S&P Global
Market Intelligence

Aflac Incorporated NYSE:AFL

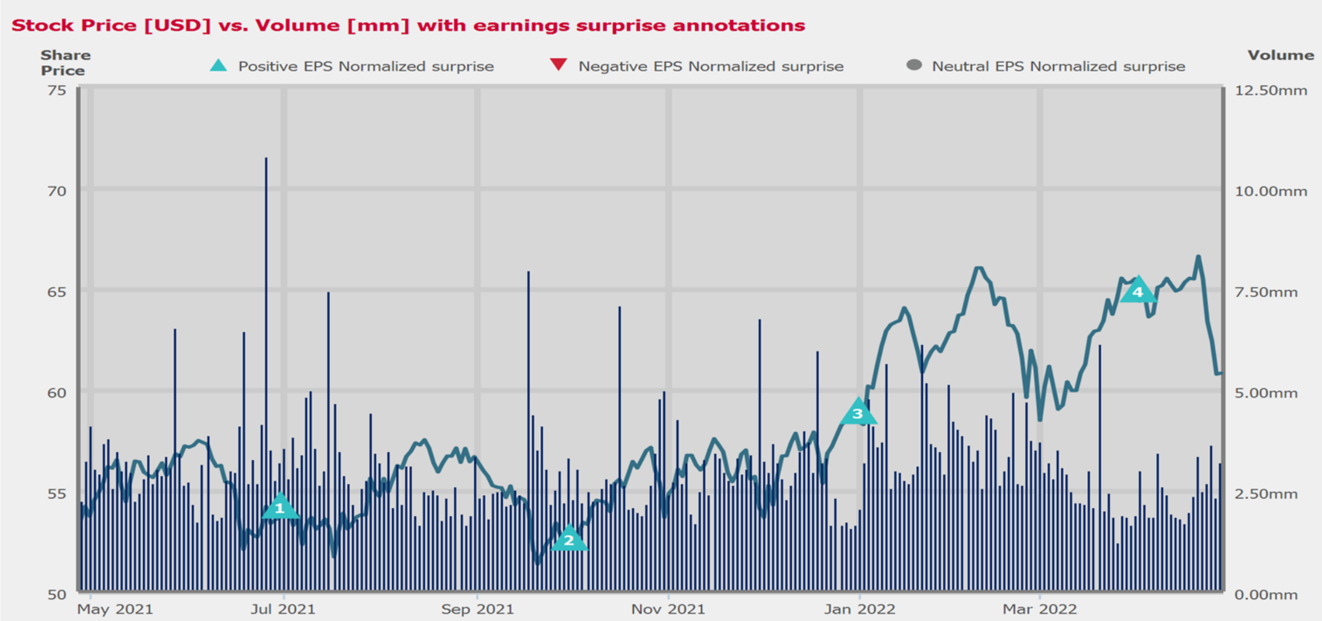
FQ1 2021 Earnings Call Transcripts

Thursday, April 28, 2022 12:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2022-			-FQ2 2022-	-FY 2022-	-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.37	NA	NA	1.28	5.22	NA
Revenue (mm)	5134.85	NA	NA	5046.65	19557.22	NA

Currency: USD
Consensus as of Apr-28-2022 10:30 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2021	1.28	1.59	1 24.22 %
FQ3 2021	1.32	1.56	2 18.18 %
FQ4 2021	1.26	1.33	3 5.56 %
FQ1 2022	1.37	1.42	4 3.65 %

Table of Contents

Call Participants

EXECUTIVES

Bradley Dyslin

Daniel Paul Amos
Chairman & CEO

David Young

Eric Mark Kirsch
Executive VP, Global Chief Investment Officer & President of Aflac Asset Management LLC

Frederick John Crawford
President & COO

Koichiro Yoshizumi
Deputy President, Director of Sales & Marketing and Director - Aflac Life Insurance Japan

Max Kristian Broden
Executive VP & CFO

Teresa Lynne White
President of Aflac US

Unknown Executive

Virgil Miller

ANALYSTS

Alexander Scott
Goldman Sachs Group, Inc., Research Division

Erik James Bass
Autonomous Research LLP

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

John Bakewell Barnidge
Piper Sandler & Co., Research Division

Nigel Phillip Dally
Morgan Stanley, Research Division

Ryan Joel Krueger
Keefe, Bruyette, & Woods, Inc., Research Division

Suneet Laxman L. Kamath
Jefferies LLC, Research Division

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Presentation

Operator

Good morning, and welcome to the Aflac Inc. First Quarter 2022 Earnings Call. [Operator Instructions]. Please note this event is being recorded. I would now like to turn the conference over to David Young, Vice President of Investor and Ratings Agency Relations and ESG. Please go ahead.

David Young

Thank you, Andrea, and good morning. Welcome all to Aflac Inc.'s first quarter earnings call. This morning, we will be hearing remarks about the quarter related to our operations in Japan and the United States from Dan Amos, Chairman and CEO of Aflac Incorporated; Fred Crawford, President and COO of Aflac Incorporated, will then touch briefly on conditions in the quarter and discuss key initiatives.

Yesterday, after the close, we posted our earnings release and financial supplement to investors.aflac.com along with a video with Max Broden, Executive Vice President and CFO of Aflac Incorporated, who provided an update on our quarterly financial results and current capital and liquidity. Max will be joining us for the Q&A segment of the call, along with other members of our U.S. executive management; Teresa White, President of Aflac U.S.; Virgil Miller, Deputy President of Aflac U.S.; Eric Kirsch, Global Chief Investment Officer and President of Aflac Global Investments; Brad Dyslin, Deputy Global Chief Investment Officer; Al Riggieri, Global Chief Risk Officer and Chief Actuary; June Howard, Chief Accounting Officer; and Steve Beaver, CFO of Aflac U.S.

We are also joined by members of our executive management team at Aflac Life Insurance Japan, Charles Lake, Chairman and Representative Director, President of Aflac International; Masatoshi Koide, President and Representative Director; Todd Daniels, Director and CFO; Koichiro Yoshizumi, Director, Deputy President and Director, Sales and Marketing.

