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# Aflac Incorporated NYSE:AFL

*Earnings Call*

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# Call Participants

## EXECUTIVES

**Bradley Eugene Dyslin**
*Executive VP, Global Chief Investment Officer & President of Aflac Global Investments*

**Daniel Paul Amos**
*President, Chairman & CEO*

**David Young**

**Koichiro Yoshizumi**
*Senior Managing Exec. Officer and Asst. to the Director of Sales & Marketing*

**Masatoshi Koide**
*President, CEO & Representative Director*

**Max Kristian Broden**
*Executive VP & CFO*

**Virgil Raynard Miller**
*President of Aflac U.S.*

## ANALYSTS

**Elyse Beth Greenspan**
*Wells Fargo Securities, LLC, Research Division*

**Jamminder Singh Bhullar**
*JPMorgan Chase & Co, Research Division*

**Joel Hurwitz**

**Joshua David Shanker**
*BofA Securities, Research Division*

**Suneet Laxman L. Kamath**
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**Thomas George Gallagher**
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**Wesley Collin Carmichael**
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# Presentation

**Operator**

Good day, and welcome to the Aflac Incorporated First Quarter 2024 Earnings Conference Call. [Operator Instructions] Please note this event is being recorded. I would now like to turn the conference over to David Young, Vice President, Investor and Rating Agency Relations. Please go ahead.

**David Young**

Good morning, and welcome. Thank you for being here a bit earlier than our usual start time. This morning, Dan Amos, Chairman, CEO and President of Aflac Incorporated, will provide an overview of our results and operations in Japan and the United States. Then Max Broden, Executive Vice President and CFO of Aflac Incorporated, will provide an update on our financial results and current capital and liquidity.

These topics are also addressed in the materials we posted with our earnings release and financial supplement on investors.aflac.com, including Max's quarterly video update. We also posted under Financials on the same site, updated slides of investment details related to our commercial real estate and middle market loans. For Q&A today, we are also joined by Virgil Miller, President of Aflac U.S.; Charles Lake, Chairman and Representative Director, President of Aflac International; Masatoshi Koide, President and Representative Director, Aflac Life Insurance Japan; and Brad Dyslin, Global Chief Investment Officer, President of Aflac Global Investments.

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.

**Daniel Paul Amos**
*President, Chairman & CEO*

Thank you, David, and good morning, and we're glad you joined us at this earlier hour. The first quarter marked a good start for the year in terms of earnings, but proved to be challenging for sales. Aflac Incorporated delivered another solid earnings result. Net earnings per diluted share for the quarter were $3.25. On an adjusted basis, earnings per diluted share were up 7.1% to $1.66.

Beginning with Japan, our latest medical insurance launch in September of 2023, we are encouraged by the success that independent corporate and individual agencies have had in marketing this product, especially to the younger individuals. However, we clearly need to make better progress and plan on doing so. Cancer insurance sales, however, were modestly better year-over-year. We entered the final stage of our new cancer insurance launch in April of 2023 through the Japan Post channel, while we saw a significant and understandable year-over-year increase in cancer insurance sales through Japan Post channel.

We expect to see improvement with the start of the new fiscal year as they cross-sell Aflac cancer insurance along with the new Japan Post life insurance product. Being where customers want to buy insurance remains an important element of our growth strategy in Japan. Our broad network of distribution channels, including agencies, alliance partners and banks, continually optimize opportunities to help provide financial protection to Japanese consumers. We will continue to work hard to support each channel.

In addition, we are initiating sales campaigns around our 50th anniversary in Japan starting this quarter. Let me be clear, we have not lowered our sales outlook for 2024 and still expect to achieve it. With the launch of the new policy this quarter, Koide-san and his team are working hard achieving that objective.

In addition, we have maintained disciplined underwriting and expense management to continue driving strong pretax profit margins of 32.8%.

Turning to the U.S. As you've seen in prior years, the first quarter tends to generate the lowest sales of the year. We have focused on driving more profitable growth by exercising a stronger underwriting discipline. We are deliberately avoiding sales opportunities to certain less profitable accounts. While this appears to have a temporary impact on sales in the first quarter, we are seeing positive results in net earned premium growth, which grew 3.3%.

