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Market Intelligence

Aflac Incorporated NYSE:AFL

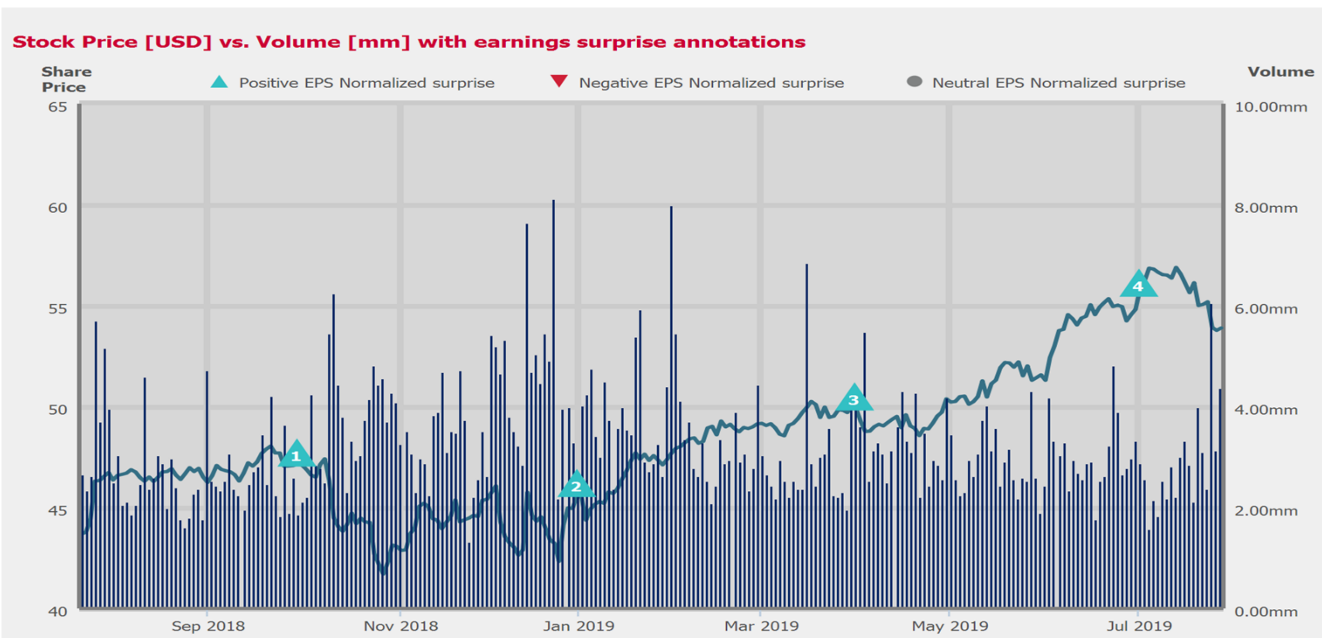
FQ2 2019 Earnings Call Transcripts

Friday, July 26, 2019 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2019-			-FQ3 2019-	-FY 2019-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	GUIDANCE
EPS Normalized	1.07	1.13	▲5.61	1.07	4.34	4.30
Revenue (mm)	5461.39	5511.00	▲0.91	5460.24	21808.90	-

Currency: USD
Consensus as of Jul-26-2019 1:12 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2018	0.99	1.03	▲ 4.04 %
FQ4 2018	0.94	1.02	▲ 8.51 %
FQ1 2019	1.06	1.12	▲ 5.66 %
FQ2 2019	1.07	1.13	▲ 5.61 %

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EXECUTIVES

Daniel Paul Amos
Chairman, President & CEO

David A. Young
Vice President of Investor & Rating Agency Relations

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Executive VP, Global Chief Investment Officer & President of Aflac Global Investments

Frederick John Crawford
Executive VP & CFO

Masatoshi Koide
President, Representative Director & COO of Aflac Japan

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Richard L. Williams
Executive VP & Chief Distribution Officer

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Evercore ISI Institutional Equities, Research Division

Presentation

Operator

Welcome to the Aflac's Second Quarter 2019 Earnings Conference Call. [Operator Instructions] Please be advised that this conference is being recorded. I would now like to turn the call over to Mr. David Young, Vice President of Aflac Investor and Rating Agency Relations.

David A. Young
Vice President of Investor & Rating Agency Relations

Thank you. Good morning, and welcome to our second quarter call. This morning, we will be hearing remarks from Dan Amos, Chairman and CEO of Aflac Incorporated, about the quarter as well as our operations in Japan and The United States. Then Fred Crawford, Executive Vice President and CFO of Aflac Incorporated will follow with more details about our financial results.

In addition, joining us this morning during the Q&A portion are members of our executive management team in the United States: Teresa White, President of Aflac U.S.; Eric Kirsch, Global Chief Investment Officer; Rich Williams, Chief Distribution Officer; Al Riggieri, Global Chief Risk Officer and Chief Actuary; and Max Broden, Deputy CFO and Treasurer. We are also joined by members of our executive management team in Tokyo 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; Koji Ariyoshi, Director and Head of Sales and Marketing.

Before we start, let me remind you that some statements in this teleconference are forward-looking within the meaning of federal security 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. The earnings release is available on the Investors page of Aflac's website at investors.aflac.com and includes reconciliations of certain non-GAAP measures.

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

Daniel Paul Amos
Chairman, President & CEO

Thank you, David. And good morning and thank you for joining us. Before I begin, I would like to briefly address news reports regarding sales practices at Japan Post Insurance. As CEO, let me start out by saying that we are not aware of any compliance issues related to the sale of Aflac's cancer insurance by Japan Post or Japan Post Insurance at this time nor have we found any issue today. Aflac has an extremely strong compliance culture in Japan and The United States. In Japan specifically, we have compliance processes in place with all of our alliance partners, including Japan Post.

