Business Update Call - Second Information Meeting

Company Participants

- Nampei Yanagawa, Group Chief Risk Officer & Head-Compliance
- Shiro Fujii, Group CFO, Director, EVP, Head-IR & IT Planning
- Yasuyoshi Karasawa, President, Group CEO & Representative Director

Other Participants

- Futoshi Sasaki, Analyst
- Kazuki Watanabe, Analyst
- Koichi Niwa, Analyst
- Masao Muraki, Analyst
- Natsumu Tsujino, Analyst
- Tatsuo Majima, Analyst

MANAGEMENT DISCUSSION SECTION

Yasuyoshi Karasawa {BIO 7391405 <GO>}

Hello everyone. My name is Yasuyoshi Karasawa and I'm President and CEO of MS&AD Insurance Group Holdings. Thank you for joining us at our Information Meeting today.

In fiscal year 2017, the global economy has continued to recover gradually. The Japanese economy has also brightened with the Nikkei average achieving the ¥22,000 after the ruling coalition won a sweeping victory in last month's Lower House general election.

This fiscal year, the world experienced natural catastrophes. My thoughts are with everyone who has been affected by these catastrophes, and I sincerely hope for the earliest possible recovery of the disaster-stricken regions. Natural catastrophes are increasing causing serious damage, the likes of which has never been experienced before all over the world.

I have always said that insurance is a component of social infrastructure, and I believe that the role of insurance is becoming increasingly important. This fiscal year, the non-life insurance industry including the MS&AD Group found itself paying many claims. It is, however, our duty to support customers affected by catastrophes around the world in rebuilding their lives and resuming business activities and to contribute to the stable growth of the world economy.

The MS&AD Group aims to continue contributing to the stable growth and development of the global economy by working to resolve such social issues while at the same time striving to further stabilize its profitability through a further enhancement of ERM.

I will start today's presentation. Now, please turn to page 1 of the handout. This page shows the main points of today's presentation. I would like to start by explaining fiscal 2017 interim results and our full-year forecast announced the other day.

I would then like to talk about progress under our current medium-term management plan, Next Challenge 2017 which is now in its final year, and our understanding of issues still to be addressed based on this progress. I will then touch on our next medium-term management plan, which is currently under examination including our goals and the direction of strategies. Finally, I will outline shareholders' returns for the current fiscal year.

Please turn to page 2 of the handout. As I mentioned in the beginning, the group core profit for fiscal 2017 is estimated to be ¥115 billion, mainly due to the successive occurrences of large-scale natural catastrophes in Japan and overseas. The full-year net income projection on the financial accounting basis is ¥145 billion, excluding these transient factors, the full-year projection is ¥220 billion.

Please turn to page 3 of the handout. A breakdown by business segment for full-year shows year-on-year profit decline of ¥4.3 billion in domestic non-life insurance business, reflecting large-scale natural catastrophes in Japan such as typhoon number 21. However, profit in the domestic non-life insurance business is expected to hit ¥4 billion higher than the initial forecast of the year and the domestic non-life insurance business is expected to reach its group core profit target.

In the domestic life insurance business, MSI Aioi Life is also steadily increasing the amount of new policies and the group is expected to reach the numerical management target for increase in EEV. Also at MSI Primary Life, although gross premiums written are slightly down year-on-year, group core profit is projected to rise and domestic life insurance business is also expected to exceed its group core profit target.

In international business, we now forecast a sharp decline in profit this fiscal year mainly because of the large-scale natural catastrophes that have occurred all over the world, and also because there is no longer any prospect of the ¥21 billion gain on the exchange of shares of Max Life.

Please refer to page 4 of the handout for details of the expected impact of natural catastrophes in Japan and overseas on full-year results. Unfortunately, the impact of these natural catastrophes were to decrease the group profit. However, the degree of negative effects of the global natural catastrophes on ESR in fiscal year is as low as approximately minus 3 percentage points. In other words, this is not a risk management issue that would exceed the risk tolerance level for the group.

We consider ERM to be a pillar of the current medium-term management plan and have pushed forward with ERM enhancement by consolidating the holding company and strengthening the holding company's risk management functions. The holding company will control the risk tolerance level throughout the group, including MS Amlin and head office main insurance business of ADI, which have been significantly affected in this fiscal year and through capital allocation to group companies and the monitoring of the risk tolerance amount.

From view point of cycle management, we can expect expansion of revenues and profit by continuing proper underwriting when premium rates enter the rising phase following these series of natural catastrophes. We will continue to control the level of risks for natural catastrophes while taking risks to a certain degree and we'll aim to ensure increased earnings in the next fiscal year and onward and stabilize earnings within a certain period of time.

Next, I would like to talk about progress under the current medium-term management plan, Next Challenge 2017, which is now in its final year, and about our understanding of the challenges still to be addressed based on this progress.

