(Unofficial Translation)
FY2023 Financial Analysts Meeting
Q&A Summary

Date: May 29, 2024 15:00-16:30
Respondent: Tetsuya Kikuta, President and Representative Director (CEO)
Taisuke Nishimura, Executive Officer (CFO)

ESR, Cash Positions, Shareholder Payouts and Risk Profile

Q **In the presentation material, it was mentioned about ALM taking into account the interest rates and surrender risks in a situation of rising interest rates, as well as definitions of each surrender risk, and measures to control those surrender risks. Considering the interest rate risk that DL has experienced in its investment in foreign hedged bonds and the higher-than-expected surrender risk that U.S. regional banks and some Japanese life insurance companies have experienced, how do you plan to control the possible future risks including an increase in surrender risk, caused by rising interest rates?**

A The mass lapse risk is one of the factors used in the ESR calculation, measuring how much future profits would be reduced if a large portion of policies were surrendered at once. This is a risk that exceeds our expectations assumed based on our past experience, yet it needs to be recognized under the capital standards, and we have to maintain the ESR range of 170% to 200% taking account of them.

Regarding the risk of cash outflow (loss on sale of bonds) that U.S. regional banks had experienced, we already expect a certain amount of increase in surrender due to the transfer from our products with single premium and no surrender deduction. Also we are already hedging against rising interest rates through swaption, and will continue to closely monitor interest rate trends and hedge against such risks. In addition, policy-reserve-matching bonds, which are held for insurance liabilities, will have a one-time negative impact on profit when rebalancing, but we will try to mitigate the impact on profit by offsetting through gains from sales in risk asset, etc.

Q **In page12, both capital and cash generating capacity have increased. Assuming that the Group adjusted profit target of ¥400 billion for FY2026 is achieved, and assuming that strategic investments of average ¥100 billion per year, can I expect the difference of about ¥300 billion as a source of shareholder returns? Are there any other additional**

factors that should be taken care of?

A The forecast for the "FY24-25 profit Free Cash" in page12 is approximately + ¥600 billion, and to do so, we have to raise the adjusted profit year by year from the current year's profit forecast to achieve the adjusted profit of ¥400 billion in FY2026. On this basis, we consider shareholder returns while maintaining a balance between strategic investments and share buybacks. Share buybacks will be carried out at a scale necessary to achieve capital efficiency that exceeds the cost of capital during the current mid-term management plan period.

Q Regarding HD's cash position on page 12, what was "Finance executed for FY2023 (both intra-group and external)" and how was the size of it? With regard to the remaining capacity of the strategic investment, with the HD cash of approximately ¥800 billion at the end of March 2027, even if you were to make total shareholder payout of approximately ¥200 billion twice, there would still be approximately ¥400 billion cash remaining. After deducting the base cash of ¥100 billion from this amount and making investments in ShelterPoint and Canyon Partners, it seems that you still have approximately ¥300 billion available for strategic investment. Furthermore, if you increase the sales of domestic equity, the investment capacity will increase. While another life insurance company has announced a ¥2 trillion strategic investment, how much is a room to increase strategic investment quota?

A The HD cash position of about ¥800 billion at the end of March 2027 might increase if the market value of domestic stock holdings rises or if there are other factors. On the other hand, with the acquisition of Benefit One, HD made intra-group financing, i.e. borrowing from DL to fund HD's strategic investments and shareholder returns. While seeking for opportunities of strategic investments, HD cash will also be used to repay the intra-group financing. There is also a chance for refinancing of external borrowings, so we will try to secure the funds for strategic investments and shareholder returns, taking account of cash availability.

Q If we consider the whole cash inflow resulting from the sale of domestic equities, not only realized gains from mark-to-market, is it possible to further increase the cash position?

A Since our investments cover insurance policy reserves in liability -side, only the capital gains exceeding the book value are subject to remittance, and not the entire amount will be remitted.

Q The material (P6) shows that the sensitivity of ESR to Japanese interest rates decreases

by 6% points for a Japanese interest rate + 50 bps, while the material (P10) shows that the sensitivity of EV to Japanese interest rates increases by 0.8 % for a Japanese interest rate + 50 bps. In other words, the balance appears to be such that capital in the numerator of the ESR will increase by about ¥70 billion and risk in the denominator by about ¥150 billion, so please tell me why risk will increase more than capital.

A If Japanese interest rates rise, while margins increase, interest rate risk decreases, but surrender risk increases. The surrender risk is the larger of mass lapse risk or normal surrender risk, and mass lapse risk is currently affected. For mass lapse risk, the risk exposure is the difference between the surrender value and the market value of the policy reserves, which is then multiplied by the mass lapse rate to calculate the amount of risk. Therefore, the rising Japanese interest rates will make the market value of liabilities smaller, while the surrender value is fixed based on the amounts promised to be paid to the policyholder in the case of traditional products without market value adjustment ("MVA"), which leads to increase the difference of those values and surrender risk. As a result, a rise in Japanese interest rates will lead to a deterioration in ESR.

