NKSJ Holdings Inc IR Meeting

Company Participants

- Kengo Sakurada, President
- Unidentified Speaker, Unknown

Other Participants

- Hideyasu Ban, Analyst
- Jun Shiota, Analyst
- Masao Muraki, Analyst
- Mitsumasa Okamoto, Analyst
- Natsumu Tsujino, Analyst
- Takanori Miyoshi, Analyst
- Unidentified Participant, Analyst
- Wataru Otsuka, Analyst

Presentation

Kengo Sakurada {BIO 15149542 <GO>}

Thank you for coming. NKSJ Group posted steady top line growth on a consolidated basis, with P&C net premium written increasing 2.1% and life insurance premiums up by 5%. However, due to the impact from natural disasters worldwide, as well as tax amendments that are one-off, an ordinary loss of JPY51.8 billion and net loss of JPY92.2 billion were recorded.

The breakdown of the JPY51.8 billion ordinary loss are shown on page four. Domestic P&C insurance underwriting loss was minus JPY66.1 billion and the overseas insurance business was minus JPY16.5b. This was on the back of natural disasters worldwide, such as the flooding in Thailand and massive typhoons. Other consolidation adjustments, which include purchase method revisions, stood at minus JPY32.6b.

On the other hand, investment profit was JPY61.7b, mainly from steady interest and dividend income and realized gain on securities. And the domestic life insurance business, which had good top line revenue, contributed by JPY1.1b.

Please turn to page five. I will now explain the breakdown of the JPY92.2 billion net loss. For the domestic P&C insurance business, due to the impact of natural disasters worldwide, as well as technical factors such as the reduction of the corporate income tax rate accompanied by a reversal of deferred tax assets, losses amounted to JPY60.1b.

In addition, for the domestic life insurance business, merger impact expenses were recognized as an extraordinary loss, leading to minus JPY11.b. The overseas insurance business also incurred losses due to the Thai flooding impact.

Please turn to page six. Underwriting profit came in at the loss of JPY66.1b. Negative contributors to the underwriting profit were the loss ratio of automobile insurance business hovered at a high level and the loss from natural disasters, such as flooding in Thailand, typhoon number 12, 15 and hail, etc.

On the other hand, we put all our forces together in the Company to facilitate the payment of losses incurred by the East Great Japan Earthquake, which proceeded very well. As a result, we recognized the reversal of catastrophic loss reserve as we had paid out the claims in FY2011, which contributed positively by JPY51.3 billion to the underwriting profit.

Please turn to page seven. Adjusted consolidated profit was JPY1.2b. In FY2011, those were the positives and the negatives for adjusted consolidated profit. Lower profit from domestic P&C business due to natural disasters and overseas business was offset by the increase in domestic life business. To calculate adjusted consolidated profit, we included the impact from lower corporate income tax rate in extraordinary items, as you can see on the bottom right.

First, let me explain about the domestic P&C business. Would you please turn to page nine? The premium in FY2011 trended more strongly towards the second half. This graph shows monthly premium income of general lines total on performance evaluation basis. The premium top line income was still [ph] driven by strong business of CALI, price revision of voluntary automobile insurance and fire insurance.

Please take a look at page 10. Page 10 is on the combined ratio, excluding the impact of CALI, financial guarantee and household earthquake insurance. In FY2011 it was deteriorated significantly to 107.5%, which is due mainly to natural disasters at home and abroad. The page shows also the combined ratio excluding natural disasters in Japan and the flood in Thailand, for your information, in which case the combined ratio declined from 99.4% last year to 98.8%.

Please turn to page 11. Here is the loss ratio on an earned incurred basis including CALI -- excluding CALI, financial guarantee and household earthquake impact. The loss ratio in fiscal 2011 was 73%, higher than the previous fiscal year, due to effects of natural disasters worldwide. For your reference, the earned incurred loss ratio excluding the effects of natural disasters and Thai floods was flat year-over-year at 63.2%.

Please turn to page 12. Fiscal 2011 was 35.4% for net expense ratios, 0.2 points lower compared to last year. The net expense ratio has been falling year after year, as efforts were made to continuously reduce Company expenses. We strive to accelerate these trends for better efficiency in the domestic P&C insurance business.

Please turn to page 13. Here is the earned income -- earned incurred loss ratio for our key line, voluntary automobile insurance. The results shown here exclude the impact of the Great East Japan Earthquake and typhoons number 12 and 15. Fiscal year 2011 was 71.4%, 0.6 points lower than last fiscal year. Although we cannot be optimistic, signs of change are being felt. Relevant measures will be taken in order to bring the loss ratio to a declining trend, both at the entry point as well as at the exit point. We will elaborate on this later.

For better profitability in voluntary automotive insurance, continuous premium rate revisions are important. So we will continue to strive to optimize premium rates. Sompo Japan revised premium rates two years in a row and has introduced premium rate segmented by age in April 2011. Nipponkoa also revised rates in January 2012. Furthermore, revisions of advisory pure premium rates, mainly non-fleet driver rating system revisions, have been filed. The revision is expected to have an effect on stopping the decline in premiums to a certain level.

Please turn to page 15. So this fiscal year the revised non-fleet driver rating system is expected to be implemented. Here is a diagram showing its effect. The effect of driver ratings revision is expected to come in stages. And this should help to curtail the impact of reduced premiums when ratings levels are promoted. In the third year, we expect effect to be approximately 2.5%. And we believe the effect is going to continue to expand.

This is the impact of Great East Japan Earthquake. The incurred losses were limited, since we reversed the outstanding loss reserve and at the same time we recognized a reversal of underwriting reserve of earthquake insurance, which was a positive factor on the underwriting profit.