I am fully committed to upholding the strong compliance culture as it is essential to maintaining the strength of our brand, reputation and franchise. Under our 2013 alliance agreement with Japan Post Group, the alliance Compliance Committee meets quarterly to review compliance trends and issues relating to cancer insurance sales within the postal's channel and take action as appropriate.

In addition, in response to this recent development, we are conducting a voluntary review of whether there are market conduct problems similar to those being reported regarding Japan Post Insurance products and the Japan Post channel. As I mentioned, at this time, we are not aware of any such problems related to the sale of Aflac cancer insurance by Japan Post or Japan Post Insurance, but we'll work closely with them to ensure that our strong compliance practices are upheld. Should we become aware of any practices that are inconsistent with our compliance standards, we will take the necessary action and steps to address it immediately. In the interim, we will continue to offer Aflac cancer insurance as part of our strategic alliance, and we do not believe that this impacts Japan Post Holdings investment in Aflac Incorporated stuff.

Now let me begin by talking about the second quarter of 2019, which rounded out a strong first half of the year for Aflac in terms of earnings, capital generation and financial strength. We are facing certain short-term headwinds on the sales front and the results are trending slightly below our expectations. I will touch on sales dynamics in a moment. But in terms of driving long-term value as we remain confident in hitting our important earned premium targets for the year.

Let me give you more details, starting with our Japan operations. Aflac Japan, our largest earnings contributor, generated strong financial results. Brad will provide more details. But let me just say that in the end terms, the results on adjusted basis were better than expected for the quarter, posting near-record pretax profit margins. As you know, we take a longer-term perspective when it comes to our business. Our focus remains on maintaining our leadership in the third sector insurance products that are less interest rate sensitive and have strong and stable margins. At the same time, we complement this core business with similarly profitable first sector protection products.

To that end, we will continue to refine our existing product portfolio and introduce innovative new products that our policyholders want and need. We are also continuing to fully engage a wide-reaching distribution network. Our traditional agencies have been and remain vital to our success as do our alliance partners. We continue to be Japan's #1 provider of cancer and medical insurance.

Consistent with our outlook comments in the first quarter, sales results in terms of year-over-year comparisons were heavily influenced by the successful launch of our breast cancer product in the second quarter of 2018. As a reminder, that was a quarter where we enjoyed a whopping 47% increase in cancer sales and a 16% increase in third sector sales.

In addition, the approach to refreshment of our medical product in 2019 takes a rider versus a whole policy approach. This is designed for improved economics that naturally results in lower reported sales. Recognizing this change in approach, we are pleased with the increase in medical sales as well as the overall cancer insurance and sales production in our associate channel.

Taking everything into consideration, we believe it's prudent to assume that there is a risk in achieving our 2019 guidance of the low- to mid-single-digit decline in the third sector and first sector product sales. However, we remain on track to hit our first sector protection and third sector earned premium growth of 1% to 2% increase for 2019.

Turning to Aflac U.S. We are pleased with the financial performance. The pretax profit margin exceeded our expectations both for the quarter and for the first half of the year, which is significant because these results also reflect ongoing investments in our platform, distribution and customer experience. With respect to Aflac U.S. sales, our broker strategies have paid off, and that business continues to grow bolstered by healthy pipeline of business. We have also been encouraged by the progress on the direct-to-consumer platform and associates alliance, which are still in the early stage.

Our main challenge within our career distribution is recruiting and retaining associates and then translating into average weekly producers. As you know, recruiting commissioned-only associates in a strong economy has always been a headwind. Setting aside economic conditions, there are also a couple of tactical issues that have impacted sales results in the first half of 2019, yet we believe are positive for the long-term and profitable earned premium growth.

These tactical issues have resulted in essentially flat sales year-to-date, which makes it harder to reach the low end of the guidance range. To put this in perspective and despite these headwinds, we still anticipate marginal growth over last year's record level of sales. Ultimately, we seek to grow profitable earned premium and continue to anticipate achieving a 2% to 3% earned premium growth target in 2019.

Looking to the long term, as you may have seen, a few weeks ago, when we announced an agreement to acquire Argus Dental & Vision, Argus is a high-quality respected provider of turnkey administrative services supporting Medicare Advantage and Medicaid Network Dental and Vision products on behalf of large health care providers. This is very important strategic move for Aflac U.S. and that it provides a platform to build Aflac's network dental and vision products. And most importantly, it places our naming on the front page of the benefit enrollment process.

Along with supporting the growth of Argus administrative franchise, we see Argus as providing Aflac with an opportunity for greater penetration into the approximately 460,000 businesses we currently serve. We also believe it opens the door to new clients that respect our brand and strong customer service model. We expect our dental and vision strategy will serve to improve recruiting and retention of agents and drives sales growth through broker and direct to consumer.

Argus announcement is consistent with our approach to balancing our financial strength with reinvesting in our business, increasing the dividend and repurchasing shares.

While Aflac has been more than an organic growth story, we recognize that prudent investment is critical to our growth strategy and driving efficiencies that will impact the bottom line for the long term. With this in mind, we look for opportunities to accelerate growth through measured bolt-on transactions that build upon our core competency of supplemental insurance and leverage our brand and distribution strengths without requiring extensive amounts of capital. At the same time, we remain committed to maintaining strong capital ratios on behalf of the bondholder, the shareholder and the policyholder.