At the same time, we have increased benefits in certain cases to improve value for the policyholders. We believe persistency will continue to improve as customers realize the value of their policies and the related benefits. We are pleased with the 80 basis points improvement in persistency this quarter. I believe that the need for the products we offer is as strong or stronger than it has ever been before in both Japan and the United States. We continue to work to restore our momentum and reinforce our leading position as we aim to exceed $1.8 billion of sales by the end of 2025.

We have also continued our disciplined approach to expense management. We are beginning to see progress on our expense ratio in group life and disability and consumer markets continue to grow in scale. We are continuing to focus on optimizing our dental and vision platform and expect to see stronger second half sales this year. At the same time, we have maintained a strong pretax margin of 21%. Overall, I'm very pleased with what Virgil and his team are doing to balance profitable growth, enhance the value of the proposition of our policyholders and curb the expense ratio.

I'd like to end on addressing our ongoing commitment to prudent liquidity and capital management. I'm very pleased with how Max has led the team to take proactive steps in recent years to defend our cash flows and deployable capital against a weakening Yen as well as the establishment of our reinsurance platform in Bermuda. As an insurance company, our primary responsibility is to fulfill the promises we make to our policyholders while being responsive to the needs of the shareholders.

We remain committed to maintaining strong capital ratios on behalf of the policyholders. We balance this financial strength with tactical capital deployment. We intend to continue prudently managing our liquidity and capital to preserve the strength of our capital and cash flows. This supports both our dividend track record and our tactical share repurchase.

We treasure our track record of 41 consecutive years of dividend growth and remain committed to extending it. I am pleased that the Board set us on a path to continue this record, when it increased the first quarter 2024 dividend 19% to $0.50 and declared the second quarter dividend of $0.50. We repurchased a record $750 million in shares in the first quarter and intend to continue our balanced and tactical approach of investing in growth and driving long-term operating efficiencies. Our management team, employees and sales distribution continue to be dedicated stewards of our business, being there for our policyholders when they need us most, just as we promised.

This underpins our goal of providing customers with the best value in the supplemental products in the United States and in Japan. In 2024, we celebrated our 50th year of doing business in Japan and 50th year as a publicly traded company on the New York Stock Exchange. We are reminded that one thing has not changed since our founding in 1955. Families and individuals still seek to protect themselves from financial hardships that not even the best health insurance company covers.

Today's complex healthcare environment has produced incredible medical advances that come with incredible cost. It's more important than ever to have a partner. We believe our approach to offering relevant products makes us that partner. We believe that in the underlying strengths of our business and our potential for continued growth in Japan and the U.S., two of the largest life insurance markets in the world, Aflac is well positioned as we work toward achieving long-term growth while also ensuring we deliver on our promise to our policyholders.

I'd now like to turn the program over to Max to cover more details of the financial results. Max?

**Max Kristian Broden**
*Executive VP & CFO*

Thank you for joining me, as I provide a financial update on Aflac Incorporated's results for the first quarter of 2024.

For the quarter, adjusted earnings per diluted share increased 7.1% year-over-year to $1.66 with an $0.08 negative impact from FX in the quarter. In this quarter, remeasurement gains totaled $56 million and variable investment income ran $11 million or $0.01 per share below our long-term return expectations. Adjusted book value per share, including foreign currency translation gains and losses, increased 8.7%, and the adjusted ROE was 13.7%, an acceptable spread to our cost of capital.

Overall, we view these results in the quarter as solid. Starting with our Japan segment. Net earned premiums for the quarter declined 6%. This decline reflects a JPY 6.2 billion negative impact from paid-up policies. In addition, there is a JPY 7 billion negative impact from internal reinsurance transactions and a JPY 1.4 billion positive impact from deferred profit liability. Lapses were somewhat elevated, but within our expectations. At the same time, policies in force declined 2.3%.

Japan's total benefit ratio came in at 67% for the quarter, flat year-over-year. And the third sector benefit ratio was 57.5%, down approximately 20 basis points year-over-year. We continue to experience favorable actual to expected on our well-priced, large and mature in-force block. We estimate the impact from remeasurement gains to be 144 basis points favorable to the benefit ratio in Q1 2024. Long-term experience trends, as it relates to treatment of cancer and hospitalization, continue to be in place, leading to continued favorable underwriting experience. Persistency remained solid with a rate of 93.4%, which was down 50 basis points year-over-year, but flat quarter-over-quarter.

