S&P Capital IQ

CONTENTS



# Aflac Incorporated NYSE:AFL

*FQ4 2012 Earnings Call Transcripts*

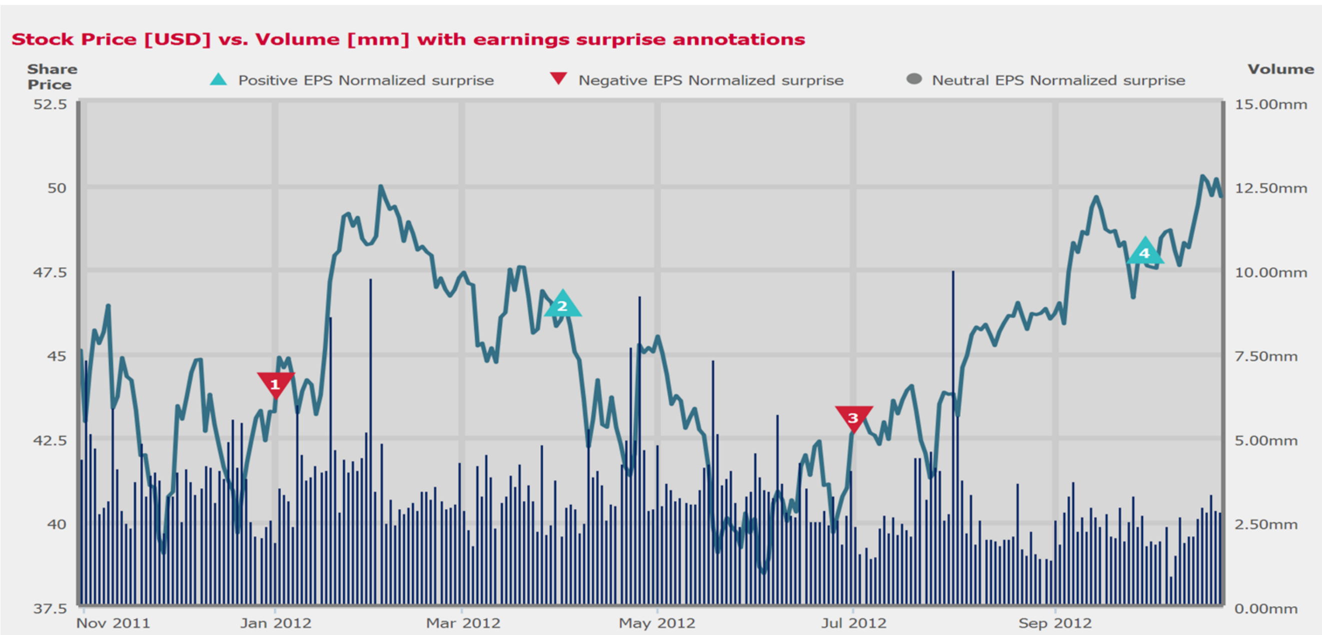
Wednesday, February 06, 2013 2:00 PM GMT

## S&P Capital IQ Estimates

| | -FQ4 2012- | | | -FQ1 2013- | -FY 2012- | |
|---|---|---|---|---|---|---|
| | CONSENSUS | ACTUAL | SURPRISE | CONSENSUS | CONSENSUS | ACTUAL |
| **EPS Normalized** | 1.48 | 1.48 | 0.00 | 1.63 | 6.60 | 6.60 |
| **Revenue (mm)** | 6513.35 | 6375.00 | (2.12 %) | 6100.96 | 25546.71 | 25364.00 |

Currency: USD

Consensus as of Feb-06-2013 1:28 PM GMT




- EPS NORMALIZED -

| | CONSENSUS | ACTUAL | SURPRISE |
|---|---|---|---|
| **FQ4 2011** | 1.51 | 1.48 | 1 (1.99 %) |
| **FQ1 2012** | 1.65 | 1.74 | 2 5.45 % |
| **FQ2 2012** | 1.62 | 1.61 | 3 (0.62 %) |
| **FQ3 2012** | 1.66 | 1.77 | 4 6.63 % |

# Call Participants

## EXECUTIVES

**Daniel P. Amos**
*Chairman & CEO*

**Eric M. Kirsch**
*Global Chief Investment Officer and Executive VP*

**Kenneth S. Janke**
*Former Executive Vice President and Head of Corporate Finance & Development*

**Kriss Cloninger**
*President & Director*

**Robin Y. Wilkey**
*Former Senior Vice President of Investor & Rating Agency Relations*

**Tohru Tonoike**
*Vice Chairman of Aflac Japan*

## ANALYSTS

**Christopher Giovanni**
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*RBC Capital Markets, LLC, Research Division*

**Erik James Bass**
*Citigroup Inc, Research Division*

**Jamminder Singh Bhullar**
*JP Morgan Chase & Co, Research Division*

**John Matthew Nadel**
*Sterne Agee & Leach Inc., Research Division*

**Nigel Phillip Dally**
*Morgan Stanley, Research Division*

**Randolph Binner**
*FBR Capital Markets & Co., Research Division*

**Thomas George Gallagher**
*Crédit Suisse AG, Research Division*

# Presentation

**Operator**

Welcome to the Aflac Fourth Quarter Earnings Conference Call. [Operator Instructions] Please be advised today's conference is being recorded.

I would now like to turn the call over to Ms. Robin Wilkey, Senior Vice President of Aflac Investor and Rating Agency Relations. Ma'am, you may begin.

**Robin Y. Wilkey**
*Former Senior Vice President of Investor & Rating Agency Relations*

Thank you, and good morning, and welcome to our fourth quarter call. Joining me this morning is Dan Amos, Chairman and CEO; Kriss Cloninger, President and CFO; Paul Amos, President of Aflac and COO of U.S. operations; Ken Janke, Executive Vice President and Deputy CFO; Eric Kirsch, Executive Vice President, Global Chief Investment Officer; Toru Tonoike, President and COO of Aflac Japan, who is joining us from Tokyo.

Before we start, let me remind you that 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 quarterly release for some of the various risk factors that could materially impact our results.

Now, I'll turn the program over to Dan, who will begin this morning with some comments about the quarter and year, as well as our operations in Japan and the United States. I will then follow up with a few financial highlights for the quarter and the year, and then we'll be glad to take your questions. Dan?