Finally, this does not impact our plan to repurchase in the range of $1.3 billion to $1.7 billion of our shares in 2019, with this range allowing us to be more tactical. This gives you an overview of the quarter and the first 6 months of the year. As you can see, we remain focused on the initiatives designed to drive growth both in the U.S. and in Japan.

Looking ahead, we believe our strong earnings growth will reflect the underlying earnings power of our insurance operations in Japan and The United States. It will also reflect our prudent approach to deploying excess capital in a way that balances the interest of all stakeholders. As always, we are working very hard to achieve our earnings per share objective, while also ensuring we deliver our promise to the policyholders.

I'll conclude by saying that I continue to be excited about Aflac's future growth. Now I'll turn the program over to Fred to cover the financial results. Fred?

Frederick John Crawford
Executive VP & CFO

Thank you, Dan. Results for the second quarter extended our strong start to the year on the earnings front, exceeding our forecasted expectations. Adjusted earnings per share of $1.13 represent a 5.6% increase over the 2018 quarter. Earnings benefited from continued strong margins both in Japan and in the U.S. Our reported results were modestly impacted by weakening of the yen as compared to the 2018 period, reducing our earnings by $0.01 per share in the quarter.

With respect to adjusted earnings, we are gradually building an alternative investment portfolio, which includes private equity and real estate equity investments. On a consolidated basis, we have committed $1.3 billion to our alternative investment portfolio. Of this amount, approximately $460 million has actually been called and invested to date. In the quarter, variable investment income generated from this building portfolio contributed approximately $0.01 to adjusted earnings per share when compared to our expectations.

Turning to our Japan segment. Earned premium for our first quarter protection type and third sector products increased 1.7% and in line with expectations. As noted in my first quarter comments, a portion of our medical sales in 2017 was a newly introduced 2-pay product, which will modestly impact third sector earned premium turns. Again, it's important to note that earned premium strain from paid-up policies does not impact profitability.

Our total benefit ratio came in at 68.9% and slightly below our annual guidance range. We continue to enjoy favorable third sector benefit ratios and associated reserve adjustments as well as the continued shift in business mix from our first sector towards third sector, which carries a lower benefit ratio. Our expense ratio in Japan was 20.5%, consistent with our projected range. We expect our expense ratio will rise in the second half of the year, as we accelerate product development expenses readying for 2020, along with natural timing of sales and marketing spend.

Net investment income in our Japan segment contributed to our strong results. As mentioned earlier, variable investment income contributed, along with build in our floating-rate loan portfolio. The low rate environment is certainly a headwind in terms of new money rates. Recognizing market expectations for a Fed rate cut, it's important to recall that we have locked in approximately 75% of Japan's floating rate income and 90% of our hedge cost for 2019. Thus, we anticipate very little impact to investment income. Overall, in Japan, we recorded a very strong pretax profit margin of 21.9%, consistent with our first quarter results and coming in higher than our forecasted range.

Turning to the U.S. results. Despite weakness in year-to-date sales, earned premium was up a steady 2.3%. Our total benefit ratio came in at 50.2% and at the lower end of our annual guidance range and generally consistent with recent claims trends in our mix of business. Our expense ratio in the U.S. was 34.8%. While higher than 2018 levels, year-to-date, our expense ratio was traveling at the lower end of our 2019 outlook range of 35% to 37%. This favorable year-to-date results are attributed to timing issues and the pace of investment in our distribution platform, promotional spend and investment in digital initiatives. Much like Japan, we expect our expense ratio to increase throughout the remainder of the year.

Net investment income in the U.S. is running a bit ahead of our plan, due in part to modest increase in allocation to corporates and variable investment income. Note also that we start pulling excess capital out of the U.S. in the second half of the year, which has an impact on segment investment income. Overall, in the U.S., we recorded a strong pretax profit margin of 20.6%, consistent with our first quarter results and at the high end of our forecasted range.

In our corporate segment, the main driver of improved earnings year-over-year is the amortized hedge income driven by our corporate hedging program. The program reduces our economic exposure to the yen while lowering enterprise-wide hedge cost. Amortized hedge income contributed $20 million on the pretax basis to the quarter's earnings with a notional position at the end of the quarter of $3 billion.

Turning to capital. Japan's solvency margin ratio has increased with the drop in rates, now exceeding 1,000%. If you remove the impact of unrealized gains and losses on available-for-sale securities, our SMR ratio stands at roughly 900%. Our estimated U.S. risk-based capital ratio at quarter end is in the 700% range. RBC is a bit elevated as we have planned increases in operating dividends and the drawdown of $500 million of excess capital scheduled for later this year. We continue to target an RBC ratio of 500% for year-end 2019.

We ended the quarter with approximately $2 billion of capital and liquidity at the holding company. This is a bit reduced from traditional levels, but simply due to timing, with material subsidiary dividends paid in the second half of the year. Asset quality remains strong with very little in the way of impairments. In the quarter, we repurchased 6.9 million shares of Aflac common stock for approximately $357 million. We are maintaining our current range for repurchase of $1.3 billion to $1.7 billion in 2019.

I'd like to follow-up on Dan's comments and make a few brief remarks on our definitive agreement to acquire Argus Dental & Vision. The transaction represents a commitment of $75 million in capital at closing and an additional $21 million in consideration paid over 3 years based on achieving certain performance targets. As noted in our announcement, we do not see the transaction impacting 2019 financial guidance for Aflac U.S., and there is no material impact to our capital deployment plans. We anticipate only a modest impact in 2020 results as it will be a natural integration and building year. The transaction is subject to regulatory approval and other closing conditions, and we expect to close in the fourth quarter.