We tend to experience some elevations in lapses as customers update and refresh their coverage. This change in persistency is not out of line with expectations. Our expense ratio in Japan was 18%, down 170 basis points year-over-year, driven primarily by good expense control and to some extent, by expense allowance from reinsurance transactions. Adjusted net investment income in yen terms was up 19.3%, mainly by lower hedge costs and favorable impact from FX on our U.S. dollar investments in yen terms as well as higher return on our alternatives portfolio compared to the first quarter of 2023.

This was offset by the transfer of assets due to reinsurance in the previous year, leading to a lower asset base and lower floating rate income. The pretax margin for Japan in the quarter was 32.8%, up 460 basis points year-over-year, a very good result.

Turning to U.S. results. Net earned premium was up 3.3%. Persistency increased 80 basis points year-over-year to 78.7%. This is a function of a poor persistency quarter falling out of the metric and stabilization across numerous product categories. Our total benefit ratio came in at 46.5%, 90 basis points higher than Q1 2023, driven by product mix and lower remeasurement gains than a year ago. We estimate that the remeasurement gains impacted the benefit ratio by 200 basis points in the quarter.

Claims utilization has stabilized, but as we incorporate more recent experience into our reserve models, we have released some reserves. Our expense ratio in the U.S. was 38.7%, down 90 basis points year-over-year, primarily driven by platforms improving scale and lower acquisition expenses. Our growth initiatives, group life and disability, network dental and vision and direct-to-consumer increased our total expense ratio by 230 basis points. We would expect this impact to decrease going forward as these businesses grow to scale and improve their profitability.

Adjusted net investment income in the U.S. was up 4.6%, mainly driven by higher yields on both our alternatives and fixed rate portfolios. Profitability in the U.S. segment was solid with a pretax margin of 21%, driven primarily by net earned premiums growth and improved net investment income year-over-year. Our total commercial real estate watchlist remains approximately $1.2 billion, with around $600 million of these in active foreclosure proceedings. As a result of these current low valuation marks, we increased our CECL reserves associated with these loans by $10 million in this quarter.

We also moved 1 property into real estate owned, which resulted in a $3.7 million gain. We continue to believe that the current distressed market does not reflect the true intrinsic economic value of our portfolio, which is why we are confident in our ability to take ownership of these quality assets, manage them through the cycle and maximize our recoveries.

Our portfolio of first lien, senior secured middle market loans continue to perform well with losses well below our expectations for this point in the cycle. In our Corporate segment, we recorded a pretax loss of $3 million. Adjusted net investment income was $43 million higher than last year due to higher volume on the investable assets at Aflac REIT and a lower volume of tax credit investments at Aflac Inc. These tax credit investments impacted a corporate net investment income line for U.S. GAAP purposes negatively by $32 million, with an associated credit to the tax line.

The net impact to our bottom line was a positive $4 million in the quarter. To date, these investments are performing well and in line with our expectations.

We are continuing to build out our reinsurance platform, and I am pleased with the outcome and performance. Our capital position remains strong and we ended the quarter with an SMR above 1,100% in Japan, and our combined RBC, while not finalized, we estimate it to be greater than 650%. Unencumbered holding company liquidity stood at $3.7 billion, $2 billion above our minimum balance. These are strong capital ratios, which we actively monitor, stress and manage to withstand credit cycles as well as external shocks.

U.S. statutory impairments were a release of $3 million. And Japan FSA impairments were JPY 3.6 billion or roughly $24 million in Q1. This is well within our expectations and with limited impact to both earnings and capital. Adjusted leverage remains at a comfortable 20.4%, at the low end of our leverage corridor of 20% to 25%.

In the quarter, we issued JPY 123.6 billion in multiple tranches with an average coupon of 1.72%. As we hold approximately 60% of our debt denominated in yen, our leverage will fluctuate with movements in the yen/dollar rate. This is intentional and part of our enterprise hedging program, protecting the economic value of Aflac Japan in U.S. dollar terms. We repurchased $750 million of our own stock and paid dividends of $288 million in Q1, 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 ROE with a meaningful spread to our cost of capital.
I'll now turn the call over to David so that we can begin our Q&A.