**Daniel P. Amos**
*Chairman & CEO*

Thank you, Robin. Good morning, and thank you for joining us. The final quarter of 2012 concluded another great year for Aflac. Let me start in more detail about the accomplishments in 2012 and our outlook for 2013, beginning with Aflac Japan, our largest earnings contributor.

Following 5 straight quarters of record-breaking production, Aflac Japan's new annualized premium sales in the fourth quarter were up slightly. Sales were JPY 49.3 billion, an increase of 1.5% over the fourth quarter of 2011. The third -- for the third consecutive year, Aflac Japan generated record sales results. Our full year sales results rose 30.8% to JPY 210.6 billion.

You'll recall that in the third quarter, we said that Aflac Japan sales would be challenging for the remainder of the year, and that's exactly what we saw. 3 primary factors affected our results, 2 of which we discussed in the third quarter.

The first and foremost factor was difficult comparisons to a year ago, which primarily reflected our expansion into the bank channel. Bank distribution has been a great benefit to us because about 70% of the bank customers are new to Aflac. However, after selling through the banks for over the last several years, we've already cycled through the first major pass at selling products to a large portion of the bank customers, particularly our higher premium WAYS product.

Second, you will recall, we expected that the consumers' interest in WAYS would decline in the fourth quarter as we lowered the rate for the discount advance premium from 1% to 0.5% in October. We believe the impact from the lower DAP, which was essentially a premium increase, was much larger than we originally anticipated.

Third, over the last several months, we've seen some insurance companies and financial institutions offering more investment-type products that compete with WAYS. We believe competition amongst various companies selling investment-type products will not only continue, but will actually intensify as we get closer to April 1 and the repricing of these type of products will be implemented. We anticipate repricing will suppress sales, however, it's more important to note that the pricing revisions will benefit us overall from a profitability standpoint.

When thinking of repricing, for our first sector products like WAYS, our objective is to balance profitability and competitiveness. Our profitability will be enhanced by higher premiums we will be charging. However, to remain competitive, we've just announced that we will raise the DAP from the current 0.5% back up to the 1% effective April 1.

After repricing the DAP change, we estimate the profitability of our WAYS product will range between 15% and 20%, which is an acceptable margin to us.

We know the Aflac brand is strong throughout Japan, and this enhances the appeal of our products. In particular, our third sector cancer and medical have been, and will continue to be, our pillar products and the foundation of the product portfolio. In 2012, we maintained our position as the #1 seller of third sector medical and cancer products in Japan. This #1 status confirms the popularity of these products and also helps drive sales because consumers want to buy from the leading provider.

Let me be clear, remaining the #1 seller of cancer and medical sales in Japan is a top priority for me. We mentioned in May at the analyst briefing that we are currently underpenetrated with the consumers who are in their 20s to 40s. That's the segment where we're going to focus our efforts on to increase sales of the third sector products.

As you may know, banks have relationships with multiple insurance providers. This, combined with the changes in the competitive product landscape, make it more challenging than ever to accurately project future Aflac Japan sales through the banks.

Clearly, bank channel sales will be challenging following 5 straight quarters of record-breaking sales results. Keep in mind, we won't gain insight into the bank strategies for 2013 product offerings until closer to the start of Japan's fiscal year, which is April 1. Hopefully, by that time we release first quarter results, we'll be able to provide you with an update on what we've learned about bank plans to sell our products.

On the other hand, we continue to have good visibility into the sales of our third sector cancer and medical products. Our traditional channels has historically been the primary driver of third sector sales. For 2013, we expect Aflac Japan sales of third sector cancer and medical products to be flat to up 5%. Achieving this target is a top priority for me and our management in Japan, and it affects Aflac Japan's bonus, as well as those in corporate management.

Now let me turn to the U.S. operation. From a financial perspective, Aflac U.S. performed very well in 2012. I think we've done a good job in managing our U.S. operations, including the budgets and people resources. Although new sales growth continued to be constrained, our top line results have been consistently strong throughout the year, in part, reflecting an improved persistency.

Aflac U.S. new annualized premium sales were in line with our most recent guidance of flat for the year. We believe persistency has improved for a couple of reasons: First, we have enhanced our customer experience at critical touch points, which has resulted in better payroll retention; and second, with the economic uncertainty we've seen over the last several years, many employees are less likely to switch jobs and therefore, are more likely to keep their current benefits.

While there are external factors we can't control, we are driven to improve the factors we can influence.

First, we continue to improve the structure of our marketing and sales area to maximize our future growth and focus on our distribution channels. Within this new structure, we are working on new training initiatives we believe will benefit our sales force and help them be more productive in the evolving environment.

Second, with a brand recognition of 94%, we continue to leverage this strength to capture the attention of consumers with the ultimate goal of driving sales. We want to continue to educate consumers on our products, while at the same time entertaining them.

Third, we evaluate and enhance our products to ensure we are in step with the needs of consumers, particularly in the economic landscape. In 2013, we are planning aggressive new individual and group product launches. With our strong brand recognition and reputation for paying claims quickly and fairly, we believe consumers are more receptive to our products, and this can only benefit us in the future.

Additionally, we'll continue to evaluate other opportunities as it relates to the change in the current health care environment, specifically, the Affordable Care Act. We do expect the changing health care environment to have an impact on how people choose to purchase insurance going forward. As such, we are looking at ways that we can effectively operate within the environment of the state and federal health care delivery system.

One thing we know from our nearly 4 decades in Japan is that even with a national health care system, consumers have significant out-of-pocket expenses and our products continue to be relevant to consumers. We believe a national health care actually presents Aflac with opportunities, as consumers become better aware of the financial protection Aflac's products help provide.

However, there are still external factors in the macro environment that affect our business. While some aspects of the U.S. economy has shown slight signs of improvement in 2012, we continue to see the economic landscape in the U.S. as challenging. That's especially true for small businesses, where more than 90% of our products are sold.

In fact, the federal -- the National Federal (sic) [Federation] of Independent Businesses, which focuses on small business owners, reported this month that the Small Business Optimism Index in December was the second-lowest since March of 2010. This means more small employers are still very guarded with respect to their business outlook, including their hiring plans. This is important because gains or losses in employment impact our universe of potential policyholders.