Before we begin, some statements in this teleconference are forward-looking within the meaning of federal securities laws. Although we believe these statements are reasonable, we can give no assurance that they will prove to be accurate because they are prospective in nature. Actual results could differ materially from those we discuss today. We encourage you to look at our annual report on Form 10-K for some of the various risk factors that could materially impact our results. As I mentioned earlier, the earnings release is available on investors.aflac.com and includes reconciliations of certain non-U.S. GAAP measures.

I'll now hand the call over to Dan. Dan?

Daniel Paul Amos
Chairman & CEO

Thank you, David, and good morning. Thank you for joining us. As I reflect on the first quarter of 2022, I'm thankful for the dedication, compassion and hard work of our committed Aflac team in the United States and Japan. Our management team, employees, sales force have continued to work tirelessly to be there for the [indiscernible] when they need us most, just as we promised. As Max highlighted in his video update, Aflac Incorporated reported first quarter net earnings per diluted share of $1.58 in the first quarter of 2022. Adjusted earnings per diluted share were solid at $1.42 in the first quarter, supported in part by the continuation of a low benefit ratio associated with the pandemic conditions. Also contributed were better-than-expected returns from alternative investments despite the weakening of the yen. We remain cautiously optimistic as we continue to navigate the pandemic.

Looking at the operations in Japan in the first quarter, Aflac Japan generated strong overall financial results, with a profit margin of 25.3%. This was above the outlook range that we provided at the November 2021 financial analyst briefing. Persistency remains strong. However, sales were constrained as a quasi-state of emergency remained in place through mid-March. This impacted our ability to meet face-to-face with customers. Also contributing to the decline in the quarter were comparisons of the first quarter of 2021 when our new medical product was launched.

Aflac Japan has continued to offer support to Japan Post Group as it gears up for the start of the new fiscal year of April of 2022. This included the transfer of approximately 10,000 Japan Post Company sales employees to Japan Post Insurance.

These sales employees will focus solely on selling Japan Post insurance products and Aflac Japan's cancer insurance product.

Since it may take some time for these employees to ramp up sales activities under the new framework, we anticipate sales momentum picking up in the second half of the year. On that note, as part of the ongoing collaboration and governance framework of the strategic alliance. I'm excited to be traveling to Japan towards the end of June to meet with Mr. Masuda, Japan Post Holdings CEO, along with the President of Japan Post Postal and Insurance companies. Given this, we expect stronger overall sales in the second half of the year, assuming that the pandemic conditions do not escalate, that we execute on our product introductions and refreshment plans and the sales productivity continues to improve at Japan Post Group.

Turning to Aflac U.S., we saw a solid profit margin of 19.8%. This result was also above the outlook range that we provided at the financial analyst briefing. I am pleased that our U.S. sales momentum has continued from the fourth quarter with a 19% annual sales increase in the first quarter. This reflects continued improvements in the pandemic conditions, growth in our core products and investment in the build-out of growth initiatives. While Aflac Dental and Vision and Group Premier Life Absent Management and Disability Solutions which we call PLADS, a relatively small part of our sales. We are very pleased with how they're contributing to our growth.

Our growth initiatives modestly impacted the top line in the short-term, but also tend to be accompanied by the sale of our core supplemental health products, as Fred will explain in a moment. In combination with our core products, they also better position Aflac U.S. for future long-term success. The need for the products we offer is as strong or stronger than ever before. At the same time, we know that consumers' habits and buying preferences have been evolving. We remain focused on being able to sell and service customers, whether in person or virtually. This is part of our ongoing strategy to increase access, penetration and retention.

Turning to capital deployment, we place significant importance on continuing to achieve strong capital ratios in the United States and Japan on behalf of our policyholders and shareholders. When it comes to capital deployment, we pursue value creation through a balance of actions, including growth investments, stable dividend growth, a disciplined and tactical stock repurchase. It goes without saying that we treasure our record of dividend growth. The fourth quarter's declaration marked our 39th consecutive year of dividend increases. This is a record we seek to extend demonstrated by our 21.2% increase in the first quarter cash dividend.

2020 will remain in the market purchasing shares with a tactical approach. In the first quarter, Aflac Incorporated deployed 500 million in capital to repurchase 8 million of its common shares. With this approach, we look to emerge from this period in a continued position of strength and leadership.

Keep in mind, in addition, we have among the highest return on capital and lowest cost of capital in the industry. We have also focused on integrating the growth investments we've made. I don't think it's a coincidence that we've achieved success while focusing on doing the right things for our policyholders, shareholders, employees, sales distribution, business partners and communities. I'm proud of what we've accomplished in terms of both our social purpose and financial results, which have ultimately translated into strong long-term shareholder return. We also believe in the underlying strength of our business and our potential for continued growth in the U.S. and Japan, the 2 of the largest life insurance markets in the world.

Thank you for joining us this morning. And now I'll turn the program over to Fred. Fred?

Frederick John Crawford
President & COO

Thank you, Dan. I'm going to focus my comments today on efforts to drive growth. I'll also provide some perspective on market and economic conditions in Japan and in the U.S.

Beginning with Japan, COVID-related critical illness, daily death and hospitalization remains at very low levels. While weekly new cases were elevated for much of the quarter, they have come down in the last month and the government's intensive infection prevention measures were lifted as of March 21st. However, for much of the quarter, we felt the ongoing COVID impact, and as evidence, a further 17% decline in traffic through our retail insurance shops as compared to 2021. We have seen COVID incurred claims increase despite the lower rate of hospitalization. This is driven by the rising cases along with COVID's designation as an infectious disease or deemed hospitalization, which allows for payment of claims for care outside of the hospital.

To give you a perspective, we estimate over 80% of our COVID-related claims in the quarter were considered deemed hospitalization. In the meantime, and despite the increase in COVID claims, third sector benefit ratios remain very low.

Sales in the quarter were weaker than we had hoped for. Provided COVID dynamics continue to trend positive. We remain confident we will hit our internal expectations for the year. While COVID conditions partially explain the weakness, we are taking additional action to strengthen the associate channel to include renewed investment in our exclusive agency platform and efforts designed to build market share with nonexclusive agencies where we have low market share. With this in mind, we are accelerating our cancer insurance refreshment timing and plan to launch in the second half of 2022.

