FY2015 1H Conference Call for Domestic Institutional Investors and Analysts

Q&A Executive Summary

Date: November 12, 2015, 17:00–18:00 (JST)

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Yuji Oosato, Executive Officer, Sony Life Insurance Co., Ltd.
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Note: The original content has been revised, sorted appropriately and edited for ease of understanding.

Q1: [Sony Life]

After subtracting the positive spread and provision of policy reserves for minimum guarantees for variable life insurance, adjusted core profit was low in Q1 of FY2015, at ¥15.9 billion, but the figure was even lower in Q2 (three months), at ¥13.3 billion. What was the reason for this?

A:

Adjusted core profit in Q2 of FY2015 (three months) was approximately ¥2.6 billion lower than in Q1. Reasons included the fact that overall sales of new policies, centering on variable life insurance, were strong, which causes expenses to increase early in the policy period. Also, the posting of some operating expenses other than commissions that we had expected for Q1 was delayed until Q2. On the positive side, insurance claims paid were high in Q1, but this amount decreased in Q2 (three months), as we had forecast.

(Additional Q: Adjusted core profit in Q2 of FY2015 (three months) was ¥13.3 billion. Going forward, do you expect this figure to return to around ¥18.0 billion, which was the quarterly average during FY2014?)

Year on year, sales of new policies are strong, so the burden of overall expenses, including commissions, is higher. We plan to continue to strengthen sales of new policies, so based on statutory accounting requirements expenses increase early in the policy period, but profit will gradually be recognized and accumulated in the future. In addition, we plan to decide on investments for future growth we are making in FY2015 by looking at the balance with profit growth.

Q2: [Sony Life]

Capital gains were good. Could you provide more detail about the “worsened financial market conditions” which attributed to the worsening of core profit?

A:

Capital gain, which is the difference between core profit and ordinary profit, was around ¥10.0 billion. This was the result of the shift to investing in bonds with ultralong-term maturity. Worsened financial market conditions with respect to core profit are in relation to variable life insurance. Looking at a breakdown of the ¥22.1 billion provision of policy reserves for minimum guarantees for variable life insurance for 1H of FY2015, the Q1 provision was ¥6.6 billion and the amount in Q2 (three months) was ¥15.4 billion. The majority of the ¥6.6 billion in Q1 was due to initial-period expenses for new policies. Of the ¥15.4 billion in Q2 (three months), around half was due to initial-period expenses for new policies. The remainder was provisions due to worsening market conditions. This was the factor that caused core profit to worsen.

The assumptions behind our forecast for the provision of policy reserves for minimum guarantees for variable life insurance in 2H of FY2015 are based on market conditions as of the end of September. Our 2H forecast includes slightly less than half the amount for 1H.

Q3: [Sony Life]

What specifically is meant by the "worsened financial market conditions" that are a factor behind the increased Q2 provision of policy reserves for minimum guarantees for variable life insurance?

A:

This refers to declines mainly in domestic and overseas stock markets. Part of the impact from market factors is offset by recording gains on hedges of variable life insurance as capital gains.

Q4: [Sony Life]

Would it be accurate to assume that a 2H recovery in the market environment would lead to a reversal of the increased amount of provision of policy reserves for minimum guarantees for variable life insurance due to worsening market conditions? Also, is such a reversal incorporated into your 2H performance forecasts?

A:

To reduce the risk of fluctuation in minimum guarantees for variable life insurance, in 2H of FY2014 we began introducing hedges on domestic stocks and foreign exchange (dollar and euro). We also began hedging foreign stocks in October 2015. As a result, we should be less susceptible to changes in the market environment, so even if market prices recover in 2H of FY2015 there is little chance of recovering the negative recorded in 1H of FY2015 (because a reversal in policy reserves related to minimum guarantees would be offset by hedging losses).

Q5: [Sony Life]

You note that you began hedging foreign stocks in October. What degree of hedge are you using?

A:

We are hedging approximately the full amount of our holdings of foreign stocks.

Q6: [Sony Life]

How are sales of variable life insurance?