Before we can say we're optimistic about our sales opportunities, we need to see sustained optimism, particularly surrounding the employment levels of smaller business. Taking all that into account for 2013, we expect Aflac U.S. sales through the traditional and brokered channel to flat to up 5%. I'll point out that for the first quarter, we won't be surprised if sales were down, considering the first quarter of 2012 was our biggest percentage increase for the year.

Having discussed our operations, let me give you an update on the investment function. I remain pleased with the continued progress in our global investment transformation. We continue to grow our investment team, and we've made excellent progress in the build-out that's ultimately designed to improve the risk adjustment returns and the profile of our balance sheet.

As we've stated for many years, our greatest investment challenge has been to invest Aflac Japan's significant cash flows at reasonable investment yields. The U.S. Corporate Bond program was initiated in the third quarter continues to be an effective means for enhancing our new money yields in Japan. You'll recall that our fourth quarter objective was to invest roughly 2/3 of our invested cash flow in U.S. dollar-denominated publicly-traded corporate bonds and then hedge the currency risk. This successful investment program enabled us to surpass our budgeted new money yield for 2012. It has also provided greater liquidity, enhanced the flexibility of our portfolio and increased the opportunities to diversify beyond JGBs.

At December 31, this program represented 6.2% of the total portfolio, which is well below our asset allocation target. In light of the success of the corporate bond program, the strong credit fundamentals of investment grade corporate credits, we intend to continue the program in 2013.

Consistent with our asset allocation program, we will balance these investments with JGBs for diversification and liquidity, as well as other investment opportunities as they may arise.

As I mentioned, Aflac's consolidated financial performance was strong for the quarter and for the year. Excluding the impact of foreign currency, operating earnings per diluted share rose 4.8% for the quarter and 5.1% for the year. As the program progressed, operating earnings per diluted share were better than expected and we finished the year toward the high end of the objective of the 3% to 6% increase before the impact of currency.

I'm also very pleased with the strength of the capital ratios, which demonstrates our commitment to maintaining financial strength and flexibility on behalf of the policyholders, the shareholders and the bondholders. Through strong surplus growth, an improved portfolio risk profile and a weaker yen, our capital ratios improved significantly in 2012. We previously conveyed that our goal was to end 2012 with an RBC in the range of 400% and 500%. While we have not yet completed our statutory financial statements, we believe the RBC ratio at the year end was significantly higher than our targets.

Additionally, we expect that Aflac Japan's solvency margin at the end, improved over the solvency margin ratio at September 30 of -- for 628%. That would put the year-end SMR well above our target range of 500% to 600%.

As we've indicated, given our capital structure, our ability to repurchase shares is largely tied to profit repatriation. In contemplating profit repatriation, our first consideration is protection of the policyholders as measured by the SMR. Next, we give consideration to the needs of the parent company and consult with Japan's management in making the determination.

We now expect profit repatriation to be around JPY 50 billion for 2013, which is a reasonable estimate, assuming that we had no additional investment losses that would reduce Aflac Japan's operating income. Profit repatriation in 2013 could provide us with a significant amount of capital that could be deployed for share repurchase. As we've said for many years, when it comes to deploying capital for the benefit of our shareholders, we still believe that growing the cash dividend and repurchasing our shares are the most attractive means, and that is something that we will continue to pursue.

Our capital strength enables us to increase cash dividend to the shareholders in the fourth quarter for the 30th consecutive year. Our objective is to grow the dividend at a rate that is in line with our earnings per share growth before the impact of the yen.

Given the strength of our capital ratios and the parent company liquidity, we resume our share repurchase activities by buying approximately $100 million for the shares in the fourth quarter of 2012 at our current plan to purchase 400 million to 600 million of our shares in 2013. Understand, unless there's extraordinary event occurs, we intend to purchase at least $400 million of our shares.

Remember, we are driving the company for increased profitability, not sales. Sales are important enough that our management is bonus-ed on them, but they are still just one component of earnings. Let me also say that we haven't missed an earnings target because of lower sales, nor do we expect that to happen. This year's other components that feed into the profitability include persistency, investment income, claims management and expense controls. It's often difficult to foresee the specifics on how these factors ultimately produce our earnings. Sometimes, one aspect of the business might be a little stronger and one might prove to be a little more challenging, but we anticipate these type of things in the budgeting process. Ultimately, the accomplishments of the fundamental facets of our business align and create another year in which we deliver on our financial growth objectives.

I want to reiterate that objectives for 2013 has not changed: to increase operating earnings per diluted share 4% to 7%. This range reflects the impact of the portfolio derisking and investing significant cash flows at low interest rates.

I would also point out that we had a better year in 2012 than expected, in large part due to the receipts of the deferred coupon in the first quarter and lower annual effective tax rate. This will make it a more challenging comparison in 2013, but we will achieve it.

In addition to operating earnings growth, we've also focused on producing industry-leading return on equity. On an operating basis, 2012 ROE was 24.6%. And as we conveyed at our financial analyst briefing for 2013, we believe it's reasonable to see our operating ROE in the range of 22% to 26%.

Overall, I am pleased with Aflac's position in Japan and the U.S., the 2 largest insurance markets in the world. First and foremost, we are focused on protecting our policyholders and providing value to our investors. We are fortunate that in the process of doing so, we have the privilege of providing financial protection to more than 50 million people worldwide. Robin?

**Robin Y. Wilkey**
*Former Senior Vice President of Investor & Rating Agency Relations*

Thank you, Dan. Let me go through some fourth quarter numbers, starting with Aflac Japan. Beginning with top line, in yen terms, revenues were up 10.5% for the quarter, investment income was up 5.2%. Excluding the effect of the weaker yen in the quarter on Aflac Japan's dollar-denominated investment income, net investment income rose 3.6%.

The persistency rate improved in the quarter and the annualized rate, excluding annuities for the year, was 94.9% compared with 94.4% a year ago. In terms of quarterly operating ratio, the benefit ratio to total premiums increased over last year, going from 72.9% a year ago to 74.5% in this quarter. This is primarily due to the growth of the net benefit reserves for our ordinary line of business, most notably our WAYS product.

The expense ratio was 18.4%, down from 19.1% in the fourth quarter of 2011. The decrease reflected tight general expense control, as well as lower commission costs associated with the sales of our first sector products, primarily WAYS again.