Please turn to page 5. The group's management vision is to create a world-leading insurance and financial services group and we have set ourselves medium-to-long-term targets in the five areas of financial soundness, profitability, capital efficiency, geographical dispersion (sic) [diversification] (07:14) and risk assets, and have steadily implemented initiatives to achieve them.

First, look at the earning power of our domestic non-life insurance business. It is safe to say that we have achieved the target to maintain combined ratio of 95% or less stably. Also, as for ESR, in terms of financial soundness, we largely achieved our target of 200% level. Based on our understanding, our commitment to the improvement of capital efficiency must also be continued from the perspectives of geographic dispersion (sic) [diversification] (07:54) and reduction in the rate of risk assets.

Please turn to page 6 and 7 of the handout. Here is a summary of progress made in the four areas during Next Challenge 2017.

Firstly, we have improved earnings power in domestic non-life insurance business. Insurance underwriting profit before reflecting catastrophe reserves a measure of our actual ability shows we believe that our profitability is number one in the industry.

Our second achievement is sustainable growth. Ordinary revenue has grown from ¥3.4 trillion when the group was founded to around 1.6 times that figure amounting to ¥5.3 trillion at the end of fiscal 2016.

The third achievement is securing financial soundness. ESR which was 144% at the end of fiscal 2010 has steadily improved throughout the periods, covered by the previous medium-term management plan and the current medium-term management plan and we have succeeded in achieving a level close to our target of 200%.

Our fourth achievement is improvement of capital efficiency. Unfortunately, capital efficiency is expected to decrease in fiscal 2017 mainly due to the impact of large natural catastrophes such as the hurricanes in North America and others. However, ROE was low until midway through the previous medium-term management plan, but we succeeded in raising both ROE on the financial accounting basis and group ROE around 8% level by the end of fiscal 2016. At the same time, we believe that there are four issues which still need to be addressed under the next medium-term management plan, namely maintenance and increase of earnings in the domestic non-life insurance business, enhancement of earnings power and the improvement of stability in other businesses beside domestic non-life insurance business, sustainable growth through business portfolio diversification and finally improvement of capital efficiency.

Please turn to page 8 of the handout. As shown in the graph, improvement in the profitability of the domestic non-life insurance business during the current medium-term management plan has been driven by improvement in the underwriting profit of automobile insurance and the solid earning structure has been put in place.

To maintain stable high profitability and to expand profits in the domestic non-life insurance business in the future, we believe it is necessary to strengthen other business lines besides automobile insurance and to establish the next profit drivers. In particular, it's important to improve the profitability of fire insurance and make it into a business line that can be expected to reliably generate profit in years when occurrences of large natural catastrophes are within the scope of initial forecast and to expand the casualty insurance sector by developing the SME market and improving ability to address new risks.

Please turn to page 9. Further improvement of productivity is also a key to maintaining and expanding profits in the domestic non-life insurance business. The group has taken reorganization by function as an opportunity to focus on improving the efficiency including integrating basic systems and consolidating back office functions and has reduced the expense ratio from almost 35% in fiscal 2010 to around 32% level.

We will promote further improvement in business productivity through measures including integrating claims service systems, reforming online systems, and introducing AI and robotics. And we would like to lower the expense ratio to 30% level in the future.

Please turn to page 10 of the handout. Thus far, the improvement in the group's profitability has been driven by the domestic non-life insurance business. In the future, we would like to increase the earnings of other businesses and first achieve a ratio of earnings in domestic non-life insurance business to other businesses of 50% versus 50%, and in the future, achieve a ratio of earnings from domestic business to international business of 50% versus 50%.

The full-year forecast of international business unfortunately was revised downward significantly from initial forecast largely due to the major natural catastrophes experienced in fiscal years 2016 and 2017. In business lines where a huge cycle for rating trends exists such as natural catastrophe risks, we intend to ensure, as part of cycle management, that profits are reliably generated in phases during which market conditions improve.

We also intend to strengthen initiatives to improve profitability in other general business lines. In the domestic life insurance business, we will seek improvement of profitability and profit stability by flexibly reviewing our products and sales strategies from the viewpoint of return on risk.

Please turn to page 11 of the handout. The domestic insurance market does not promise significant growth because of Japan's shrinking population, and growth of the international business thus will play an important part in driving the group's growth.

The Asian market, which the group sees as its strength, is expected to grow significantly compared to the rest of the world. We believe it is important to leverage such organic growth and promote through new business investments and other means both business diversification through entry to the non-life and life insurance businesses and the geographic diversification and to achieve sustainable growth.

Please turn to page 12 of the handout. We also believe that most important issue to be addressed in the next medium-term management plan is improvement of capital efficiency. We have succeeded in raising ROE from less than 1% at the time of group's formation to around 8% level. But we believe that further initiatives are necessary to achieve our target of 10% level. We plan to explain the next medium-term management plan in detail at the information meeting in May next year, but today I would like to give a brief outline of the plan and our aims under the next plan.