Please turn to page 17. This is impact from flooding in Thailand. The incurred loss amounted to JPY109.8b. Of the total incurred loss which should be borne by the domestic companies, we reversed catastrophic loss reserve for the portion of the loss already paid by the end of the year, which left a negative impact of JPY91.8 billion on FY2011 profit.

Please turn to page 19. This is about the life business in Japan. This page onward is a section to explain domestic life business. The management measurement criteria is the increase of adjusted EV, which was JPY100b. This EV growth was driven by strong new business of protection type products, which contribute strongly to EV, as well as lower surrender ratio than we initially assumed. The nominal EV growth, including other factors, was JPY148.2b, which pushed the balance of EV at the end of FY2011 to JPY615.3b.

By the way, MCEV interest sensitivity is low in domestic life business because we are investing mainly in yen denominated bonds based upon ALM principle, which means risks are controlled at low level, as you can see on this page on the right-hand side.

Please turn to page 20. Next I'd like to explain ANP, which was the driver to increase adjusted EV. The Company total ANP declined on the net basis by JPY1.5b. However, when you break it down into protection type products and savings type products, the trend is different in that underlying ANP of protection type products is steadily increasing. We plan to continue to reinforce the portfolio.

Please turn to page 21. This page introduces feedback regarding Himawari Life's products, featured by economic publications and weekly magazines. As you can see, the products have been highly rated.

Please turn to page 22. Here I will explain the status of income from insurance premiums on a profit and loss basis. Insurance premium income increased by 1.4% in 2011. A small rise is expected in 2012, by 0.4%. Premium income excluding low profitability lump sum payments were plus 4.6% in fiscal year 2011 and expected to increase 3.2% in fiscal year 2012. We would be reinforcing higher margin products and we plan for a steady rise.

Next is page 23. Next our profit indicators on an accounting basis. The NKSJ Group positions the domestic life insurance business as a growth area. And has been in the process of generating results. And we have been in the process of shifting resources from the P&C insurance business to expand it.

After absorbing rising business expenses related to the shift, basic profits increased by JPY5b, from JPY800 million in fiscal 2010 to JPY5.8 billion in fiscal 2011. In 2012, it is expected to rise even further, to JPY8.7b. Net income posted a JPY11.1 billion loss, due to items such as the JPY11.7 billion merger cost. Net income for fiscal 2012 is planned at JPY2.2b.

Next, on page 25, here are the trends of the overseas insurance business. As you can see on the left-hand side, top line is steadily growing. With regard to net income, or bottom line, this was affected by the floods in Thailand in fiscal 2011, resulting in a loss. But a V-shaped recovery is forecasted for 2012.

On the next page, here we talk about strategies and explain the progress we have made so far in overseas strategies. In our Group, we put overseas insurance business as a growth driver and intend to develop this business to that income driver, following domestic P&C business and life business.

As you can see on this page, we plan to grow organically in existing locations overseas, as well as utilizing M&A opportunities to grow faster and more drastically. We are assuming investment in this area of JPY200 billion over three years until FY2012. But the amount is not fixed. Our stance stays unchanged in that we invest where appropriate. It might increase more above JPY200b, or it might come below JPY200b.

We are currently studying to clarify market-by-market strategy, to study possibilities to put more stake in existing locations by each business line, to keep the momentum of growth of overseas insurance business. And we'd like to have an occasion in the future to explain in more details to you.

Please turn to page 28. As we announced earlier, our Group established Prime Assistance Inc., which is engaged in assistance business, on April 2. This company is going to start its operation in October. And this company plans to launch road assistance service to policyholders of automobile insurance of Sompo Japan and Nipponkoa from October. It aims to enter into assistance business other than road assistance in the future.

With the start of Prime Assistance Inc., we'd like to evolve our business into a true service industry by offering innovative various services which can contribute to the peace of mind and the security of our customers.

Please turn to page 30. This page is on our full-year consolidated forecast for FY2012. We plan to continue the increase of top line income and turn recurring and operating profits into black, which will realize a significant improvement from the previous year when we encountered various natural disasters.

Please turn to page 31. Here's a breakdown of the JPY64 billion ordinary profit outlook for 2012. The breakdown is shown here. Underwriting profit for the domestic P&C insurance business is projected for a JPY61.9 billion loss, due to JPY24.3 billion in system cost and the continuing losses from automobile insurance.

Automobile insurance can expect, like said earlier, an improvement going forward due to premium rate revisions and driving rating system revisions. We also plan to engage in cutting expenses even further, without any exceptions, in order to improve base cost.

Another significant positive factor is reversal gains from catastrophic reserve related to Thai flooding claims payments and substantial investment gains, mainly from sales of marketable securities. After accounting for the life insurance business and other businesses, ordinary income of JPY64 billion is expected.

Please turn to page 32. Here we compare fiscal 2012 ordinary profit with last fiscal year. I am going to skip through the details. However, the key point here is the increase in system cost. Occurred loss of automobile insurance is projected to be mostly unchanged year over year. So it does not appear on the chart. This is considered to be relatively conservative.

Please turn to page 33. This chart focuses on the domestic P&C insurance business. Net premiums written are expected to maintain a growth trend, which started from the second half of last fiscal year. An increased assumed reinsurance of fire insurance will contribute positively in income. However, increases in insurance ceded will make growth flat year-over-year.

Loss ratio is projected to improve by 0.8 points, due to less natural disasters. However, a 1.4% increase in net expense ratio is anticipated, as a certain level of system integration cost will be recognized. As a consequence, the combined ratio excluding extraordinary factors is expected to be 0.6 points higher, reaching 103.6%.

And here are the assumptions for the business forecast, which are raised on page 34. I hope this will be of your reference.

The projections for the life insurance business is shown on page 35. Sales of protection type products are expected to be brisk this fiscal year too. Hence, EV growth is expected to be at high levels, at JPY85b, which is after taking out extraordinary one-off factors from the JPY100 billion result recorded in fiscal 2011. Adjusted EV is expected to be JPY85 billion in growth.