# Question and Answer

**David Young**

Thank you, Max. Before we begin, I just want to remind everyone, please mark your calendars for our financial analyst briefing on December 3 at the New York Stock Exchange. We'll have more information coming out. [Operator Instructions].

**Operator**

[Operator Instructions] The first question today comes from Elyse Greenspan with Wells Fargo.

**Elyse Beth Greenspan**
*Wells Fargo Securities, LLC, Research Division*

My first question, starting with U.S. sales, which you guys said were weaker than expected in the quarter, but you did reaffirm the longer-term guidance for sales in that business. So can you just give us a sense of how you expect sales in the U.S. to trend from here?

**Virgil Raynard Miller**
*President of Aflac U.S.*

This is Virgil from the U.S. First, let me start with a little bit more color on how sales performed in Q1. As you mentioned, they were a little bit softer for Q1. A couple of drivers for that. First, let me start with our plans, our life, absence and disability business. Normally, that is a business that takes place the latter part of the year. Well, last year, in 2023, we did have some business process in Q1, so therefore, we were down with that comparison. That is an anomaly. That normally doesn't happen. So again, I expect continued strong performance from that line of business for the remainder of the year. So that was a timing element.

The other timing element involved on the dental and vision business. As Dan mentioned in his opening, we continue to work on optimizing that platform. So we had softer sales. We have a dental product. We're expecting to continue to build out that platform, make those improvements and have a stronger year in the second half of the year.

Last, I will close with -- to emphasize, though, I will continue to focus on our strong underwriting discipline. To give more color on that, we're really looking to bring on business that has long-term profitability, which we believe has strengthened the company over a long-term range. This allows us to pay claims and return shareholder value and also helps us with building on persistency. So we do have an improvement in persistency of 80 basis points. We had higher earned premium of 3.3% and we had strong profitability of 21% -- profit margin of 21% in the quarter. So we believe this is the rightly way to manage the company going forward.

**Elyse Beth Greenspan**
*Wells Fargo Securities, LLC, Research Division*

And then my follow-up, shifting to sales in Japan. The third sector sales went negative this quarter. You guys did highlight some initiatives you have to improve sales in Japan. But just hoping you could provide more color specifically on how you expect the third sector sales to trend over the course of 2024.

**Daniel Paul Amos**
*President, Chairman & CEO*

Let me let Aflac Japan answer that, but I think the most important thing is we still expect to attain our objective for the full year. So Koide, would you mind taking that or Yoshizumi.

**Koichiro Yoshizumi**
*Senior Managing Exec. Officer and Asst. to the Director of Sales & Marketing*

[interpreted] Thank you for the question. This is Yoshizumi, I will be answering your question. Starting from 2024, what we are expecting is that we expect to exceed 2023 results. Due to the following reasons, we are expecting our sales will recover. Number one, we are planning to enhance our associates' channel sales agents, I mean increase the number of sales associates. And in 2023, we approximately hired 600 new sales agents -- recruited and have enhanced their training. We are expecting that these 600 will become more productive in the second quarter and be successful.

And we are also continuing agent recruitment in 2024 and taking steps to ensure their effectiveness. And the second point is that we are going to be promoting the sales of Japan Post new product as well as our cancer product through the Japan Post channel. And we do expect that cancer insurance sales will increase in the second quarter. And then my third point is related to Yorisou Cancer Consultation Support, which has been highly rated by our customers. This is our consultation service for our customers that could further differentiate ourselves from our competitors.

And we will be using TV commercials, web video ads, et cetera, and leverage them to differentiate further against our competitors. And my fourth point is that we have plans to implement measures to attract more young and middle-aged customers as medical insurance has been well received among those segments and with significant growth at large nonexclusive agencies.

And furthermore, we are planning to launch a new asset formation type of product in June. The product will include future nursing care coverage feature that will bring value to young customers. We also expect to sell additional third sector product to these new customers through concurrent and follow-on sales. And by implementing these measures, we expect an increase in second quarter sales and exceed 2023 results, and as we aim to steadily increase sales. We are aiming for a steadily increase in sales toward our 2026 targets. That's all from me.

**Operator**

The next question comes from Tom Gallagher with Evercore.

