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Market Intelligence

Aflac Incorporated NYSE:AFL

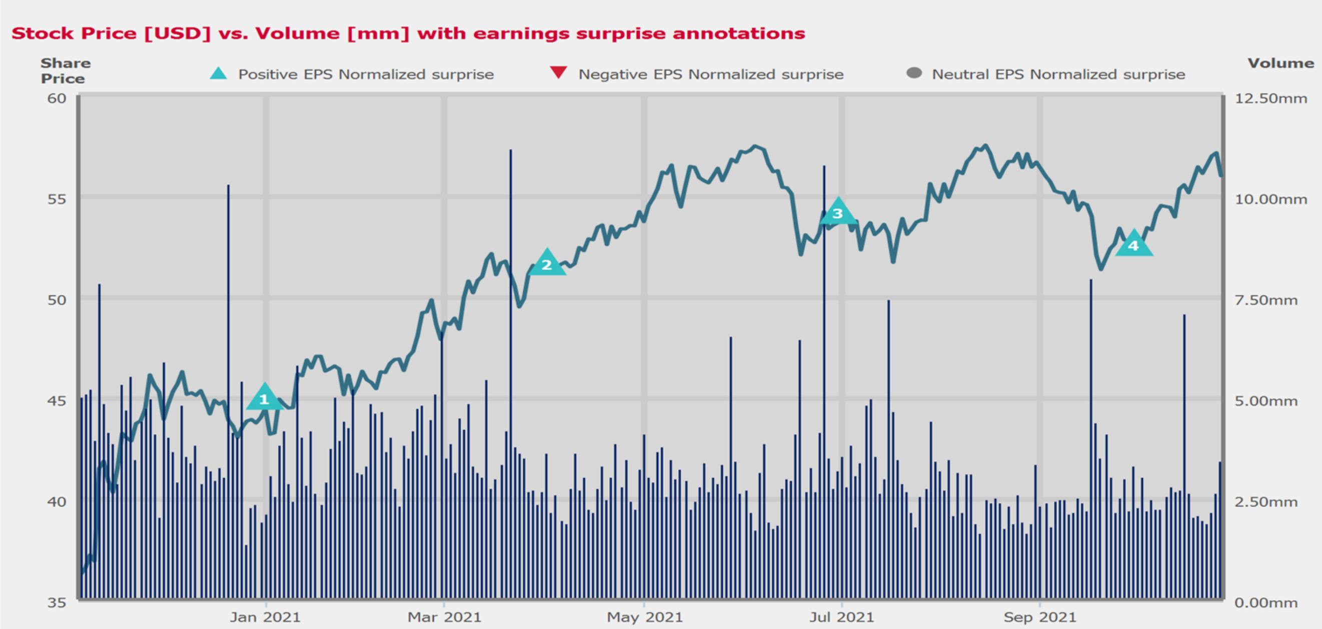
FQ3 2021 Earnings Call Transcripts

Thursday, October 28, 2021 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2021-			-FQ4 2021-	-FY 2021-	-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.32	1.56	▲18.18	1.24	5.72	NA
Revenue (mm)	5362.02	5237.00	▼(2.33 %)	5340.02	21545.08	NA

Currency: USD
Consensus as of Oct-28-2021 10:30 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2020	1.04	1.05	▲1 0.96 %
FQ1 2021	1.21	1.51	▲2 24.79 %
FQ2 2021	1.28	1.59	▲3 24.22 %
FQ3 2021	1.32	1.56	▲4 18.18 %

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Chairman & CEO

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Presentation

Operator

Good day, and welcome to Aflac Third Quarter 2021 Earnings Conference Call. [Operator Instructions]. Please note, this event is being recorded.

I'd now like to turn the conference over to David Young, Vice President of Investor and Ratings Agency Relations and ESG. Please go ahead.

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

Thank you, Ian. Good morning, and welcome. As always, we have posted our earnings release and financial supplement to investors.aflac.com. And this morning, we will be hearing remarks about the quarter related to our operations in Japan and the United States amid the ongoing COVID-19 pandemic. Dan Amos, Chairman and CEO of Aflac Incorporated, will begin with an overview of our operations in both countries. Fred Crawford, President and COO of Aflac Incorporated will then touch briefly on conditions in the quarter and discuss key initiatives, including how we are navigating the pandemic. Max Broden, Executive Vice President and CFO of Aflac Incorporated will conclude our prepared remarks with a summary of third quarter financial results and current capital and liquidity.

Members of our U.S. executive management team joining us for the Q&A segment of the call are Teresa White, President of Aflac U.S.; Virgil Miller, President of Individual and Group Benefits; Eric Kirsch, Global Chief Investment Officer and President of Aflac Global Investments; Al Riggieri, Global Chief Risk Officer and Chief Actuary; June Howard, Chief Accounting Officer; and Steve Beaver, CFO of Aflac U.S.

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

Before we begin, some statements in this teleconference are forward looking within the meaning of federal securities laws. Although we believe these statements are reasonable, we can give no assurance that they will prove to be accurate because they are prospective in nature. Actual results could differ materially from those we discuss today. We encourage you to look at our annual report on Form 10-K for some of the various risk factors that could materially impact our results.

As I mentioned earlier, the earnings release is available on investors.aflac.com and includes reconciliations of certain non-U.S. GAAP measures.