Stepping back, the Argus announcement is consistent with our broader approach to tactical M&A. We seek to acquire respected platforms with knowledgeable executive teams for a measured amount of capital at risk. In this case, our return on investment is driven by continued growth in the administrative services business of Argus, the build of profitable Aflac network dental and vision premium and the indirect benefit of further lift in our overall supplemental worksite franchise.

In terms of our annual EPS outlook for the year, we are guiding to the high end of our currency neutral range of $4.10 to $4.30 per share. We are certainly tracking year-to-date at a pace that exceeds the range. However, we are only halfway through 2019. And as mentioned, timing of expenses has contributed to our year-to-date results, and we have important growth and platform investments scheduled in the second half of the year.

In closing, the second quarter represents a continuation of our strong earnings and margins, both in Japan and the U.S. Capital generation remains robust. And our Argus announcement represents a sound tactical move to drive growth in the U.S.

I'll now hand the call back to David to begin our Q&A session. David?

David A. Young
Vice President of Investor & Rating Agency Relations
Thank you, Fred. Now we are ready to take your questions. [Operator Instructions] We will now take the first question. Operator?

Question and Answer

Operator

[Operator Instructions] Our first question is from the line of Jimmy Bhullar of JPMorgan.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

So I had a question on sales and specifically first on U.S. sales. Teresa, if you could talk about what drove the weakness this quarter? And I think you haven't had weak -- negative sales in the U.S. for several years. And are you still confident in results improving and you being able to achieve sales close to, I think, previously you said they'd be stable for the year versus 2018?

Teresa Lynne White
President of Aflac US

Jimmy, I'll let Rich speak to the sales question. I'll just make a strategic comment. One of the things that we're really focusing on is earned premium growth. And some of the tactical things that Rich will talk about, some of the decisions that we made have impacted the sales side from an earned premium growth -- profitable earned premium growth perspective. So I'll let Rich speak specifically to the sales.

Richard L. Williams
Executive VP & Chief Distribution Officer

Thank you, Teresa. As Dan had mentioned, there were couple of tactical issues that created some headwinds in the quarter alone that we actually believe will be long-term favorable for sales and for earned premium growth. The first issue that we speak to, which occurs from time to time is simply large case volatility, and this also can create a little bit of noise and persistency, but we are actually comfortable with those decisions and confident it's favorable to the company.

Second, we consistently evaluate our partnerships to ensure they are profitable. And in the quarter, we made a decision to no longer move forward with a particular partnership, which impacts sales in the short term, but in terms of profitable earned premium growth will actually be positive to the company. And then, I think, the third part of your question, again, Dan alluded to the fact they were essentially flat year-to-date. We realized it would take a favorable second half of the year. We performed like that in prior years, but we know it'll take a good finish to the second half of the year, which is why I think Dan mentioned we anticipate seeing growth for the year. We'll leave it at that.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

Okay. And if I could just ask one more on Japan sales, have you seen any impact from -- on your sales via the Post because of all the commotion and sort of publicity about sales practices at the Post? And do you feel that this could affect sort of the long -- the Post and sales via the channel longer term, even though it's not related directly to your sales?

Daniel Paul Amos
Chairman, President & CEO

I'll start with that and then if Japan wants to step in, they can say something. But what I would say is, is our projection is, as anytime something of this magnitude is brought up with -- in this particular case Japan Post, it's taken everyone's attention over there. And so with that means there's less attention on sales. So I do -- we do expect some impact. We're in July. So we don't have numbers that we know that are representative of what the quarter will turn out to be. So it's too hard to tell. But certainly, in my earlier comments, we are expecting some softness, and we'll just have to watch it and see. And accordingly, we'll -- the one thing I will say is we're having a better than what we had anticipated with our existing distribution channel. So they are doing quite well. So we will continue to push there as well, and then we'll just take it and see what happens.

Operator

Next question is from the line of Humphrey Lee of Dowling & Partners.

Humphrey Lee
Dowling & Partners Securities, LLC

A question for Teresa about Argus. Can you talk about your expectation for the integration and the rollout of Aflac-branded network products? I think one of the main key appeal for the Argus acquisition is to move into the network's dental products as opposed to the indemnity products that you offer. So maybe you can talk about some of the opportunities that you see and kind of where you see the sales can get to?

Teresa Lynne White
President of Aflac US

So I'll start out. And Rich Williams, I have to give him credit. This is one of the properties that he brought on to the Aflac platform. One of the things that really we feel good about, as it relates to Argus, is that it will accelerate our earned premium growth beginning 2020, and we believe that, and places Aflac on the first page of the benefits enrollment. We believe that that's good for us from an access standpoint, but we also feel that it will be great from a persistency perspective as well. Specifically to the tactical pieces and the integration, I'll let Rich speak to that. Rich?

Richard L. Williams
Executive VP & Chief Distribution Officer

All right. Thank you, Teresa, and I'll just echo your comments. Obviously, the demand for network dental and vision continues to be very high. It is very consistent with our growth strategy in accessing all the markets that we know we want to serve. And it actually allows us to reach through all 3 of the distribution approaches that Dan mentioned our career agents, our brokers and direct-to-consumer. Again, just echoing the comments, I think, Fred mentioned it, we will in 2020 will have a measured rollout. And then in 2021, going forward, we'll have a national rollout, and we're very excited about this.

Daniel Paul Amos
Chairman, President & CEO

The one thing I would note is, this dental and vision is predominantly for small- to medium-size accounts. The large accounts are much more aggressive and less profitable, and so we see this -- it's that correct space...

Teresa Lynne White
President of Aflac US

We say it as a primary play. It's a small business, and that's where we see the greatest need. However, because of the Aflac brand and our partnerships with larger businesses, our larger brokers houses, we see an opportunity there as well.