Next I will explain items such as progress on management plan. Please turn to page 37. This page shows the trend of past adjusted consolidated profit and this year's guidance. Adjusted consolidated profit in FY2012 is projected to recover significantly year-on-year, to JPY53.7b.

We are assuming a drastic improvement of domestic P&C business, because we will not have impact of flooding in Thailand. However, we are still assuming a loss in the domestic P&C business since we are projecting a loss to continue in voluntary automobile insurance segment. In the domestic life business, we are projecting continuous profit contribution. And overseas business will recover as well.

On the right-hand side of this page, we are showing current plan, which we made in September last year. The target timeframe for this plan is FY2015. But it is clear that we must improve fundamentals of our profit structure in domestic P&C business through actions such as thorough cost reductions. In the light of this, we have announced the full merger in March. And the key question -- key challenge for us is to capitalize on the benefits coming from the full merger. And this is the biggest solution.

Please turn to page 38. This is about the merger we announced on March 23. These are extracts from the news releases. As written here, Sompo Japan and Nipponkoa will be merged, aiming at the first half of FY2014. And establish the new company Sompo Japan Nipponkoa. The new company will be at the top of the industry in Japan in terms of net premiums written as a standalone company.

In this type of era, we cannot gain understanding from investors and shareholders only by appealing the scale. So as written here, we are going to address these five challenges. The points are as follows. We are going to have a full merger at the first half in 2014. That's not the point. But we have two more years until then. So the key question is how to use those two remaining years and update you on the progress that we are making towards the final full merger. And myself and Futamiya and our staff will put all our forces together to realize these plans.

Please turn to page 39. This is Group strategy -- this is the current Group structure. And we may change this Group structure, depending upon the future plan. But this is the Group structure as of now.

Please turn to page 40. Upon the addition of full merger, we are in the process of scrutinizing our management plan. We wanted to show you the revised management plan assuming and incorporating the benefits from the full merger. Today, however, as written here on this page, there are various schemes, systems, processes that are being scrutinized. And we'd like to go through all the cost elements and we'd like to sort them out. And we are going to announce the revised plan in autumn this year. And we would like to explain the details to you then in autumn.

Please turn to page 42, the balance sheet topics. First, allow me to confirm adjusted consolidated net assets. As of end of March this year, the total was slightly higher than JPY1.9 trillion, or JPY4,638 per share. There were factors which had a downside impact, such as the decrease in catastrophic loss reserve due to natural disasters and net loss. However, EV from the life insurance business offset the loss, resulting in a slightly higher number compared to last year.

Please turn to the next page. Here are Japanese Standard based solvency margin ratios for the core three companies. Due to short-term revisions, asset risk evaluations were tightened. But exceed the regulatory requirement level of 200% substantially.

On page 44, here we look at capital and risk based on internal standards on economic value basis. Currently, these are internal metrics that are applied. Capital and risk status are shown here.

First of all, capital and risk used to be managed on a pre-tax basis. From this time onwards, they will be managed on an after-tax basis in anticipation of Europe's Solvency II and international accounting standards. Risk level wise, we use as a Group value at risk of 99.95%, which is equivalent to a AA ranking.

The results are shown on the graph. There is a buffer of more than JPY400b. And the solvency margin ratio, capital divided by risk, is 129%. Then, on the right-hand side, you can see the various assumptions and sensitivities.

Please turn to page 45. Here we talk about ERM. On a (inaudible) basis, we have started to manage our business. And based on this concept, capital allocation and risk evaluation is performed. As you can see, for domestic P&C insurance, we are not expected to grow its size substantially. So our plan is to sell down strategic holding stocks and thoroughly revise cost structure to improve capital efficiency.

As for the domestic and overseas life insurance businesses, these are considered as growth areas. We would like to use capital released by the domestic P&C insurance business and take appropriate risks in order to expand the businesses in size, as well as in profits.

Please turn to page 46. Let me next explain our asset portfolio. First, about domestic P&C, the total amount is a little bit over JPY6 trillion. Policy of general account investment is diversification. And the policy of savings account investment is ALM in our portfolio, as you can see on the right-hand side.

As for the general account investment, which represents 70% of total, we have sold down domestic equities but it still accounts for more than one-third. Therefore, we do recognize that we need to further reduce the exposure. In the corporate Group area, we have to come up with the revised way of selling our products. The duration gap between assets and liabilities of savings account is short, which is two years. Therefore, interest rate risk is limited.

Please turn to page 47. This is asset portfolio of domestic life business. It's mostly invested in yen denominated assets, highly conservative. Asset and liability duration gap is short, 12 and 14 years. So the gap is only two years. The high product mix of highly profitable protection type products in Himawari Life is one of the reasons. Therefore, we don't need to take higher risks than what we are taking now.

Please turn to page 48. This shows our exposure to GIIPS countries in Europe. The balance has been limited to begin with. But we have reduced exposure furthermore over the past six months, to JPY24 billion in the total Group at the end of March 2012. This level is 1.2% of our adjusted consolidated net asset value, which is fully manageable.

Please turn to page 49 for financial guarantee business. We recognized profit of JPY800 million in guarantee business, as we can see on this graph. And we sold all primary insurer ABS-CDO guarantees, which were the root cause of past losses.

Please proceed to page 50. This graph shows a breakdown of total risk. The total amount of risk is JPY1.5 trillion. And this is the breakdown by risk categories. As you can see, asset management risk is relatively large. And within asset management risk there is high concentration on risks of domestic equities, which is a common characteristic in the industry.

