English Translation of FY2015 4Q Conference Call for Domestic Institutional Investors and Analysts

Q&A Executive Summary

Date: May 16, 2016, 16:30–17:30 (JST)

Respondents: Hiroaki Kiyomiya, Managing Director, Member of the Board, Sony Financial Holdings Inc.
Yuji Oosato, Executive Officer, Sony Life Insurance Co., Ltd.
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Note: The original content has been revised, sorted and edited appropriately for ease of understanding.

Q1: [Sony Life]

ESR was down as of March 31, 2016, but at the same time Sony Life's method of calculating ESR strikes me as being extremely conservative. What are your thoughts on the ESR level, considering your conservative method of calculation?

A:

We understand your view that our method of calculating ESR is conservative. Also, we are taking our ESR as of March 31, 2016 (104%) very seriously. We are currently engaging in deliberations and discussions on future measures for improving this level.

Q2: [Sony Life]

ESR was at 104% on March 31, 2016. What would it be at current levels? How does 104% compare with the alarm point you use for internal management?

A:

Interest rates are currently down from their level on March 31, 2016, and we recognize that yields on ultralong-term JGBs (40-year JBGs) are at around 40bp. We are currently calculating ESR, but we believe it would be below 104%, probably below 100%. Our alarm point is set higher than 104%, so since that point was reached we have been considering a variety of measures, including product revisions.

Q3: [Sony Life]

Looking at risk amount based on economic value, insurance risk is up ¥300.0 billion compared with December 31, 2015. I assume dynamic surrenders rose; what sort of countermeasures are you considering to hedge against risk?

A:

The decline in interest rates is the main reason insurance risk has gone up. We recognize that hedging against insurance risk is difficult. Our approach is to proactively take on insurance risk and carefully control market risk. As we mentioned earlier, taking ESR levels into account we are considering various approaches without any constraints.

(Additional: Will you continue purchasing ultralong-term JGBs to lock in interest rates at their current level, or are you considering an increase in capital?)

A:

There is no change in our basic policy to continue purchasing ultralong-term JGBs and carefully controlling ALM. When thinking of ways to improve new business value, we will also need to consider whether capital is at a sufficient level, but we believe increasing capital would be difficult.

Q4: [SFH]

How will the drop in Sony Life's ESR affect your thoughts on the dividend payout ratio? During the course of a year, Sony Life invests assets of around ¥500.0 billion in new capital inflow as the difference between income from insurance premiums and insurance claims and other payments. If ultralow interest rates continue in FY2016, interest profit is likely to worsen by around ¥5.0 billion compared with FY2015. Under these conditions, it seems to me unlikely that you would be able to consider raising the dividend payout ratio to 50% or higher. Would it be safe to assume that the year-end dividend for FY2016 will be flat year on year, and you will see the situation and then consider the year-end dividend from FY2017 onward?

A:

Our policy is to steadily increase dividends in line with earnings growth over the medium to long term, deciding this level based on indicators of soundness and taking into account overall capital policies and the like. As we expect profits in FY2016 to be essentially flat, we will maintain the FY2016 year-end dividend at the previous year's level. We will explain our medium-term dividend policy at our corporate strategy meeting scheduled for June 1, 2016.

Q5: [Sony Life]

What was your reason for changing the method you calculate new business value? This approach may be appropriate for products with lump-sum payments, but putting in locks every three months does not seem to reflect and match up with interest rate fluctuations for products with level payments.

A:

We understand that some people have this view. However, of particular note in FY2015 were funding limits in August 2015 and the January 2016 revision in premium rates on variable life insurance. These factors represented major changes in the economic assumptions for products between as of the beginning and the end of the fiscal year. Valuing all products like this at interest rates as of the end of the fiscal year, as we have done with the previous method, could invite misunderstanding, hence our decision that this was inappropriate.

Q6: [Sony Life]

If you are changing your method of calculating new business value, won't you also have to carefully evaluate your economic assumptions for lapse and mortality rates every three months? And don't mortality rates vary, as they are affected by seasonal factors?

A:

We review our lapse rate every three months and use the average value for three years. We review mortality rate once each year, and use the three-year moving average value, so there are no seasonal factors.

Q7: [Sony Life]

In line with your change in the method of calculating new business value, will it be possible to disclose sensitivity every three months?

A:

At the moment, we plan to disclose sensitivity once each year.

Q8: [Sony Life]

Sales conditions for variable life insurance appear to have normalized following the January 2016 revision in premium rates, but new business value in Q4 of FY2015 (three months) was minus ¥1.7 billion. Given this situation, what are expectations for new business value in FY2016?

