IR Meeting Q&A (November 24, 2016)

– Progress of Mid-Term Management Plan –

Domestic P&C Insurance Business

Q: In automobile insurance, the combined ratio has improved markedly in the past few years. What is your outlook for changes in the competitive landscape, including reductions in the automobile insurance premium rate going forward?

A: We believe the future course of automobile insurance premium rates will follow two stages. The first is the introduction of Advanced Safety Vehicle (ASV) discounts and other such initiatives as reported by some media sources. Going forward, if the advisory rates calculated by the General Insurance Rating Organization of Japan (GIROJ) are revised, we will also need to consider reflecting these revisions in our premium rates, among other matters. However, given that the safety of ASVs will ultimately be factored into the premium rate for each car model, we believe the impact on our top line will not be that significant. The second stage will be to address the improvement in the combined ratio mainly owing to the recent decrease in the number of accidents. Industry consolidation in the Japanese market has already narrowed down the number of players to three mega-P&C insurance companies, so it is unlikely that they will compete fiercely to reduce premium rates. In addition, although the number of accidents is decreasing mainly due to the increased market penetration of ASVs, repair costs have been surging, and a hike in the consumption tax rate is expected in October 2019. Therefore, we will need to monitor trends closely going forward.

Q: I believe you are exploring the idea of expanding new types of insurance in specialty fields. To what extent do you expect these types of insurance to impact earnings in the future?

A: We believe that if new forms of risk are recognized in conjunction with technological innovations such as automated driving, this will give rise to new insurance needs. Based on our belief that specialty fields have relatively higher profitability, we plan to continue focusing on these fields. However, we don’t expect these fields to grow larger than, for example, automobile insurance. Automated driving has been discussed at the World Economic Forum Annual Meeting in Davos and other forums. We believe it is still too early to discuss the extent to which specialty fields will grow as earnings sources. However, we will continue to push ahead with research.

Q: Overseas, there have been some instances of moral hazard vis-à-vis wearable devices. For example, when insurance companies distributed wearable devices to customers, accurate data was not sent back because the customers allowed other people to use the devices. How will you address these sorts of issues?

A: We are seeing examples of some companies using social media to prevent moral hazard. We would also like to pursue research into these types of approaches.

Domestic Life Insurance Business

Q: The weight of protection-type products at Himawari Life has been increasing. However, medical insurance has longevity risk. To mitigate this risk, Himawari Life could take the approach of diversifying risk by underwriting mortality risk. Will you, for example, consider measures such as proactively selling life insurance focused on mortality risk?

A: We need to sell a well-balanced mix of insurance products without excessively concentrating on any specific type of risk. We will consider taking steps such as expanding sales of products offering death protection compensation, without relying too much on medical insurance.

Overseas Insurance Business

Q: Could you please provide any updates on the agreement regarding the commencement of procedures on the acquisition of Endurance Specialty Holdings Ltd. (“Endurance”) since the announcement date?

A: Even before the agreement regarding the commencement of procedures on the acquisition, we had discussed our goal of building a truly integrated global insurance business platform with Mr. John Charman, the CEO of Endurance. We have confirmed that there is no change in this direction. Both sides recognize the importance of prompt decision-making and timely information sharing among management in each country or region. For business in developed countries, we seek to establish a management style where decisions can be made by a small number of people.

When considering integration with overseas subsidiaries in the U.S., U.K., and Switzerland, and Sompo Canopius and others, one approach will be to make use of Endurance's resources in fields such as personnel systems, human resources development, IT systems and ERM. We expect the reinsurance market to continue softening going forward, and it will thus be crucial to secure profitability by developing insurance underwriters. In regard to global human resources development, Endurance has advantages over us in some respects. Meanwhile, by joining the Sompo Holdings Group, Endurance will be able to capture synergies in terms of capital charges. Moreover, looking at other benefits, Endurance's products could be supplied via our licensing network. We have not quantified the synergies at this time. However, we will examine these matters through the post-merger integration (PMI) process.

Q: In 2015, Endurance acquired U.K.-based Montpelier Re Holdings Ltd., which holds securities in its trading account. Fluctuations in the fair value of these investment assets will have an impact on earnings on an accounting basis. How do you plan to address the calculation of adjusted consolidated profit, which represents funds for shareholder returns?

A: Adjusted profit in the overseas insurance business is defined, in principle, as the accounting-based profits of Group companies without adjustment. Therefore, according to the current definition, fluctuations in the fair value of securities in the trading account could have an impact on adjusted consolidated profit. Meanwhile, we will examine optimal ways to address Endurance's accounting policies through the PMI process.

Q: In fund procurement related to the Endurance acquisition, is there any possibility that the existing asset management portfolio balance could be upset due to the need to generate cash?

A: We are currently in the stage of formulating a procurement plan for the acquisition funds. In any case, we do not anticipate anything that would drastically alter the existing asset portfolio balance, or have an impact on investment profits. Considering the recent low interest rate environment, we will retain the option of procuring funds from external sources, as we shift to the execution of an optimal fund procurement plan.

Shareholder Returns

Q: What level of shareholder returns should we expect in the future?

A: Considering the impacts of the closing of procedures on the acquisition of Endurance, snow damage in the current fiscal year, and other factors, we will thoroughly discuss how we will choose the balance between dividends and share buybacks in the Board of Directors meetings. Management seeks to achieve attractive shareholder returns that do not fall below the amount of total shareholder returns for the previous fiscal year.

Under the Mid-Term Management Plan running through FY2020, we are targeting a total payout ratio of 50% as a medium-term target. Efforts will continue to be made to reach this target. We have indicated that the total payout ratio for a single year may fall below 50% in periods when ESR declines due to M&A activity and other situations. However, looking at the facts surrounding our shareholder returns based on FY2016 results, if we attain the projected amount of adjusted consolidated profit, and maintain the same amount of total shareholder returns as in the previous fiscal year, our total payout ratio would be around 44%. We will decide whether to raise the total payout ratio to 50% with an eye on our final business results. There is no change in our goal of continuing to deliver shareholder returns that meet the expectations of investors.

Q: What are your thoughts on the flexibility of shareholder returns?

A: We have not changed our policy of seeking to achieve adjusted consolidated profit of ¥300.0 billion and adjusted consolidated ROE of 10% or more in the future. We also envision driving further earnings growth through M&A activity. However, our first priority is to execute the closing and PMI process for Endurance. For this, we will need to carefully assess the situation regarding these procedures. In addition, we will determine the shareholder return policy while confirming trends in uncertainties such as snow damage, and carefully gauging our expectations for our final business results for the current fiscal year.

Q: What is your approach to balancing dividends and share buybacks?

A: Our basic approach is to maintain stable dividends, in principle, while enhancing shareholder returns by increasing earnings per share through share buybacks. We would also like to set our shareholder returns in consideration of the comparative levels of dividend yield and total shareholder return yields of other companies and other industries. Looking ahead, in order to achieve attractive shareholder returns, we aim to determine shareholder returns, including the balance between dividends and share buybacks, while continuing to seek the opinions of investors and analysts.