**Thomas George Gallagher**
*Evercore ISI Institutional Equities, Research Division*

Just wanted to circle back on Japan sales. Do you think the issue, as you try and assess it today, is more of an industry issue? Is it Aflac-specific? The reason I ask is I think you mentioned you're deliberately not underwriting certain products in Japan. When I hear that, I think that implies there's some irrational pricing or product features that you don't like. So just a little bit of color on what's going on? Is it medical, where that's happening? And overall, how do you see that playing out?

**Daniel Paul Amos**
*President, Chairman & CEO*

Let's let our Japanese cover that, and I don't -- I'll pick up on it a little bit more, too.

**Koichiro Yoshizumi**
*Senior Managing Exec. Officer and Asst. to the Director of Sales & Marketing*

[interpreted] This is Yoshizumi once again. Let me answer your questions. Regarding the medical insurance sales, we have been increasing our sales on year-on-year basis, especially to those customers under age 50 or 40 and below. And also, this -- our sales in large nonexclusive agency sales on a year-on-year basis, increasing significantly this year. And this large nonexclusive agency sales is a benchmark to see how well the medical insurance is doing.

We are planning to roll out promotional measures to further enhance our sales to young and middle aged customers, who we have been selling already successfully. That's all for me.

**Masatoshi Koide**
*President, CEO & Representative Director*

[interpreted] This is Aflac Japan, Koide. I would like to be adding a few comments. In Japan right now, third sector sales is becoming more and more competitive year-on-year. And our strategy is to have solid sale by meeting these customers under the very competitive situation by launching new products in both medical and cancer insurance. And we'd like to do this in a timely manner by really taking in the needs of customers.

And as Yoshizumi-san mentioned earlier, regarding the associates channel sales agents increase, particularly as we increase the number of sales agents, we are not only increasing the headcount, but we are also trying to increase the productivity per head per year through training. In that way, we should be able to increase our sales and strengthen our sales in third sector. Another strength of Aflac in Japan is that we have very strong alliance across the entire Japan, namely the Japan Post network because Japan Post has a nationwide network that can sell our products.

And as Yoshizumi-san mentioned, the Japan Post network sales recovery is taking a bit more time. However, just as Yoshizumi-san mentioned, Japan Post Insurance sales is increasing, especially in its activity volume. So not will they only be only increasing their sales activities and association activities, they will also -- they should also be increasing the actual sales on cancer, and that's what we are hoping to have done. That's all from us.

**Thomas George Gallagher**
*Evercore ISI Institutional Equities, Research Division*

Dan, anything you would add? Or should I ask a follow-up?

**Daniel Paul Amos**
*President, Chairman & CEO*

Yes. Okay. Let me make a couple of comments, and then anything else you want to ask, we'll be glad. First of all, our cancer insurance is doing very well, both through our existing distribution channel and Japan Post. The other thing I would say is that the medical products are more competitive, and we have to continue to watch that. That's really nothing new, but it hasn't slacked up. And then we don't sell the foreign currency products that some of our competitors sell. We just don't think we want to take on that exposure and pass it on to our customers. And so we haven't done that. So I think those are the real differences that are created. Any other question you had, Tom?

**Thomas George Gallagher**
*Evercore ISI Institutional Equities, Research Division*

Yes. And just for a follow-up, the weaker persistency in Japan. Can you talk a little bit about what you're seeing there from a product standpoint? Is that cancer and medical that you're seeing it on? And do -- is it just lapsing of coverage? Or is it switching to other companies, do you suspect?

**Max Kristian Broden**
*Executive VP & CFO*

So Tom, let me take that. One of the main reasons is that we obviously have an aging block of in-force. So our new sales is lower than our lapsation. That means you have a natural aging of the overall block, yes. When you have that, then you're going to see some higher surrenders, lapses and also mortality associated with the overall block. So it's very natural when you have an aging block that you have higher lapses. That in combination with -- we've also now -- in the last 5, 6 years, we moved into a little bit of a shorter product cycles. When you have that and you refresh products, you tend to have a little bit higher structural lapse and reissue come through your block. So I would point those are the 2 main reasons why we are probably in an environment now where you have a slightly lower persistency now structurally than what we did see 5, 6 years ago.

**Operator**

The next question comes from Jimmy Bhullar with JPMorgan.