Pretax profit margin declined during the quarter, going from 18.8% to 17.7%. With a contraction of the margin, pretax earnings increased 4.1% in yen terms.

Now let me turn to Aflac U.S.

Total revenues rose 5.8% for the quarter. The annualized persistency rate for the year improved from 76.2% a year ago to 77.1%. And looking at the operating ratios for the quarter, the benefit ratio to total premiums declined slightly from 57.7% a year ago to 57.4% in the quarter.

The operating expense ratio increased slightly, going from 34.2% a year ago to 34.6%. The profit margin for the quarter was unchanged from a year ago at 14.6%. Pretax operating earnings increased 5.9% for the quarter.

Turning to the investment activity for the quarter, starting with Aflac Japan. For the quarter, approximately $3.1 billion of Aflac Japan's new cash flow was invested in the corporate bond program with a gross yield of 3.22% and an annualized hedge cost of 41 bps. The yield, net of hedge cost, was 2.81%.

Additionally, we invested $1.4 billion from the proceeds generated as the result of debooking activity. This brings the total cash flow invested in the corporate bond program for the year to approximately $7 billion, with a total yield on the corporate bond program of 3.3%.

Approximately 35% of our new cash flow was invested in JGBs in the fourth quarter for an average yield of 1.77%. In Japan, the total new money yield for the quarter was 2.73%, down 3 basis points from September 30 and up 65 basis points from a year ago.

The portfolio yield was 2.87% at the end of December, up 3 basis points from the end of September and 42 basis points lower than a year ago.

JGC [ph] yields saw some increase toward the end of December. As of December 31, 20-year JGB yields were 1.75%, 11 basis points increase from September 30. 10-year JGB yields as of December 31, 4.79 bps, a 1 bps increase from September 30.

In terms of U.S. investments, the new money yield for the quarter was 3.52%, a decline of 42 basis points from September 30, and 183 points from a year ago. The yield on the portfolio at the end of December was 6.35%, down 16 basis points from September 30, and 37 basis points from a year ago.

Turning to some other items in the quarter. Noninsurance interest expense in the quarter was $50 million compared with $42 million a year ago. The higher interest expense primarily reflected increased borrowing during the year compared to a year ago.

Total company pretax operating margins declined, reflecting the increase in the benefit ratio in Japan caused by strong sales of ordinary line of business. Parent company and other expenses decreased from $20 million a year ago to $6 million in the fourth quarter of 2012.

On an operating basis, the tax rate was 34.1%, compared with 34.6% a year ago.

Consistent with what we said last quarter, going forward, we expect the effective tax rate throughout 2013 to be between 34% and 34.5%, excluding tax benefits recognized in 2012, and assuming FSA earned premiums decline year-over-year, which is in line with Dan's comments earlier.

As Dan mentioned, we've taken several actions during the year to utilize capital losses that would expire in 2013, and we've significantly reduced the losses that are scheduled to expire in '14. We expect to continue the actions we have initiated to utilize the remaining capital loss carryforwards in managing our -- in our investment portfolio.

As reported, operating earnings per diluted share rose 2.1% to $1.48 in the quarter. Weaker yen decreased operating earnings by $0.04 per diluted share. Excluding the yen impact, operating earnings per share increased 4.8% for the quarter.

Lastly, let me comment on the earnings outlook for 2013. As you heard Dan say, we've affirmed our guidance for 2013 of a 4% to 7% increase in operating earnings per diluted share, excluding the impact of the yen.

So that you understand the significance of our 2013 EPS objective over 2012 actual results, let me put this in perspective for you.

In 2012, we received tax benefits from a [indiscernible] for the years 2008 and 2009. And we made a revision for the full year effective tax rate.

The unusual benefits received in 2012 totaled approximately $38 or $0.08 per share. We also recovered a previously written-off coupon as part of a sales transaction executed during the year that resulted in a onetime benefit to operating earnings of $23 million or $0.05 per share.

If you exclude the impacts of these benefits from the 2012 operating earnings result, operating earnings per diluted share in '12 would've been $6.47. This year, we estimate that a JPY 1 move on the average annual exchange rate will equal approximately 4.3 cents per diluted share.

Considering the weakening of the yen in recent months, if we achieve our objective of 4% to 7% increase in operating earnings per diluted share for the year and the yen averages 90 for the full year, we would expect operating EPS to be in the range of $6.37 to $6.57 per diluted share.
Now, we are ready to take your questions. [Operator Instructions] Now, we'd be happy to take your questions. Thank you.

# Question and Answer

**Operator**

[Operator Instructions] Your first question comes from Nigel Dally, Morgan Stanley.

**Nigel Phillip Dally**
*Morgan Stanley, Research Division*

So with the Japan benefit ratio, clearly, quite a large increase this quarter on a sequential basis, but at least historically, fourth quarter has typically had some reserve recalibrations. So I'm hoping to get some color on how much reserve recalibrations impacted the ratio this quarter. And whether on the back of the trends we've seen emerge, whether we should be expecting a somewhat higher benefit ratio in 2013 than you previously guided to back at Investor Day.

**Kriss Cloninger**
*President & Director*

Nigel, Kriss Cloninger. A bit of a scratchy voice this time. But you're correct in that the fourth quarter benefit ratio was higher than those we experienced in the first 3 quarters, partly because of, as you characterize it, reserve recalibrations that we typically do in conjunction with reviews of primarily closed blocks of business in Japan and the U.S., where we look at the reserve balances that we forecasted relative to the interest rates used in valuing those blocks in the prior year. Our SOX procedures require that we do this in the fourth quarter as kind of a routine thing. And this year, we increased the benefit reserves on a Japanese block of business we call dementia. You've probably heard of it before, it's similar to long-term care in the U.S. And that was approximately a JPY 3 billion reserve increase in the fourth quarter. I believe we had a similar adjustment in the fourth quarter of the prior year and actually, the fourth quarter of the prior year was up even more than the first 3 quarters. But that doesn't indicate that, that's going to have a trend going forward, Nigel. The ratios, excluding that, that reserve adjustment, were right in the middle of the trends I have shown at the FAB meeting last May, where I broke out what the expected benefit expense ratios and profit margins were for the core health and other block and the ordinary block separately. And then I aggregated them in total. And all of our ratios fell within those ranges that I had guided to last May. And I believe that those ranges will continue to prevail throughout 2013. As I indicated last May, I did a 2-year weighted average ratio I expected for 2012 and '13, and so we're still in good shape in that regard. As a matter of fact, our 2012 experience, profit margin came in right in the middle of the range at 19.5%. Benefit ratio was a little bit higher. Expense ratio was a little bit lower in the aggregate because we produced more WAYS than we produced health -- core health benefits and so that affected the weighted average. The final thing I'll say is that I did caveat things last May saying, okay, these are ratios that will prevail over the course of the 2-year period, but you're going to see some seasonal fluctuations. And I was thinking primarily of the fourth quarter adjustments that we make that you saw and pointed out. So I'll conclude just by saying I believe everything's in line with what we had expected.