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

Daniel Paul Amos
Chairman & CEO

Thank you, David, and good morning. Thank you for joining us. With the pandemic conditions continuing to evolve, I'm proud of our response over the last year. I am also grateful to our team of employees and sales representatives who have empowered Aflac to adapt to what has been a very challenging time for everyone.

During the third quarter, we saw a rise and then a decline in COVID cases and hospitalizations in both the United States and in Japan, but to varying degrees. With that in mind, I continue to address our employees in a way that's similar to how with my own family. I'm keeping them informed in updates from the medical community and encourage them to get the COVID-19 vaccine because I want people to avoid being sick or even worse being a casualty due to this pandemic.

As we entered the fourth quarter, when the weather gets colder and indoor gatherings increase, the recovery from the pandemic remains uncertain, and we must remain diligent.

For the third quarter, adjusted earnings per diluted share, excluding foreign currency impact increased 10.1% for the quarter and 20.1% for the year. These results are largely driven by lower-than-expected benefit ratios and higher net investment income, primarily in Japan.

Looking at the operations in Japan in the third quarter, Aflac Japan generated solid overall financial results as reflected in the profit margin of 26.3%, which was above the outlook range provided at our financial analyst briefing for 2020.

As Max will explain in a few moments, Aflac Japan has reported very strong premium persistency of 94.5%. Aflac Japan sales were essentially flat for the quarter. Sales for the first 9 months of this year were approximately 66% of 2019 level. We continue to navigate evolving pandemic conditions in Japan, which include widespread state of emergencies that extended to multiple prefectures and persisted through the third quarter.

These states of emergency in Japan are much less restrictive and more limited in scope than lockdowns in other countries, but they have impacted face-to-face sales opportunities. As we entered the fourth quarter, the ability to meet face-to-face with customers appears to be improving somewhat gradually. And the degree to which our ability to meet face-to-face continues to improve with a very key driver in the recovery of our sales.

We were encouraged by the September launch of our new nursing care insurance in Japan, which we view as another opportunity to meet the needs of certain consumers. However, it's still very early in the launch of this new product to determine the potential of the nursing care insurance. In addition, Aflac Japan continues to work to strengthen the alliance with Japan Post, which resumed proactive sales of the cancer insurance on April 1.

We expect continued collaboration to further position both companies for the long-term growth and a gradual improvement of Japan Post cancer insurance sales in the intermediate term.

Now turning to Aflac U.S. We saw a strong profit margin of 22.2%. This result was driven by lower incurred benefits and higher adjusted net investment income, particularly offset by the higher adjusted expenses. Aflac U.S. also continued to have strong premium persistency of nearly 80%. Sales increased 35% for the quarter and are at approximately 78% of sales for the first 9 months of 2019. These sales results reflect what we believe are improving pandemic conditions in the United States, allowing us more face-to-face meetings and enrollments than prior periods. In the U.S., small businesses have gained some incremental ground toward recovery, which we expect to continue gradually.

Within the challenging small business and labor markets, we continue to make investments in developments of traditional independent sales agents that make up about 53% of our sales as of the third quarter of 2021. At the same time, larger businesses appear to be more resilient, given their traditional reliance on online self-enrollment tools, and we continue to invest in the group platform.

Group business, which is being driven by broker performance is performing very well. Excluding our acquired platforms, group sales have generated a year-to-date sales increase of 14% over the same period for 2019.

As we enter historically higher enrollment periods in the United States, we remain focused on being able to sell and service customers, whether in person or virtually. With an eye toward responding to the needs of consumers, businesses and our distribution, we continue to build out the U.S. portfolio with Aflac network Dental and Vision premier life and disability. These new lines modestly impact the topline in the short term.

These new products in combination with our core products, better position Aflac U.S. for future long-term success. Pandemic conditions have served to fuel our long-standing strategy of being where people want to purchase insurance in both the United States and in Japan. And while face-to-face sales remains the most effective way for us to convey the financial protection only Aflac products provide, the pandemic has clearly demonstrated the need for virtual avenues to help us reach potential customers.

We have continued to invest in tools for our distribution in both countries and to integrate these investments into our operations.

As always, we place significant importance on continuing to achieve strong capital ratios in the U.S. and Japan on behalf of our policyholders and investors. We remain committed to prudent liquidity and capital management. With the fourth quarter declaration, 2021 will mark the 39th consecutive year of dividend increases. Our dividend track record is supported by the strength of our capital and cash flows. At the same time, we will continue to be tactical in our share repurchase and focus on integrating the growth investments we've made in our platform.

We are well positioned as we work toward achieving long-term growth, while also ensuring we deliver on our promise to our policyholders. By doing so, we look to emerge from this period in continued position of strength and leadership and look forward to sharing more about our strategic and financial priorities at the financial analyst briefing on November 16, 2021.

Now let me turn the program over to Fred. Fred?

Frederick John Crawford
President & COO

Thank you, Dan. Recognizing we have our analyst and investor briefing scheduled in the next few weeks. I'll keep my comments brief before handing off to Max on the quarter's financial results. Beginning with Aflac Japan, as Dan noted, it was an unusual quarter with the states of emergency declarations across most of the country. Declarations are triggered in Japan by, among other things, a combination of rates of infection and hospital utilization by prefecture.