Please turn to page 51. As explained already, we had a target of reducing strategic holding stocks by one-half during the three-year period from fiscal 2010 to 2012. The first year came in low, at JPY45.3b. But the pace was accelerated in the second year, reaching JPY127.6 billion in fiscal 2011. For this year, last year levels would be a minimum requirement and we would like to exceed it substantially.

But as a matter of course, we will monitor the stock market conditions, as well as the situation in Europe, as we decide on the timing of sales. Even after the current target is achieved, this will not be the end. We believe further cuts of strategic stock are necessary when considering capital efficiency and future tighter capital requirements.

That is why we are thinking about compiling a new medium-term plan, targeting an even larger reduction by fiscal 2015. This is currently under consideration. We hope that we will be able to solidify a plan by fall this year and share it with you. We would like to also consider how we can transform the business model at the same time, as we continue to sell down strategic holding stock.

Please turn to page 52. Here I will explain about returns to shareholders. Dividends for fiscal 2012 are based on basic policies regarding shareholder return. And are expected to be JPY80 per share.

In case management plans are revised, including investment plans related to the merger of two companies, or in case the medium-term business outlook or capital outlook changes due to fluctuations in the business environment or market, there may be a possibility that we revise shareholder return policies because fiscal 2015 will not be the end. We would like to solidify our plans by the fall period. And also once again share our views on shareholder return policies.

To give you a sense of current dividend levels, on the right-hand side of the slide, factors that may impact capital and risk are shown. For the next four years capital is expected to increase, led by a profit accumulation. And risk is expected to decline, due to reduction of strategic holding stock. However, we do believe that considering future overseas investments you can see that we have sufficient source for dividends without undermining the capital buffer.

From here on is the appendix. So I hope you can refer to it later. Although brief, this concludes my presentation. Thank you very much.

Questions And Answers

A - Unidentified Speaker

Now we'd like to open the floor for questions. When you ask a question, would you please state your name and company name? Would you please raise your hand, if you have questions? Please go ahead.

Q - Masao Muraki {BIO 3318668 <GO>}

My name is Muraki from Deutsche Securities. I have two questions. First question is about voluntary automobile insurance business. I'm on page 15. This shows the impact -- positive impact from the revision of non-fleet driver rating system. And this is the premium impact. But how about impact that you estimate on the claims payment side? Would you please give us the details on the expected benefit on the claims side?

My second question is on page -- related to page 44. So you have changed the calculation method or definition. And based upon this current solvency ratio, what is your targeted ultimate level? And versus the EU Solvency Margin II regulation, you're applying higher risk confidence level. But if you adjust this definition to European Solvency Margin II, what would be the number? If you have done the trial calculation, would you please share with me?

A - Kengo Sakurada {BIO 15149542 <GO>}

To your first question, I can just briefly explain my thinking, philosophy. In terms of the loss impact, probably the loss level -- current loss level will continue even after the revision of pricing table. So we are assuming positive benefit on the premium income side. But we assume the loss to hover at this high level. And I am going to pass the second question to my colleague.

A - Unidentified Speaker

Also in terms of the first question, as Sakurada answered, our projection does not incorporate any positive benefit on the loss side. But always, in reality, this deters the loss applications when the pricing table is revised. So in the medium-term business plan, in 2015, in total of Sompo Japan and Nipponkoa this is still the calculation result. It's not the finalized number. But the balance will be increased by about JPY10b. But this is just the result of trial calculation, which is not incorporated in the medium-term plan.

And let me answer your second question. Starting from the end of March 2012, we are going to introduce this new way of managing capital. QIS5, European Solvency Margin II Standard is almost equivalent to our calculation method, which is after-tax basis. I hope I answered your second question.

Q - Masao Muraki {BIO 3318668 <GO>}

Thank you. So much. Relating to your answer for the first question, other than the pricing table revision, what kind of actions are you trying to take? Are you taking any actions to prevent losses or to mitigate losses, or to improve the pricing structure?

And my second question, follow-up question, is also on page 44. The 99.95% is value at risk definition that you have used. But if you apply European Solvency Margin II Standard, then I think there is a difference between your confidence level and European confidence level. But may I understand that you have come up with 99.95% based upon the European confidence level assumption?

A - Unidentified Speaker

Let me answer the second part of your question. 99.95% is value at risk criteria based upon the European Solvency II regulation. And our targeted rating is AA. To execute all the actions in the medium-term business plan, we'd like to aim at AA. Currently, although the rating is A in 2011, we'd like to improve the rating to AA. So in terms of the risk volume, we have applied more stringent value at risk.

And about the first question, relating to the voluntary automobile insurance business, both for Sompo Japan and Nipponkoa we are trying to raise prices to improve the premium income. And we have done so for the past one to two years at both companies. In the voluntary automobile insurance, as you know, we can recognize the premiums on the installment payment basis, because people pay on the installment payment basis.

So it takes time, whilst you recognize on the denominator. So it takes 24 months. There's a time lag until we fully enjoy the benefit from the pricing increase for the full 24 months. So 2012/2013, we will not have the direct and full positive impact from the price increases.

This completes my answer. Thank you. So much.

Q - Masao Muraki {BIO 3318668 <GO>}

Other than price increase and (inaudible) to drive a rating system revision, what else? What other actions are you taking at the entrance and at the exit point?

A - Kengo Sakurada {BIO 15149542 <GO>}

Of course you have to apply more stringent underwriting processes. And you have to do this steadily. Then you can harvest from this, for sure. If you have a very stringent underwriting process, then at the end it should improve the profitability. So at Sompo Japan and at Nipponkoa we are going to have very controlled underwriting.

And at the exit point, we'd like to prevent losses and we'd like to optimize the repair cost. So we are trying to tie up with the designated repair shops, which are bearing fruits. So these are minor actions that I would like to make sure that we take those actions to improve the profitability of that business.