Please refer to page 13 of the handout. We established a long-term scenario for the next medium-term management plan and formed our understanding of the business environment and identified risks and opportunities. While growth in the Japanese economy and the world economy are expected to remain slow in the future, our understanding is that the development of digital technologies and innovation will transform society, and based on this understanding, we plan to conduct business operations that tap into the risks and opportunities that will accompany this transformation.

Please turn to page 14 of the handout. The next medium-term management plan will cover the four-year period from fiscal years 2018 to 2021. This is positioned as a period in which we will look toward achievement of our management vision of creating a world leading insurance and financial services group and as a plan for putting in place a structure that will enable flexible adaptation to environmental changes and we have named it Vision 2021.

Our aims are to achieve our goals for capital efficiency and financial soundness and to maintain a scale of business operations that puts us among the world's top 10 non-life insurance companies and groups ranked according to ordinary revenue.

Please turn to page 15 of the handout. We are currently reviewing methods used to calculate group core profit and group ROE, although, we are not able to indicate target values yet today. We will discuss it including profit and loss of reserves and capital gain and loss of strategic equity holdings, taking into consideration constructive opinions received from investors to date.

We would like to restructure our business portfolio to achieve a ratio of domestic non-life insurance business to other businesses of 50% versus 50% as indicated at the medium-term target previously. We will also continue to actively reduce our strategic equity holdings, planning to reduce them by ¥500 billion over five years including the current fiscal year so that they account for less than 10% of consolidated total assets and less than 30% of the group's integrated risk amount in line with our reduction targets.

Please turn to page 16 of the handout. ERM will also be an important theme underpinning the next medium-term management plan and we will seek to further strengthen ERM. Over the period of the current medium-term management plan Next Challenge 2017, we've had much success in improving financial soundness and profitability. Under the next medium-term management plan, we will continue working to further improve capital efficiency.

Regarding profitability, we will seek to improve ROR through the monitoring of individual businesses and individual operating companies. Regarding financial soundness, we will manage ESR at a reasonable and appropriate level. And on the premise that ESR is kept stable at that level, we will control capital to achieve the target level for ROE.

Please turn to page 17 of the handout. We're also carefully examining our shareholder return policy so that we are able to talk about it in May next year. However, our basic goal is to continue to pay stable dividend and to repurchase our own shares flexibly. Lastly, I'll talk about shareholder return for the current fiscal year.

Please turn to page 18 of the handout. As announced the other day, we have resolved to pay an interim dividend for fiscal 2017 of ¥65 per share. We will consider full year shareholder return in fiscal 2017 including share buyback with consideration for the new shareholder return policy in the next medium-term management plan.

Although we lowered our full year group core profit forecast for the current fiscal year due to the frequent occurrence of natural catastrophes, we forecast a full year dividend of ¥130 per share which is an increase of ¥10 from the previous year in accordance with our shareholder return policy of returning approximately 50% of group core profits for shareholders in the medium run and our basic goal of paying stable dividends.

This year, unfortunately, due to a record number of natural catastrophes since the year 2011, we forecast a sharp decline in profit at international business where we expected to expand. However, excluding such transitory factors, we believe we have steadily achieved the target under Next Challenge 2017 and have succeeded in achieving sustainable growth and improvement in profitability and capital efficiency.

Under the next medium-term management plans starting in fiscal year 2018, the group will set its sights on realizing its vision of creating a world-leading insurance and financial services group. We will maintain increased stable profits in the domestic non-life insurance business while, at the same time, significantly expanding the domestic life insurance business and international business in seeking improvement in capital efficiency through a certification of ERM. We ask for your ongoing support as we continue to make efforts to live up to the expectations of investors and all the shareholders.

This concludes my presentation. Thank you.

Q&A

Q - Masao Muraki {BIO 3318668 <GO>}

Muraki, Deutsche Securities. I have two questions. The first one relates to international business and the second one shareholder return. The right-hand side of page 10 refers to the changes made in underwriting portfolio composition of international business. As we reduced the natural catastrophe risks, non-natural catastrophe business underwriting was increased. But this time non-natural catastrophe related portfolio showed significant increase in loss ratio. How does or real risk management department of a holding company or MSI monitor the process while the underwriting of general business lines is being increased? So, could you share with us the monitoring process in that regard?

The second question relates to shareholder return. I would like to seek your confirmation on what you have showed us as the direction of the medium-term management plan of the next period? This upper-left part of the definition of page 15 that relates to definition is your consideration of catastrophe loss reserve provisioning or capital gains on strategically held shares oriented toward increasing the resource for shareholder return as some of your peers are doing.

And when the definition is changed, is target payout ratio of 50% going to be studied as well? As you know when your peers change the definition, there are cases where percentage itself was modified and another factor relating to this 50% relates to ESR which is very close to 200% which is your target. It's almost there. Does this allow you to consider potentially increase of 50%? Whether my understanding of the definition is correct and based upon that definition, how should I consider this payout ratio which stands currently at 50%?