The precise impact is difficult to calculate, but the practical implications include reduced face-to-face consultations, limited access to on-site workers and payroll solicitation, reduced foot traffic to the roughly 400 owned and affiliated retail shops that we sell through and restricted travel between prefectures, which further constrains sales professionals.

When looking at claims experience through the third quarter and since inception of the virus, Aflac Japan's COVID impact has totaled approximately 31,000 claimants with incurred claims of JPY 5.6 billion. We expect conditions to improve and remain focused on what we can control, including product development and advancing our business model. Our medical product EVER Prime continues to do well with medical sales up roughly 14% in the quarter and 36% year-to-date over the same period in 2020. Our market share has improved, but we're still at roughly 85% of the medical sales enjoyed in 2019, which was also a medical product refresh year. So pandemic conditions in the quarter are having an impact.

Regarding our nursing care product. Since our late September launch, we have sold nearly 10,000 policies. This is a strong start, but within our expectations, given the marketing support put behind the product. From a risk perspective, this is a supplemental product aligned with coverage provided by the Japanese government and targeting the mass market. Benefits are, therefore, less rich and capped, both in amount and duration. The product is designed for protection versus savings with modest interest rate sensitivity.

In summary, the product has a similar risk profile to our existing third sector products. We continue the development of noninsurance services that wrap our cancer and now nursing care product offerings. This has become more common among the large domestic insurers and we see these services as important for both defending and building our market share.

Turning to the U.S., pandemic conditions remain at elevated levels with the spread of the Delta strain of the virus. As of the end of the third quarter, Aflac U.S. COVID claimants since inception of the virus, has totaled approximately 79,000 with incurred claims of $135 million. Dan covered overall U.S. sales conditions. I'll focus my comments specifically on our buy-to-build growth platforms. Our 2021 Dental and Vision strategy can be summed up as a year of launch, learn and adjust.

This quarter, we processed over 1,600 cases, up 30% over the second quarter, as we roll out training and development to agents and launch in additional states. We are focused on small- and medium-sized businesses with sold cases averaging around 95 employees. Looking forward into 2022, we continue building out our dental network and readying the platform for increased volumes as we move upmarket and introduce a direct-to-consumer individual product.

Our premier life and disability team successfully renewed 100% of their current accounts, a testimony to their high-quality service model. We are preparing to launch with Connecticut administering benefits for their statewide paid family and medical leave program in 2022. This is an administrative-only contract leveraging our acquired leave management platform.

With respect to our e-commerce initiative, Aflac Direct, we currently offer products in 46 states. We are actively building out a licensed call center and currently have 14 licensed agents. The call center platform is in the early days of building and augments our digital-only conversion rates as well as reduces operational dependency on call center vendors.

In the third quarter, these 3 platforms accounted for roughly 13% of sales and are expected to build as a percentage of sales and earned premium in the coming years.

Before handing off to Max, a few comments on operations. In Japan, we continue to drive volume through our online sales solution. Year-to-date, we have processed over 38,000 online applications with September being our largest month since launching the capability. We are pushing forward on technology and digital modernization and are sizing the investment required to streamline our policyholder services platform.

This is the largest operating platform in Japan and a key to driving down our long-term expense ratio. In the U.S., our premier life and disability platform completed a successful transition this month from Zurich on time, on budget and without client or customer disruption. We are focused on migrating our voluntary business to a new group administration platform and building out critical data connections with leading benefit administration and HR systems. The goal is to ensure ease of doing business, smooth onboarding and renewals and quality service and analytics.

When looking at our Japan and U.S. expense ratios going forward, we continue with critical platform development despite a period of weaker revenue. We expect to stay within previously guided ranges for expense ratios recognizing prolonged pandemic conditions require recalibrating the precise trajectory and timeline for reaching our ultimate targets.

Finally, at Aflac Global Investments, performance remains strong. We continue to advance our sustainable investing platform and recently refreshed our strategic asset allocation work. Our team will dive deeper into operations and strategic execution at next month's Analyst and Investor Briefing.

Let me now turn things over to Max to cover financial performance. Max?

Max Kristian Broden
Executive VP, CFO & Treasurer

Thank you, Fred. For the third quarter, adjusted earnings per share increased 10.1% to $1.53, with a $0.02 negative impact from foreign exchange in the quarter. This strong performance for the quarter was largely driven by lower claims utilization due to pandemic conditions, especially in Japan. Variable investment income ran $0.11 above our long-term return expectations. Adjusted book value per share, including foreign currency translation gains and losses, grew 10.1%. And the adjusted ROE, excluding the foreign currency impact, was a strong 16.2%, a significant spread to our cost of capital.

Starting with our Japan segment. Total earned premium for the quarter declined 4%, reflecting first sector policies paid-up impacts, while earned premium for our third sector products was down 2.6% due to recent low sales volumes. Policy count in-force, which we view as a better measure of our overall business growth declined 1.8%.

Japan's total benefit ratio came in at 66.1% for the quarter, down 520 basis points year-over-year, and the third sector benefit ratio was 55%, down 670 basis points year-over-year. We experienced a greater-than-normal IBNR release in our third sector block, as experience continues to come in favorable relative to initial reserving. Utilization continues to be constrained by pandemic conditions, and we now have more than a year's worth of pandemic data. And with that, our model output is more refined, leading to increased releases.