**Operator**

Your next question comes from Jimmy Bhullar, JPMorgan.

**Jamminder Singh Bhullar**
*JP Morgan Chase & Co, Research Division*

I had a question on capital repatriation. Just wondering how you think about -- or actually, capital deployment. How do you think about the pickup in RBC and the solvency margin given the weaker yen? Would you be willing to deploy the extra points for buybacks or something else? Or is that unlikely even that the currency can move around? And then related to that, just maybe, Dan, if you could comment -- or Kriss, just the pace of buybacks expected for 2013? Should it be more front-end loaded or would you do it evenly through the year?

**Kenneth S. Janke**

*Former Executive Vice President and Head of Corporate Finance & Development*

Jimmy, this is Ken. Let me start out with the RBC SMR question. Clearly, we're benefiting from a weaker yen. A JPY 1 move probably adds about 3 to 4 points on the SMR and about 4 to 5 points on the RBC. But what we'll do is we'll have to evaluate it as we get a little bit closer, especially with respect to repatriation. We've always discussed our RBC and SMR in terms of yen sensitivity, so we do want to make sure that we provide for some kind of buffer if we see a reversal in the yen weakening because a strengthening yen would penalize it a little bit.

**Daniel P. Amos**
*Chairman & CEO*

What was the other question? I forgot.

**Jamminder Singh Bhullar**
*JP Morgan Chase & Co, Research Division*

Just the pace of buybacks.

**Daniel P. Amos**
*Chairman & CEO*

Well, I think, if there's an opportunity in the first quarter, we'll take advantage of it a little bit more so than we would in the second half because it just ensures earnings growth and it benefits us.

**Kenneth S. Janke**
*Former Executive Vice President and Head of Corporate Finance & Development*

And I'd add to that, Jimmy, we do have pretty good liquidity at the parent company. Our operating cash balance was about $770 million at the end of 2012. And clearly, buying earlier in the year has a greater benefit to EPS for the year.

**Jamminder Singh Bhullar**
*JP Morgan Chase & Co, Research Division*

And you mentioned $400 million at a minimum on buybacks, but the top end of your range is $600 million. How likely is a $600 million number given that if you look at current exchange rates, your repatriation amount is actually -- it implies $500-some million at current exchange rates?

**Daniel P. Amos**
*Chairman & CEO*

Well, we have no problem with that additional capital at the corporate level if we need it to be able to do that. So we're going to take it as it evolves. But I think the way you should view this is, is that $400 million, we're trying to -- unless some cataclysmic event, guarantee, and we'd like to do more than that and we'll watch it as the year goes on and make a decision accordingly.

**Operator**

Your next question comes from Eric Berg, RBC Capital Markets.

**Eric Noel Berg**
*RBC Capital Markets, LLC, Research Division*

So you had your discounted advance premium and it was a great boon to sales, but then it sort of crimped profitability, so you took it away. But that hurt sales terribly, so now you are bringing it back. Two questions. Sort of, one, where does this leave you from a profitability point of view? In other words, why did you do this and where does this lead -- why was this the right decision to take it away and then bring it back, and don't you run the risk of confusing customers and distributors by, well, flip-flopping like this?

**Daniel P. Amos**
*Chairman & CEO*

Well, it's actually not so much flip-flopping because we're only putting it in effect when the rate increase goes into effect. We're try -- so in essence, we didn't want to double rate increase to them. So what we've done is, we've put the rate increase in effect by [ph] the DAP going from 1% to 0.5%, and then we're bringing it back because we've got another rate increase on top of that. And Kriss can talk about that, but the actual rate increase was more appropriate last year at this time with the declining interest rate and an increasing interest rate that we're moving into right now. Kriss?

**Kriss Cloninger**
*President & Director*

Well, I'll just say, Eric, as we saw declining interest rates throughout 2012, we felt like we were being pressured on profitability from the immense popularity of the 1% DAP rate and the significant impact on production of WAYS. I mean, we were getting extraordinary volumes of WAYS production. And we felt like maybe we were selling dollar bills for $0.50 kind of thing. So we felt like in order to protect the margins going forward, we needed to diminish some of the, perhaps above average market appeal for the WAYS product by cutting the DAP rate to the level that most other companies were crediting, which was in the neighborhood of 0.5%. So we implemented that in October. We did several other things during that same period of time when interest rates were declining, during 2012, we put some production caps on child endowment and we redid the 5-pay WAYS and things like that. So we were trying to protect the profitability that the analyst community and we were concerned with. And so we tried to protect our core profitability, we made those changes. Now, come April 1, we're going to reprice products given the change in the standard valuation interest rate down to 1%. The premium rates on the WAYS products are going to go up 15% to 20%. The margins are going to go up toward 20% as a percent of premium. And we felt like we needed to restore some of the market appeal of the one -- of the discount advance premium rates, so we decided we could easily afford to change it back from 0.5% to 1% in order to better posture us competitively in the industry. So it's not a flip-flop, it's a reaction to changes in market conditions is how I would characterize it.

**Daniel P. Amos**
*Chairman & CEO*

And let me say this, Eric. We knew when we introduced cutting the DAP, that this was a possibility we might do in April. So we told the banks that was always a possibility, that it could happen.

**Eric Noel Berg**
*RBC Capital Markets, LLC, Research Division*

So here then is my follow-up. Let's not call it a flip-flop, that's too harsh a word. It is what it is. You made one addition and now, you've changed course. By doing -- by thinking the fact that you have, I guess I'm interested, it sounds like you will not be as well off from a profitability point of view, a margin point of view, as would have been the case if you kept this DAP in place. But net-net, where will all these actions leave you once you have -- I mean, the bottom line is total dollar profits, not margins, right? It's about total dollar profits, not sales, not margins, but total dollar profits. So net-net, when you have the price increase in April to restore the full DAP, where will that leave you relative to what would have been the case if you had kept the DAP in place?