With respect to Japan Post, we have experienced sequential growth in sales with increased proposal activity as we continue to roll out a successful pilot program launched late last year. As Dan mentioned, the April transfer of 10,000 sales employees to Japan Post Insurance was completed without disruption. Our alliance now is best characterized as distribution through 20,000 post offices, 10,000 sales employees selling from 223 locations within the Japan Post Insurance Network and 88 Japan Post Insurance branches focused on corporate sales. Importantly, cancer sales targets have been communicated to the regional offices of both the postal system and within Japan Post Insurance for the first time in 3 years.

With respect to our elderly care products, sales were softer in the first quarter after an initial promotional period. This market is still relatively small, roughly 1/10 the size of the medical product industry. The market is further divided into 2 distinct and equally sized classes of product, protection and savings. We are focused on the protection segment of the market where we have quickly captured market share in the high teens. We are well-positioned with competitive product should the government of Japan contemplate shifting more of the burden to individuals.

Turning to the U.S. The markets for voluntary and other worksite benefits have effectively recovered to pre-pandemic conditions. However, we are navigating inflation in a challenging labor market. When we reflect on the U.S. economic environment, we are especially focused on 2 areas of impact to our U.S. model, recruiting and persistency. Tight labor markets create difficulty in recruiting to a full-time commission-based profession. We are, therefore, focused on improving conversion rates of new recruits to producing agents and reengaging veteran agents who are less productive during the pandemic.

Our strategy has been successful, driving a 7% increase in average weekly producers year-over-year. In addition, veteran agents are better equipped to leverage our recent product expansion and strategy to grow within the small business brokers.

In terms of persistency, it's important to note our account persistency was stable in the quarter. However, policyholder persistency was weak and broad-based, which leads us to believe it's partially attributable to the extreme movement in the labor markets. We track the labor department's quit rate, which had been declining during the pandemic then jumped in the first quarter to levels not seen in recent history. While higher turnover in the small business sector is common, the so-called great resignation, along with COVID and return to office dynamics is driving higher turnover. Unfortunately, when employees leave their place of work, they often leave their policies behind.

With this backdrop, what is most impressive about the sales results Dan covered is the balance. Split by product type, group voluntary was up 23%, individual benefits up 17%. Split by channel, agent sales were up 15% and broker up 25%. Our buy-to-build platforms were all up year-over-year, with the combination of network dental and vision, Premier Life and Disability and consumer markets up 65%, albeit off a small but building base. We track the halo impact of dental and vision sales and for every dollar of dental and vision sales, we were able to cross-sell $0.57 of other voluntary product.

Finally, we launched Aflac Pet Insurance powered by Trupanion targeting the larger case market and are busy responding to requests for proposals. It's the balance in our results that give us added confidence that performance should continue throughout the year.

Turning to our investment operations, we do not have any direct exposure in Russia or Ukraine. Of course, our large global credit portfolio does include multinational companies with business interests in the impacted region but nothing significant enough to cause us concern among what are generally large, high-quality credits. We are closely watching secondary risk, namely the impact to the European energy sector, the conflict's impact to existing supply chain and inflation risk and a risk of recession in Europe. While increasing yields erode some of our unrealized gain in the bond portfolio, we also have benefits from rising interest rate environment. Rising rates obviously provide a tailwind for new money investments.

Further, our sizable floating rate portfolio will benefit directly from aggressive Fed rate hikes as their interest rate resets are based off short-term rates. Given the significant move in the forward rate curve, we expect -- we elected to lock in a portion of the expected rate increases by increasing the notional of our interest rate swap strategy such that now approximately 70% of our income is protected from changes in short-term interest rates over the next 5 years. In addition, the holding company holds short-term investments that will benefit with rising short-term yields.

Our alternative portfolio continues to deliver strong results. We understand these portfolios could very well give back some of the gains as the year goes on, but we're off to a strong start in generating the favorable returns expected from these portfolios.

Finally, Max provided helpful perspective on our exposure to the weakening yen in his recorded comments. In short, while there are GAAP reported impacts, we are well protected from an economic perspective and do not see the weakness in the yen as altering our investment strategy, hedging strategy or overall capital deployment activities. There are certainly no implications to our business model, which reinforces our strategic focus on currency-neutral outcomes.

I'll now hand the call back to David to take us to Q&A. David?

David Young
Thank you, Fred. [Operator Instructions] Andrea will now take the first question.

Question and Answer

Operator

Our first question comes from Nigel Dally of Morgan Stanley.

Nigel Phillip Dally
Morgan Stanley, Research Division

So I wanted to start in the U.S. I know there's some potential seasonality in the lake, but if losses remain high, are you considering some potential strategies to improve persistency? And if so, what are some of the options that you have available to you?

Daniel Paul Amos
Chairman & CEO

We have -- and I'll let Teresa and Virgil comment on this, but we have had for a while, a number of strategies underway to help over the long run persistency, not the least of which has been our expanding product portfolio. As you know, we believe dental and vision, for example, will, over time, contribute to better persistency just by the very nature of the product and how that works. However, we think that much of the persistency issue that we're seeing right now is a combination of, number one, the falloff, the final falloff of state regulations that were requiring policies to remain in place. But on a larger scale, we think this labor force in motion is contributing to a lot of the lapse rates, and we would expect or anticipate that to eventually calm down. In the meantime, we remain focused on activities that drive better persistency, but we think right now, there's certain market conditions influencing it. Virgil, Teresa, if you have any comments.

Teresa Lynne White
President of Aflac US

I'll just mention, you nailed it as it relates to some of the high-level things that we're doing. But we also in addition to the stickiness of the product which you talked about with the product mix, we're also from an operational perspective, making sure that we stabilize account retention, account persistency. Because when we do that, we know that our premium persistency is generally stable as well. But as you see it, what we're seeing today is a lot of what we think might be labor market, a labor force impact based on what's going on. And so we're thinking that, that's what's going on with our premium persistency at this point. And so more to come on that.

Nigel Phillip Dally
Morgan Stanley, Research Division

Great. And as a follow-up, just on Japan sales, the sales decline, I think was perhaps a little worse than some of what we're expecting medical appeared particularly weak. So perhaps you can discuss why that was the case and with your expectation that sales recover in the back half. Should we expect that mostly to be in cancer given your product refresh? Or do you also expect a rebound in medical as well?