**Jamminder Singh Bhullar**
*JPMorgan Chase & Co, Research Division*

So the first question is just along the lines of what's been discussed already. And I think Virgil mentioned this as well. This is in your press release also, Dan. Just disciplined underwriting is not something that people generally associate with Aflac because your products have pretty high margins, just given the nature of your business. So I'm wondering what's changed? Because it seems like the environment for pricing in your business -- with higher interest rates, you could potentially even price them better than before. So wondering if it's outside factors that have gotten worse? And maybe you could talk about the U.S. as well, where you're seeing your competitors trying to be more aggressive? Or what's really different now than before? Because it's not like before you weren't trying to be disciplined, right? So just anything that you could sort of highlight on that, especially in the U.S. market, you talked a little bit about Japan.

**Virgil Raynard Miller**
*President of Aflac U.S.*

Yes. Let me add to that. Again, this is Virgil. I just want to say that what you're seeing is the evolution of our block of business. Our group voluntary benefit business has continued to grow over the past several years. And really, when we talk about that underwriting discipline, that is where you're most are going to see that. If there's strong competition out there, fierce competition in the group business, and what we're doing is making sure though that we are able not only to compete, but we want to look at the business that yields profits.

So any time you bring in new business on the books, of course, there is acquisition expenses and everything that go into that, we want to make sure that we're getting the right business on the books that has the tendency to persist. So we're able to end up absolutely making profit on that business over a couple of years' period.

**Daniel Paul Amos**
*President, Chairman & CEO*

And if you think about it a minute, it will make plenty of sense is that -- you take an account that has high lapsation, then you have a low benefit ratio and you have a high expense ratio and basically no profit. So you actually improve every aspect of the business -- the overall business when you just don't write it. And that's what we've been looking at and seeing and then that allows us by doing that for our -- as we've increased benefits and other policies to move it up and give a better value. So it's a good balance that we think ultimately creates value not only for the policyholder, but ultimately for the shareholders as well.

**Jamminder Singh Bhullar**
*JPMorgan Chase & Co, Research Division*

Okay. And then, Max, do you have an update on the Japan ESR and its potential impact on your Bermuda reinsurance or just overall capital management strategy?

**Max Kristian Broden**
*Executive VP & CFO*

So our ESR in Japan continues to track well. We are running a little bit north of 250% on our ESR based on our internal model. We would expect relatively soon in the second quarter for the FSA to come up with a final calibration. I would not anticipate that, that would have a material impact on our -- i.e., the difference between the FSA calibration and our current internal model. So I wouldn't expect to have that number move materially.

But then obviously, we will assess the ESR based on that, and we will talk about it in more detail in December. But currently, we're tracking on our internal model a bit north of 250%.

**Operator**

The next question comes from Joel Hurwitz with Dowling and Partners.

**Joel Hurwitz**

So Japan continues to see pretty strong remeasurement gains. Can you just talk about the underlying claim trends that you're seeing there? And I guess if this level of favorability of the remeasurement gains persists, should we likely see a bigger unlocking this year or would more experience be needed?

**Max Kristian Broden**
*Executive VP & CFO*

So Joe, the main driver continues to be the hospitalization trends that have been favorable for a long, long period of time, and they quite frankly have continued to improve. The way we do -- when we do our reserving, we are looking to true up to current experience, but we don't necessarily anticipate that it will be a continued future improvement in that experience. And that's why you see these -- if the hospitalization trends continue to improve from current levels, then you could see in the future but that will lead to future remeasurement gains as well. But if they stabilize at current levels, then you wouldn't necessarily see that.

**Joel Hurwitz**

Okay. Makes sense. And then just in Japan expenses, they came in very favorable this quarter. How much of that was cost controls that could be sustainable longer term versus just seasonality or timing?

**Max Kristian Broden**
*Executive VP & CFO*

Yes. There's a significant element of both seasonality and timing in this number. And for the full year, we are tracking towards our expense ratio outlook of 19% to 21%.

**Operator**

The next question comes from Josh Shanker with Bank of America.

**Joshua David Shanker**
*BofA Securities, Research Division*

There's a lot of news out there right now about the Japanese government doing some major intervention to support the yen. What does that mean for the cost of your hedging program?