A:

Funding limits on variable life insurance in August 2015 and the January 2016 revision in premium rates were announced at the same time in May 2015, so we believe the majority of the demand surge was in June and July. Our sales forecast for 2H assumes a demand surge ahead of the January 2016 revision in premium rates, with sales returning to stable levels after that point. Compared with 1H, we expect 2H sales to be slightly more than 50% of the level in 1H. Sales in October 2015 were essentially according to forecast.

Q7: [Sony Life]

What is your forecast for capital gains in FY2015?

A:

Our initial forecast for FY2015 capital gains was approximately ¥8.0 billion for the year, essentially all of which was from the shift to investing in bonds with ultralong-term maturity. However, because we proactively shifted our bond holdings in 1H, we recorded about ¥10.0 billion in gains on the sale of bonds. In 2H, we expect to record capital gains from the shifting of bond holdings of around the same amount as in 1H. This assumption is incorporated into our current, revised operating performance forecast.

Q8: [Sony Life]

What is your new business margin other than for variable life insurance? What will be your new business margin after the January 2016 revision in premium rates?

A:

We are not disclosing our new business margin on individual products. After the January 2016 introduction of revised premium rates on variable life insurance, at current interest rate levels we are assuming a new business margin of around 5% for the company as a whole.

Q9: [Sony Life]

I understand that sales of variable life insurance are down. Are sales of other products increasing? Also, in 1H the contribution of variable life insurance to new business value was small. If variable life insurance makes up a lower percentage of sales, with a relative rise in the percentage of other products, wouldn’t new business value rise in 2H compared with 1H if interest rates remain constant?

A:

During the period when variable life insurance sales were strong, the sales ratio of other products fell in terms of their relative contribution to overall new policies. Sales of variable life insurance are currently stable, and the sales ratio of other products is increasing. Of other products, sales are particularly high for income protection insurance and other protection-type products, as well as “Living Benefit Term Life Insurance (Living Standard

Type)," which launched in November 2015. Assuming that interest rates remain constant, sales of variable life insurance after the August funding limits should contribute to new business value, and we expect that the new business value in 2H will increase compared with 1H.

Q10: [Sony Life]

Regarding hedging on variable life insurance, what will be impact on EV of hedging costs as you expand hedges from Japanese stocks and foreign exchange to include foreign stocks?

A:

As these are futures, the hedging cost is essentially zero.

Q11: [Sony Life]

Theoretically, under U.S. GAAP, increased sales of variable life insurance should lead to higher profit. Why wasn't operating profit under U.S. GAAP increasing?

A:

Under statutory accounting, the provision of policy reserves for minimum guarantees for new policies of variable life insurance is large during the first year of the policy period, which puts downward pressure on profit. U.S. GAAP does not include this sort of accounting treatment, so profit is generated from the initial year. However, in Q2 of FY2015 (three months) a global downturn in stock market caused investment yields to decline. This triggered the accelerated amortization of deferred acquisition costs (DAC), an approach that is unique to U.S. GAAP.

Q12: [Sony Life]

I understand that sales of variable life insurance were stronger than you had forecast. Do you plan to reflect these results into your product development process and sales management going forward?

A:

Funding limits were introduced in August 2015, and premium rates are scheduled to rise in January 2016. There are numerous other choices, but we are thoroughly committed to consulting-based sales and accordingly, we take some time to formulate measures so we can avoid making sudden product revisions or halting sales. Furthermore, we have decided on the content of product revisions by taking into overall account the profit improvement effect and the impact on the systems front. Funding limits were implemented in a relatively short period of time, but we effectively spent more than six months on the increase in insurance premium rates. Where risks are likely to manifest, we recognize the need to strengthen our operations, systems and other structures so that we can respond flexibly.

Q13: [Sony Life]

In FY2013, you saw a surge in demand ahead of the cessation of endowment insurance sales. After that, variable life insurance sales have risen and it is taking time to make product revisions. Is your ERM cycle functioning properly? Shouldn’t the past two years have provided the experience needed to recognize risk and be flexible in setting prices?