Humphrey Lee
Dowling & Partners Securities, LLC

So just looking at dental and vision sales right now, they're kind of probably running a little less than $80 million a year or so. Do you expect that to kind of maybe becoming multiples of that kind of in a few years? How should we think about the sales growth trajectory?

Richard L. Williams
Executive VP & Chief Distribution Officer

So obviously, we have projections that we've looked at over the long term for the network dental and vision. And I think what we would like to do is lay it out in more detail the entire business plan at the Financial Analyst Briefing in September.

Operator

Next question is from the line of Andrew Kligerman of Crédit Suisse.

Andrew Scott Kligerman
Crédit Suisse AG, Research Division

Great. First question just back to Japan Post. It was my sense that you were considering rolling out a new medical product in the second half of the year. I'm assuming that's probably on hold. And any color around that?

Frederick John Crawford
Executive VP & CFO

Well, let me make sure that you understand the record -- and this is Fred. There's been no announcement or official plan to roll out any medical or additional third sector product within the Japan Post system. What is true is that one of the pillars of the alliance is to explore product extension, and it's only natural that it would likely involve -- to the degree we rollout additional product, it would likely involve third sector products. I wouldn't be as specific as to say medical products per se. But those discussions are under development. As we've said before, this year, 2019, is much more of a building out plans and looking for those opportunities that makes sense.

What I'd also say is that it is very important. It's always been very important that when we think about product, any new product in the Japan Post system that there's really 3 parties involved. Obviously, Aflac and obviously the Japan Post postal system where we currently distribute cancer product. But we also are mindful of Japan Post Insurance and the type of product development activities they have underway. And so it's really the 3 parties that need to come together and understand those dynamics when it comes to expanded product. But right now, there really are no official plans that are prepared for any type of announcement. It's really more a planning year on that front.

Daniel Paul Amos
Chairman, President & CEO

Ariyoshi or Koji, would you -- I mean, Koide, would you like to make any comment?

Masatoshi Koide
President, Representative Director & COO of Aflac Japan

This is Koide from Aflac Japan. Fred's comment is completely right.

Andrew Scott Kligerman
Crédit Suisse AG, Research Division

Okay. Should I follow up with the second question?

David A. Young
Vice President of Investor & Rating Agency Relations

Go ahead, please.

Andrew Scott Kligerman
Crédit Suisse AG, Research Division

Okay. So the Japan benefits ratio was superb at 68.9% versus your guided 69% to 71% for the year, and it was clearly led by the third sector products. Do you think this is the new normal? Can we expect to see either low end or even below low end of that guidance that you had laid out?

Frederick John Crawford

Executive VP & CFO

I think one thing is for sure is that, the benefit ratio thus far year-to-date in Japan is traveling at the low end of our expected range. It is based on fundamentals in terms of the claims dynamics and associated reserve adjustments. Interesting, last year, you may recall the benefit ratio was somewhat brought down by lapse in reissue activity where you'd see naturally a lower benefit ratio and a higher expense ratio, as you release reserves on products and then write down DAC, et cetera. So you had a number of moving parts that were influencing ratios last year. So I think there is some stability in that favorable level of benefit ratios. I think you have to be careful because claims activity can move around. But given the size of our product set and the amount of in-force we have, they tend to be fairly stable.

One thing I would note though is you have really more of an influence from mix than you do download trends in third sector benefit ratio. If you look at third sector benefit ratio over the years, over the last 2, 3 years, you've certainly seen that downward pressure and that's helping results. And I would say, it's stabilizing around the current levels. But what you see in terms of our reported benefit ratios on a consolidated basis is largely attributed to the mix shift from first sector to third sector. But the answer to your question, Andrew, is yes, there's nothing that tells us that we would see certainly any deterioration. Material improvement, I think that's a bit speculative at this point, but it's certainly favorable.

Operator

Next question is from the line of Alex Scott of Goldman Sachs.

Taylor Alexander Scott
Goldman Sachs Group Inc., Research Division

First question I had also on Japan Post. I just wanted to revisit it because I guess when I look at what Japan Post disclosed, I mean it sounded like a fair amount of the concern was specifically around lapse and reissue. And I know that you guys have had a fair amount of lapse and reissue in the couple of years as you've expanded into additional Japan Post offices. So I guess what gives you comfort that the lapse and reissue activity that you saw is somehow different from the lapse and reissue activity that Japan Post is concerned about?

Frederick John Crawford
Executive VP & CFO

I'll start. This is Fred. I'll start by answering and then certainly welcome any commentary from our Japan colleagues. But let me start by saying that it's very difficult for us to make any assumptions around what the dynamics are as it relates to lapse and replacement or any sort of redundancy of policy dynamics that are being investigated on the Japan Post and Japan Post Insurance side. So I don't want to speculate on the nature of those products other than to say it's very different than a cancer product.

In the case of our cancer products, remember, a great portion, if not all of the lapse and reissue activity, is really related to the fact that it is a greatly improved product. When you go 4 years between the improvement of an old cancer product and a new cancer product, you're talking about fairly substantial advancements in the quality of coverage because there's been substantial advancements in the quality of care treatment that has developed in the cancer space. The other dynamic that we added this year is we have a rider feature on the cancer product that allows for a premium waiver feature while you're on claim, and that was new and also very attractive to the client.

And when you do a lapse, and so for starters, there's really strong dynamics around the improvement for the client to move into a new cancer product. Now when you do, do a lapse and reissue, one of the things that you have to be very careful about is we're reunderwriting the individual, okay? So there's a new underwriting process. And our policies have essentiality a delay, if you will, coverage doesn't kick in for about 3 months or so. That's a natural feature of cancer products. So when you buy the cancer product, you go for a period, a wait period, so to speak, of about 3 months.