Q - Natsumu Tsujino {BIO 2234779 <GO>}

My name is Tsujino from JPMorgan. I have three questions. In 2013 -- my concern is about the projection for 2013. There's a reversal of JPY52.5 billion coming from the flooding in Thailand. So that would be positive. And in 2012 the system cost JPY24.3 billion increase. In the original plan for three years or so, you were assuming a high level of system expenses. So next fiscal year, if there is no improvement of other losses, you will lose JPY52.5 billion positive benefit from JPY64b. So net loss might be incurred in the next fiscal year as well. Â So are you going to sell down more Japanese equities, that is, holding stocks? So that's my first question.

However, if you look at page 51, from 2012/2015, for these four years, JPY127 billion in '12. And in the remaining three years, are you assuming JPY120 billion still, at the same pace? It depends on the stock market. But it will be difficult for you to generate sale gains from those equity stock sales. So you have to really accelerate the sale of strategic holding stocks. That's my second question.

My third question relates to the risk volume, risk amount, page 50. I have to look at the details of the insurance risk. But domestic stock risk is JPY0.7 trillion, equities about JPY1.5 trillion or JPY1.6 trillion. So that means, in reality, risk co-efficiency is close to 50%. And based upon the Solvency II criteria, you have to apply 99.95%. But there's a standard approach guideline, the risk weight for equities is about 30% according to that guideline. Personally, 99.95%, then the risk should be higher than 30%, personally. But you have considered all of those considerations. Then, risk that you calculated as high as this, after considering all of those factors that I have just mentioned?

A - Kengo Sakurada {BIO 15149542 <GO>}

I wasn't able to understand your last question. But let me answer your first question. For results for fiscal year 2013 or our outlook, the system costs incurred in 2012 and integration costs in 2013 and the positive effects that are going to fall off. You're saying that it's going to be hard for us to generate a profit. If we want to generate net profit, what are we supposed to do? Would that mean we are going to sell off strategic holding stock?

Logically speaking, I agree to your point. But with regard to how much we are going to sell, like I mentioned earlier, compared to the past three years we probably won't be able to do the same. What we need to do now is not do logical calculation in order to show good results. We need to consider how we can minimize damage on our business. Setting that damage at zero would be unrealistic.

By far, we hope that we can have a solid numerical target that we can share with you. But logically speaking, your logic is correct. Just by underwriting profit in fiscal 2013, the target numbers probably won't be able to be achieved. I think this applies to respective companies.

Thank you very much.

A - Unidentified Speaker

With regard to risk related to strategic holding stocks, the estimates you raised are the estimates we also have been running.

Any other questions? The person in the back.

Q - Jun Shiota {BIO 4127431 <GO>}

I am Shiota from Daiwa. I have two questions. Like mentioned earlier, like on page 50, point seven is the domestic stocks risk that you raise here. So whether or not you need to reduce this. If you reduce it, where is it going to go to? This amount of risk is just going to go down. And that's it.

Then, the risk buffer on page 44, are you going to have a better cushion? With regard to the current risk buffer, do you think it is insufficient? Is that why you would like to reduce the risk related to stock? That's my first question. And if you're going to reduce stock even more, where is that risk going to go to?

The second question is in the part in your presentation you talked about JPY200 billion investment in the overseas business. And you talked about clarifying the strategies for each market. I believe you're going to start to share that with us in the fall period. With regard to clarifying the strategies for each market, can you give us a little bit of more flavor on that point?

A - Kengo Sakurada {BIO 15149542 <GO>}

With regard to your first question, whether or not we see the buffer as sufficient or insufficient, it depends on how we see our future business plan. Simply speaking, we are not just going to let risk go because we don't think that's a smart way of managing the Company.

So where is that risk going to go to at this point in time? One thing that can be considered is overseas life insurance and new businesses. Capital intensive overseas businesses would be an option. For life insurance, we don't really think that we are lacking capital at this point in time. So where is the risk going to go? If it's for capital intensive businesses, I mentioned overseas, for overseas currently we haven't decided anything on this yet. So this would be my personal point.

We don't want to go into places where we are not familiar with. We would like to go into areas that we know well and bring our manager resources there. That means we have a vehicle there or an office there. Another thing would be something that we can feel assured with, meaning developed countries. So that will be one option.

For developed markets and other markets, the reason of entry would be different. What I mean by this is that for risk premium the definition of it or the way we would interpret it would be different. For developed countries, it would be a distribution of earnings. For so-called emerging countries, this would be acquiring future growth. So we wouldn't have one consistent ROE target, because the risk premium is different by market.

Also, in the case of emerging countries, we would like to clarify the reasons why we entered those markets. Are we going to buy the growth of the local markets? If we are going to do that, we are going to buy the growth for automotive insurance growth. We would like to focus on certain targets when entering those countries. If it's Indonesia, if it's Thailand or Malaysia, we basically will think about the best way to enter the market to acquire the growth in the automotive insurance business.

So should we invest in an existing business or should we acquire a channel? We wouldn't just simply think about engaging in a merger and acquisition. So we are considering various ways we can realize this. By fall, I'm not sure if we can provide a breakdown because there will be some confidential areas. But I hope we can persuade you and have a satisfactory explanation by then.

Q - Jun Shiota {BIO 4127431 <GO>}

If that is the case, goes back to my first point with regard to the JPY200 billion investment budget, do you believe the current buffer is sufficient, or until your policies are solidified by fall you don't really believe a significant amount is going to be announced?

A - Kengo Sakurada {BIO 15149542 <GO>}

At this point in time, I can't really answer your question whether we believe it is sufficient or not, because we are considering the plans right now and it will be a function of that. We have used JPY50 billion something. And the balance would be JPY150b. That is not the way we are going to look at this number.

A - Unidentified Speaker

With regard to where we are going to use this number, this amount. And whether we believe it's sufficient is insufficient, I can't answer your question. But with regard to the actual number or amount itself, let me follow up on that.