**Kriss Cloninger**
*President & Director*

Well, you're exactly right, Eric. It's a question of a trade-off in volume versus margin. And that's what I said when we went into WAYS in the first place relative to the third sector health. We're going to write a higher volume of products with a lower margin. We finally decided, okay, the margins got too low given the interest rate environment, so we took the repricing action of lowering the DAP in order to restore some margin. When we did that, we knew we were going to lose some volume, which we did here in the fourth quarter. So that's -- but as you say, the impact on total profitability, you can get as much profit with a lower volume of higher-margin products than you can with a higher volume of lower-margin products. Now come April 1, we're being forced by market changes to increase the base policy premium rates on the WAYS. But in order to stay competitive, we believe that it's necessary to go ahead and increase the

DAP rate so that we don't lose so much volume associated with being uncompetitive, that we don't achieve the margin. So you're right. If we had maintained DAP at 0.5%, our margin would have been higher, but it would have been closer to 25% than, say, the high-teens to 20% that we expect after we raise the DAP back to 1%. And we think that, that will posture us in the market to be competitive and will achieve a higher volume of production at a reasonable margin and enhance the overall profitability of the company.

**Daniel P. Amos**
*Chairman & CEO*

Yes, and I want to say one thing. This is not uncommon in the life insurance area when you're dealing with these type of issues. We knew it going in. We knew that when we decreased the DAP, we could raise it back because of the other, depending on what was happening. If we had been in an environment where between October and now, we saw interest rates going down, we certainly would have kept it enforced. But it gives us flexibility to monitor and adjust to ultimately help. And it's nothing that our competitors are not doing, too, and we're totally aware of it. Now, from your standpoint, it's new. In the third sector products, we never had these issues. But we're very aware of it, we're on top of it and we understand what we're doing.

**Operator**

Your next question comes from Chris Giovanni, Goldman Sachs.

**Christopher Giovanni**
*Goldman Sachs Group Inc., Research Division*

I guess, first question around the independent agency count in Japan, which showed a significant decline quarter-over-quarter and is now down to, I think, levels seen in '08. So I was sort of curious, what's going on there? Is that really what you're kind of playing for and focusing on with the focus now on cancer and typical third sector product sales?

**Daniel P. Amos**
*Chairman & CEO*

Toru, you want to answer that?

**Tohru Tonoike**
*Vice Chairman of Aflac Japan*

Yes, thank you. Yes, let me say that the decline in the number of the recruits of the individual agents is something we intended to do because we found that from the expense of the past couple of years, we found that recruiting too many agents and to train them are not effective -- efficient enough for us to do it. So instead, we decided to shift that -- some of our resources used for that purpose to other more products -- productive areas, including the bank channel development. So we shifted the people and the money from that to the other areas. And as a result, as you may see, the number of the recruits dropped substantially. But we made more efforts in training them. Training the smaller number of the new recruits so that they can be productive within a short amount of time. So even though the number of recruits declined over more than 30%, the rate of, I would say, the success rate of the past year recruits, the ratio of the newly recruited agents becoming productive within the year increased by 13%. So net-net, the annual premium of sales produced by these past-year recruits were down around more than 20%. But in terms of the yen, the decline was somewhat less than JPY 600 million. But put it in the perspective, that is only less than 0.3% of our total annual premium. So we believe that decline was made up or more than made up for, by the growth in other areas, which -- to which we shifted our resources. I can't tell how much will increase by then, but we are confident that will -- we did it on purpose and we are confident that we did the things right.

**Christopher Giovanni**
*Goldman Sachs Group Inc., Research Division*

Okay. And then just my follow-up question. You obviously talked about raising the DAP now. You did make a number of other changes to kind of restrict some sales in the bank channel. So curious if now that Eric's getting better, new money rates over there, if you guys would consider loosening up any of those other changes as well if sales don't come through.

**Kriss Cloninger**
*President & Director*

We have loosened up the restrictions on the child endowment. We have put some production limits in place that we've loosened up. We're not changing the 5-pay WAYS decision. We feel like that was a good decision to put the emphasis more on the 10-pay WAYS that has a 10-year surrender charge. So we're not changing that. But we are staying with the whole life WAYS and making changes to the discount advance premium rate and the gross premium levels on WAYS in general. We're also looking at sales incentives to certain banks and to address competitive situations where other companies have come in and given incentives and the like. So the market response to competitive conditions is multifaceted, shall I say. And we're trying to stay on top of it all because we have relationships with virtually all the banks in Japan, so we get feedbacks what's going on, and we're continuing to emphasize staying competitive.

**Daniel P. Amos**
*Chairman & CEO*

But I think the message that I would give you is, is that the foundation that had built Aflac Japan, which is cancer, and now medical, is what we're concentrating on. Because it was a -- somewhat of an anomaly the way it happened with the banks and our ability to write that first sector product, specifically WAYS, we took it because it was there and it was a great profit for us. But we're now shifting money and resources back to the traditional channel, which where is, we believe, is we want to stay #1 in both medical and cancer, and that's what we plan on doing going forward. And that's where the bonuses are tied, and now, we just get back to it. But it was a strategic decision we made at the time. We told you that we didn't know how long it would last. We now see it coming more to an end, and we see us concentrating on banking the profit margins we've discussed in the past and going back to doing that on the third sector.

**Operator**

Your next question comes from Randy Binner, FBR.

**Randolph Binner**
*FBR Capital Markets & Co., Research Division*

I just want to pick up on the repatriation conversation from a different angle. I think Jimmy was asking about how the currency impacts it. But I was more curious to kind of understand what the methodology was that led to these impairments this quarter on Tunisia and UniCredit, and just to clarify, if those were impaired or sold. I guess what I'm trying to get to is to understand if there's other bonds that are still kind of in low mark-to-market positions, if those could be at risk in the next couple of quarters and if that would work against potential repatriation.