Max Kristian Broden
Executive VP & CFO

I think we'll let Koide-san and Yoshizumi-san answer that question. But you have, in fact, identified some of the issues. Number one, realize the first quarter last year, medical was during a fresh launch period. And we normally see medical sales come down, really sales of all products come down after that initial launch period. However, there's no question that COVID conditions are really impacting across-the-board results. Cancer held up better for the simple reason that we're seeing some increased momentum slowly within the Japan Post system and that offset things. But generally speaking, you have it right. And then I'll let Koide-san and Yoshizumi-san talk about the types of things we're looking at in the second half of the year to improve sales results in addition to our cancer launch.

Koichiro Yoshizumi
Deputy President, Director of Sales & Marketing and Director - Aflac Life Insurance Japan

[Foreign Language] This is Yoshizumi. Thank you, Fred. Let me answer the question. In Japan, in the first quarter, with the explosive infection increase, we have been impacted very much. And that goes to both the salespeople who visit the customers, as well as those customers who visit our agency shops. For example, in February, the number of people -- the customers visiting our insurance shops decreased by 22%. And we are also gathering information from various associates to analyze what actually had occurred. And as far as we hear, it seems like appointments that our agencies are trying to make for a visit to customers has been declined by like 30%. And I believe your question was related to medical.

And in regards to the medical insurance, we did launch a new product last year. And since it's been a year since we launched the product, I think we have gone through a cycle of customers. We did have a plan that our medical insurance in the first quarter sales will decrease, and the fact is that the actual sales was even lower than we had expected because of the impact of Omicron. And as for the future sales measures, we would like to further promote our sales activities through online sales. And we would also like to be proposing more comprehensively our coverage and benefits to our customers using the new products such as nursing care product and our work lead product. And the rest are basically what Fred has said.

And then now regarding Japan post Group, there was a big organizational change there. And what that means is that the sales consultants from Japan Post Company, this is the post office company, has been transferred to the Japan Post insurance company. And the preparation to move this many people over to Japan Post Insurance took place in the first quarter, and they are fully prepared, and they have gotten a very good start in April. The Japan Post Group will resume their sales under the new organization now that they have a good infrastructure in place for sales.

Daniel Paul Amos
Chairman & CEO

Let me make 1 comment. This is Dan. What I think you're seeing evolve here with sales in the U.S. and in Japan is that we've got 1 more quarter, the second quarter, of things adjusting, but I see things moving back to a new normal. What that normal is, I'm not exactly sure, but I don't think it's going to be that different from the way we've been enrolling in the past. And I think you'll see that in the second half of the year. And I have not been to Japan in quite a while, and I can't wait to get back, but I have been talking, all of us have, with Japan constantly. And I don't think you can underestimate the impact of those cost of moves that they had in terms of restrictions.

But they are over right now, and assuming that we don't see it come back in any great degree, I think you're going to see the second half. And the second quarter start to improve, but the second half really be more like the past in terms of our selling ability because as they mentioned, people coming into the offices was down 22%, some other things. And those are just reflections and they affect everything. They affect recruiting, they affect new sales, they affect every aspect.

Operator

Next question comes from Suneet Kamath of Jefferies.

Suneet Laxman L. Kamath
Jefferies LLC, Research Division

I wanted to start with Japan again. Just as we think about these new product refreshes and launches, it seems to us that the shelf life post these launches has been shortening over time. Maybe years ago, you had a couple of years of runway, now it feels like it's a couple of quarters if that. So I'm wondering, one, if you think that's a fair observation? And two, is some of what we're seeing in Japan due to increased competition? In other words, do you have any data on your market share in medical and how that's changed over time?

Max Kristian Broden
Executive VP & CFO

Yes, I think let's have Japan maybe comment on it. But what I would tell you, Suneet, is in general, your comments, I think, hold up a bit, and I think it is, in fact, largely due to the competitive environment. One of the things that I would tell you, just as an observation, is in 2016, when the Bank of Japan went to their negative interest rate environment, we saw a slow and steady migration of shift towards third sector and not a first sector, not surprisingly. But for a period of time, you had firms that were moving into currency product, and then all of a sudden, rate movements and other reserving dynamics rendered currency product to be less attractive. And so that started to back off.

And now you have companies, including domestic companies that have subsidiaries that often specialize in third sector business, even, by the way, property casualty insurance companies that have life and health-related subsidiaries are getting into the action as a way to drive more business. Competition and intense competition is not new. That's been around and we've navigated that for years and years, but there's no question that has become more intensified, which means your product cycle, product refreshment and the nimble nature of how you go at product has to speed up and be quicker.

So yes, the life expectancy of a new product is shorter, but that simply means that you have to be quicker to revise and refresh products than maybe the old 2-year cycles for medical and 4-year cycles for cancer. That's my perspective based on talking with our Japan colleagues. But I'll let Koide-san or Yoshizumi-san comment.

Koichiro Yoshizumi
Deputy President, Director of Sales & Marketing and Director - Aflac Life Insurance Japan

[Foreign Language] And as we just mentioned, the market is becoming very, very competitive. And especially the medical insurance market is really evolving or changing almost every day. What we are saying is that the good -- the data until it's good, it's becoming shorter and shorter. On the other hand, since we do have very good sales and solicitation platform and using that base, and we do believe that we can still grow this area with our overwhelming brand, a very strong brand. We also have very good advertisement capability. And even with this very severe competition, I think we can work towards expanding the market and really make efforts and perform.

Now let me go into cancer insurance. Regarding new products for cancer insurance, we are thinking of it that because it is still before the approval of the authority, we cannot say -- tell you about the details. We are thinking of a product that would differentiate ourselves from our competitors by having very competitive benefits, as well as various services that would support the cancer patients from the time of when they start developing cancer until these patients recover to society or work. That's all for me.

Suneet Laxman L. Kamath
Jefferies LLC, Research Division

And then I just wanted to pivot. Fred, you had made a comment, I mean in your prepared remarks about the floating rate portfolio and having the income on that locked in for 5 years, or 70% of it locked in for 5 years. Can you just go into a little bit more detail on that? I'm just trying to think through if the Fed is really aggressive, does that mean that you've limited some of the upside? Or just how do we think about that?

