 2010 and 2011, over twice as fast as the global average.

As GDP per capita increases in developing markets the marginal dollar that is allocated to life insurance, savings and investments -

the products that we sell - increases rapidly. That is why in our sector these markets will grow at least 2 times as fast as GDP as they become wealthier.

Which brings me to the opportunities the future holds for us in a more unpredictable world.

Firstly, the opportunity for Australia to capitalise on its position to benefit from a robust and growing financial services industry, to generate economic activity and attract regional dollars, and even become a local financial services hub.

Secondly, I will comment on the opportunity for Australian companies. Companies such as AXA, but also other companies in the financial services sector.

Australia already has many attributes that make it attractive as a regional financial centre. These include a highly professional sector, a good legal system and available skilled resources. And there is no better time to be pushing the advantage as the benefits to Australia are significant. More importantly we will be cementing Australia’s key relationship with the region. However, unless we also have the right regulatory and fiscal environment in place these advantages will not be sufficient to create Australia as a regional financial services hub.

In particular the discussion paper issued by APRA in March this year on the supervision of conglomerate groups contains a number of regulatory proposals which work against this objective. Whilst one understands regulators' natural desire to insure against any possible failure in the system, particularly against the background of the Global Financial Crisis, the danger is, if implemented as currently proposed, it will be very difficult to attract companies to run international operations from Australia.

On the fiscal side, if I am an overseas investor and I want to invest in Asia via Australia I will not do so if my returns are diminished by Australian taxes. This is the "sticky fingers" point addressed in the Johnson report. It is therefore good news that the Government has responded to Mark's recommendations by reducing withholding taxes and announcing its intention to remove them completely when fiscal circumstances allow. Let's hope that time is not too far away.

If we address these things I also think we can achieve better prospects for Australian companies doing business in the region. Australia financial services companies account for approximately 30 percent of the total market cap of the ASX. The sector employs more than 400,000 highly professional people and represents approximately 10 percent of GDP. For all of the opportunity that is offered however, Australian financial services companies are significantly under represented in Asia.

10 years ago there were more Australian insurance companies doing business in the region than there are today. Our key competitors among the international companies come from continental Europe, the US and the UK; they do not come from Australia.

Developing business in Asia is not simple and it is also takes time. AXA Asia Pacific Holdings has been operating in the region for more than 25 years. We originally entered through the acquisition of Sentry in Hong Kong in 1986 for approximately A$50 million. Since then we have built a formidable footprint of 15 businesses across eight countries with more than 4,000 employees and 60,000 agents and advisers. Today our Asian businesses represent approximately two thirds of our Group operating earnings. In the proposed transaction with NAB and AXA SA these Asian assets are valued at A$9.4 billion.

I will talk more about some of the challenges and strategies for developing business in Asia in a moment. However, it is important to make the point that it is not a single homogenous market. The countries in which we operate each have very different characteristics that are important to appreciate and recognise if one is to be successful.

Each has very different cultural, political and religious backgrounds. The way in which business is conducted is also very different and obviously there are many different languages that one needs to accommodate in your business model and systems. Indeed, languages do not just differ from country to country but within regional parts of countries as well.

One of our key challenges has been to build a regional model. This requires significant investment to enable us to achieve synergies through single technologies, systems and processes across the region but accommodating all of the language and regulatory differences which require us to structure and distribute our products differently for each market.

Given the significant differences another key challenge is to recruit, retain and develop local management with a strong understanding and empathy for the local dynamics. This challenge is heightened by virtue of the fact that the markets are growing very rapidly and competition in the region is intense. This means that the number of local executives available to support the growth in the industry is much lower than it needs to be. People therefore are the most significant constraint to the successful development of business in the region.

Ultimately successful and capable executives in all parts of the world are attracted to work for successful companies. This is very much the case in Asia where the best local talent wants to work for the biggest, best and most successful companies. We benefit from the success and breadth of our operations across the region and are able to offer exciting and long term careers.

Notwithstanding the many differences that exist across the region there is one common feature of all of the markets in which we operate and that is the barriers to entry, particularly for foreign companies, are considerable. By barriers I mean that in most markets foreign investment conditions apply and therefore joint venture partners are required. These take a long time to develop.

Many markets in Asia also do not issue new licences. For example Thailand, Malaysia and Korea so entry opportunities are limited. Further, even where one achieves a licence further approvals are often required before you can commence business operations.

Even where new licenses are available on a 100 percent basis, partnerships and relationships are always a key feature of conducting business in Asia. In this respect the most valuable partners are those that can offer significant distribution and on the ground operational support. For example Bank Mandiri with whom we set up a JV in Indonesia in 2003. I was there yesterday with their new CEO marking that fact we have already taken over the large domestic player Bumiputera to become the second largest life insurer for new business.

Therefore companies aspiring to be successful in the region will need to do the hard yards and take the time to build the long term relationships necessary with both customers and business partners.

It is no coincidence that the strongest competitors in the region including AXA are those who have done this and given the other considerable barriers to entry, those that have been there the longest.

These challenges need to be considered against the very significant rewards that exist. I have already shared with you the evolution of the value of our businesses in Asia from around A$50 million in 1986 to A$9.4 billion today.

Our growth continues to accelerate with sales in Asia up 52 per cent in the first half of 2010 compared to the same period last year. That is very substantial growth from an already large footprint particularly against the background of a still relatively muted and uncertain recovery from the Global Financial Crisis in the rest of the world.

Which brings me back to where I started my presentation – financial services in an unpredictable world.

There is no doubt that the Global Financial Crisis has had a profound impact on the financial services industry and a wider impact on the global economy. Indeed it is unclear whether we can yet declare that it is over and investor sentiment remains very fragile.

There will also continue to be significant regulatory change affecting business more generally but financial services in particular.

However, while the world may have become more unpredictable, the fundamental characteristics that make the industry attractive over the longer term have not changed and we will continue to see strong growth in the sector. This is particularly the case in our region, because I think we can safely predict that Asia is going to outperform the rest of the OECD world in economic growth terms.

We are also likely to see an increased level of M&A activity which is often the case after a period of significant market dislocation.

Finally before closing and when speaking about unpredictability it would be remiss of me not to mention, albeit briefly the uncertainty AXA APH has had to deal with over recent times. But the fact is large complex transactions take time to work through and as we announced the other day the Independent Directors have provided a further period of time to allow the ACCC to complete its deliberations on this matter.

What is crucially important in the meantime is to maintain a strong focus on business as usual regardless of the corporate activity around us. That is exactly what our people have done and will continue to do; which is why our businesses are performing well.

For the half year to 30 June 2010 we expect Group Operating Earnings to be approximately $270 million up 6 percent on 2009. In Australia and New Zealand Operating Earnings are expected to be up very strongly, 25 percent to $110 million.

We also saw growth in Operating Earnings in Asia on a local currency basis which we expect to be up 19 percent although this will be more than offset when translated into Australian dollars due to the strengthening of our currency.

Net profit after tax before investment experience and non recurring items is expected to be approximately $285 million, up 7 percent.

Obviously investment earnings were impacted by the fall in markets as illustrated by the 12 percent reduction in the ASX over the six months and we expect these to be $60 million lower than our normalised investment earnings. Given this we saw a reduction in profit after tax and non recurring items when compared to 2009.

Thank you for your time and I would be happy to take any questions.