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

First, let me respond to your question about international business. MS Amlin's stance to reduce natural catastrophe risk as much as possible from the viewpoint of a cycle management, including the environment that continued to get softer was based upon a shared recognition and awareness with MSI and its executives - executing department since natural catastrophe risks have been consolidated in MS Amlin and MS Frontier Re that was consolidated with Amlin. And so the reduction, the reduce in (24:22) orientation was assured with MSI.

Amlin, as a company, that generated on average around ¥30 billion in profit in the past 10 years or so, about half of MS Amlin's earnings come from natural catastrophe business with investment income accounting for a little less than 40%, and the general business risk, a part where the company incurs expenses accounting for a mid to 10% level. Its business model therefore has been one of making profit mainly from natural catastrophe and investment income. In this context, recognizing that natural catastrophe business faced a softening business conditions, the company tried to reduce this part while taking general business risks. And underwriting, of course, was left to MS Amlin, but with respect to actual monitoring, the policy is producing bad results and the causes were discussed mutually by both companies.

And we were already in that part of the cycle where we do away with; that is we organize poorly-performing general reinsurance businesses, non-life insurance being a short-term policy based business, while it takes a year or so to eliminate adverse policies, but since MS Amlin's business model is not structured to generate substantial earnings from general business risks. So long as the causes are identified, we assumed that we could easily restore profitability in a year or so by eliminating those bad accounts. Based on this assumption, we are reviewing our underwriting policy. In this regard, unlike in Japan, the parties to a contract does not have ties of obligation. And so, if a policy produces bad result, naturally rates go up or party can easily decline to underwrite a business. Allowing a year or two to sort out adverse policies in general line risks, we can make a general line business healthier.

With respect to dividend, it is now under consideration. As described here, the two factors you've mentioned are included. We are also mindful of the fact that IFRS does not have a concept of reserve or catastrophe losses and we are also discussing whether or not it is appropriate to include capital gains and equity sales in dividend sources. So that's what we are discussing and our discussion includes those aspects.

Are we going to keep 50% without any change? Answering all these would divulge a future dividend policy, so we would keep some flexibility in that regard. In addition, you referred to ESR of 200%. We are not yet at a stage in which ESR is stably at 200%. So, right now, we are studying a review of both its range and the current dividend policy based on the assumption of keeping and increasing it as much as possible. Since our CFO is responsible for this matter, I'd like Mr. Fuji to supplement what I have just mentioned.

A - Shiro Fujii {BIO 16476704 <GO>}

As Mr. Karasawa mentioned, I feel sorry for not being able to give a complete or full answer. For example, if we use figures before reflecting the catastrophe loss reserve, in our case, volatility will be much higher than in the past. Earnings and core profit will become much more volatile. When we think about that, is it right to keep 50% or is it better to set a range instead of a single point? For instance when the profit increases, the ratio may be smaller, but when profit decreases, a level may be somewhat higher.

Such an approach is also put under study. I wish I could be more articulate. One other point in relation to international business discussed earlier, in addition to MS Amlin and natural catastrophe, including Aioi Nissay Dowa's inward overseas reinsurance business, how the holding company is monitoring this risk can be further elaborated by Mr. Yanagawa, our CRO since he is with us today.

A - Nampei Yanagawa {BIO 19390245 <GO>}

Yanagawa is my name. Since it was discussed in conjunction with Amlin, I'd like to refer you to pages 40 and 41 of the slides or handout. These two pages showed the interim financial results of Amlin business and cycle management on the bottom of the page, so there are two pages covering those. Overview of interim financial results were already explained through a conference call or when the financial results for the medium-term was announced, so please refer to those table.

Allow me to focus on the bottom page, characteristics of Amlin business is to earn profit by taking natural catastrophe risks and the keyword here is cycle management. and on the left-hand side, you'll see A, B, and C. The phase A, emphasis is placed on underwriting profit. Underwriters need to downsize portfolios in phases of falling premium rates; and phase B strictly underwrite highly profitable policies; and phase C take action for growth in the next cycle. Such is the pattern of behavior of reinsurers or insurance companies that have natural catastrophe as main revenue sources.

Aioi Nissay Dowais shown on page 45. The slide on page 45, International Business and International Non-Life Insurance Business and Head Office Reinsurance Business in parentheses. This refers to ADI's business. Net premium written and net income in fiscal 2015 appear very small, standing at ¥18.1 billion and ¥0.4 billion respectively, but fiscal 2014 (sic) [2017] (31:22) forecasts are as shown. You see top line forecast there with net income is in the negative.

Moving on to Head Office Reinsurance Business features, the AD as the reinsurance business is characterized by partnership in inward reinsurance on the premise of maintaining business relationship in both inward and outward reinsurance over the medium-term. Basically, ADI does not act as a reinsurance player in the open market. Its business is conducted within closed partnership comprising known business partners.