And one of the things that we're very, very careful about in our compliance standards and it's all with the customer focus is we do not want any of our customers to go through any period of time where they have inadvertently gone naked on coverage or have no coverage, particularly with something that can be a severe and impactful as cancer diagnosis. So we take great strides to ensure that there is that level of consistency and coverage throughout, and that naturally will have a bit of an overlapping period for lapse and reissue, but it's in the spirit of protecting the client.

So I just want to make sure you understand. It's a very different product dynamic. It requires a different type of attention to compliance to look out for the customers' interest, and that makes it a very different dynamic than what we understand to be the situation in the broader level of investigation in products.

Daniel Paul Amos
Chairman, President & CEO

Any comments, Koide.

Masatoshi Koide
President, Representative Director & COO of Aflac Japan

We do not have any additional comments.

Daniel Paul Amos
Chairman, President & CEO

Okay.

Taylor Alexander Scott
Goldman Sachs Group Inc., Research Division

So maybe my follow-up, just switching over, I guess, to reserves, rate assumptions, I mean can you comment at all on sort of what you guys assume in terms of ultimate rate assumptions? And I know a lot of your products dissects these. So I think there's plenty of margin there. I wouldn't expect any kind of impact as we go through actuarial review process, et cetera. But any impact on DAC or anything else we should be thinking about as we kind of head into that?

Frederick John Crawford
Executive VP & CFO

No. I would say, in general, our products, particularly as it relates to reserve adequacy and reserve reviews are not very sensitive to rate estimates. You will naturally -- if you are resetting your long-term rate assumptions in your gross premium valuation work, you will naturally see that as a net negative to the margins you have. But it's so overwhelmed by morbidity margin that we have in our products that it tends simply not to be a mover. We disclose, as you know, our gross premium valuation margins. And I've said this to my team here coming from companies that are in the retirement space, the type of GPV margins we have on our actuarial analysis, I've never seen before in my career. So you have very large actuarial margins up into the mid-teens and higher, and that's driven by morbidity.

So even when you take a downdraft of margin compression related to low prolonged interest rates, we just simply have a comfortable position. It's not true across all product categories. Certainly, first sector more savings oriented products can be a bit more pressured, but they're, again, because of our investment strategies backing those products, we have healthy margins. So I don't have any concern on that front. But it is, of course, is a headwind to net investment income. That's really more on earnings and GAAP issue, but it's certainly not keeping me awake on the reserve front.

Operator

Next question is from the line of Ryan Krueger of KBW.

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

One more question on the Japan Post. They announced that they're going -- they plan to eliminate sales targets. Does that also apply to their sale of Aflac's products or just their own?

Daniel Paul Amos
Chairman, President & CEO

Koide, take that, please?

Masatoshi Koide
President, Representative Director & COO of Aflac Japan

Yes. We agreed with Japan Post that our sales targets will continue.

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

Okay. So they will continue to have them for your product. And then, Fred, on short-term interest rates, I know you mentioned there wouldn't be much impact in 2019. As you move into 2020, how would you expect impact from the floaters relative to hedging costs to come through? Should they mostly offset or would you see some impact?

Frederick John Crawford
Executive VP & CFO

Yes, you have it right. Because we have hedged the majority, if not all of our floating rate portfolio in Japan, as you roll off the locked in LIBOR rates and the locked-in hedge costs and you roll into 2020, all things held equal, you end up rolling into, yes, lower LIBOR rates but also lower associated hedge cost. And therefore, the net effect of those issues on net investment income end up being muted.

Now there can be some dislocation in the market between hedge costs coming down and LIBOR rates coming down. It tends to generally be a rule of thumb that they're aligned and correlated, but there can be dislocation. But absent any sort of minor dislocation, we think net investment income is somewhat protected because of the just the nature of the fact that we have a hedge dynamic on the floating rate instruments.

Operator

Next question is from the line of Erik Bass of Autonomous Research.

Erik James Bass
Autonomous Research LLP

Maybe a follow-up on that line on just the investment income. And Eric, if you could comment about where you're investing new money? And if there's any change sort of strategically in terms of where you're investing? And if the kind of the floating rate portfolio still makes the most sense and is getting attractive yields at this point?

Eric Mark Kirsch
Executive VP, Global Chief Investment Officer & President of Aflac Global Investments

Sure thing. Our investment plan and where we're investing is consistent with our investment plans. No major left or right turns. And it's also consistent with the strategic asset allocation work that we do with the portfolio. On the margin, as you're looking forward, there is a point or 2 of additional U.S. dollar investing relative to yen investing, but that's consistent with our long-term plans.

Within the U.S. allocation, the floaters continue to be attractive for us. But I would emphasize, our criteria is strong, strong underwriting. It is equally why we like the asset class because we get preferred terms and conditions. But even within those asset classes of middle-market loans and transitional real estate, we see some spread compression because they're attractive in the market. But when I compare those to, say, investment-grade corporates where we have a healthy portfolio and spreads are so tight, we still like the relative value of loans.

And one other aspect that I'll mention. As you look at our new money investments, particularly for the loan portfolio, which are typically 3 to 5 to 7 years in maturity, a number of those loans has a natural prepayment. Some business plans end up getting completed sooner. Some projects just want to get refinanced. So some of the new investments are simply rolling over from prepayments and finding new loans to replace those. So that's at a high level some of the things we're seeing and where we're investing.

Erik James Bass
Autonomous Research LLP

And then one follow-up on the dental acquisition. Just thinking more strategically, I mean, how do you see having that capability changing your competitive position? And does it open doors with either new brokers or new employers that you haven't been able to access historically?