A:

In May 2016, we have temporarily halted sales of lump-sum payment whole life insurance (no-notification type), semi-participating individual annuities and short-term payment endowment insurance. We also plan to revise premium rates on short-term payment endowment insurance in July 2016. These are examples of our ongoing efforts to regularly check the profitability of individual products and to halt sales and revise premium rates based on the results of those checks. With interest rates falling, managing profitability will become even more important going forward.

Q9: [Sony Life]

Why is the level of your ordinary profit forecast for FY2016 (¥62.5 billion) lower than ordinary profit for FY2014 (¥78.3 billion), as well as the ordinary profit forecast for FY2015 you announced one year ago (¥74.1 billion)? The level of your operating income forecast for FY2016 under US-GAAP (¥150.0 billion) is also lower than the operating income forecast for FY2015 that you announced one year ago (¥175.0 billion). Why is this?

A:

The main reason for the decrease in the level of our ordinary profit forecast for FY2016 under J-GAAP is the impact of falling interest rates. Other factors are that the volume of variable insurance sales in FY2016 is likely to be higher than we had planned at the start of FY2015, and we expect operating expenses to be higher. The decrease in the level of our operating income forecast for FY2016 under US-GAAP is affected by the operating expense increase, as under J-GAAP, but falling interest rates are the main factor.

Q10: [Sony Life]

To what extent do your performance forecasts for FY2016 take into account the provision for policy reserves related to minimum guarantees? Also, around how much variable life insurance do you expect to sell in FY2016?

A:

We expect a level of 70–80% of the FY2015 provision for policy reserves related to minimum guarantees and delta hedge gains (losses), net (¥30.8 billion).

Q11: [Sony Life]

Does this mean that variable life insurance continues to sell well?

A:

Because we revised premium rates in January 2016, we expect the sales volume to be lower than in FY2015. At the moment, foreign currency denominated insurance is steady, and variable life insurance is down year on year, but as one component of our lineup of whole life insurance we expect to continue selling a certain amount of variable life insurance going forward.

Q12: [Sony Life]

Page 40 of the presentation materials, entitled "Analysis on Ordinary Profit for Life Insurance Business," indicates a negative ¥12.0 billion for gains on sale of securities. Would it be accurate to assume that there will be essentially no gains on sale of securities in FY2016?

A:

Gains on sale of securities in FY2015 were mainly due to the shifting of bond holdings for ALM purposes, and were around ¥19.0 billion in addition to some ¥7.0 billion in investment income on specific money trusts. For FY2016, we forecast gains on sale of securities at around ¥7.0 billion, which is down ¥12.0 billion from FY2015. We expect the shifting of bond holdings to be difficult in FY2016, due to the current interest rate environment, and we expect to sell off around ¥7.0 billion in risk assets.

Q13: [Sony Life]

What is your forecast for positive spread in FY2016? Also, page 40 of the presentation materials, entitled "Analysis on Ordinary Profit for Life Insurance Business," indicates a negative ¥3.0 billion for interest income and dividends due to lower interest rates. What is the breakdown here? Does this, for instance, include factors other than those stemming from lower interest rates, such as a decrease in income from private equity funds?

A:

In FY2016, we expect a year-on-year decrease in the positive spread of around ¥5.0–6.0 billion. A negative ¥3.0 billion of this amount stems from lower interest income and dividends due to the decline in interest rates. The graph on page 40 of the presentation materials indicates this as "decrease in interest income and dividends due to lower interest rates." The decreases caused by other factors than lower interest rates, such as a decrease in private equity fund revenues (¥2.0–3.0 billion decrease) are presented on this graph as "Others."

(Additional: Due to the decline in interest rates, ordinary profit is forecast to fall 5% from the approximately ¥60.0 billion recorded in FY2015. Will the effect really be this great?)

A:

Assuming annual new cash inflow of around ¥500.0 billion, 1% drop in interest rates has a negative impact of ¥5.0 billion. Current yields on 40-year JGBs are around 40bp. Given our average cash inflows during the period, we expect the negative impact to be around half of that ¥5.0 billion.

(Additional: Will the decline in profit be due to the effect of lower interest rates on the portion of new cash inflow but not on the maturing portion?)

A:

Because Sony Life is working to lengthen durations, essentially no investments will be maturing in FY2016. The decrease in profit due to reinvestment of the new cash inflow portion.

Q14: [SFH]

What will be some of the highlights of your next mid-term management plan? Also, will the numeric targets in the mid-term management plan be set on a rolling or several-year fixed basis? What are your thoughts in this direction?

A:

We plan to explain this at our corporate strategy meeting scheduled for June 1, 2016, when we will also talk about our measures and dividend policy.