Adjusting for greater than normal IBNR releases and in-period experience, we estimate that our normalized benefit ratio for the third quarter to be 68.7%. Persistency remained strong with a rate of 94.5%, down 50 basis points year-over-year. Consistent with past refreshed product launches, we have experienced a slight uptick in lapse rates on our medical product, as policyholders look to update their coverage.

Our expense ratio in Japan was 21.4%, down 30 basis points year-over-year. Constrained business activity lowered our expenses in Q3, which we view to be a temporary phenomenon. We generally expect increased spending on key initiatives to continue and especially in Q4, as we tend to see some seasonality in spending and booking of projects.

Adjusted net investment income increased 19.7% in yen terms, primarily driven by favorable returns on our growing private equity portfolio and lower hedge costs, partially offset by lower reinvestment yield on our fixed rate portfolio. The pretax margin for Japan in the quarter was 26.3%, up 690 basis points year-over-year, a very good result for the quarter. This quarter's strong financial results lead us to expect the full year benefit ratio for Japan to be below the 3-year guidance range of 68.5% to 71% given at FAB. And the pretax margin to be above the 20.5% to 22.5% range given at -- for the full year 2021.

Turning to U.S. results. Net earned premium was down 1%, as lower sales results during the pandemic continue to have an impact on our earned premium. Persistency improved 110 basis points to 79.9%, 70 basis points of which are from lower sales, as first year lapse rates are roughly twice the level of in-force lapse rates.

In addition, there still remains about 40 basis points of positive impact from emergency orders. Our total benefit ratio in the U.S. came in lower than expected at 45.1% or 320 basis points lower than Q3 2020, which itself was heavily impacted by the initial pandemic.

Lower and deferred claims utilization impacts our IBNR held for incurred claims within a year. And as we get more data, our long-term models increased reliance on raw data leading to IBNR releases. This quarter, they amounted to a 3.5 percentage points impact on the benefit ratio, which leads to an underlying benefit ratio, excluding IBNR releases of 48.6%.

We expect the benefit ratio to increase gradually throughout the remainder of the year with the resumption of normal activity in our communities and by our policyholders. For the full year, we now expect our benefit ratio to be in the range of 43% to 46% versus original guidance of 48% to 51%.

Our expense ratio in the U.S. was 38.9%, up 170 basis points year-over-year, but with a lot of moving parts. Weaker sales performance negatively impacts revenue, however, the impact to our expense ratio is largely offset by lower DAC expense. Higher advertising spend increased the expense ratio by 40 basis points.

Our continued build-out of growth initiatives, group life and disability, network dental and vision and direct-to-consumer contributed to a 260 basis points increase to the ratio when isolating these investments. These important strategic growth investments are somewhat offset by our efforts to lower our core operating expenses, as we strive towards being the low-cost producer in the voluntary benefits space.

Net-net, despite a lot of moving parts, Q3 expenses are tracking according to plan. In the quarter, we also incurred $7.8 million of integration expenses, not included in adjusted earnings associated with recent acquisitions.

Adjusted net investment income in the U.S. was up 9.1%, mainly driven by favorable variable investment income in the quarter. Profitability in the U.S. segment remained strong with a pretax margin of 22.2%, with a low benefit ratio as the core driver.

With 9 months now in the books, we are increasing our pretax expectation for the full year. Initial expectations were for us to be towards the low end of 16% to 19%. We now expect to end up above the range indicated at FAB 2020.

In our Corporate segment, we recorded a pretax loss of $41 million, as adjusted net investment income was down $12 million versus last year due to low interest rates at the short end of the yield curve and change in value of certain tax credit investments. These tax credit investments run through the corporate net investment income line for U.S. GAAP purposes with an associated credit to the tax line. The net impact to our bottom line was a positive $5 million in the quarter. To date, these investments are performing well and in line with expectations.

In the fourth quarter, we do expect a significant tax credit investment to fund, which will bring some volatility to the corporate NII line as well as an offsetting credit to the tax line. Our capital position remains strong, and we ended the quarter with an SMR in Japan of north of 900% and an RBC north of 600% in Aflac Columbus. Unencumbered holding company liquidity stood at $4.2 billion, $1.8 billion above our minimum balance. Leverage, which includes the sustainability bond issued earlier this year, remains at a comfortable 22.6% in the middle of our leverage corridor of 20% to 25%.

In the quarter, we repurchased $525 million of our own stock and paid dividends of $220 million, offering good relative IRR on these capital deployments. We will continue to be flexible and tactical in how we manage the balance sheet and deploy capital in order to drive strong risk-adjusted return on equity with a meaningful spread to our cost of capital.

Finally, I would like to mention that we will begin to expand our disclosures around the adoption of LDTI in our Form 10-Q and at FAB. At a high level, we do not see this accounting adoption as an economic event with no impact to our regulatory financials or capital base. There will be no change to how we manage the company, cash flows or capital.
With that, I'll hand it over to David to begin Q&A.

Question and Answer

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

Thank you, Max. We are now ready to take your questions. [Operator Instructions]

Ian, we will now take the first question.

Operator

[Operator Instructions]

At this time, our first question comes from Nigel Dally of Morgan Stanley.

