FY2016 Q1 Conference Call for Domestic Institutional Investors and Analysts
Q&A Executive Summary

Date: August 10, 2016, 16:00–17:00 (JST)

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Note: The original content has been revised, sorted appropriately and edited for ease of understanding.

Q1: [Sony Life]
What sort of internal deliberations are currently underway regarding the purchase of ultralong-term bonds? If interest rates fall further, will you continue buying ultralong-term bonds to control interest rate risk? When controlling interest rate risk, if your assumptions are that 30–40-year bonds will not be negative, your downside risk is limited, and it seems that you would have a choice to leave your duration mismatch even if it expanded somewhat. What are your thoughts on this?

A:
It is our policy not to purchase bonds with negative yields. Other than ultralong-term Japanese government bonds, we have purchased US Treasuries, as we are selling US dollar-denominated insurance. Looking otherwise at the status of our investments in Q1 of FY2016, ultralong-term Fiscal Investment and Loan Program (FILP) agency bonds and corporate bonds made up around 60% of our purchases of yen-denominated bonds. We expect to maintain around that same ratio in Q2. Interest rates were particularly low in the first week of July 2016, so we decided to hold off on purchasing ultralong-term bonds and wait for developments. Depending on interest rate movements going forward, it is possible that we may not be able to make investment activities in the same manner as previously. We are continuing to discuss this situation internally.

Q2: [Sony Life]
I would like to know more about the breakdown of the capital gains contained described in "5. Reconciliation to Core Profit and Non-consolidated Ordinary Profit" on page 12 of the "Summary Information on Sony Life's Financial Results for the Three Months Ended June 30, 2016." Of the ¥8.8 billion in net gains on derivatives, around how much was the delta hedge on separate account assets (variable life insurance)? Also, what, specifically, were the other capital gains and foreign exchange gains or losses?

A:
Breaking down the capital gains of ¥11.0 billion, the main components were ¥8.8 billion in net gains on derivatives, ¥0.9 billion in gains on sale of securities, ¥4.7 billion in other capital gains and ¥3.1 billion in net foreign exchange losses. Of the ¥8.8 billion in net gains on derivatives, ¥4.9 billion was delta hedge gains (losses), net on variable

life insurance. Of the remaining amount, main items were around ¥3.0 billion in hedge gains (losses), net on Japanese stocks held as available-for-sale securities and around ¥1.0 billion in valuation gains on interest rate swaps. The ¥0.9 billion in gains on sale of securities came from gains on sales of foreign currency bonds. Together with the ¥1.6 billion in net foreign exchange gains recorded in the net foreign exchange losses, profit realized from the sale of foreign currency bonds came to around ¥2.5 billion. Other capital gains were a reversal of policy reserves and others related to currency market fluctuations on products denominated in foreign currencies.

Q3: [Sony Life]

The decrease in the positive spread appears to be because of lower dividends from private equity funds, but ignoring that factor how much would the positive spread have changed year on year? Also, I believe that the fall in insurance claims and other payments affected the increase in ordinary profit and core profit. Were there seasonal or special factors for the decrease in insurance claims and other payments?

A:

The decrease in the positive spread during Q1 of FY2016 was mainly due to lower dividends from private equity funds. Going forward, however, we expect interest income on bonds to shrink if the low interest rates continue. The decline in insurance claims and other payments was not due to special factors. The payments were high for Q1 of FY2015, but it is difficult to identify the reason for the decline in payments. Viewed over a one-year period, insurance claims and other payments should stabilize to some degree.

Q4: [Sony Life]

Excluding the positive spread as a factor for the increase in core profit, profit still increased. Was that partially due to a contribution from lower costs on sales as the new policy amount decreased?

A:

The decrease in new policy amount had essentially no impact on the rise in core profit. Rather, this was due a decrease in insurance claims and other payments and a period shift in operating expenses.

Q5: [Sony Life]

How does the level of Sony Life’s annualized premiums from new policies look when viewed on a quarterly basis? While working to control product quality, is it possible for Lifeplanner sales employees to maintain the expected sales level?