Frederick John Crawford
Executive VP & CFO

I think yes is certainly the first answer. Dan mentioned in his comments with our existing client base of 460,000 businesses, that's a great opportunity for cross-sell. But we also know, as Teresa alluded to us getting in the first page the benefits menu that this is going to open new accounts for us especially in that small business marketplace, which also has the halo effect on additional voluntary and supplemental sales.

Daniel Paul Amos
Chairman, President & CEO

The one thing in respect to Japan -- I mean to U.S. group business was we were overwhelmed with the business when we first took it on. And Teresa is making absolutely sure that, that doesn't happen in this case because we went backwards, before we took one step back -- we took 2 steps forward. Teresa wants to make sure we take 2 steps forward. So we're rolling this out in a more effective manner, and so that's going to be very important. But everyone is excited about the potential for what it can do long term. Not -- certainly not this year and not even next year because we're just rolling this out...

Teresa Lynne White
President of Aflac US

We have a limited rollout in 20...

Daniel Paul Amos
Chairman, President & CEO

2021 is the year.

Teresa Lynne White
President of Aflac US

2021 is the year. Absolutely.

Operator

Next question is from the line of John Barnidge of Sandler O'Neill.

John Bakewell Barnidge
Sandler O'Neill + Partners, L.P., Research Division

My questions on U.S. persistency. The last couple of years ticked up in 2Q sequentially, but this year ticked down. I understand it's modest. But is there any color whether related to the partnership that you stopped dealing what that drove it?

Teresa Lynne White
President of Aflac US

The answer is yes. Consistent with Dan's remark, we knew we were going to have a little bit of noise as it relates to persistency as we've started looking at some of partnerships. And again, the goal is generating high-quality sales with good persistency. And so we're really trying to drive the earned premium -- profitable earned premium growth perspective. So you've got it [out in life].

John Bakewell Barnidge
Sandler O'Neill + Partners, L.P., Research Division

Okay. My follow-up question sticking with the U.S. and that acquisition. I know getting on the first page is really important. I know the penetration of supplemental insurance products in the U.S. is much lower than it is in Japan. Have you thought through like kind of where you think persistency could go in the intermediate and long term because of now having a broader dental and vision and first-page product for the broader suite of products that you have?

Frederick John Crawford
Executive VP & CFO

So a couple of things. First of all, network dental and vision does have an element of employer paid. And so consequently, the persistency is certainly higher than we see on our supplemental products. So that's favorable. But we also know that as they value the network dental and vision product, that can have a halo effect on our sort of our core supplemental benefits. It's also a different wallet, so that's another thing that we're excited about. So less likely for cannibalization of our core supplemental benefit sales. So the combination of those things is what gives us optimism.

Operator

Next question is from the line of Suneet Kamath of Citi.

Suneet Laxman L. Kamath
Citigroup Inc, Research Division

Back to Japan Post, if I could. Dan, can you help us -- I know it's early days, but can you help us maybe frame the size of this issue in terms of the impact on consumers? I mean, if we go back little over 10 years...

Daniel Paul Amos
Chairman, President & CEO

I can't hear you. It's not...

Suneet Laxman L. Kamath
Citigroup Inc, Research Division

Can you hear me now?

Daniel Paul Amos
Chairman, President & CEO

Yes, I can.

Suneet Laxman L. Kamath
Citigroup Inc, Research Division

Perfect. Sorry about that. So what I was trying to get at is if you could help us frame the size of this Japan Post issue, given I acknowledge that it's early days. We went through that whole claims payment issue little over 10 years ago, and I just want to get a sense of what it's doing in the competitive dynamics or the consumer in Japan to the extent you can comment?

Daniel Paul Amos
Chairman, President & CEO

I wish I knew. I don't know. We don't think it's going to be tremendous, and we certainly don't think it's long term because we believe Japan Post will fix whatever problems they've got as soon and as quickly as they can. I can give you more color on it at the end of the next quarter. But I've got to get a quarter under our belt to see. We never had an issue like this where another distribution channel has had a situation like this.

And frankly, we don't know all the inner workings nor should we expect to know what's going on with Japan Post. We do know that they're continuing to sell our product, and we know that consumers want and need cancer insurance and will be buying it, and it's a top line issue in Japan to make sure they are covered. So other than that, I really do not know. But the claims review was an industry issue not specific to one insurer. So other than that, that's my only comment.

Suneet Laxman L. Kamath
Citigroup Inc, Research Division

Okay. That's fair. And I guess...

Masatoshi Koide
President, Representative Director & COO of Aflac Japan

This is Koide from Aflac Japan. Let me explain supplementally in Japanese.

[Interpreted] Well, what is actually happening in Japan and the issues faced in Japan is related to Japan Post, but particularly the Japan Post Insurance product. So it's not insurance industry overall issue as we had with the claims issue before. That's it.

Suneet Laxman L. Kamath
Citigroup Inc, Research Division

That's helpful. And my follow-up is, we have been reading in the press, and I don't know if this is true, but a couple of the other product providers to Japan Post have suspended sales in that channel. Is that what you're hearing as well? And is that something that you considered?

Daniel Paul Amos
Chairman, President & CEO

No. We did not consider suspending sales. We are licensed in 20-something thousand different post offices. I think other insurers are in much smaller amounts. And we feel our products are too important to suspend with no issue out there concerning us. So absolutely not.

Masatoshi Koide
President, Representative Director & COO of Aflac Japan

This is Koide again. Let me explain in Japanese.

[Interpreted] Japan Post and Japan Post Insurance have announced the discontinuance of sales of product of just Japan Post Insurance's. They have not formally announced to not sell products other than their own, including Aflac and other insurers or other providers. That's all from me.