Nigel Phillip Dally
Morgan Stanley, Research Division

I wanted to touch on Japan sales. Hoping to get some color on a number of points. First, progression of sales throughout the quarter, in particular, whether you saw a sharp dip during the Olympics.

Second, as the emergency orders were lifted. Have you seen sales rebound if it's possible to comment on that.

And third, an update on the ramp-up in cancer sales within Japan Post?

Daniel Paul Amos
Chairman & CEO

Well, let me just get Aflac Japan to start with that, and then I may make a comment afterwards, but I think that'd be best. So Koide, however you want to handle this, please?

Masatoshi Koide
President, CEO & Representative Director

Yes. Yoshizumi-san will answer to this question.

Koichiro Yoshizumi
Executive VP, Assistant to the Director of Sales & Marketing and Director

[Interpreted]

This is Yoshizumi of Aflac Japan. Thank you for the question. Let me start from our situation in the third quarter. And in the third quarter, since we had the largest spread of COVID-19 due to Delta strain. And as a result of that, the state of emergency declaration, which only covered 20 prefectures in the second quarter increased to 33 prefectures in the third quarter.

In other words, the state of emergency declaration area covered 90% of population in Japan.

And so there were impact to our sales performance and results due to decrease in face-to-face both station and meetings with customers and also delaying some of the worksite for station as well as the number of traffic -- customer traffic coming into our walk-in shops.

And on top of that, there were some restrictions in traveling across prefectural borders, which prevented us from visiting customers. However, under this environment, we have been able to arrive at a point the same level of sales as with the third quarter last year. That is because of the online solicitation that we have conducted. And also the new product that we launched at the end of September, which was a new nursing care product. So as a result, we have been able to reach the same level of sales as in the third quarter last year.

Right now, in the fourth quarter, there is no area in Japan that is covered under the state of emergency declaration. And the economic activities are becoming much more active in Japan, although it's gradual. And we are expecting that our site sales will grow in the fourth quarter with -- by focusing on the sales of the nursing care product.

Daniel Paul Amos
Chairman & CEO

I will -- go ahead, please.

Masatoshi Koide
President, CEO & Representative Director

[Interpreted]

This is Masatoshi Koide from Aflac Japan. I will address the overall strategic alliance. But before doing so, Yoshizumi-san, would you please talk about our sales performance or prospects through the Japan Post channel.

Koichiro Yoshizumi
Executive VP, Assistant to the Director of Sales & Marketing and Director

[Interpreted]

Okay, once again, this is Yoshizumi. While the new policy sales increased over the second quarter. However, the pace of recovery has been moderate.

Well, this was driven by several factors, including that it has been approximately 2 years since Japan Post refrained from conducting proactive sales. States of emergency limited the ability of sales representatives in many areas to meet customers and preparations are underway for the upcoming transfer of sales employees from Japan Post Company to Japan Post Insurance.

We have been conducting a range of activities to help promote sales through the Japan Post channel. For example, in the third quarter, we conducted training aimed at improving Japan Post agent mindset and skills. We did so through activities to inform policyholders about the latest coverage and engaged in proposal activities for those not yet covered by cancer insurance.

We are currently promoting cancer insurance sales by managing the sales process, which includes approaching customers, getting to know their needs, informed them of the latest coverage, making proposals based on the proposal form and closing the deal. We are emphasizing with Japan Post to increasing the number of proposals.

As the Japan Post Group announced in September, approximately 10,000 sales employees to be transferred from postal network to Japan Post Insurance will offer only Japan Post Insurance and Aflac cancer insurance product.

We believe that preparations for the transfer and transition of these employees also affected third quarter sales activities. And against that backdrop, sales will continue to strengthen, but we expect that a full recovery will take time.

Okay. That's it for me. So I will give it back to Mr. Koide. Koide-san, please.

Masatoshi Koide
President, CEO & Representative Director

[Interpreted]

In the June agreement to further expand the strategic alliance, we confirmed that Aflac cancer insurance sales are an important part of Japan Post Group's co-creation platform vision which is a central theme of its medium-term management plan. We also confirmed that Japan Post Group will continue to promote cancer insurance sales as an important product in its sales strategy.

In October, Aflac and Japan Post Group senior executives held our quarterly strategic alliance committee meeting. At that meeting, the Japan Post Group President, Charles Lake, I and others met. We had a very constructive discussion about the current situation, including the pace of sales recovery and discussed specific measures to improve cancer insurance sales.

We walked away pleased by the strong commitment expressed to strengthen the alliance to achieve growth. Against that backdrop, we expect that cancer insurance sales through the Japan Post channel will steadily recover over the medium term.

Daniel Paul Amos
Chairman & CEO

All right. You heard a lot because there's been a lot going on because we consider this to be one of the most important issues that we are looking at. Let me just sum it up by saying that the third quarter definitely hurt our production everywhere because of people being required to stay at home under those emergency orders to some degree. And not like Europe, but strong enough that hurt sales. Has the attitude of the management team at Japan Post changed in any way from what it was earlier in the year? The answer is no.