A:

Regarding your question on annualized premiums from new policies, we would like to provide explanations about the new policy amount instead. The new policy amount hit a record high last fiscal year, and we aimed to see a higher figure in the current fiscal year. However, we will be revising premium rates in October 2016, so we recognize that exceeding the previous year’s level may be difficult. Even so, we aim for the level to be close. When we introduce revisions in premium rates, we make decisions based not only on profitability but also on take into account a host of other factors, such as the competitive environment. We do not want to be in a situation where margins are high but we are unable to obtain sales volume. Rather we aim to maximize value, which is the product of margins and sales volume. For this reason, as we move toward a revision in premium rates we need to confirm current conditions and prepare to increase our ability to propose necessary coverage that customers will accept even in the face of an increase in premium rates.

Q6: [Sony Life]

Looking at ESR as of March 31, 2016, after revaluation, was the decline in lapse risk the reason for the decrease in insurance risk, or were there other factors?

A:

You are correct. The decrease in the insurance risk was due to the decline in lapse risk.

Q7: [Sony Life]

After applying UFRs, interest rate sensitivity after revaluation as of March 31, 2016, is calculated using the scenario of a 50bp decline in interest rates. A 50bp decline from the current interest rate level would lead to negative interest rates, so did you stop at zero (assuming zero for all negative interest rates)? Also, what would be the sensitivity for a 10bp parallel decrease in interest rates?

A:

For the scenario of a 50bp decline in interest rates, we stopped at zero. We did not go into negative interest rate territory.

Sensitivity due to a 10bp parallel decrease as of March 31, 2016 after revaluation would be a decrease of between ¥25.0 billion and ¥30.0 billion (not adjusted for the zero stop).

Q8: [Sony Life]

This time, the calculation of ESR after revaluation has been changed slightly, to include frictional cost in the numerator. What is your schedule for revising your method of ESR calculation going forward? Also, in the past I believe you have explained that your specific standard for ESR was the 100% level. Going forward, what will be your relationship between adjusted ESR and shareholder returns, risk reduction and potential capital procurement?

A:

With regard to the ESR calculation method, we plan to make revisions in anticipation of the introduction of solvency regulations based on economic value in Japan, and we aim to implement these changes within FY2017. Also, we are very conscious of the 100% level for ESR. Viewed year on year, the risk of falling interest rates has now materialized. Looking at interest rates as of June 30, 2016, after verifying the situation from a variety of perspectives, internally we concluded that the further decline of ESR from the current level will be limited. At present, we believe it will be possible to recover ESR by maintaining profitability and accumulating new business value. For this reason, we will revise premium rates on whole life insurance in October. That being said, a number of situations could arise in the future. If necessary, we might consider such moves as issuing subordinated debt. Essentially, we do not intend to make decisions along with a black-and-white statement that “If ESR falls below a certain level, we will take immediate action.” Rather, we will continue to consider the situation, taking various circumstances into account.

Q9: [Sony Life]

As non-participating ultralong-term insurance lowers ESR, are you not considering a shift to limited participating insurance? Or do you believe there is no choice on non-participating ultralong-term insurance but to wait for interest rates to rise?

A:

Pricing of yen-denominated whole life insurance are rising, so we are shifting sales toward US dollar-denominated whole life insurance and fixed-term insurance, which offer price advantages. As such, we are changing our product portfolio. At present, our percentages of protection-type products and US dollar-denominated whole life insurance are both increasing. Non-participating versus participating are not really factors affecting the decline in ESR.

Additional Q: [Sony Life]

Would your product portfolio change over the next three years?

A:

Our product portfolio is already changing at present. In addition, we plan to revise premium rates on yen-denominated whole life insurance in October 2016, so we believe our product portfolio would change sooner than two to three years in the future.

Q10: [Sony Life]

Around how much new business value do you expect to accumulate due to such factors as product revisions? I understand that under your previous standards, the necessary level of the medium-term ESR was 150%. How much do you expect ESR to improve as a result of accumulating new business value?