With regard to risk buffer, we have a little bit over JPY400 billion right now. For overseas mergers and acquisitions, if we do JPY150 billion M&A, the risk amount would be about JPY70 billion or JPY80 billion larger. On the other hand, the effect from reducing strategic holding stock, if we reduce JPY100 billion risk buffer wise, this would be equivalent to a little bit over JPY30b. That's based on our estimates.

So like mentioned earlier in our medium-term management plan we would like to ensure that we achieve our medium-term management plan so that we can compete on a global level. We are striving for a AA rating. And we would like to engage in overseas mergers and acquisitions. That means that for strategic holding stocks we need to cut this level. So that we can be better balanced.

Q - Takanori Miyoshi {BIO 16985826 <GO>}

Miyoshi from Goldman Sachs. I have two questions. First is regarding domestic P&C insurance. Regarding your targets for 2015, at this moment the image is Mr. Sakurada earlier said the challenges are clear, that improving the domestic business is imminent. However, looking at 2012, system related cost is JPY24b. Auto insurance, you're looking at it conservatively, expecting a JPY61.9 billion loss and minus JPY30 billion for adjusted profit. However, your plan is to reach JPY80 billion in 2015. When you think about this realistically, how much of an improvement do you have in mind right now? Can you give me an image? That is my first question.

With regard to my second question, it's about reducing risk. You talked about damage control earlier. And by selling down strategic holdings stock there might be an impact on your business. From 2012/2015, if you're going to sell down JPY500b, that is a considerable amount. So what kind of initiatives are you thinking regarding damage control?

A - Unidentified Speaker

So let me answer your first question, in the P&C business what's in our minds towards 2015. In September last year, we announced the medium-term management plan. In that plan, JPY81 billion adjusted income was announced. And the assumptions behind that are as follows.

Combined ratio should be improved by 5%. That's the assumption behind that number. Out of 5% improvement, 3% improvement will come from the improvement of business expense. Number wise, JPY2 trillion or close to JPY2 trillion revenue. So JPY60 billion cost curtailment will be executed. And the remaining 2% improvement will come from pricing revision of automobile insurance or profitability improvement of voluntary automobile insurance. And we'd like to improve the combined ratio by 5%.

That is assumption behind the management plan. JPY81 billion adjusted profit target in 2015. That's the plan we announced in September last year. And back then, Sompo Japan/Nipponkoa full merger was not assumed. So as Mr. Sakurada mentioned, we are trying to scrutinize the plan. We are trying to revisit and review the plan. And we are going to announce the revised management plan in fall this year.

Q - Takanori Miyoshi {BIO 16985826 <GO>}

So as an image, the biggest gap is the merger related cost. You may have to spend more cost. And the question is how much you can offset that by other improvements.

A - Unidentified Speaker

Well we didn't have a plan to fully merge the two companies. But one platform, two brands. But we assumed co-location of various offices and we had a plan to reduce headcount originally, in the September plan. So it depends on what will happen to that. We did not assume full merger.

So what are we going to do in terms of the salary level of employees at the new fully merged company? We didn't assume anything for that in the revised plan. So we may have to spend more cost for some areas. And there are some areas where we can cut further more versus September plan, which are all under scrutinization now.

A - Kengo Sakurada {BIO 15149542 <GO>}

Let me supplement. It depends on where we set the benchmark in each business line. And if we look at the cost indicators in each business line, it will be very clear for us to identify the places of improvement. And thus the damage control.

And let me answer your first question, damage control relating to the selling of strategic holding equities. We are going to go back to ABCs of business, meaning what is the ultimate need of corporate clients towards insurance. We are not trying to aim at risk transformation transfer. They are looking for captive insurance or derivatives. They are looking for various kinds of risk protections. So it's not a simple risk transfer. But they are looking for solutions. Many of them look for the overall solutions; especially global customers look for the overall risk protections. So that's happening in reality.

And the second point, we have to provide capacity, meaning the risk associated with the equity, is it -- does it -- should we charge that to capital, or by providing capacity should we charge to the capital, meaning we have to transfer the investment risk to the insurance risk. And if that's controllable easily, then we should do that. And we have to assume more risks in terms of the reinsurance.

But these are not only options. Other options include, not across the board. But we have to think about the core business of customers and the service business of NKSJ Group. Can we tie them in some form, meaning it's not only the relationship between insurance clients and the insurance company. But can we work on something else as alliance partners?

Anyhow, we are trying to hammer out various solutions to control the damage, by selling strategic holding stocks. And we have to think about the environment. And the environment is being eased for us to sell equities more easily than before, especially on the profit -- impact on the profit.

Q - Takanori Miyoshi {BIO 16985826 <GO>}

Thank you. So much for your answer.

A - Unidentified Speaker

Are there any questions?

Q - Wataru Otsuka {BIO 16340098 <GO>}

My name is Otsuka from Nomura Securities. I have two questions. First question relates to page 38. You have listed five challenges. And the most critical strategic challenge is number one in terms of customer evaluation. So when you say customer, is it corporate customer or individual customer?

And you are aiming at becoming the top in terms of the service quality. How are you going to continue this? And when you reach the top evaluation from the customer, are you assuming the increase of premium income or are you assuming the increase of profits? Do you have any numerical targets when you reach those goals? I am sure you have not finalized and solidified everything. But as far as you know, would you please share with us?

My second question is on page 13. Loss ratio of voluntary automobile insurance business is improving and there is the sign of improvement gradually. But the newly merged company Sompo Japan Nipponkoa will be formed. And can we see the acceleration of the improvement of the loss trend in the light of what is going to happen to agencies? So after the full merger, what will happen to this trend? So those are my questions -- two questions.