We are aligned. They are large shareholders. They know that so goes their production will play a big impact on the company, Aflac specifically. And what will take place. Is it slower than we thought -- it's slower than I thought. I was hoping it would pick back up. But with the emergency, it did slow it down. Do I think they will recapture where they were? I absolutely do. Do I know the time on it? I do not. Do I think that top management is pushing it? Yes, I do think they're pushing it. Do I think the lower management levels are on board yet? I think they're very tentative because not about our products, but any products because they've been pushed by the FSA, not to make any mistakes to be -- so it's just a little bit slower getting them comfortable back to normal where they can begin to go.

So I still think we have a winner with Japan Post. I think it's nice that not only are they selling for us, but that they are a large shareholder because that ties us so closely together. So I know you've heard a lot about this, so I'll stop there. Thanks.

Frederick John Crawford
President & COO

Nigel, you also asked a very specific question about the quarter. Let me just give you some color. July was about JPY 4.4 billion in sales. August JPY 3.7 billion and September rebounded back to JPY 4.5 billion. That may suggest on the surface, some impact related to the Olympics, but it's extremely difficult to calculate that type of precise impact. I think the broader issue is states of emergency picking up throughout the quarter, as we discussed earlier. I'd also note that September had about 300 -- a little over 300 million of sales of the new care product, which we launched in the last 7 days of the month. So that will give you an idea of some of the trend dynamics.

Operator

Our next question comes from Humphrey Lee of Dowling & Partners.

Humphrey Lee
Dowling & Partners Securities, LLC

My first question is on the IBNR reserve releases, but more about the reserving practice. I feel like we've tried to get to a better understanding for a while now, but you have continued to see these favorable reserve releases for a number of quarters. I appreciate the guidance for the full year basis, that's helpful, at least for kind of looking at the fourth quarter.

But just can you walk us through your reserving process during the pandemic. And should we see more releases in the coming quarters as long as COVID is still around since on a rolling basis, the IBNR that you set up 12 months ago will have to be released if claims incidents remain low?

Max Kristian Broden
Executive VP, CFO & Treasurer

So Humphrey, so first of all, we have not changed our reserving practices. They continue the way they have always been, and follows the same methodology. When it comes to future reserve leases, that's very difficult to predict. But in general terms, I would say that if we continue to be in pandemic conditions with low claims utilization, you are likely -- and therefore, you're likely to continue to see some reserve releases come through our results, simply because we continue to reserve the way we have before. We have not adjusted our new claims reserving to the more recent claims utilization experience, but we continue to reserve to a more normalized claims expectation.

Humphrey Lee
Dowling & Partners Securities, LLC

Okay. Got it. My second question is related to the U.S. sales, especially those through your broker channel, which has continued to show good recovery. Given the channel has the largest production in the fourth quarter, have you seen any early signs of what the fourth quarter may look like through that channel?

Daniel Paul Amos
Chairman & CEO

Teresa?

Teresa Lynne White
President of Aflac US

Yes, this is Teresa. I'll make a couple of comments, and then I'll ask Virgil to respond specifically to the question. But as far as broker sales, first of all, we benefited from really stellar broker sales in the third quarter. We also benefited from veteran sales as well in existing and new accounts. From a broker standpoint, you know that during the quarter, we have the Delta variant.

So with that, we saw pressure with career agency sales. And so one of the ways that we mitigated that was to pivot and drive broker contracting so that we could set up the third and fourth quarter for good sales through that channel.

So I'll let Virgil respond with additional color.

Virgil R. Miller
Executive VP & President of Group & Individual Benefits Divisions

Yes. Thanks, Teresa. Just to add up a few things you said, Teresa. Within -- what we saw in the third quarter return about veterans. Veterans, we talk about really being 5-years plus. I saw a 10% increase over last year in the return of those veterans. That gives us a good start going in Q4, specific to the broker channel. Third quarter, we saw a 62% increase year-over-year. And also that was 112% performance compared to 2019 pre-COVID. I am optimistic we will see the same thing going into fourth quarter. Our pipelines are strong. And so therefore, we stick with our expectations going through the rest of the year.

Operator

Our next question comes from Jimmy Bhullar of JPMorgan Securities LLC.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

I just had a question on Japan sales, and you gave a very detailed response to the earlier question. But I think everyone was sort of surprised that sales declined on a sequential basis. And to the extent this was driven by more widespread emergency orders and the Olympics, I just wanted to see if you could comment on how you feel sales activity will pick up now that the orders have been lifted? And have you seen that already now that you've gone through the first month in the fourth quarter.

Frederick John Crawford
President & COO

Yes, Jimmy, 1 thing I would say and our Japanese colleagues can weigh in if they'd like, but a few things. One, I think we -- it's very difficult to give a precise percentage, if you will, as to what the impact of the rolling states of emergency and the Olympics are in the third quarter. And so that makes judging the fourth quarter more difficult. But we clearly expect conditions to be better in the fourth quarter.

We also -- as you remember, we only had 7 days -- or my earlier comments, we only had 7 days of the new care product sales in September. And we continue to see momentum through the first 20-plus days in October in that product. And then meanwhile, we continue to work with Japan Post. And so we have a positive view of the trend lines heading into the fourth quarter for all of those things, but it's very difficult to put sort of percentage or more precise guidance around that, and we wouldn't venture to do that. But certainly, conditions suggest that we will see some recovery.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

And then just on the U.S. business, can you sort of compare and contrast what's going on in the agency channel versus the broker channel, it seems like the broker business has obviously done better and then also similarly small versus larger employers where it seems like the larger employer markets coming back a lot faster than smaller employers.