A:

We discontinued sales of 30-year lump-sum payment non-participating endowment insurance in January 2014, and discontinued sales of 20-year insurance in October 2014. After that, we stopped selling some types of educational endowment insurance. We make such decisions according to prescribed rules and by taking numerous factors into overall consideration. We would like to accelerate the response of our systems to make changes flexibly. We believe that we are identifying potential risks as early as possible and beginning to discuss measures ahead of time. Essentially, we believe our ERM is functioning appropriately.

Q14: [Sony Life]

How are sales of educational endowment insurance? How is competition with Japan Post Insurance?

A:

We have heard that Japan Post Insurance is enjoying extremely strong sales of educational endowment insurance, and our business is not unaffected. However, we also provide consulting to customers who wish to purchase educational endowment insurance. In the process, they become aware of the importance of death production, which leads to the sale of death protection products. For this reason, we plan to continue steadily providing educational endowment insurance. Our sales of educational endowment insurance are fundamentally year-round and stable.

Q15: [Sony Assurance]

What analysis would you arrive at if you divided out the car accident ratio by number of accidents and unit insurance claim amounts? What is the impact of summer typhoons?

A:

The number of accidents has increased year on year, in line with the rise in the number of policies in force, and unit insurance claim amounts remain unchanged year on year. The accident ratio and unit insurance claim amounts both remain steady.

The impact of the typhoons was approximately ¥200 million, including provision for reserve for outstanding losses. This amount did not have a significant impact on operating performance.

Q16: [Sony Assurance]

Ordinary revenues were up 4.0% in 1H of FY2015, which is essentially in line with your forecast for the full fiscal year of a 4.4% increase for FY2015. You are making an aggressive bid to acquire new policies,

leading to a 10% increase in operating, general and administrative expenses. How is your progress on acquiring new policies compared with your 1H plans?

A:

In general, sales are proceeding according to plan. Income from insurance premiums is slightly lower than we had expected, but progress is in line with our expectations in terms of the number of policies written. We believe that the reason for this is that we acquired more than expected new policies of the 20th rating which incorporate lower premiums. Policy acquisition is generally stable.

Q17: [Sony Assurance]

Is the market as a whole, including competing direct insurers, stepping up premium reduction activities?

A:

The market can be divided up generally into major insurers and direct insurers. The major insurers are generally maintaining their premium levels or reducing them slightly. By contrast, in general the direct insurers are reducing their levels. Because policy conditions and other factors differ among insurers, we do not see a direct link between the premium rate pricing and the number of policies flowing into or away from our company.

Q18: [Sony Bank]

It appears that progress on acquiring deposits is low. What are your policies and forecast regarding deposit volumes in 2H and thereafter?

A:

In October 2015, we increased our interest rates on six-month and one-year time deposits slightly, to 0.2%. As in the past, our policy is to manage loans and deposits in a manner that balances business scale and profitability. In order to maintain our interest spread in a low-interest-rate environment, we have a policy of not setting interest rates too aggressively. That being said, since 2H of FY2014 mortgage loans have been extremely strong, and we recommenced sales of card loans in summer of FY2015. As a result, we recognize that current investment conditions require us to accumulate funds, so we plan to expand our balance of deposits by setting interest rates aggressively while keeping a balance with profitability. This winter, we plan to run a bonus campaign, although we do not expect this to have a major impact on performance for FY2015.

Q19: [Sony Bank]

Will you change your target interest rate spread of 0.9%?

A:

Our policy of maintaining the spread at around 0.9% remains unchanged.

Q20: [Sony Life, Sony Bank]

Sony Real Estate Corporation is beginning business. How is your tie-up with Sony Real Estate progressing? Is there any impact on your business?

A:

Sony Real Estate is one real estate company with which Sony Bank has a tie-up in place in the mortgage loans business. Sony Life also has a tie-up with Sony Real Estate, and Sony Life's Lifeplanner sales employees are beginning to introduce customers who have needs involving real estate transactions. As this is a new initiative, we plan to proceed cautiously during its trial period.

Q21: [SFH]

Your progress rate on profit in the life insurance business and consolidated net income appears slow in comparison with your revised forecast for FY2015. Do you expect to reach your targets?

A:

1H profits were down sharply as a result of the life insurance business, but we believe it will be possible to achieve the revised performance targets we announced on October 29, 2015.