A - Kengo Sakurada {BIO 15149542 <GO>}

Japan's number one, industry's highest level of customers' evaluation. And we've been appealing this for a long time and I'm glad that you asked on this. It's almost like a slogan. And over the past two years, we've been appealing this slogan. And I talked about this at a general managers' meeting at the Company. And this is almost like preaching to the priests.

So we have the definition behind this call. And we cannot share with you every assumption. But we have included objective statistics as assumptions to measure this, evaluated by third parties. And we measure the complaints, the number of complaints to association. And we compare that number with the numbers of other companies. And we include the feedback from customers in questionnaires.

So we have various statistics to measure the success of customer evaluation. We don't just listen to customers' voices. But we include the number of claims and other statistics, as I mentioned. And we capture the trend of those numbers.

And we would like to make sure that we become number one. The reason is clear. The pie is being enlarged. So it's critical for us to increase the market share. And customer satisfaction is the only way for us to expand the market share. And it's very clear, to avoid the pressing competition, we have to enhance the customer satisfaction. Customers will be willing to pay the price for the quality of services.

And to increase the market service -- market share, I am a strong believer that customers are not really thinking about choosing products. But they are choosing people to select the best product for them. Because of that, we'd like to be the best number one in terms of customer evaluations. So we have to heighten the level of staff at agencies and at the Company. And this is something that we have to work on forever.

And there is no strategy that doesn't entail the benefit on the actual results. So market share improvement will be translated into the increase of top line and profits. So the strong performing agencies and good customers control risks by themselves, or by ourselves. So the profitability should be always better than the market profitability. So when the market share goes up, then it should entail the improvement of our profitability and top line as well.

So it's not the growth scenario you might say. At Sompo Japan and at Nipponkoa, in total, there are about 20 million customers. And some of them have only CALI product with us and some customers have multiple numbers of products, P&C product and life products with us. And I am going to explain by taking another chance to explain the details about the profile of customers. But NK Group and Sompo Japan, in the total group, we have to provide peace of mind or security towards policyholders. And that's the meaning of becoming best number one in terms of customer evaluations.

They don't have to think that we are the traditional -- most traditional company or prestigious company. And we hold questionnaires once in a while. And they feel they want safety, health, peace of mind. And they are looking for services in those areas. Not all 20 million people. But if half of them, if 10 million people can get high quality of those services that are charged, then maybe they will pay JPY10,000 per year additional for those services. And if we can provide that services to 10 million people, then we can generate JPY100b.

Of course, the reality is not as easy as it sounds. But this is the meaning behind this slogan. We have the customer portfolios, as many as 20 million people. So we'd like to make them fans of our Company. That's why becoming Japan's best number one company in terms of customer evaluation is at the top of this pyramid. And I loved your question. Thank you. So much for asking about this.

Q - Wataru Otsuka {BIO 16340098 <GO>}

What about my second question, regarding the merger? What's going to change?

A - Kengo Sakurada {BIO 15149542 <GO>}

Regarding that question, on a quantitative basis, from a loss ratio point of view, we have to think about the denominator and the numerator. When you compare Sompo Japan and Nipponkoa, Sompo Japan is better at this point in time.

With regard to the loss ratio, it's pretty much comparable when comparing both companies. And unit claim amount is slightly different. But I believe Sompo Japan is slightly lower at this point in time. However, there aren't any major differences. So by becoming larger, for example for insurance claims payments, we will be able to increase our negotiating power for repair cost. And we will be able to reinforce our underwriting and focus on agents that are good at underwriting.

So by -- through the merger, it doesn't necessarily mean that loss ratios are going to improve right away, immediately. I hope that answers your question.

Q - Wataru Otsuka {BIO 16340098 <GO>}

And the second part, you were talking about focusing on certain agents. So with regard to net premiums written of JPY1.9 trillion that you have at this point in time, does that mean that there is a risk of this falling?

A - Kengo Sakurada {BIO 15149542 <GO>}

I am not going to say either. But the relationship between the channel and the customer, I think you really need to look at the strength of the relationship, meaning we want to raise customer evaluation. And it's important to improve that through the agencies. But it's not just that. We also need to directly access to the customers and work together with the agencies. If you skip the agencies, they will become skeptical. So it's not good situation.

But let's say questionnaires, currently on my page there is about 300,000 people. And the agency and Sompo Japan's My Page is linked with one another. And NKSJ is able to directly approach the customer through these pages. So these are the routes that we would like to secure. So that for the not so high in quality agencies we can be more selective with them and avoid a situation where customers drop off.

Q - Wataru Otsuka {BIO 16340098 <GO>}

Thank you very much.

Q - Mitsumasa Okamoto {BIO 1513316 <GO>}

I am Okamoto from Merrill Lynch. I am sorry I'm going to go back to page 50 again. I understand your point very well. But if you do M&A because of a capital buffer the underwriting risk co-efficient will probably rise. Someone touched upon that earlier. Risk may be distributed. However, when something like the Thailand flooding occurs, it was concentrated risk. That's a different story. So how are you going to manage your underwriting risk? Of course, you could use various types of disaster insurances. But how are you going to manage underwriting risk in light of the merger? Are you going to change your organization, integrate risk management? Can you give me your thoughts that are on your mind?

And with regard to reducing strategic holdings stock, you showed us some diagrams earlier. And you need to control underwriting damage is what you said. But when you look at the overall profitability, would there be a case where the strategic holding stocks are skewed to a certain industry? Is that tolerable? Or do you still think that you need to have distribution within your portfolio? Can you give us your thoughts?