Teresa Lynne White
President of Aflac US

I'll ask Virgil to respond to that.

Virgil R. Miller
Executive VP & President of Group & Individual Benefits Divisions

Yes. Thanks, Teresa. So first, I'll start on a large case market. In the large case market, like I said before, we've seen good performance with our overall broker channel, again, they're performing about 112% of 2019, predominantly selling the group product. Group product is dominating now in large case space. We've seen really 146% of 2019 sales when it comes to group. So I agree with you, we've seen strong recovery in the large case space. Really, that relates to the fact that the large case space is already really used to more virtual and online experience sales.

A little bit more, let's say, headwinds in smaller case. Small case that we continue to dominate with our career channel. Again, I iterated earlier that we saw a return of our veterans. We have veterans come back to produce in that third quarter that had not produced all year, so we're looking well. Add that 2 together, really, one of the things we've been doing, though, is ensuring that we go to market as a unified sales distribution channel.

Distribution continues to be a core competency of Aflac as it has always been. And you will see that for broker-driven sales in the lower case space, our agents participate in many cases, that's fulfillment. So that's a key aspect is there's overlap when the 2 work together also.

Frederick John Crawford
President & COO

One of the things that we're seeing, Jimmy, in the U.S. is you've read a lot about the labor markets. And when you think about the 3 to 99 space, which is where our agents sell, that's a particular part of the economy that obviously was hit harder and it's taking longer to recover from the pandemic. They're now facing a different kind of issue, and that is can they get the help to actually keep the businesses open and running properly.

So labor market conditions are very difficult to navigate right now for many small businesses. That same dynamic goes to our recruiting. So recruiting dynamics are more challenging in this type of a labor market. There's a lot of speculation about those conditions also starting to improve more so as we get out of the fourth quarter into early part of next year. But I just want to remind folks that you tend to think about the pandemic and that's, of course, affected small businesses, but labor market dynamics are also uniquely impactful to that franchise.

Operator

Our next question comes from Tom Gallagher of Evercore ISI.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Max, just a follow-up on some of the underlying claim trends you were referring to. The -- I heard what you said about U.S. is returning closer to normal, but Japan remains below normal. How much lower is Japan in terms of the underlying claims trends? Are we talking about 1% to 2% below normal? Is it closer to 5%? Can you comment on what the level is? And then also relatedly, how does that split between medical and cancer? Is it below normal for both? Or is 1 kind of driving that?

Max Kristian Broden
Executive VP, CFO & Treasurer

So Tom, specifically for Japan, it bounces around from month to month. But I would say that it's single digits below normal run rate. It is what we have experienced for an extended period of time. In the U.S., it's been a little bit more volatile where we've seen anything between 0% and 20% below normal sort of claims run rates. And more recently, we have approached more and sort of normal run rate, especially when we look at the -- for example, the first 2 weeks of the fourth quarter, we have come back to more -- certainly more normal levels.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Got you. And then the between medical and cancer in Japan, where -- is it across both or is it 1 or the other?

Max Kristian Broden
Executive VP, CFO & Treasurer

It's really both where we have seen it. It's for -- again, it's different for different benefits within those products. But generally speaking, when we sort of average it out and look at both product lines, we see similar impacts on both medical and cancer.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

And when you say single digit, is it mid-single digit or high or low?

Max Kristian Broden
Executive VP, CFO & Treasurer

Single digits.

Operator

Our next question comes from John Barnidge of Piper Sandler.

John Bakewell Barnidge
Piper Sandler & Co., Research Division

Sticking with the U.S. benefit ratio a little bit. I get it, it seems reasonable to assume claims utilization coming in that next quarter. But given the IBNR nature, how do we think about like the time decay of this as it leaks forward.

Daniel Paul Amos
Chairman & CEO

I think you were cut off. You might want to ask the question 1 more time because we only heard part of it.

John Bakewell Barnidge
Piper Sandler & Co., Research Division

I get it seems reasonable that claims utilization will normalize in that next quarter. But given the IBNR nature, how should we think about that time decay of that tailwind may be leaking into subsequent years?

Frederick John Crawford
President & COO

I'll kick off, and then I'll ask Al Riggieri, our Chief Actuary, to maybe give some comments as well. But generally speaking, you tend to see a quicker reaction to more recent claims trends in our U.S. business than what you see in Japan. But please, Al, if you would like to add some color, please.

Albert Riggieri

Sure. The U.S., as Max said, was a little bit more -- it fluctuates more. So you'd see a little bit more fluctuation around that. But we go through approximately 12 months of inquiries to really get zeroed in on the claims level. So it takes data and time to mature the information coming in and looking at it for IBNR.

So the judgment during the period, I'd expect it to continue to have a little -- a bit of a tail going out the back end through the remainder of COVID. But with -- as the claims rebound, you'll begin to see more of normalization back into normal sort of benefit ratio trends.

Operator

Our next question comes from Erik Bass of Autonomous Research.

Erik James Bass
Autonomous Research LLP

Max, can you just talk about how much capital generation is running ahead of your initial expectations this year, given the strong results? And how does that play into your outlook for capital deployment?