Operator

Next question is from the line of John Nadel of UBS.

John Matthew Nadel
UBS Investment Bank, Research Division

I may have one on Japan and one on the U.S. You reiterated the 1% to 2% growth target for net earned premium in Japan. But in the first half of the year, I believe if I got the numbers right, you're down almost 1% year-over-year. What gets you there in the back half of the year?

Frederick John Crawford
Executive VP & CFO

John, just a clarification. The 1% to 2% increase is really third sector and first sector protection earned premium. What you see in the way of a broader decline in overall premium is really related to predominantly first sector, which by design is coming down in premium. So really our guidance is again specific to third sector and first sector protection premium.

John Matthew Nadel
UBS Investment Bank, Research Division

Got you. Okay. And so where are you tracking on that particular owning through the first half of the year then?

Frederick John Crawford
Executive VP & CFO

Right on. We had an increase of 1.7%, and so right on our guidance. As I mentioned, John, something to make sure to understand is that, the only reason why it's a tick below 2%, which was our original outlook is simply because we've had to account for the recognition of paid-up policies actually on the third sector side. We issued a medical policy that became very popular in the bank channel back 2 years ago in 2017. And so we're seeing some of those paid-up policies come through. But realize that's really a paid-up issue. So it has no implications for profitability and it'll work its way through the system.

John Matthew Nadel
UBS Investment Bank, Research Division

Got you. Okay. And then a question on U.S. on the sales side. Teresa, any chance you can help us understand this distributor that you guys have sort of canceled working through? What sort of contribution to your 2018 sales that single distributor accounted for?

Teresa Lynne White
President of Aflac US

So what we're really doing is we're assessing all of our contracts. Some of them are distributors; some of them are accounts, just the type of accounts that we sell. But at the end of the day, what we're looking at is the overall persistency of the book of business that we have. And with that, we're making assessments to say whether those folks make sense for us, whether those distributors that sell in specific areas make sense for us, and we're making those decisions. Now as to the timing, I'm looking at the full year and making those assessments. And we believe, I think, our persistency is a 12-month rolling persistency. So we see it as working itself out in 2020.

Operator

Our last question is from the line of Thomas Gallagher of Evercore.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Dan, just a few follow-ups on the Japan Post situation. So just curious, when did Aflac begin its review of the situation? And when would you expect to complete it? And then just a related question. I assume this is going to be probably a longer review by the regulators of Japan Post itself. If it does take a while, was that going to delay its intention to purchase the 7% stake in Aflac at all? Does that come into play? I know you commented a little bit on that before and you didn't think it would impact it, but just from a timing standpoint, would that potentially impact it?

Frederick John Crawford
Executive VP & CFO

So first regarding the acquiring of the stock, we have no indication. And maybe Max why don't you remind everybody of -- Max negotiated that deal together with myself and folks in Japan. So just again remind investors of the agreement related to buying stock.

Max Kristian Broden
Senior VP, Deputy CFO & Treasurer

Yes. So Japan Post has -- they began -- they announced to the market that they began purchasing our stock in May and they have a 12-month period to purchase our stake in Aflac Incorporated. They will make an announcement to -- through the -- through an SEC registration when they reach 5%. And after that, they will also make announcements as they have another 1% increments. To date, we have no indication of them changing their view in terms of buying Aflac stock. So that's all I would say about that.

Daniel Paul Amos
Chairman, President & CEO

Okay. And what was your first part of the question?

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Dan, the first part of the question is, when did Aflac begin its review of the sales practices? And when would you expect to complete your -- that review? Do you think it will be done by the time you report 3Q?

Daniel Paul Amos
Chairman, President & CEO

Well, let me point out that the quarterly, the alliance compliance committee meets to discuss any issues, and they've been doing it since 2013. So from that standpoint, it's always been -- and it doesn't just cover compliance issues. They also relate to just cancer sales and what's going on in that regard. But as far as our review, we're just continuing to ask more questions and we will cover in greater detail at the FAB. But right now, we don't have any drop-dead dates. We're just monitoring what's taking place because again we've had not a single complaint about it. And so from that standpoint, we're just going out and making sure that we're not seeing any other things. But at this time, we just don't see it as a problem and are moving on by selling our products with that distribution channel.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Got it. So you're not -- you're actually not doing a formal investigation or review. You're more monitoring the situation. Is that a fair way to describe it?

Masatoshi Koide
President, Representative Director & COO of Aflac Japan

Let me make supplement comment on Aflac Japan.

Daniel Paul Amos
Chairman, President & CEO

Go on.

Masatoshi Koide
President, Representative Director & COO of Aflac Japan

[Interpreted] As Dan has mentioned, ever since 2013, where we have assigned a comprehensive business alliance agreement, we are having this compliance meeting and reviewing compliance on a quarterly basis. And the review that Aflac is conducting on our own is to make sure that that there is no similar example that is being covered in the media in regards to Japan Post Insurance product sales through Japan Post channel. So from that perspective, the scope of that review that we are -- that we conduct is very limited. And since this review is conducted by the company ourselves, so it's not an investigation, it's a review.

David A. Young
Vice President of Investor & Rating Agency Relations

All right. Thank you, Koide-san. And I believe, operator, that was our last call. We are now past the hour. I just want to thank everyone for joining us today and hope that you will tune in for our Financial Analyst Briefing on September 25 in New York. Please feel free to contact our Investor and Rating Agency

Relations department for any information or questions that you may have, and we look forward to speaking with you soon. Thank you.

Operator
Thank you. That concludes today's conference. Thank you for participating. You may now disconnect.