

Q&A (Summary) of Conference Call for Domestic Institutional Investors and Analysts on the Result of Sony Life's Market Consistent Embedded Value (MCEV) as of March 31, 2009

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Q&A (Summary)

Q1: I would like to ask about the fall in MCEV resulting from a decline in interest rates. Based on your sensitivity as of March 31, 2008, you explained that a 100bp drop in interest rates would cause the value of existing business to decline ¥220.0 billion. However, the sensitivity information on page 27 of your handout shows the change due to a 100bp fall in interest rates to be a decline of ¥289.6 billion. Isn't this a rather large change compared with what was actually an average change in the yield curve drop of 0.5%?

A1: Breakdown of the interest rate sensitivity as of March 31, 2008, that we disclosed last November, is shown in this handout as a change in adjusted net worth. Although a 100bp decline in interest rates would cause adjusted net worth to increase ¥147.9 billion, subtracting this effect from the change in MCEV results in a decrease of approximately ¥440.0 billion in value of existing business. Using the 0.5% actual change in average interest rates, the decline in interest rates on the value of existing business has a downward impact of around ¥220.0 billion.

Q2: When forecasting future MCEV, what period should we be looking at interest swap rates and Japanese government bond yields? Average duration on liabilities is between 20 years and 30 years; should we look at interest rate movements over that period?

A2: Yes, that is correct.

Q3: The free surplus is negative. Is this figure indicated simply from the standpoint of calculating MCEV, or will the figure have some impact on your future capital policies?

A3: Sony Life's statutory solvency margin ratio exceeds 2,000%, which we believe to indicate ongoing financial soundness. The free surplus is negative based on the calculation of required capital using an internal model for calculating the solvency capital requirement (SCR) stipulated by QIS4. Aiming at responding to this, we are planning to perform duration matching of the assets side and the liabilities side, and to review product details.

Q4: I believe that required capital was positive as of March 31, 2009. Was capital cost accordingly subtracted from MCEV?

A4: We set required capital for each period in the future, calculating that cost as the frictional cost. The frictional cost as of March 31, 2009, was up compared with March 31, 2008. This was because of an increase in the required capital. The increase in required capital had a downward impact on MCEV value through the frictional cost.

Q5: The interest rate sensitivity of adjusted net worth as of March 31, 2009 (see page 17 of the handout), is shown with changes in value corresponding to 100bp upward and downward movement of interest swap rates. What would be the change in value corresponding to changes of 50bp?

A5: We do not make calculations using 50bp, but the impact on value would be slightly less than 50% of the example using 100bp.

Q6: Sensitivity resulting from a 25% increase in the implied volatility of swaptions was a ¥20.9 billion decrease as of March 31, 2008. As of March 31, 2009, this figure was a decrease of ¥69.5 billion, indicating higher sensitivity. Why was this?

A6: In general, this can be explained by what they call "Vega", which is used to indicate changes in option prices in response to changes in implied volatility. The reaction on sensitivity is largest when exercise prices are close to the intrinsic value of swaptions. Under the current interest rate conditions, the projected interest rate on minimum guarantees is near the level of the implied forward rate of interest swap rates. In our analysis, these are the conditions in which "Vega" is largest. In addition, Swaption volatility level has risen during the past fiscal year, and the upward portion, multiplied by 25%, has a downward impact on the changes in value. We analyze that these are the reasons of higher sensitivity in the implied volatility.

Q7: That impact is shown in ¥134.0 billion decrease in the time value of options and guarantees from the last fiscal year?

- A7: That is correct.
- Q8: Looking at your analysis of the reasons for change in MCEV from the end of the previous fiscal year (page 11 of the handout), the value of existing business was down ¥362.5 billion. Would you explain how the value of existing business decreased by breaking down with each factor, the increase in implied volatility and the flattening of term structure of interest swap rates?
- A8: Typically, when assets and liabilities are fully matched in ALM, adjusted net worth would be expected to increase even if the value of existing business decreases. So sufficient matching was not performed in our case. In addition, the impact of unrealized losses on securities and other factors caused adjusted net worth to decrease. With regard to factor analysis, when running a simulation we built a simultaneous scenario for changes in implied volatility and changes in interest rates, and then recalculated, which made accurate and detailed breakdown more difficult. However, in our internal analysis we used implied forward rates calculated on the basis of interest swap rates when projecting the average investment yield on assets. The impact was a decrease of around 0.5% compared to the results of last year's analysis. If we apply the sensitivity used last year, a 100bp decline in interest swap rates has the effect of reducing the value of existing business by approximately ¥440.0 billion (change in MCEV of minus ¥289.6 billion – change in value of adjusted net worth + ¥147.9 billion), and a 0.5% fall in interest swap rates has a negative impact of ¥220.0 billion, equivalent to 50%.
- Q9: Twenty-five year interest swap rates fell 33bp. Didn't this change have any meaning?
- A9: For Sony Life, there was some risk in the term structure of interest swap rates, but in terms of sensitivity that we disclosed, interest rates simply exhibited a parallel shift, making sensitivity difficult to determine. The flattening of the term structure of interest swap rates had a major impact on the decline in MCEV. This impact appears to have worked in two ways. First was the effect of the difference in the duration of assets and liabilities as of March 31, 2008. On the assets side, our portfolio was focused on 10-year bonds, whereas the structure on the liabilities side created longer-term cash flows than on the assets side. This duration mismatch has a major downward impact on MCEV in a flattening of the yield curve. The second way in which this worked is unique to our own composition of liabilities. As Sony Life does not have a long history, we have only a short history of most level-premium policies, resulting in a net influx of cash for the foreseeable future. Owing to this net influx, a decline in interest swap rates for the foreseeable future causes our present value to increase—a structure that is a plus for our company. In other words, when interest swap rates for a short-term fall and long-term interest rates increase, the yield curve steepens, causing our MCEV to rise. However, the flattening of the curve as of March 31, 2009, making risk more evident than would have been the case simply from the sensitivity disclosure using a parallel shift.
- Q10: How do you position or consider MCEV from a management perspective? Will you take any sort of action to raise MCEV?
- A10: We consider a number of indicators important in determining the value of the life insurance business, not only MCEV. MCEV is not yet considered commonplace for determining economic value, but we believe this is useful information for determining economic value. We also consider this information useful from the viewpoint of determining the Company's risk profile, so Sony Life will continue to take this approach in the future. At the management vision briefing on June 4, our management will explain our positioning of MCEV in terms of management, as well as how we review the figures.
- Q11: Have you taken any actions, such as hedging investments in assets, in response to changes in MCEV after March 31, 2009?
- A11: We have not taken any action such as hedging investments in assets for the purpose of raising MCEV. Valuations based on MCEV are not grounds for making short-term changes in product strategy or investment strategy. However, in a long-term we do plan to extend the duration of assets to narrow the duration gap between the assets side and the liabilities side.
- Q12: In terms of sensitivity, you said a parallel shift of interest swap rates is not enough to analyze the change in MCEV. In the future, do you plan to provide additional guidance to the market regarding MCEV on a quarterly basis, or do you plan to provide supplementary explanations?
- A12: We do not plan to provide guidance on a quarterly basis. We also do not plan to disclose sensitivity quarterly, which is one component of MCEV disclosure.
- Q13: How much have such factors as interest swap rates changed MCEV between March 31, 2009, and the present, reflecting changes in the market? Please indicate any trial calculations you may have performed.
- A13: We have not performed any current calculations. However, by looking at changes in the yield curve, it would be safe to say that there has been no major change.