Debates at La Maison Dorée

On Tuesday, 5 February, at the Debates at La Maison Dorée, before more than 300 top executives from BNP Paribas, Michel Pébereau welcomed Henri de Castries, Chairman of AXA's Executive Board, and emphasised the closeness of relations between the two groups.

Henri de Castries presented the points of convergence between the banking and insurance businesses, which have developed along the same lines over the past ten years, in response to the demands of the clients themselves. As one of the points of convergence between banking and insurance, Henri de Castries emphasised the importance of Customer Relationship Management (CRM).

As a conclusion, Henri de Castries presented AXA's vision of the future. The Group must focus on its core business—financial coverage—carry out operations on its key markets, in an «open architecture, develop relationships as a consultant, promote a global brand and, lastly, be a benchmark employer.

Banking, Insurance: Where are the Points of Convergence and Development?

Henri de CASTRIES
Chairman of the Board of Axa

I am delighted to be here to talk to you this evening, even though it is not an easy thing to do. Our relationship is an old and solid one. It is good to talk to friends, but it is not easy to speak in front of specialists, in front of the Chairman of BNP Paribas and its teams.

Your day-to-day results have been spectacular and your shareholders – we in particular - applaud them.

I have chosen to talk to you about banking and insurance, even though I have resorted to a certain amount of simplification to bring out the salient facts. I would also like to convey my vision of the future to you. You have to know where we are coming from and understand the possible areas of collaboration on which to build the future.

I. How Are We Going to Move Forward?

1. Banking *and* insurance: in-depth progress

Over the last 10 years, the world of bankers and insurers has changed radically. 10 years ago, our sectors were closed off and their turnovers were lower and less global. The 1993 figures speak for themselves. Manufacturing and distribution were separated from each other at that time. 10 years later, stock market capitalisation has increased tenfold for Axa and for BNP Paribas. The increase rate is even higher for managed assets.

2. Dictated by customer needs

a. Demand has significantly increased

In the private individual sector, customer demand has led to change. Our customers are demanding more comprehensive services - hence the areas in which our professions overlap. We have gone over to life insurance on the banking side. Insurers have discovered that risk cover is one of the real services that they can offer; they have had to move into asset management and even towards banking-type products, which they can provide or not, as the case may be.

b. A dual range

However, private customers have not expressed a clear preference for either insurers or bankers. Some market analysts consider that life insurance products merely enable insurers to contain market share losses, since their distribution networks are too costly. But I think this is far from the truth. Let's look at the savings market. In the savings market in general in Germany, France and the USA, the bankers that dominated the market at the beginning of the 1990s saw their market shares being eroded, while insurers, previously in a marginal position, did fairly well. In France, Axa's market share (excluding external growth operations) doubled.

3. Backed up by the deregulation and expansion of capital markets

Deregulation has facilitated convergence. Over the last 10 years, deregulation has applied to solvability rather than product control. Deregulation has facilitated innovation, competitiveness and therefore convergence.

Moreover, individuals are increasingly demanding. Their demands are more sophisticated and customers are looking for structured ranges that reflect their needs. This is even truer in the case of company liability.

4. Comparable evolution on the stock markets

Beyond this convergence, changes in the value of each sector show that the markets have not favoured one sector more than the other. Insurance had a little bit of a lead, but the situation has changed over the last 18 months. In any case, for 10 years the market made no clear differentiation between banking and insurance.

5. Insurance boosted by the favourable economic climate

I believe that the insurance sector has surfed two specific economic waves.

The first of these waves was disinflation. In the 1980s, insurers were mainly involved in non-life insurance. Here the frequency of claims, the level of financial revenue, the cost of claims, directly affected by inflation, and the level of overheads were the 4 determining factors. In the 1980s, provision was made for losses, with inflation always over-estimated in relation to the figures. This led to provision surpluses, which were not a result of insurers' technical skill. But the sector generated significant value because of over-conservative or over-cautious pricing. Like the others, Axa built its prosperity on that in those years, even though we did not manage our losses any better than the others.