**Eric M. Kirsch**
*Global Chief Investment Officer and Executive VP*

Let me start by reminding everybody that the strategy throughout 2012, particularly after the first quarter, when we did a very specific derisking program, was to look at our portfolio throughout the year and be opportunistic with respect to when good opportunities presented themselves, to improve the quality of the balance sheet that we would do that, but only do that when it represented good value for our policy and shareholders. We did not sell anything in a panic throughout the year. We were very careful. And we had a very successful year altogether, reducing about $4.6 billion of multiple positions throughout Europe and the financials. And we do not have a specific derisking strategy going forward. Having said that, we will always look for opportunities to improve the risk/return profile of this balance sheet for the long term and if we see something of value, then, of course, we'll take advantage of that. With respect to your 2 specific questions, with respect to UniCredit, that's a good example. That's an example of a credit we could have been comfortable holding. But amongst our holdings, we felt there was some risk with respect to UniCredit itself and its knock-on effects to our particular holdings. I can tell you, early in 2012, we saw values for those particular assets that did not represent good value for our shareholders or policyholders, and we said thanks, but no thanks. In an improved market as we've had, we saw particularly good value and in fact, that impairment is associated with the sale of those securities. Tunisia, on the other hand, is slightly different in terms of the risk that we see. As you may know, in December, it got downgraded by one of the agencies. And in our view, the risk with Tunisia is more geopolitical risk, as opposed to credit risk. But nevertheless, because of the situation in the Middle East, it's a risk we're cognizant of. With those things in mind, we did decide to take an impairment reflecting our current views on Tunisia, which we thought that was the conservative thing to do. On a forward-looking basis, there is no specific derisking program. But of course, we'll always look at our holdings. We'll react to credit ratings. We'll react to market conditions and take appropriate actions when we feel necessary. I think as you look over the next 12 months, Europe is still, of course, a concern, but our positions in Europe have decreased. As you look at that as a percent of the portfolio, it's gone from about a year ago, 30% to 20%. And I have said, as that bucket of assets continues to decrease, the quality of what we hold in Europe is actually increasing, vis-à-vis, the total bucket of what we had in Europe. I don't expect Europe to become volatile as it did during '11 and 2012, but you can't rule that out. So assuming anything from a stable environment, we wouldn't expect much activity or impact to our holdings. Of course, if Europe should become more volatile, that would create for our holdings perhaps some rating pressures. But again, the size of our assets in Europe, the financials, have all been reduced substantially. So it's much lower risk than we faced when I arrived a little over a year ago.

**Randolph Binner**
*FBR Capital Markets & Co., Research Division*

That was very comprehensive. One quick follow-up. Just kind of from an -- there's a little bit of overlap or timing issues with the FSA here and then the way we look at the company. But just to clarify, the risk to the repatriation would be whatever credit losses could happen in the first and second quarter of '13. Is that correct?

**Kenneth S. Janke**
*Former Executive Vice President and Head of Corporate Finance & Development*

This is Ken, Randy. Yes, that's correct. It's really until we file our FSA financial statements, which is typically kind of early/mid-June. All the losses that we incur to the fourth quarter of 2012 are reflected in our current outlook for FSA results.

**Operator**

Your next question comes from Tom Gallagher, Crédit Suisse.

**Thomas George Gallagher**
*Crédit Suisse AG, Research Division*

I guess for Dan or Kriss. If you're not able to give us WAYS sales guidance for 2013, how confident are you for 2013 EPS guidance? And just asking that obviously, because WAYS were about 45% of your sales in Japan last year.

**Daniel P. Amos**
*Chairman & CEO*

I'm extremely confident. We've -- I've never missed a earnings guidance since I've been CEO going on 23 years. Saying that, it's harder now than it used to be. But -- and in my mind, I have a number for what I think bank sales will be. But I'll remind you that last year, I told you we'd be down 10% on this call and we were up 30%. So to make a projection when there was that much volatility the last year, just seems like it would not be a realistic number. So I just want to wait until I get a little closer and see what's going to happen. But with all the things we have in going on in terms of persistency, the controls we've had over the budget, the claims and how they've tracked exactly where we said we would, the new money rate on an upward trajectory, all those things make me confident that we will achieve it. But again, it's a little harder because of different things.

**Kenneth S. Janke**

*Former Executive Vice President and Head of Corporate Finance & Development*

Yes, Tom, this is Ken. Let me add one thing because you've seen this story before. You'll recall, in the early 2000s, we had sales pressures in Japan following the liberalization of that market, we had sales pressures in the United States following our duck bubble when sales had done so well for a period of a few years. And in all those times, we didn't miss earnings, and largely, that's because the vast majority of our revenues and earnings come from a renewable source. When you consider the persistency rates, about 90% of Japan's premium income comes from renewals, and investment income is largely from a renewable source, so we have a pretty good idea right now what about 80% to 85% of our revenues are going to look like for 2013. And with the stability of the -- and predictability of the benefit and expense ratios, that's what gives us visibility into earnings. So the bottom line is we have more visibility into the income statement than we do right now for the sales through the bank channel.

**Thomas George Gallagher**
*Crédit Suisse AG, Research Division*

No, that's helpful. And just my follow-up is the 15% to 20% acceptable margin. I just want to make sure I understand the parameters of that. And Kriss, that's 15% to 20% versus premium, or is that total revenues?

**Kriss Cloninger**
*President & Director*

It's like present value of profits to present value of premiums. It's kind of an actuarial thing. But it's really representative of the GAAP profit margin as a percent of -- well, it'd be of revenues.

**Thomas George Gallagher**
*Crédit Suisse AG, Research Division*

And when you say present value, is there -- are we going to see any accounting disconnect from that in the first year or 2 that those products come on the books? Meaning, is it lower in the initial years or will we see that level of profitability emerge from a GAAP accounting standpoint kind of right out of the gate?

**Kriss Cloninger**
*President & Director*

Well, for all of our business, we've got certain costs that are nondeferrable and have to be expensed in the first year. But other than those nondeferrable expenses, the margins tend to be level for each year of the product life as a percent of revenue.

**Thomas George Gallagher**
*Crédit Suisse AG, Research Division*

Got it. So for year 2, that's when you see it emerge, year 1 is just the [indiscernible]

**Kriss Cloninger**
*President & Director*

Right. Right.

**Operator**

Your next question comes from Erik Bass, Citigroup.