The second bullet point head office reinsurance is mainly inward comprehensive quota share treaty business ceded by leading reinsurers or Lloyds syndicates underwritten on strict standards and guidelines, and therefore it is not reinsurance of a group of direct policies put together and head of is under rights business ceded by professional reinsurers.

Shown on the right hand side are risk management and governance cycle and formulation of reinsurance businesses policy, examination and judgment of underwriting or post-underwriting monitoring are conducted with ADI's risk management and holding companies in risk management working together. And this is how the cycle is managed.

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

Then the lady on the third line from the front, please?

Q - Natsumu Tsujino {BIO 2234779 <GO>}

Tsujino of JPMorgan, thank you very much for the opportunity. Recent news reports indicate that you are once again interested in an acquisition in North America. You've had this sort of experience with Amlin and after having that experience, what sort of stance do you have, vis-à-vis, a large-sized acquisition going forward? I don't want to sound overbearing, but what sort of things are you implementing in order to reinforce your due diligence framework for future acquisitions? What sort of things are you thinking in order to solidify those due diligence? Can you share with us what you can do in that regard?

And another point and here, again, I'm not sure whether or not it is appropriate to put it this way but Amlin and (34:18) has been visible to us since the first quarter. We've seen some addition to reserves and profits were quite low and already since 2016, it tended to be hit by all the natural catastrophes, so we were aware of that. And then, the second quarter saw what actually happened and therefore, internally, the issue must have been recognized much earlier in the current fiscal year. But while that was going on, you made rather ambitious investments in summer of this year. So, I'm somewhat under the impression that you may have become a bit too aggressive in this regard. So what sort of control was in place or was exercised? That's what I would like to be enlightened on.

And lastly, also in relation to acquisition or investment, some of the more recent deals included acquisition of a partial interest rather than 100%. So does this show any change in your stance or while you being open to taking a partial stake such an opportunity has just happened to be brought to your attention?

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

So, it is about M&A, overall. Am I right in understanding it in that way? First of all, with respect to North America and other geographies, as I mentioned at the outset, we continue to believe we need to further diversify our business portfolio, including life insurance and international businesses because the domestic non-life insurance still occupies a very large weight in the profit.

In the non-life insurance business, we need to achieve geographic diversification of the risks which is concentrated in Japan. So, from that perspective, we would like to continue investing including acquisitions.

In this context as we have been indicating, Asia has been our priority geography as we have been saying and followed by Lloyd's market where we acquired Amlin. In North America, if there is a good deal, not that anything is going on right now but we will take action in North America. So, we've already indicated that.

You imply that Amlin indicates a failure of our due diligence, and we may have a separate occasion to explain that. But relating to natural catastrophes, from a perspective of cycle management, some might think that a business with such a risk model should be purchased when the market is about to harden. We, however, are aware that such a risk could manifest itself, fully recognizing the cycle management. Even then, so long as an entity has know-how in underwriting such business or cycle management capability, we believe earnings or know-how in this area is worth acquiring over at medium- or long-term, and so it was within certain expectations.

MSI or MS&AD on the other hand thought that business portfolio need to be diversified as the company reduces general business-aligned risks, which accounts for smaller portion of a profit in Amlin's business model and Amlin share the same views.

Amlin tried to expand casualty business but because of some poorly-performing accounts included there, a failure of underwriting was the biggest factor. Causes for such poor results, however, were already determined and by parting from those policies, I think this business model can be revived within the range of our expectations.

Just for your reference, with respect to reinsurance, we have our own reinsurance subsidiary called MS Frontier Re. It used to produce annual profit of between ¥5 billion to ¥10 billion and this company was consolidated with Amlin's reinsurance company, and its risk management policy was re-examined. If it had been left as MS Frontier Re as it had been, it would have incurred a loss of a little shy of ¥20 billion. But included in Amlin's underwriting scheme, it's loss was controlled to around ¥8 billion. In this regard, risks that could have become manifest have been curtailed quite a bit, including measures to reduce reinsurance rate, so we positively evaluate such aspect.

On the other hand, poor result (39:43) policies in the general business line on the other hand were somewhat concentrated in European continent. But the causes, for instance, a specific channel is producing bad results have been determined by improving on them. I think we can realize the corporate value that we had originally expected and we'd like to do that by, again, what I think, (40:09) experiences.

They have urged us to upgrade our due diligence ability through a series of M&As. I do believe that due diligence was properly done on MS Amlin as well, making best use of our experiences including business model MS Amlin operates with, we'd like to enhance our due diligence capabilities and conduct further M&A with such enhanced capabilities. So I'd like you to understand that we are reinforcing the structure for that.

The other question was on our investment in ReAssure or Challenger in Australia. With regards to minority investment, in the case of non-life business, geographic diversification may be a part of the rationale since we already have expertise in operating the business through direct underwriting.