Frederick John Crawford
President & COO

Yes. And we have Eric and Brad Dyslin here that can provide color, but just a couple of points to be very clear on remember, what we're doing effectively is locking in the forward curve, not current rates. In other words, we're locking in the expectation in the marketplace for aggressive Fed action. And so that's the very nature of the swaps. So we're not losing out, if you will, on that aggressive forward. What we're doing is we're protecting against the risk of that reversing or calming down or not meeting the expectations that are embedded in the forward curve. Also note that we've got about 10 billion of floating rate floaters, if you will, in our general account, and another 2 billion at the holding company. And so we still remain relatively exposed if you want to define it that way to taking advantage of a rate environment that exceeds the forward curve expectations. So we haven't taken it all off the table. But I'll let either Eric or Brad comment.

Bradley Dyslin

Yes. Thanks, Fred, and that's an excellent start. I would just dive a little deeper to have you understand when we do our planning, if you will, which is, of course, the current year plus we look out over 5 years for the floating rate book, we typically use forward curves. The last set of financial plans we did were back in November, which Max then uses as part of the overall franchises EPS, if you will. But the forward curves, as you know, because of the Fed change in policy has substantially increased. So if you just look at projecting based on the forward curves, where the floating rate income will be over the next 5 years, significantly higher than what our plan was. Having said that, we all know forward curves are never realized.

So we have an opportunity to basically say, we don't really know what's going to happen in years 2, 3, 4 and 5. But what we do know is if the forward curves became true, there's a significant amount of pickup in income. What we've chosen to do is take about 70% of that book and do a fixed or floating rate swaps such that we've locked in a good portion of that upside. If the forward curves end up coming down, an example of that would be many people are talking about recession in the U.S. next year. Those forward curves will likely never be realized in years 3, 4 and 5 because the Fed will then change policy. If rates continue to go up because the Fed is even more aggressive, fortunately, we've got a good portion of the book, about 1/3 that's not covered by the swap.

So we'll still enjoy some upside as well. And then, of course, over the next few years, we continue to invest potentially in more floating rate assets. So we've got good exposure to rising rates as well.

Suneet Laxman L. Kamath
Jefferies LLC, Research Division

Would you be willing to size the pickup just from November to March on that portion that you've locked in?

Frederick John Crawford
President & COO

Yes, I think we would have to kind of give some thought to that. The pickup this year is relatively modest. It's not insignificant, but remember, all we're really doing is locking in the pickup that's there anyway, if you will. We're trying to -- so I think -- well, let us give some thought to that. I don't have the numbers right in front of me because we've looked at it more on a present value over the life of the swap, what it has done. But it's not immaterial to net investment income.

Bradley Dyslin

Yes. And I would further say, there is a pickup in income from our floating rate book this year. But when we talk about the forward curves as an example, LIBOR started the year at 10 or 17 basis points 1 and 3-month LIBOR. It's currently 3 months LIBOR is like 120. So we get a pickup this year. Now the forward curves when we went out -- if you look at the forward curves for years 3, 4 and 5, LIBOR is projected to be 2.5% plus. That's if the Fed goes through with all these aggressive rate hikes. So there is a positive tailwind to our income from the floating rate book this year, but we'd have to come back to size it.

Operator

The next question comes from John Barnidge of Piper Sandler.

John Bakewell Barnidge
Piper Sandler & Co., Research Division

What percent of sales in the first quarter was consumer markets and buy-to-build products? I believe it was 10% last year and expected to grow this year.

Frederick John Crawford
President & COO

So go ahead, Teresa.

Teresa Lynne White
President of Aflac US

I'll let Virgil respond to that.

Virgil Miller

Okay. Thank you, Teresa. So 6% to 7% -- in between 6% and 7% for Q1, remember, there's seasonality in our numbers. So when you talk about 10%, our numbers grow, especially during the fourth quarter, which would give us a higher annual average. So we're anticipating this year that when you combine all the buy-to-build, we'll end up between 10% and 15% again this year. Again, first quarter, though solid growth with the 6% to 7% was more than we had anticipated. So we're starting to gain traction out in the market with those products now.

John Bakewell Barnidge
Piper Sandler & Co., Research Division

Great. And then my follow-up, how much of the decline of the -- in the U.S. has captured fab? Or did it end up coming in higher than anticipated?

Frederick John Crawford

President & COO

Would you ask that question again?

John Bakewell Barnidge
Piper Sandler & Co., Research Division

Sure. How much of the higher lapsation rates in the U.S. were captured into the guidance reflected at the fab in November, or did lapse rates end up coming in higher than anticipated?

Frederick John Crawford
President & COO

We did see a higher lapsation that we planned for Feb of last year. So there is obviously an impact going on here running through our financials across the benefit ratio, expense ratio and also the bottom line through lower earned premium as well. But the net impact on all of those 3 combined is a favorable $5 million in the quarter. So that's the way I would think about it. Overall, obviously, it lowers future net earned premiums because we're sitting with slightly lower policies in force than what we otherwise would have expected. So from an embedded value standpoint, it's clearly a negative. That being said, sales were off to a strong start this year, and that builds embedded value for us for the future as well. So there's a number of puts and takes, but in the quarter, there was a bottom line $5 million positive impact from higher-than-expected lapses.

Unknown Executive

Let's come back to the swap because we pulled up some of the numbers, and so we can answer that question more directly. So Eric, why don't you kind of give us a little bit of idea.

Eric Mark Kirsch
Executive VP, Global Chief Investment Officer & President of Aflac Asset Management LLC

Yes. Our current projection for the year, and this assumes the forward curves for this year materialize is about an extra $39 million of income from our floating rate versus our plan.

Operator

The next question comes from Erik Bass of Autonomous Research.

Erik James Bass
Autonomous Research LLP

I was hoping maybe you could talk about kind of the other moving piece in NII, which would be the hedge costs. So could you talk about the outlook for hedge costs and the Aflac Japan business. And as these move higher, are you still able to generate the same level of spread on the U.S. dollar assets? Or are you making any changes to your investment approach?

Bradley Dyslin

Yes. Thank you very much for the question. First, talking about this year, as you'll recollect for a number of years now, our strategy has been at the beginning of the year to lock in our hedge costs. For the majority of the buck, there are moving parts. So that was very good for us this year because our hedge costs were locked in on the forwards at about 89 basis points. And on the FX options, we do at around 44 basis points. And altogether, I think about $110 million of estimated hedge costs for this year. Obviously, hedge costs are higher with short-term rates going up significantly. So just to give you a flavor of the differential, and this really wouldn't impact us until 2023. Forward costs today for 12 months forward is around 256 basis points versus what we're paying this year of 89. So a significant increase, and we expect that from what's happening with interest rates.