Q The mass lapse risk is probably calculated based on an assumption of 30% for individual insurance if the same assumptions as the new economic value-based regulation are used, but please let me confirm whether it is normal for the mass lapse risk to be higher than the increase in capital. The sensitivity of other life insurance company is also negative, but the increase of denominator has not led to a larger increase than the numerator.

A We are not sure what other companies change and do not change the parameter when measuring ESR sensitivity. We would like to explain the details of our calculations, including the breakdown in the future.

Q In the previous mid-term management plan period, you were trying to reduce the risk which will be realized under the situation of interest rates drop, by purchasing ultra-long-term JGBs shown in page16. However, this initiative is not highlighted in the current mid-term management plan. Is it correct to understand that you will continue reinsurance transactions only, and do not expect to purchase a large amount of ultra-long-term JGBs?

Looking at page18, you will be shifting to strategic investments from shareholder returns, but will the timing be during the current mid-term management plan period or when you think ROE consistently exceeds the cost of capital?

A We will continue to purchase ultra-long-term JGBs. However, such interest rate risk has already decreased considerably, so we will purchase ultra-long-term JGBs just to fill in the insufficient duration backet for ALM purpose. As for the timing of shifting to strategic investments, we hope to achieve ROE exceeding cost of capital during the current mid-term management plan period. Therefore, we will be gradually shifting to strategic investments from the next mid-term management plan period, which will begin in FY2027.

Equity Selling

Q **It has been reported that the FSA will investigate companies' disclosure of cross-shareholdings. Will this affect DL's domestic shareholding policy? You said that the appropriate level of domestic equity risk is currently under consideration, but once that level has been clarified, will there be an increase in the amount of equity sales?**

A Our equity investment department makes investment decisions on DL's stocks held for pure investments. Buy-side analysts are assigned in the equity team, aiming to outperform the TOPIX. Asset allocation is determined by DL's investment planning department, which optimizes risk-return on an economic value basis. This strategic allocation is assigned to the equity investment department, which is the in-house asset manager, along with a benchmark. Stocks held in DL's general account, which are invested through this asset allocation management and stock selection process, are classified as pure investments (stocks invested for purposes other than pure investment also exist, but those have been disclosed separately). In the situation such that stock market rises and equity risk increases further, interest rates rise significantly, or there is a shortage of cash for strategic investments, the amount of equity sales will increase from the amount we set in the mid-term management plan. The amounts of reducing equity holdings eventually is currently under discussion, but we will proceed with sales toward our goal throughout the period including the next mid-term management plan starting in FY2027.

Domestic Insurance Business and Sales Strategy

Q **It was mentioned that domestic insurance sales is getting to be recovered based on your internal indicator. Please tell us if it is possible for DL to regain its competitive advantage in the domestic life insurance business in a competitive environment, while competitors are also rushing to boost their business.**

A Since the misconduct in 2020, DL had basically been a compliance-centered operation. It did not promote sales much and did not develop new products during that time, and in December 2022, HD President and DL President Succession was announced, and since then, under the decision of both presidents, sales promotion has been resumed from FY2023. New products require about a year of development time, and as a result, the first new product launch was in January 2024. Subsequently, new products, including product revisions, were launched in

March and April consecutively. We recognize that the competitive environment in Japan is very severe, especially for protection products, partly due to the major macro factor of the declining birthrate and aging population. In addition, because DL did not promote sales much for three years, resulting in a large decline of sales due to individual company factors, we are currently in the process of recovering to the pre-COVID-19 level as quickly as possible. The source of those growth is the increase in activity due to the accelerated speed of new product launches, which is a major reason why the top line is growing even in the current competitive environment.

Q　Given that the standard yield rate for insurance liabilities of 0.25% will not change for the time being unless the domestic interest rates dramatically increase, positive spread of 0.8% or so will be generated from the linked 10 year bonds.　However, will there be a disadvantage compared to mutual companies who sell longer duration insurance products such as 30 to 40 years whole life insurance products, since they will earn more positive spread and provide higher policyholder dividend?

A　We believe that there will be differences in product design from the mutual companies in terms of cost of capital point of view. Rather than selling products that do not have negative margins, we will specialize in products that provide capital efficiency that exceeds the cost of capital. Especially when interest rates rise, it will be difficult to compete with mutual companies with same type of products. Rather, we need to develop more distinctive products. In DL, single-premium whole life insurance products are not sold now because of the cost of capital perspective, and it will be difficult to offer such a product as our main product going forward. However, in our experience, it is better and more effective as marketing perspective to appeal to customers when choosing products based on attractive price and product features, rather than on policyholder dividend. For example, DL's "Step Jump," a variable crediting rate product, and DFL's savings products with MVA sold through bancassurance channel have seen good sales momentum. We also believe that the rise in interest rates will further enhance the attractiveness of these products. Rather than policyholder dividends, we will develop products and set crediting rates that customers want to choose, such as a variable crediting rate products and products with MVA.

Q　Do you think it is feasible to achieve the VNB target of approximately ¥105 billion for this fiscal year? Additionally, could you provide insight into the long-term outlook for VNB?