Max Kristian Broden
Executive VP, CFO & Treasurer

It clearly runs above what we initially expected. And you can essentially break it down as the upside is primarily driven by the lower-than-expected benefit ratios. They pretty much immediately flow through into higher statutory earnings and also higher FSA earnings as well, which then drives our capital formation and generation and ultimately, dividends up to the holding company.

So you can use the difference between our reported benefit ratios and our normalized benefit ratios as a guidance for what that sort of increased capital generation this year would be. Now when we then think about capital deployment, we have significant capital around the company and all the operating subsidiaries. We operate with very strong capital ratios.

And also at the holding company, we hold a very high level. Therefore, if our capital generation in a single year or a single period deviates from our initial expectations, it's not necessarily driving or changing our tactical view of how we deploy capital.

So I wouldn't necessarily immediately lead it into that from a -- on a short-term basis. Obviously, long term, it's more capital that we have available to us to deploy into our different deployment strategies.

Erik James Bass
Autonomous Research LLP

Got it. And then as a follow-up. Fred, you mentioned some of the ancillary products and services that you could offer kind of around the cancer and senior care product. Just want to get a sense of what those might be and how you would, I guess, bring those to market?

Frederick John Crawford
President & COO

Yes. It's becoming a very developed approach by not many, but a few of the leading insurance companies in Japan. And it's largely developed around care products historically, and that is offering certain concierge services for the elderly that are attached to elderly care insurance policy support, everything from nursing care support to in-home modernization to reduce the risk of injury, et cetera.

You're seeing some of that, of course, go on in the U.S., and it's going on in Japan, too. Our approach has been to, a, make sure that we're building out those types of services around the care product. But also, we think there's an opportunity for particularly Aflac to do that in the cancer space. And the way to think about it, we have formed an entity in Japan called Hatch health care. And that entity has been building out these noninsurance services surrounding cancer and now care insurance.

And effectively, the way it works is you as a policyholder, have an ability to call in to effectively a concierge desk that then helps direct you to either internal or third-party contractual agreements to support both diagnosis and early screening type services on cancer as well as post-cancer diagnosis care, everything from nutrition to mental health to other dynamics.

And so this is in the early stages of being built. We've been working on it for about 2 years now. It's now starting to become in a spot to be put into action.

But we think this is really the next horizon, if you will, of securing our market share and building our capabilities on the cancer side. And then also, it's really a necessary entity in supporting care insurance and competing with the other big care providers in the country.

Erik James Bass
Autonomous Research LLP

Got it. Is it fee for service or part of your covered under your premium?

Frederick John Crawford
President & COO

Yes. Essentially, it's covered under the premium. And then once you funnel through a concierge desk. It depends on what services you request and then there are charges that are applied through third-party contractual arrangements predominantly. That is the vision at the moment. So it's more around customer service, persistency, sales opportunity and market share. I should note that these types of services would also be offered on cancer policies sold through Japan Post. So it's really both a defensive and offensive play. But ultimately, this Hatch health care entity would drive its own independent revenue through contractual relationships and margins with third-party providers.

By the way, these are the types of things we would develop more at the financial analyst briefing because it's probably better done there. But just to provide you some color.

Operator

Our next question comes from Ryan Krueger of KBW.

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

Max, could you talk a little bit about your -- the potential uses of excess capital at both the holding company and in the U.S. subsidiary over the next few years? And if you'd look to work that down?

Max Kristian Broden
Executive VP, CFO & Treasurer

Yes. So let's start with the U.S. Clearly, we are carrying excess capital right now. But we also have a number of growing businesses that are building. And we would expect over time that, that will drive through growth, that will drive quite some new business strain. And if we are successful in really executing on our plans, that will gradually drive down the capital level towards a long-term RBC ratio of 400%.

When we move up to the holding company, we clearly have significant readily deployable capital at $1.8 billion as of today. This will continue to support the deployment strategies that we have through dividends. We increased the dividend earlier this year by 17.9%. We have a very long-standing track record, as Dan mentioned, in terms of continuing to increase the dividend.

We have done a number of smaller acquisitions as well, where we have allocated capital to. And we've been an very active acquirer of our own stock as well. So I would expect that all of these to continue. I see the same headlines as all of you in terms of tax surcharge on buybacks. And obviously, we will study the details very, very closely. And that may mean that we will change our strategy somewhat. But long term, I don't see that as a significant change to how we generally funnel the capital back to shareholders.

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

And then just 1 follow-up since you mentioned you were going to start providing more LDTI disclosure. Have you had conversations with the rating agencies on, I guess, debt to capital levels, given the potential impact to equity and kind of confirmed with them that your debt is still appropriate.

Max Kristian Broden
Executive VP, CFO & Treasurer

We've had a number of conversations with rating agencies and, quite frankly, for quite some time, we began already in 2019 to have close discussions with them and they have continued throughout the LDTI project.

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

All right. I just want to thank everyone for joining us and remind you that, as mentioned today, we will be hosting our Virtual 2021 Financial Analyst Briefing on November 16, beginning at 8 a.m. Eastern. Registration opens today. So keep an eye out for that and reach out to Investor and Rating Agency Relations if you need more details or have questions. And we look forward to having you join us then on the 16th and wish you all continued good health until then. That concludes our call for today.

Operator

The call has now concluded. Thank you for attending today's presentation. You may now disconnect.