A - Kengo Sakurada {BIO 15149542 <GO>}

With regard to the first half of your question, in the non-life insurance industry in Japan I think everybody has the same challenge. So I'm not making excuses. However, we do need to do a good job on ERM. However, we shouldn't use the word this happened unexpectedly from a risk management point of view, especially for floods. The risk management on a global basis was insufficient is what people say as a consequence. When looking at major natural disasters, whether it's hurricanes, typhoons, earthquakes, we believe we are well prepared. But this was a blind spot for us.

So in retrospect, we decided to establish an ERM project. It's been six months since then. I cannot say at this moment in time when we are going to be complete. As a result, you talked about underwriting risk increasing if we sell down our strategic holding stocks. That might be true from a logical % point of view; however, we are looking into ILV by Lloyds right now, which talks about natural disasters.

But there are companies who are still able to generate profits. So how are they controlling their risks is what we are looking into; where is the expertise around underwriting is what we are researching through reinsurance. We do have relationships with those companies. So we are trying to compare ourselves with them to see what's different.

So should we take underwriting risk or asset management risk when comparing the two? The global trends, whether it be in Europe or in the US, it's more about taking underwriting risk in order to increase earnings. That's the right way to go for insurance companies. So we would like to receive your advice in making efforts for strategic holdings stocks and how much of a skew is tolerable. Currently, we can't tell you who we are -- what names we are going to sell.

I think this applies to all companies. But in the case of our Company we are skewed towards transportation and financials. So I believe you are trying to point out we should increase our exposure to transportation and financial sectors. But it's important that we reduce our exposure overall. And a risk of being exposed to a specific sector may impact risk. But I haven't received that sort of analysis yet. So when the time comes I would like to explain that. But I do believe your point was that we should be cautious. So I would like to thank you for your advice.

A - Unidentified Speaker

Any other questions? The person in the back.

Q - Unidentified Participant

You talked about a new revised plan that you're going to announce in the fall. With regard to stock price measures, profitability for the domestic P&C insurance business needs to be improved. And I believe drastic revisions may need to take place. Should we expect that drastic measures are going to be included in the plan that you are going to share with us?

Another question is if the measures are drastic, you might face union issues. That would be one obstacle you may face. And non-life insurer unions in the financial industry, some are considered to be somewhat radical. And I believe the salary structure is a little bit different between the two companies. So if you converge to the lower one this might create issues as well. So are you working with the unions in discussing these problems?

A - Kengo Sakurada {BIO 15149542 <GO>}

With regard to negotiations between the Company and labor unions, with regard to the plans we are going to announce in the fall, as a matter of course, we are not going to be talking about top line targets that are aspirational because our investors will probably not believe in us, which means people will focus more on cost reduction measures. I understand your point. And when comparing management indicators, it's clear where our problems lie. And I believe that's why you've asked the question. We do understand the challenges we face.

And of course we need to consider what kind of measures are going to be implemented. At this point in time, we can't declare if it's going to be drastic or moderate. And it's also a matter of perception as well. I think it's subjective. Some people may think it's drastic; some people may think it's moderate. But I think we need to work hard in discussing these matters.

Also, going concerns need to be considered. In order to jump, you need to bend your knees. But you don't want to go down and not come up. So in order to jump, we need to think about how much our knees need to be bent. That's what we would like to consider.

I don't think this answers your question. But I would like to say that we do recognize the challenges we face and we do understand that we will need to negotiate with the labor unions. And we are not procrastinating these issues. But at this point in time we can't quantify anything or give you our policies.

A - Unidentified Speaker

Any other questions?

Q - Hideyasu Ban {BIO 15250840 <GO>}

My name is Ban from Morgan Stanley Securities. I have one question. After listening to your explanation, maybe it's not appropriate for me to really stick to this point using the numbers or ratios. But let me ask you a question about expense ratio, which is in the mid-35% level. And you would like to drive it down to 32%, 3percentage points increase -- or sorry, improvement. And in the industry I think you are aiming at achieving close to 30%. And to achieve that I think your direction is to improve the economy of scale by merging the two companies. So in FY2015, or by that year or in the longer term, is it your commitment to bring the expense ratio down to close to 30%?

And you would like to maintain the top level of the quality of people at the Company, at agencies. So you have to strike a good balance. So what is the ultimate goal of the percentage of the business expense ratio?

A - Kengo Sakurada {BIO 15149542 <GO>}

I cannot assert on that point at this point. But we shouldn't think that Japanese market is the exception or very unique. The uniqueness is about the Japanese market that include the strategic holding stock issue. And there is a dual structural issue at the solicitation point. So in the area of globalization, Japanese insurance companies, I don't think this type of structure is allowed, only to P&C companies or to Japanese companies only. So this has to be corrected.

As a result, profitability of the insurance business will be improved and efficiency will be improved. So the combined ratio should improve. And we have to manage the combined ratio in the range of 95% to 98% moves [ph] and in the United States. This moves cyclically. But the past cash flow underwriting era is now over. So we have to bring the combined ratio below 100%. And in addition to that, we have to earn profits from investment. So 95% is a good level, in my opinion. It's not easily achievable, though.

And loss ratio and business expense ratio, the balance between the two, I think we have to strike a good balance and improve both. In terms of the business expense ratio, we have to correct this dual structure issue. As I mentioned earlier, the good agencies have to underwrite good quality of policies. So to eliminate the dual structural issue, we have to bring down the business expense ratio. So our sales and marketing people have to be reduced in number; that will bring down the labor cost. And to do that, we have to use good quality of agencies.

So profitability improvement by enhancing the quality is consistent logically with bringing down the combined ratio. It's easy to say. But it's not easy to realize. So as somebody mentioned, we don't want to lose policyholders, or we don't want to lose agencies. So the point is that we have to hear good feedback from customers saying that they like Nipponkoa or they like Sompo Japan.

I don't know if it answered your question. But thank you so much.

A - Unidentified Speaker

Any other questions? No more questions? This concludes the presentation for today. Thank you. So much for joining us today.