The second wave from which we benefited was stock market expansion. That disappeared in 2000, but for 10 years the expansion of these markets supplied companies with added value. Moreover, in the life insurance sector, all the products invested in shares generated larger commissions than expected – hence the exceptional profits. We used the money to finance our expansion. Other companies used their resources to change their rates. Today those companies are in difficulty!

II. The Current Situation

I think our business models have several points in common:

- the retail/corporate separation;
- the distribution/production separation, since factories are not networks;
- CRM, normal for BNP Paribas, but a real novelty for Axa 3 years ago – the first shared database for Axa's 8 million customers in France was created in 2001; this database shows that we have 20% of the car insurance market and 60% of these customers have a single Axa product, which probably seems surprising to you. Moreover, we sell less than 2 products per client;
- the importance of asset management:
- the importance of people – we are in the service sector;
- the importance of globalisation – the local player niche strategy is probably not profitable in the long term.

However, we have not been successful across the board. Bankers are more productive than insurers. 10 years before us, I am sure that you were working on proper cost control. Financial control does not exist for insurers because the first thing we do, before providing the service, is to collect the money from our customers. So we have to create artificial financial control. However, insurers are more international than bankers. But few players have the French and US banking cover that BNP Paribas has. Open architecture exists, but is not very widespread, either in our sector or in yours. To maximise our position, we have to agree to place our products in networks over which we have no control and allow our networks to sell products that are not ours. Finally, certain insurers provide banking insurance, but the service is not equally successful in all cases. And we do not have a model whose success is proven.

So finally, does convergence, and even full-frontal competition in some customer segments, determine a single successful model? I don't think so. The model depends on the vision and the vision depends on the sector. Now I'd like to talk to you about Axa's choices.

III. Axa's Vision

Claude Bébéar quickly understood that to succeed you had to concentrate on one sector and know how to adapt. Today, we have a single profession – financial coverage. We want to operate in key markets, in open architecture. Our range focuses on consultancy. We want to be supported by a global brand. We also want to be a benchmark employer.

1. Financial coverage

So we have gone beyond the term «insurance».. We must not confuse the product and the function. Financial coverage goes beyond the insurance product itself. We want to give customers the right products so that they can manage physical or financial risks throughout their lives. Initial needs are property cover (auto, home, health…). Then we deal with life cover, which customers want when they start a family. Then we cover savings, portfolio building, asset management, retirement and inheritance.

So financial coverage does not just come down to a single model. In some countries, broker networks dominate the market, as in Belgium. Nor do we want to provide everyone with everything and we are not aiming at establishing the same network distribution everywhere. For example, we want to develop life insurance and asset management in the USA, instead of non-life insurance.

2. The markets

Our key markets are the main developed countries and a few other countries, depending on their expansion opportunities. The industrialised countries represent 14% of the world's population, 77% of world GDP, but 91% of Life Insurance premiums and 90.3% of IARD [Fire, Accident and Non-Life Insurance] premiums.

3. Open architecture

This term applies to a broader range of products, access to non-proprietary, multi-relational distribution, initial development of one's own sales force, then the choice of privileged partners and excellence in production and distribution.

On the other hand, open architecture does not mean destroying our profession or abandoning our brand for a few extra sales. Nor does it entail buying or merging with a bank to gain access to distribution and products. Finally, open architecture definitely does not entail becoming a supermarket with no identity.

4. Consultancy

We want to sell solutions, build long-term relationships and train our sales force. So we do not go in for hard sell or for developing a single contact and providing advice, to the detriment of product and service quality. I have noticed that, in the long term, the consultancy aspect could be affected by two factors: customer rotation where commissions only depend on bringing in customers, as in some former UAP networks, and the political debate on pension funds.