And similarly, options would probably cost us around 2x more than what we paid given increased FX volatility and overall levels of the yen. So when we get to next year, if rates stay where they are, hedge costs would be significantly up probably by about 125% or so on the book. Now having said that, our book does change over time. So I can assure you the balances in all of our asset classes or even when we revisit our hedge ratio, that may change as well. But that's just looking at it as a static buck. The other thing to remind you of though as well on our forward book, which is much reduced than what it was, those forwards are applied against our floating rate assets.

So those floating rate assets, as we just discussed with Suneet's question, their income is going up substantially. So the income well, not 100% correlation will go up pretty close to the amount of the hedge costs going up. So the net should stay pretty even with the 1 variable being the level of spreads on the assets and those spreads have generally been going up. So on a net basis, at least on the forward book, it should be pretty neutral, but the actual line item of hedge costs would definitely go up.

Daniel Paul Amos
Chairman & CEO

I want to make a comment is I've always said I like evolution, not revolution. And for you that have been following our stock for 10 years or more, I just want to tell you what a sophisticated model we have today and how it's evolved not only from Eric and Brad and the team and what they've done, but also our Board and our specifically, Tom as Chairman and what they've done from an investment standpoint. It is very gratifying to hear as we get into such volatility and change in the last year or so, even in the last 3 months with the yen, and yet we have prepared for it. And to hear these answers, I just want all of you to know how -- what hard work and dedication they've done through Fred and Max and what's going on. So Max, I think you were going to make a comment.

Max Kristian Broden
Executive VP & CFO

Yes. I wanted to add 1 more comment. So Eric, when you think about these forwards in Aflac Japan, that's about $4.5 billion of notional at the end of the quarter. At the holding company, we also have $5 billion of notional going the other way. So even in a scenario where you would have dislocation in the marketplace, that could significantly increase the hedge costs for Aflac Japan. You would have an associated increased hedge income at the holding company. So from an enterprise standpoint, we somewhat reduced the exposure to volatility in hedge costs as well.

Erik James Bass
Autonomous Research LLP

And I guess, maybe putting it all together, so you talked about the benefits to NII this year, kind of the floating rates being higher. It sounds like the hedge costs are locked in. So maybe those -- is that a net benefit you'd expect this year? And then the comment on 2023 based on what you've locked in for the floating rate expectation for hedging costs and then what happens in corporate that kind of putting it all together is sort of a neutral impact.

Frederick John Crawford
President & COO

I think putting it all together, it's a positive impact yes. We realize we've got a $30 billion -- $30 billion, $31 billion U.S. dollar portfolio, and I think we have $6 billion of it hedged. So you've got $10 billion of floaters. We've locked in 70% of it. I mean, it's a positive catalyst. There's no question.

Operator

Next question comes from Jimmy Bhullar of JPMorgan Securities.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

I had a question following up on I think, Dan, your comment on the environment sort of returning to normal. As you think about sort of the whole sales process in the U.S., how close to normal, is it in terms -- or are there still ongoing headwinds, whether it's people working from home, or business is less interested in letting agents come in and pitching to their employees or scheduled meetings? So how do you think about like a return to normal pre-pandemic versus ongoing headwinds that might preclude sales from getting to pre-pandemic levels over the next year or so?

Daniel Paul Amos
Chairman & CEO

Well, I'm going to let Virgil, but let me just say just take our company, for example, Today, we really have our first officer meeting for lunch today, and we've got about the 150 people coming, and that is normally -- that includes our directors. And we -- that's about a little lower than what we normally have back pre-pandemic, maybe we would have add up to 200. So it gives you an idea of how things are getting back to normal. They're not quite there. But as I said, I look forward to happen in the second half. I look for everything to kind of move back. But it will be a new normal. I mean there will be a certain amount of people that will work from home, but things are moving back. So let me let Virgil because I'm real pleased of what Teresa and Virgil have done in terms of having an impact on sales. And I've been very pleased with persistency until this issue that just came up in the first quarter, and I know they'll address it and fix that problem too as we go forward. So go ahead, Virgil. You can start and then if Teresa wants to make comments, she can do whatever she wants, she's the boss.

Virgil Miller

Thank you so much, Dan. Yes. So let me give you anecdotal comments on going to support with some numbers. So one of our key focuses was to return to normal by driving our culture. So as Dan mentioned, we got back last year to a lot of the normal things we do. That includes like having sales meetings. We gather our top-producing sales agents, our veterans out there to make sure that they were informed a lot of strategies and kept that momentum going. They were very, very pleased to bring everybody back together. As well as our brokers, working with our broker/sales professional teams, which is when our company is out in the market and bringing in those broker partners, we still had our events where we sat around and [indiscernible] straight to them, make sure we're collecting their feedback and make sure we've got the right model to support the service levels they need going forward.

Having said that, you also mentioned about how things have changed about face-to-face and being able to support virtually. So I will tell you this, that we're able to provide the level of service, however, whether it's face-to-face, whether it's virtual, whether it's self-enrollment. I'll share a couple of numbers with you to support that. One back looking at pre-COVID 2019, 95% of our sales were face-to-face. As you saw the highlight of the pandemic in 2020, our face-to-face sales were at 80%. The rest of them were done in either during virtual enrollment, a hybrid type model or self-service. And now if I look at Q1, 85% of our sales are back to being face-to-face. So to sum that up, of course, we were more face-to-face pre-pandemic.

We saw a tremendous drop in that, and we were able to accompany still getting our products sold through other means. And now you can see that number face-to-face going back up. So I hope that helps. But overall, I can tell you there's a lot of momentum in the sales for us right now. I expect more of the same. The headwind we spoke about earlier that Fred mentioned was around recruiting. Again, recruiting was important, but we did adjust our model to reengage our veterans. Our average week of producers are up, our productivity is up across our lines and our conversions. We saw 11% increase in converting veterans who have been here more than 5 years in Q1. So as you can see, the confidence of my voice here, I'm feeling very good about where we're going to see in the remainder of the year.