In the case of life insurance, while we try to capture growth of business, it is an extremely locally-based business. We have been investing to gain approximately 30% stake, joining hands with influential local partners. The percentage was determined not out of trepidation but rather when we invest in life insurance business and the like, more often than not, a local company or a company with expertise takes the majority stake with us in a minority position.

We have been selectively choosing those with whom we can build partnership relationship to bear fruits. For instance in the case of life insurance in Malaysia, our stake is 30%; 25% in India; and 50% in Indonesia. And in the case of ReAssure, we're aiming at 15% basically and in the case of Challenger, initially aiming at 10%. In the next step, we're aiming at 15% so in line with types and conditions of business, when we gain know-how, we would have a minority stake, but in the case of non-life insurance business, basically, we will invest and acquire 100% in principal. So, that's our basic stance, vis-à-vis M&A.

Q - Natsumu Tsujino {BIO 2234779 <GO>}

Thank you very much. Our policy is producing bad results. What part of general buying policies are you going to replace? And also that might result in having to sack some underwriters. So from that perspective, would you be able to increase the more favorably performing businesses? Could you supplement on that aspect?

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

In this particular case and in the case of Amlin, basically as it reduced natural catastrophe risks, it conducted a variety of casualty businesses using a headroom made in risk tolerance level.

Newly-conducted businesses however contain some poorly underwritten policies in some specific channels, and to eliminate these accounts would mean the company is back to the previous base.

For that part, the profit from general business risks, which used to be over 10% of ¥30 billion, that is ¥5 billion to ¥6 billion. So, we'll be able to stabilize earnings at such levels by removing bad result accounts.

We are going to review various manner of risk taking and reorganize underwriting policies for expansion. Also we'll exclude channels with adverse performance. By doing so, we'll gradually expand the business through better channels. And this is a sort of business model we are jointly discussing.

As for Continental Europe, we have our own subsidiary on the continent called MSIGEU through a closer collaboration between Amlin and the European subsidiary. Improvements in those areas will be made. I understand. Did I answer your question?

Next, the person in front of the previous question.

Q - Kazuki Watanabe {BIO 15948747 <GO>}

Watanabe with Daiwa Securities. I have two questions. The first one relates to page 17 of the handout and relates to the thinking of shareholder returns during the period covered by the next management plan. And the last part of bottom right-hand side says, the level of a return is being considered to maintain the same level as that under the current medium-term management plan. And also earlier you made a comment that you might revise the total payout ratio to a range including 50%. Even under the change, the total amount of return is kept at or above the current level. Is this how it should be interpreted?

Second one relates to domestic non-life insurance profit forecast in the next medium-term plan. I think there are various factors including reduced premium for automobile insurance or consumption tax increase. Can you envision increase in earnings from domestic non-life business for the next four years? Is profit level from domestic non-life business with the next four years expected to be higher or lower than the current level?

And also the bottom left of page 15 describes target business portfolio and it says 50% is made from domestic non-life business. Does this mean 50% of newly revised or newly defined group core 00:46:21 profit?

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

Could you supplement me later on? The first one, what being considered to maintain the same level implies is to allow more flexibility in our thinking even with these additions as was asked earlier by Mr. Muraki. In that sense, what I wanted to say here is that we have no intention of lowering it from the present level at a minimum rather than keeping the current level. By saying this here, I wanted to show our ambition without making too excessive promise. That's how I would like to understand. Is that right, CFO?

The second point, I also explained domestic non-life profit level in the presentation, I believe. We expect underwriting profit of automobile insurance to gradually diminish. On the other hand, underwriting profit of fire insurance, especially that of fire insurance, has been in the negative since fiscal 2013. The Residential segment has been showing improving trend thanks to rate adjustment in fiscal 2015 and termination of long-term fire policy of over 10 years.

Fire insurance, however, continues to have negative underwriting profit mainly in Commercial segment. We're endeavoring to improve the segment as we embed ERM in our operations. During the next medium-term plan period, I think we can increase domestic non-life profit by reinforcing underwriting our business lines where underwriting profit now is in the negative or lines in need of improvement through stronger ERM exercise.

As for the top line, the automobile insurance now has a bit lower premium. And as the coverage has expanded, what sort of premium revenue is envisioned and increasing tone of revenue we saw in the past may not hold. At the same time, we're going to envisage maintenance and expansion of domestic non-life insurance underwriting profit by cultivating SME business or offering coverage for new risks especially through expanding Casualty segment. And with this assumption, the medium-term - next medium-term plan is being formulated.

Is there another question? Did I answer your question?

Q - Kazuki Watanabe {BIO 15948747 <GO>}

It says 50% of profit is made domestically. Does the profit here mean newly defined group core profit?

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

My apologies, there are two aspects I'd like – I'd be troubled if you say we changed the criteria or definition to change this. New definition would reflect such thinking, and even with the existing definition, we would like to have the target met. So, either old or new definition of a group core profit, we'll make sure that the target will be met. So, definition will not be changed to simply hit the target.