5. The brand

At the beginning of the 1990s, Claude Bébéar was the first to talk about a new global brand. A global brand and a global rating are guarantees for customers. In fact, the amount of time in existence does not necessarily mean that a product is safe. The brand has to have a content that is based on its promise. I should add that a global brand can have extraordinary repercussions, as we saw with Coca Cola in Belgium. The slightest problem takes on a global dimension. So we have recently spent a lot of time explaining to analysts that because Alliance Capital uses one of an American company's product lines does not cast doubt on the solid basis of our company.

6. A benchmark employer

I will not insist on the need to be a benchmark employer just to serve up the usual clichés. This aspect is genuinely a decisive one for me. For 20 years, people management has been one of Axa's declared values. We think that things have to be clear: an employee who performs well, but who does not respect our values has no place in our Group. We do not want to promote a mercenary attitude. An employee who is under-performing, but who respects the house values, must be given a second chance.

I will end by mentioning our challenges in the near future. They are simple ones, but difficult at the same time. Firstly, whatever the effects of fashion, we have to focus on our profession. That explains the sale of DLJ. I think it was extremely urgent to break away from that particular bank because it did not at all represent our profession. We have to look at our core business regularly. If we do not, we risk investing where we shouldn't.

Secondly, Axa has to find a new direction for its internal growth. That's the heart of the matter for me. Apart from acquisition operations, our internal growth rate was below the market average, although for good reasons. Internal growth was not a priority. But today it is a priority.

Thirdly, we have to take up the challenge of industrialisation, which brings us back to productivity and leverage. We need to create an industrial culture that is doubtless more familiar to you than to us. I think that the Group still has phenomenal productivity potential. This autumn we launched a savings plan. The amount may look enormous from the outside, but it has considerable potential. It means that we will have to develop our internal culture and maybe look for specialists on these subjects from outside. But, with Michel Pébereau here, I won't take the process industrialisation issue any further.

Finally, we will have to concentrate on service quality and knowing our customers. We are often seen as bureaucratic organisations. It's up to us to change this view of us.

To conclude, in a profession that is still buoyant, convergence between bankers and insurers exists as far as our customers are concerned, but it certainly isn't the only way to succeed. So it doesn't matter whether a cat is white or black, it still has to catch the mouse!

Thank-you for listening to me. I will be very happy to answer any questions.

Discussion

Finally, what does the head of an insurance company sell? You have talked about services, professions… Do you sell financial services, for example?

Henri de CASTRIES

I'll refer you back to what I said about our profession. Our hunting ground is customers.. Our range is clear – insurance cover and asset management products. We have to tell our operations managers and explain to them that the IT sphere has to be efficient, but is not supplied directly and the same applies to service centres. So there is no problem telling company directors what they are selling. I don't think these heads of companies feel any unease as regards banking products. And they have understood that they do not themselves have to create the products that we sell.

Could you come back to the Allianz/Dresdner business model, especially for employee savings funds, which seems to be one of the lines of attack?

We are sceptical about that particular model – which doesn't mean that it won't work. Allianz has put 30 billion euros into buying Dresdner, to gain an additional market share and to attract new customers in Germany. 30 billion euros isn't a negligible amount, even for Allianz. The figure represents 50% of Axa's capitalisation! Has it been it the best investment for the company?

The German life insurance market isn't profitable at present. Policy holders are now getting 98% of the benefit of the insurers investment performance. A lot of German companies are still living off the accumulated added value, but, as in France, this trend may well disappear. I also think that the operation is motivated by the financial markets rather than a desire to increase market share.

To quote another example, Axa has acquired Sanford Bernstein, in the United States, for 3 billion euros, and has spent 2 billion on a Japanese company. We have acquired new customers in markets with better prospects than the German market for «only» about 5 billion euros.

You talked about insurer globalisation. I'm thinking about Axa in the USA. But a lot of bankers had their fingers burnt by their American adventures. Does that mean that you have had more success in incorporating the cultures?