Teresa Lynne White
President of Aflac US

Yes. And I'll just mention, we're just well positioned to address many of the headwinds that we were seeing in the environment, specifically due to our financial strength, our distribution model and our digital solutions. And so you hear the energy in Virgil's comments, and that's because there is a tremendous amount of momentum in our sales force today. And so we're going to ride that momentum, and we'll continue to address any issues that we see come up in the market.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

And then just in terms of progression of sales through the year, the last couple of years, obviously, have been off because of COVID. But prior to that, typically, your second quarter used to be higher in sales than the first quarter, and obviously, fourth quarter, you've got a lot of broker sales. Should we assume a similar pattern this year as well or is there something else that would affect the results?

Virgil Miller

Yes. So I'll see that the first quarter is certainly higher than we anticipated. And I think higher than most anticipated for us. So we are very pleased with that. We certainly will see the same seasonality definitely in the third and fourth quarters where you'll see the majority of our production. Again, we're looking to maintain this consistency in the second quarter, but I would tell you that the momentum -- and a lot of it has to do with the contributing factors we mentioned earlier, that will come from our buy-to-build. With our Premier Life and Absence Products and Disability, those products really is the selling season right now, early in the year, and those sales will come through in Q4. So the growth and the seasonality of the highest impact you'll see is definitely going to be. We'll look to maintain this consistent momentum from Q1 going into Q2. But again, I expect more on the third and fourth quarters.

Operator

Next question comes from Alex Scott of Goldman Sachs.

Alexander Scott
Goldman Sachs Group, Inc., Research Division

First one I had is on capital deployment. When I think about what you're saying on the economic hedge and how it's not just the GAAP EPS impact we got to think about here, it's also this economic hedge. I mean my understanding of that hedge is with the yen weakening, it would actually make your capital in Japan stronger. And just in general, I think the capital of the overall business stronger. And if that's the case, I think it will give you maybe GAAP EPS is short-term hurt, but then you have like more capital deployment opportunities as a result of that. Am I understanding that correct? And if I am, how -- what are your priorities for deploying that capital if the yen remains weaker and you have that flexibility?

Max Kristian Broden
Executive VP & CFO

Yes, Alex, I think that the way you sort of described it is a reasonable description of how our long-term hedging model actually works. Capital in Japan, obviously, is stronger with a weakening yen. And you know our SMR sensitivities. You can go back to our fab disclosures, and we give those sensitivities there so you can sort of calculate what the impact is on the capital position in Japan. And also, if you travel over to the holding company in this quarter alone because we issue debt denominated in yen, you saw our leverage drop 60 basis points simply because of the FX move in the first quarter. So that ultimately leads to a somewhat higher debt capacity over time. And then you should also expect that over time, as the $5 billion of forwards as they settle, they convert into cash. At the end of the first quarter, we had $3.6 billion of unencumbered cash at the holding company. And I use the term encumbered that's actually quite important in this context because it excludes any collateral receipt that we have.

And obviously, that will add to that pile of cash if the FX rate continues to be at this current level. We have forward that the settlements are spread out. There's no specific sort of tower that generally settle. We got some forward settle every month. So over time, this hedging program will then convert into cash. So short-term, you're going to see our EPS obviously get hit by it from the translation impact. But over time, it leads to deployment opportunities by lower leverage FX forwards converted into cash. And then also long-term, you have a higher capital position in Japan associated with the dollar portfolio that we have in Japan that strengthens the SMR in a scenario of weakening yen.

All these sort of balances out to some extent over the long-term. As it relates to deployment of additional capital, it follows the same criteria that we have for all deployments of capital, that we deploy where we see a good risk return based on an IRR basis.

Alexander Scott
Goldman Sachs Group, Inc., Research Division

And then maybe a little more of a housekeeping question. In corporate, how should we expect that to trend from here? I guess there's just a lot of moving parts because you have these offsetting derivatives that are sort of housed in corporate, I believe. So I mean, could you help us think through where the run rate of earnings for that segment would be or even how maybe if you can't do that, how to think about net investment income and corporate?

Max Kristian Broden
Executive VP & CFO

Yes. So first of all, the derivatives housed at the corporate level, the mark-to-marketing impact does not run through the GAAP EPS number, but the amortized hedge income does. And that's a fairly stable number. So if you look at the results for corporate this quarter, we're running a little bit high on expenses in the quarter and a little bit low on NII in the quarter. The NII was somewhat depressed by our tax credit investments that run as a negative through the NII line. But then obviously, you have a favorable offsetting impact on the tax credit line. As discussed earlier, we do have most of the assets at the holding company are floating rate in nature. So obviously, that means that as the short end of the yield curve now has increased and come up, you're going to see a little bit of a pickup in NII over time. So if you look at the results of this quarter, there's some puts and takes and a lot of moving parts. But generally, I think it's a decent run rate for the time being.

Operator

The next question comes from Tom Gallagher of Evercore ISI.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

First question, Fred, just to come back to the underlying benefit ratio in Japan, the 69.1%, I think, excluding the extraordinary IBNR releases. That's a little bit above the range that you've guided to. I think you explained why it happened, just elevated medical coated claims. Is it fair to expect that this is going to drop back down to within the range for the balance of the year as COVID cases go down?

Frederick John Crawford
President & COO

Yes. It's -- let me actually give you some perspective, if you don't mind, just over the last few quarters on incurred claims related to COVID because it will really illustrate what's going on with this most recent Omicron. If you go back to the first quarter of last year, our incurred claims were around JPY 800 million. In the second quarter, it picked up to about JPY 1.3 billion, obviously, very small numbers. In the third quarter, it picked up to JPY 2.3 billion, and that was actually the Delta peak. That was right when that Delta peak took place when we had claims coming in, then they dropped down in the fourth quarter to about JPY 100 million, so almost nonexistent. And then in the first quarter, JPY 8.3 billion.

And so what I think, if you're living and working in the U.S. and if you're following largely U.S. companies and economy, I think many don't realize just what a peak of Omicron we saw here in Japan, you're talking about case levels that we're running at around 100,000 a week, 2x, 3x at least the level of peak that what you saw during the Delta. Now fortunately, it's a very mild version of Omicron. And fortunately, vaccination rates, particularly among the elderly in Japan are very high. And so as a result, you haven't really seen hospitalization nor have you seen deaths pick up in Japan. But don't think for a moment that that's because things calm down. It's quite the opposite.