A:

In Q1 of FY2016, our new business margin dropped to negative 0.0%. During that quarter, in May we discontinued sales of single premium whole life insurance and short-term endowment insurance, and we shifted our product mix from yen-denominated whole life insurance to US dollar-denominated whole life insurance. This move began showing signs of effectiveness halfway through that quarter, and in Q2 the situation improved further. In Q3, we plan to revise insurance premium rates centered on whole life insurance. If interest rates are stable, our new business margin should turn positive. As we anticipate making further changes in our product portfolio, at the moment it is difficult to make a specific forecast for new business value. However, we are targeting ROEV at 4–5% over the medium term, and this fiscal year we will work to achieve that level.

Additional Q: [Sony Life]

Regarding your medium-term target level for ESR, would it be correct to assume ROEV growth of around 4% in the numerator?

A:

As of July 31, 2016, ESR had improved to around 110%, and the figure has now improved even more. However, we believe it would be premature to indicate an appropriate level as we did based on the previous standard at this point. We are currently laying the groundwork to ensure that ESR does not fall below 100%. We will indicate appropriate levels for ESR going forward, as we move ahead with preparations such as revising our definition of the risk amount.

Q11: [Sony Life]

You say that ESR was around 110% as of July 31, 2016. What were the denominator and numerator amounts? Also, have there been any changes in risk amount?

A:

This is a rough estimate, but MCEV was around ¥1,140 billion, and ESR was approximately 110%. The risk amount also changed.

Q12: [Sony Life]

Under your current ESR calculation method, if interest rates fall, your insurance risk rises due to a sharp increase in risk of a falling lapse rate. At the same time, the cost of non-hedgeable risks grows, causing capital to drop, to the effect is counted doubly, in both the denominator and the numerator. Is the logic here correct? Because you decided on the current calculation method, you had no choice but to disclose ESR of 95%, but do you expect to fix this double-counting problem when you revise your ESR calculation method in FY2017?

A:

We are working to revise insurance risk with a view to FY2017, and we plan to include in our revisions to the calculation method a way of combining the lapse risk coefficient and the risk amount. With regard to double-counting, this problem will not be resolved even after revising the risk coefficient. As ICS and Solvency II are both in agreement on this front, we believe it is the general calculation method that recognizes corresponding non-hedgeable risks as risks rise.

Q13: [Sony Life]

Your new business margin has fallen off considerably. If long-term interest rates fall further, is it possible that you will stop acquiring new policies?

A:

In October 2016, we plan to discontinue sales of interest rate-sensitive whole life insurance. We monitor interest rate conditions and consider product revisions on an ongoing basis. When we do so, we consider decreases in commission levels and rises in insurance premium rates. If as a result we end up with product designs that customers are unwilling to accept, our policy is to discontinue sales and proactively sell products with designs that we can offer customers.

Additional Q: [Sony Life]

Following a variety of initiatives, after your new business margin rises somewhat do you expect returns on

the capital that supports new policies to recover to a level above your assumed capital cost? Do you assume that business will exceed your capital cost?

A:

Comparing to capital cost rates, at present there are some products that are not maintaining a sufficient margin. We would like you to understand, however, that at the moment our ROEV growth target is 4–5%.

Q14: [SFH]

Sony Life's ESR was below 100% as of June 30, 2016. Don't you plan to limit shareholder returns at around this level?

A:

As was mentioned earlier, we believe Sony Life's ESR is at a level where recovery is possible. As of July 31, 2016, ESR had recovered to around 110% due to interest rate rises, and the figure has rebounded further as of the current date. For this reason, we do not plan to change our dividend policy.

Q15: [SFH]

If performance for full-year FY2016 is up and EPS is above ¥110, is it possible that dividends will rise?

A:

In principle, we aim to increase dividends as income grows. If results for FY2016 are up substantially, we will consider raising dividends after taking medium- to long-term income growth into consideration.