Q - Kazuki Watanabe {BIO 15948747 <GO>}

Thank you very much.

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

Is there anybody else wishing to ask a question? The person by the window in the back of the room.

Q - Tatsuo Majima {BIO 15338044 <GO>}

Majima of Tokai Tokyo Research Center. In terms of the page – in the earlier page, expense ratio target to be 30%, it was mentioned, although any specific fiscal year was not mentioned. But your group has two non-life insurance companies, and the number of employees are very high, and the number of agents twice as many as others; and the other peers originated from the first and second companies. Whereas in the case of your company merged a third ranking with sixth or seventh ranking companies and I suppose agent productivity is not high either. You already have disadvantages in reducing expense ratio compared with the peers above you. Do you have any means to bring it down to 30% or so to merge them into one company may be possible way but that would also mean that top line will come down as well. So do you have any scheme to achieve 30%?

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

So your question is only one on this expense ratio?

Q - Tatsuo Majima {BIO 15338044 <GO>}

Yes.

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

You compared three groups in terms of expense ratios and I wouldn't venture to mention more specifically. But in comparing expense ratios of three groups, our group is positioned in the middle of the group and almost the same level. I don't think the ratio is outstandingly high. And obviously, expense ratio at Mitsui Sumitomo Insurance with the lowest expense ratio in the group, it is at 30% level. As a group, as a whole generate synergy 30%. In my view, it's not an unattainable level.

And furthermore, as I mentioned at the outset, the expense ratio was 35% when the group was formed. Reorganization by function and other initiatives brought it down to the present level of 32%. Under the next plan, claim services will be made more efficient through common claims service systems. And renewal of online systems will further enhance efficiency. The use of advanced digital systems and reform of business processes will improve efficiency further. With these improvements, the prospect of 30% expense ratio is in sight.

On the other hand, investment in IT system is needed as we move toward a new era. Assuming that we need to overcome increased investment in IT systems, 30% may not be attained during the next plan partly due to factors you mentioned. But excluding those additional (53:12) investment under the next plan, operation will be made more efficient to bring 30% into site. Use of common claim service systems would be conducive to head count reduction in claim services and common products and business processes will proceed at an increasing speed. Our CFO will make supplementary remarks.

Q - Tatsuo Majima {BIO 15338044 <GO>}

Well, excuse me a little more but I wanted to ask about was, I'm not saying it's low. No, but you reduced it from 35% to the current level. This must have required substantial efforts compared with other two companies. A further reduction from the current level maybe more easily achieved by the other two companies, so including that in your growth with these two non-life companies and your group must have overstretched themselves to lower expenses to the current level. Aare you going to reduce it further? Do we have room to reduce it further?

A - Shiro Fujii {BIO 16476704 <GO>}

Allow me to respond to that question. Fujii is my name. True. Looking at corporate expenses and agent commission, including agent commissions, partly due to our business line mix, they tend to be higher at our group. And therefore, the difference attributable to business line mix stems from business lines with very high ROR such as residential, fire, and automobile insurance. So, we can tolerate it even though we're a bit behind.

With regards to corporate expenses, as you mentioned, we worked hard to reduce it, overstretching efforts or not. But here, we think there is a room for further improvement. As was mentioned earlier, the common claim service system is being built. It will become operative in fiscal 2019. On the production front, we will begin to introduce common products in mainstay business lines in fiscal 2019. So once these are launched, good progress can be made.

And also, with respect agent, as I mentioned, far-reaching business reform is carried out at the present. And therefore, combining all those, as Mr. Karasawa mentioned earlier, we cannot show you now whether the plan reformulate can reduce it to 30% as described here, but aiming at that, we would like to push ahead with those initiatives. To put it differently, there is enough room for further improvement.

Q - Tatsuo Majima {BIO 15338044 <GO>}

So does this mean 30% is going to be achieved while keeping two companies?

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

Of course, all possibilities are included in the option as it has been to-date. So, that's how I would like you to understand our situation.

Q - Tatsuo Majima {BIO 15338044 <GO>}

Thank you very much.

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

And then, other questions? The person on the farthest back of the room, maybe third line from the back.

Q - Koichi Niwa {BIO 5032649 <GO>}

Niwa of Citigroup Securities. I have two questions. One relates to your thinking on ESR and the other, your thinking on reinsurance rate. And the first one is a bit detailed and technical. The level of ESR currently is at 200% and you said that it is not that stable. However, the stock market has improved since the end of September and I think it seems more stable than otherwise. But even then, you have concerns, what aspect of ESR are you concerned about? So, that's the first question relating to ESR.