This is the most severe peak of infection rates, particularly in that February time period that Japan has seen throughout the entirety of the COVID environment. As a result, that's why you're seeing some of the face-to-face dynamics and what Dan mentioned about on again, off against states of emergency going on. Now the reason I pointed out the nature of our claims was that this deemed hospitalization issue. Essentially, the life insurance industry of Japan got together and agreed with the government to [pacify] the COVID-19 inversion -- variants of COVID-19 as an infectious disease. And when you do that, you're allowed to cover, if you will, you're allowed as a doctor to diagnose and allow for at-home treatment and cover the claims related to at-home.

The reason for that is Japan does not want infectious disease to cause hospital capacity issues. And so they allow more degrees of freedom as to where that care takes place. So we're seeing claims go up not because of the severity, but because of the sheer volume or frequency of cases and at-home treatment. We would expect that to [calm] down over time because we've seen cases come down, but there's a lagging effect. Right now in April and May, for example, we're seeing claims coming in that are likely related to 2, 3 months ago related peak levels. So we think that's probably going to continue, I would say into the second quarter, it's early.

We don't really know at the end of the day, what it may mean for the benefit ratio in the second quarter, but we should see COVID claims continue, but then calm down as the year goes on. And again, remember, while this is all going on, and you have lower activity levels, lower face-to-face. You're seeing other types of medical claims not come in. And so you don't necessarily see your benefit ratio moving in the wrong direction. It's just the mix of claims have shifted during this period of time. So it's quite interesting, and we've been busting down this data and looking at it very carefully. But you should expect claims in COVID to continue, I would say, into the second quarter given the lagging effect, but not necessarily be dramatic upward pressure on benefit ratio. I would not anticipate that.

Max Kristian Broden
Executive VP & CFO

And Tom, just to give you some more color on it. if you take the incurred impact from COVID in the quarter on a normalized benefit ratio was a little bit north of the 100 basis points. So if you take that and you isolate that component, that will take your normalized benefit ratio in the first quarter, smack in the middle of our range of 67% to 69%.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Got you. That's helpful, guys. My follow-up is with the recruiting numbers down so much in the U.S. on both career agents and brokers, and knowing there's a lag in terms of recruits converting into sales. But then taking that together with your comment about improvement in productivity gains based on some of those initiatives. What do you think that all -- if you add all that up, does to sales, if you look out, I don't know, 2, 3 quarters from now, do you think you can maintain the strong momentum you're seeing in the U.S. It sounded like from what Virgil said he thought so, but I'm just curious if you think, just given the severity of the drop in recruiting, whether you think that's going to start to impact your sales.

Daniel Paul Amos
Chairman & CEO

Well, if they don't, they won't make bonuses. So it's certainly going to impact them. But Virgil, you want to comment?

Virgil Miller

Yes, thank you, Dan. So if you look at the numbers, we still recruited over 10,000 career agents last year and over 5,000, close to 6,000 small brokers that we do business with. And when I talked about the focus -- well, the focus was converting on them, so think about it coming out of Q4 last year, which is the busiest time of the year, we put a lot of focus on getting those converted. And I'll tell you, we had a 70% increase in broker conversions in Q1. So that strategy is working. Now having said that, that's not to say that recruiting is important. It is a formula. You can add it up. You can look at the productivity, you can look at conversion rate and to tell you how many people we need to hit our numbers. Right now, we're solid because we are seeing, again, when those veterans come back and reengaged, the veterans produce at a higher rate. So I am -- I've read these numbers over and over. We are optimistic about how we're going to look. It's not to say that we're not going to still recruit.

So I can tell you right now, we've got some additional efforts going on in 2Q. And I look at it on a weekly basis. So if I look week over week back in March, seeing progress in the final few weeks in March, and that progress is translating over into April.

Frederick John Crawford
President & COO

One thing I would add, and Virgil can add color to it, but 1 column that you may be looking at in the recruiting is the recruited agents through brokers. And remember too some of our comments at year-end and this past quarter, we're focusing on driving sales now through small business brokers as well, which has not been historically a focused effort of our company. And as a result, you saw the recruiting level of broker agents go up dramatically in 2021, averaging over upwards of 1,200 to 1,500. Now what does that mean when you recruit a small business broker? What it means is you've appointed them and they have appointed you to be eligible to sell product through that broker. It doesn't mean you're selling product through that broker. And so one of the things that Virgil is talking about when he uses the term conversion, is that we're now working on those large amount of brokers that were signed up and appointed last year. We're now focusing on converting them into actually generating sales through their brokerage platform. So that's a big piece, and there's a lot of runway yet to go on that.

Operator

The next question comes from Ryan Krueger of KBW.

Ryan Joel Krueger
Keefe, Bruyette, & Woods, Inc., Research Division

I was just curious if you could give -- I know you can't give exact quantification, but if you could give any qualitative commentary on how much you think Japan Post could contribute as we begin more actively selling cancer products again. Maybe 1 metric you could help us think about it I think I believe Japan Post was about 1/3 of your cancer production prior to the misselling issue. If you could give any thoughts on what percentage of your cancer sales do you think they could build back up to?

Daniel Paul Amos
Chairman & CEO

Well, we can't go into any detail regarding Japan Post, they've always been. You know since the inception of Japan post, they have asked us to never go into detail. Basically, they stopped last year, and they have regained a position, but it's still very low. And all I can tell you is they have committed to us that they are dedicated to seeing a return to stronger production. And I'm expecting that. As you all know, they are large shareholders I feel like that's important. And the message that I've been saying is those 2 tie together with them. And so we will have to wait and see. But I'm encouraged about the production but I can't, at this particular time, give you any more detail other than to say we have a wonderful relationship. They know what we want, they want to help us. It's just the timing and how to do it. But there's no problem that I can tell you other than just getting it started again. There's absolutely nothing. They're happy with us, we're happy with them, but we want to see the production now.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to David Young for any closing remarks.

David Young

Thank you, Andrea, and I want to thank all of you for joining our call this morning. If you have any follow-up questions, I'd be happy to take them. Please contact me via e-mail or phone, and look forward to speaking to you all soon. Until then, take care.

Operator
The conference has now concluded. Thank you for attending today's presentation, and you may now disconnect.