**Erik James Bass**
*Citigroup Inc, Research Division*

Robin touched a little bit on the deferred tax assets, and I was just hoping you could provide a little bit more color on what you're doing and kind of what the cash tax benefit is to the company? And then I guess related, is there any potential to accelerate some of the tax assets that are maturing in future years?

**Kenneth S. Janke**
*Former Executive Vice President and Head of Corporate Finance & Development*

Erik, this is Ken. We entered into a series of transactions last year. Without getting into great detail, but that allowed us to offset all of the tax-based losses that we incurred for 2012, as well as to eliminate the carryforwards -- all of the carryforwards to 2013, which amounted to $214 million, and a substantial portion, about 60% of the tax loss carryforwards that expire in 2014, about 60%. So we feel like we're in pretty good shape. We're going to continue to explore transactions that make economic sense to the company, first and foremost, and that would benefit our operations. And hopefully, we'll be able to address those in the process.

**Erik James Bass**
*Citigroup Inc, Research Division*

Okay. And can you just remind us kind of what the kind of the aggregate amount of future potential deferred tax assets you have remaining?

**Kenneth S. Janke**
*Former Executive Vice President and Head of Corporate Finance & Development*

We've got about $2 billion. I mean, a little less than $2 billion. The most significant portion of which is the $1.3 billion of losses that were generated in '11 that would expire in '16.

**Robin Y. Wilkey**
*Former Senior Vice President of Investor & Rating Agency Relations*

Thank you, Erik.

**Operator**

Your last question comes from John Nadel, Sterne Agee.

**John Matthew Nadel**
*Sterne Agee & Leach Inc., Research Division*

Most of my questions have been asked and answered, but maybe I'll follow up a little bit on WAYS. In the second half of 2012, your new money investment rate in Japan was considerably above the 2.50% level, where I think, in the past, you've indicated you need that level of investment rate to be able to hit that 17% to 21% targeted margin on your prior WAYS design. So if we ignore, Kriss, the impact of those nondeferrable costs that you mentioned in the response to Tom, would you say that your WAYS sales in the second half of 2012 were achieving those targeted margins?

**Kriss Cloninger**
*President & Director*

Yes. Yes, I believe they were, John, particularly with the higher investment yield and the like, combined with the reduction in the discounted advance premium rate. Actually, if we could continue at, say, the 2.5%, that investment yield on new money, I wish we didn't have to change anything as far as discounted advance premium and gross premium rates. I wish we didn't have to go through this repricing activity we've got to go through April 1. But -- so the margins were good, in my mind, but we have no choice relative to the repricing in April 1 because if we don't reprice, there's going to be a significant regulatory surplus drain associated with the higher reserves, associated with the 1% standard valuation rate. But I was comfortable with the fourth quarter margin, given the higher net investment yield, and that's why we feel confident that we can restore the discounted advance premium rate come April 1.

**John Matthew Nadel**
*Sterne Agee & Leach Inc., Research Division*

And then just a quick follow-up. So if we then -- if we're thinking about that hitting that targeted margin with a 2.5% or better investment yield -- new money investment yield, in year 1 with taking into account the nondeferrable costs, how much does that cut into that margin in year 1? I mean, I'm thinking about it this way, you had massive WAYS sales in 2011, they more than doubled in 2012, I mean, is it possible that with those nondeferrable costs behind you, at least on those 2 big years of sales, that the margin jumps in 2013?

**Kriss Cloninger**
*President & Director*

Well, it certainly will on that block of business. That's for sure.

**John Matthew Nadel**
*Sterne Agee & Leach Inc., Research Division*

And I mean, order of magnitude, Kriss, can you give us a sense for how much those nondeferrable costs drag that margin in year 1?

**Kriss Cloninger**
*President & Director*

Yes. Let me think for just a second. I would say they could drain it 20% to 30% of premium. So we might be looking at flat -- at virtually 0 to slightly negative margin, in the actual reported, in the first 12 months of the business is in effect. Actually, it pretty much occurs at issue, at the time of issue, because when the business goes on the books, we first put up the deferred acquisition cost, and that's an offset to the expenses incurred. But the asset we establish is not as high as the actual expenses that we incur, particularly into the new DAC standard that we had to implement recently. So it's a bit of a drain, but it's -- it happens all the time. And so we got a mixture of second-year business coming in with a higher margin and new business going on the books with a lower. But you're right, the big volume of WAYS we put on the books depress the margin in, particularly, the third and fourth quarter.

**John Matthew Nadel**
*Sterne Agee & Leach Inc., Research Division*

And I'm sorry, if I could sneak one more follow-up on this, because I think it's important. I mean, it sort of comes back to the question around expectation for sales of this product in 2013. If the year 1 margin is 0 to slightly negative, but the year 2 margin can be mid-teens or higher, then it -- doesn't it -- it seems pretty important to understand or to have some expectation as to whether WAYS sales are going to be down, up or flat in '13 versus '12.

**Kriss Cloninger**
*President & Director*

Yes. Well, you're right. I mean, it will relieve some of that strain associated with nondeferrable acquisition costs and the new business will come on at a higher margin. That's what I was trying to get to back in Eric Berg's question. You're right. A higher volume of lower-margin business, you achieve one level of profit, then subsequently, if you write a lower volume of higher-margin business, you can be similar in total profitability. I think that's what you're getting at, is that even though sales are going to be down, profits aren't going to be down nearly as much and may in fact be up.

**John Matthew Nadel**
*Sterne Agee & Leach Inc., Research Division*

Well, I mean, in fact, it seems based on your answers around the nondeferrable cost, Kriss, that if WAYS sales are indeed down year-over-year in '13, that profits have to be up, all else equal because...

**Kriss Cloninger**
*President & Director*

You get to Ken's point about 90% of the profits being associated with renewal business, so...

**John Matthew Nadel**
*Sterne Agee & Leach Inc., Research Division*

Well, plus the lack of the low -- the lack of the nondeferrable costs.

**Kriss Cloninger**
*President & Director*

Yes. Well, on the margin, you're correct.

**Robin Y. Wilkey**
*Former Senior Vice President of Investor & Rating Agency Relations*

Thanks. All right. Thank you very much. If you want to call later on the office and -- to ask any follow-up questions, please do so. If not, we will -- we have everything out on our website. And we appreciate you attending the conference call. Thank you.

**Operator**
This does conclude today's conference. Thank you for attending. You may disconnect at this time.