A series of conditions have to be present to ensure success.

- You have to know exactly what you are buying and be certain that it represent your profession, as you did in the case of Bank of the West.

- The same applies to Equitable, bought by AXA in the USA, (thanks to Michel François-Poncet) - you have to know what you are buying and what you want to do with it, what aspects are not working and what has to be put right. This company's distribution network was healthy, but the company was ruined because its asset / liability management was not up to scratch. The Japanese company that we bought had made the same mistakes.

- Finally, the challenge of cultural integration is a substantial one.

Day-to-day management of the cultural difference is difficult – when a group goes global and multi-cultural, the top executives' humility and ability to listen increases in importance.

But we also made mistakes. In Australia, we should been quicker in getting rid of the team that carried out demutualisation of the company that we had bought.

Given the convergence of products sold by bankers and insurers and of customer convergence, what about a multi-channel distribution model?

In France, we work with agents, employee networks and brokers. The difference between banks and insurers lies in the way that our employee networks operate: sales representatives do not have agencies within Axa Conseil; most of the time they are with their customers.

We should also mention the Internet. It is a backup for the network and for sales. After all, it is only a very limited distribution network. But it is a help to our employees and customers. We are a bit sceptical about the ability to of the Internet to act as a distribution network in itself. There are contrasting experiences in the case of non-life insurance. We are certainly the leading re-insurer worldwide. But there is only one country where the Internet is the principal channel (60% of new business in Japan). However, I must remind you that our Japanese company is very small. The Internet has enabled us to cut purchase costs. But in France, or Germany, it only represents 10 to 15% of new business. So we are rather doubtful about the Internet as a central distribution tool.

You mentioned the mistakes made by the Japanese company bought by Axa. These mistakes can be extrapolated to the whole life insurance sector, or almost the whole. How do you see developments there?

I'd like to be sure that I haven't made a mistake! I have just spent a week in Japan. There is no doubt that the country is in recession. The traditional Japan is badly managed and is in the process of disappearing, but the modern companies have very active R&D. The country is readjusting, albeit with difficulty, but it is definitely readjusting. Moreover, the savings interest rate is very high and social contributions and taxes are low. For operations like ours, two points matter: new business and confidence. I think that we have worked well. Unlike AIG, for example, which set up a *defeasance* structure by «wiping out the past» and ruined the former policy holders; while we changed the company structure from top to bottom, we did not ruin the customers. We respected the teams and kept on the sales teams, which were good. We have a large business volume and our company is seen as being anchored to a powerful Group. However the sector overall is virtually bankrupt – that's a fact. Of the 10 leading players on the market, 7 will survive and only with great difficulty.

The European Commission seems to want to regulate the financial conglomerates. What do you think of that?

Gérard de la Martinière would be better qualified than me to address this point with you. The Commission's aim is a praiseworthy one and the Commissioners want to avoid company over-leverage. But there are two points that worry us more:

- The European approach to concentration – look at Schneider and Legrand;
- Accounting standards – the implementation of standards creating volatility for results, while in no way creating economic wealth in the sector, seems unacceptable to us.

I will add a third point: following the terrorist attacks in the autumn, European regulation is more than ever necessary. But it is exhausting for a company to discuss the same urgent issue with a variety of regulatory authorities.

Within the framework of the convergence you talked about, what is your position on traditional *private banking*?

We are currently reviewing the issue. The answer to your question depends on the countries themselves. For example, we have very rich customers that have come to us through asset management. We also have big retail customers who come to us for life insurance. We have to identify these customers more efficiently. For example, Agents will have to have new tools at their disposal. But I am not sure that our vocation is to offer all private banking services.

Michel Pebereau

We are coming to the end of our meeting. Thank you for your presentation, in which you set out Axa's contribution in the various sectors as **the** global brand (we are in the process of creating one) and your values. We owe you a lot.

So thank-you for being our friend and our partner and for coming this evening.

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