And secondly, when considering the next medium-term plan, is there any room for changing capital and risk exposure or risk volume for ESR? That is to say, could this level move up or down, or is it based upon existing rules? So, please share with us your thinking here. And the other one relates to international insurance, and you shared with us about the cycle management, but how should we consider the margin of increase in the premium next year? Is it 10% or 20%? What do you envision in this regard?

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

So, first let me start with the reinsurance premium. It just so happened that last week, I made a business trip to Switzerland, and I had a chance to exchange views with a top executive of a Swiss Re. And from the perspective of cycle management, how would rates evolve especially in the cat loss area in North America? At this point, his thinking or understanding was more or less the same as ours. Since Swiss Re is a leading player in the class, his view I thought was quite likely to materialize. What the market is telling us is a 10% plus or minus 5% including some wishful thinking. And here again, we also share the same understanding.

With respect to ESR, I'll have CFO to elaborate later on. But it is currently shown at 199%. At the end of fiscal year, if a variety of acquisition deals are finalized, the ESR will come down once again to around 195% or 196%. So, it will take a while before 200% can be restored as things stand now. But in the meantime, we will continue to reduce strategic equity holdings to improve capital efficiency. So, we have in mind a level measuring 200% steadily. But we are thinking of some revisions with respect to the thinking of ESR in the context of our next medium-term plan. So, I'll have Fujii, CFO, to elaborate on that.

A - Shiro Fujii {BIO 16476704 <GO>}

I have to ask you to wait until May for details, but a various points and opinions have been presented and currently we use figures before tax currently. And we are – various approaches including the calculation on after-tax basis. We have shown 200%, and we already discussed this earlier is a reference to a single level as we do now a good method or would it be better to describe it in the range including those the study is now underway. And in this material, as we study and consider capital control, we are discussing and examining various options.

In terms of the formula or criteria, we would also like to use after-tax figures as others do. Coefficient use for risk calculation is reviewed every year, so they could be reflected as well. So that's how I'd like you to understand our thinking here. Would that be all right?

Q - Koichi Niwa {BIO 5032649 <GO>}

May I ask additional question? Looking at page 57, I feel that during the next medium-term management plan to put it directly is the company going to enter a phase of viewing capital policy to return surplus capital or is it in the phase of a preserving growth through acquisition as was discussed in relation to M&A? Which stage is the company going to be in? My focus of interest is that in this long-term vision, a stage of quantum expansion seems to be the period covered by the next medium-term plan. So, that's what I would like to be elaborated on.

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

Basically, we're not just pointlessly seeking top line alone. That's not our intention. Naturally, we first consider profitability and then look at M&A deals including whether or not the deal is conducive to better capital efficiency. And that's how we have done in the past. But the outcome was not always in line with their expectations which makes me feel embarrassed and frustrated. But basically that's the policy that we have been operating by as was mentioned in the initial presentation.

We have no intention of stop growing going forward but when there are fewer opportunities for growth, how should the capital be used? From the viewpoint of improving efficiency, returning capital is going to be included as an option. You've asked which stage the company is in right now. It could be on either stage, the basic orientation however is to achieve robust growth to increase the absolute amount of profit.

Yes. The person behind that. The man behind that.

Q - Futoshi Sasaki {BIO 17564798 <GO>}

Thank you. Sasaki of Merrill Lynch Securities. I have one question. In considering your company or your group, the ASEAN market is very important. We've been explaining that. But in the Chinese market, the foreign owned insurance companies will be more and more allowed to enter the market through deregulation. What sort of approach are you taking with the mainland China or what sort of approach are you going to take going forward? What is the thinking on the part of the management?

A - Yasuyoshi Karasawa {BIO 7391405 <GO>}

With his back to our initiatives in China's market, actually in the context of financial reorganization there are two geographies where a functional reorganization of ADI and MSI has not been completed and they are China and Thailand. Although our thinking is aligned with respect to a basic direction partly because of the relationship with each company's partnerships, the progress has been slow to date. In the case of MSI, it has allied with the Pacific which is the third ranking company in China and in the case of automobile insurance the Pacific undermines the risk and we take a certain share of that.

In the case of ADI, it has allied with (01:04:19) which ranks the second and the relationship very similar. And in our case our local subsidiaries mainly underwrite the Japanese corporations and both of these companies are generating profit although ADI has been profitable with occasional losses and amongst foreign-owned companies, those company's profit levels are very high. However, even today, a combined market share of a foreign-owned companies in the Chinese market is less than 2%. As the market becomes more deregulated, we continue to cultivate and develop business of local risks leveraging those partnership, Mitsui Sumitomo with the Pacific and ADI with (01:05:07) And so those local risks would be cultivated through the context of those collaboration or partnership with those local entities.

What about the chance of additional investment in the next five years? Is there any chance of making additional investment?

In terms of additional investment, MSI is a minority shareholder of the Pacific insurance including the capital increase there or are we talking about the investment in Chinese market, we will act flexibly when capital needs to be increased in line with business development or when such equity investment is needed.

Thank you.

[Abrupt End]