A　Regarding the recovery of new business performance, DL's VNB had been significant in the past, but recovering from the decline caused by the COVID-19 pandemic is not an easy task.

However, there are currently positive signs of recovery, and we aim to further enhance productivity to improve it.

Q **In the previous mid-term management plan "CONNECT 2020," you had set a target of about ¥230 billion in VNB. What are the differences in the upside and downside between that time and now?**

A The current target is to bring DL's sales performance in the retail sector back to pre-COVID-19 levels by the final year of the current mid-term management plan period. If we can do so, we will be able to achieve such the level of VNB for the group. However, the number of sales reps has decreased by more than 5,000 due to the switch to a selective hiring policy that emphasizes quality and the increase in retirements during the pandemic. In addition to the decline of headcount, productivity (sales volume) per employee has been considerably low over the past three years due to the lack of new product launches. In other words, the "decline in the number of sales reps" times "decline in sales volume per salesperson" has largely put downward pressure on VNB over the past three years. Although the number of employees has bottomed out this fiscal year, we do not expect that it will increase by about 5,000 in the future and return to a 40,000-person workforce. Therefore, it is extremely important to raise productivity per person to more than 1.5 times the previous level, and the main focus of our quality-oriented efforts is how to increase productivity per person. Productivity per person in April and May 2024 has already returned to pre-COVID-19 levels, and the shortage in the top line is due to the reduction in the number of sales reps. However, since the number of sales reps will not increase, the major challenge for the recovery of VNB will be to increase the productivity per sales rep which has already recovered to the pre-COVID-19 level, further in future.

<u>Overseas Business</u>

Q **You mentioned that you would like to make strategic investments in overseas partly utilize funds from DL. With the yen continuing to depreciate, please tell me whether the environment is such that economic rationality can be justified as an investment opportunity, and whether this is the right time to aggressively invest in overseas.**

A Foreign exchange rates are not a major consideration in strategic investments in overseas. In terms of the profitability of investment opportunities, we consider the internal rate of return and hurdle rate under the local currency basis, and evaluate the economic rationality basically without significantly changing the assumption in the future fluctuation of FX, driven by the current FX-rate level. On the other hand, the value of life insurance companies basically increases when interest rates rise. In recent years, the corporate value of life insurance companies has risen considerably on a global basis. In particular, we think the value of capital-heavy insurance companies is rising. Considering this, we think that we need to be cautious in an evaluation of such investment opportunities. However, we intend to actively seek investment opportunities in areas where competition is relatively less heated, such as capital-light insurance companies like ShelterPoint, which we reached an agreement to acquire, and insurance companies that have strengths in niche areas.

<u>**Management Strategy**</u>

Q Please tell us about your thoughts on whether your business plan could change if domestic interest rates rise significantly. For example, if interest rates on JGBs rise significantly, would it be possible to sell risky assets and purchase JGBs, thus changing into a company that generates positive spread by simply taking on insurance without taking on investment risk? On the other hand, there is a possibility that various changes may occur that have not occurred in the past 20 or 30 years, such as the possibility of investment opportunity if there would be financial institutions whose financial soundness deteriorated, etc. In such cases, please tell us to the extent possible what management decisions your company might make.

A We think that a rise in domestic ultra-long-term interest rates would be a great benefit, especially in asset management and the development of new products. On the other hand, we think it is a bit difficult to allocate assets to ultra-long-term bonds in a short period of time. Since most of the bonds we currently hold are policy reserve-matching bonds, there are certain rules regarding their replacement. We will proceed with the replacement of assets to realize the benefits of a large rise in interest rates on ultra-long-term bonds, but we think this will take a certain amount of time. If such a situation were to occur, for example, while we will sell ¥1.2 trillion of stocks on a market value basis over the next three years, the cash that would be reinvested, excluding capital gains to be remitted to HD, would be allocated to ultra-long-term bonds with high yield to maturity, thereby improving profitability and enhancing ALM.

Q If the sale of domestic equities continues, there will be profits for a while, but eventually, this source will be exhausted, potentially leading to a profit cliff. Could you provide your thought on whether it will be the domestic business or the international business that overcomes this issue?

A For a certain period, the realization of unrealized gains from the sale of DL's domestic equities will boost profits and significantly contribute to remittances to HD. Regarding future profit drivers, from the perspective of capital circulation management, we plan to reinvest in growth businesses while domestic business cashflow("CF") is still expected. In preparation for the period after CF from capital gains on domestic equity sales can no longer be expected, we believe it is necessary to build a self-sustaining business portfolio using CF generated from the second and third pillars created through strategic investments. It is crucial to increase profit contributions from DFL and asset management in the retirement and savings business, and overseas businesses. In this regard, we do not foresee a 'profit cliff' occurring.

Note: We made partial additions and alterations in preparing the above summary for clarity.

[Abbreviated company names]

HD: Dai-ichi Life Holdings, DL: Dai-ichi Life, DFL: Dai-ichi Frontier Life