**Max Kristian Broden**
*Executive VP & CFO*

So Josh, volatility can obviously impact the pricing of options. That will be -- that together with all the other sort of normal inputs into the pricing of an option would be the main impact from that. The level itself has less impact to the ultimate cost of those put options. So at this point, we see relatively limited impact to the pricing of options. Quite frankly, I think that the volatility in the yen -- even though it's been trending, the short-term volatility has been quite low recently.

So given that, we don't see any significant impact. I would tell you, though, that obviously -- that there's been a significant move overall in the yen because it's been trending and it has been weakening. And that obviously has an impact to all of our financial statements and capital ratios. The way we approach this is that we take an economic view and we try to protect the economic value of Aflac Japan with a holding company lens. And we feel that we are very well protected with the 3 levers that we are using to do that. That being the U.S. dollar assets we hold in a Japanese general account. That being the yen-denominated debt that we issue out of the holding company and then also the FX forwards that we have at the holding company. So we have designed this program with these kind of moves in mind. And at this point, the program overall is performing very well.

**Joshua David Shanker**
*BofA Securities, Research Division*

And look, I don't want to lessen the significance of a very large dividend increase as well as a lot of shares bought back in the quarter, but it seems to me that the capital ratios are even higher now at the end of the first quarter than they were at the end of this past year. I've been harassing David a little bit on better color, but can you walk through all the gating factors in your internal model that guide your willingness to return capital to shareholders?

**Max Kristian Broden**
*Executive VP & CFO*

So the overall return on capital to shareholders is really, quite frankly, driven by, number one, satisfy the capital ratios in the subsidiaries, and that means all of the subsidiaries. Then we look at the pool of capital that we have at the holding company, which currently sits at $3.7 billion on an unencumbered basis, which is roughly $2 billion north of our minimum liquidity level. We then think about what is the capital generation going forward. And that helps us then think about how we can deploy capital, both short term, i.e. in the next couple of quarters, but also long term, i.e., thinking about what it's going to look like over the next 2, 3, 5 years as well.

That helps us sort of guide then also what kind of returns we can expect on dividend, buybacks, et cetera, when we take these into account what other alternatives we have for that capital. And obviously, we try to deploy the capital in the areas where we think we can get the best IRR.

**Operator**

The next question comes from Wes Carmichael with Autonomous Research.

**Wesley Collin Carmichael**
*Autonomous Research US LP*

In the transitional real estate portfolio, Max, I think you mentioned foreclosing on a loan and taking it on balance sheet as real estate owned. Can you just talk about are there other loans that you're monitoring right now? And maybe just give us an update on the size of the overall watchlist there?

**Bradley Eugene Dyslin**
*Executive VP, Global Chief Investment Officer & President of Aflac Global Investments*

Sure. Wes, this is Brad Dyslin. In the quarter, we saw our overall commercial real estate, which is predominantly the transitional real estate, as you've called out, the watchlist has been relatively stable. Our overall foreclosure watchlist is about $1.2 billion. Of that, about half is in active workout proceedings where we are fully prepared to foreclose on the property. We did have one, as you mentioned, that we foreclosed in the quarter. We were actually able to book a small gain on that. The accounting rules are such that if the appraised value exceeds our loan value, we're able to book it at the higher value. It's a pretty small number, but it does highlight the value of disciplined underwriting and maintaining a good, solid loan-to-value on the underlying assets.

Generally, things were stable in the quarter. We are seeing some very early signs of life in the market. We're seeing headlines about a lot of capital being raised in different outlets, focused on commercial real estate. That will certainly help with liquidity. It's a little bit early, but we're optimistic that we could be turning a corner here in the next couple of quarters. Of course, all eyes are on the Fed right now to see the impact that will have. But all in all, nothing really significant to happen to our watchlist in the quarter.

**Wesley Collin Carmichael**
*Autonomous Research US LP*

Thanks, Brad. And just turning to the U.S., could you maybe just talk about agent recruiting. What's the environment like given the strong employment in the U.S.? And are you kind of expecting that to change any in your outlook there?

**Virgil Raynard Miller**
*President of Aflac U.S.*

Yes. So I would say it's definitely a tough environment we're recruiting for commission roles out there. Still, I would tell you, if you look back at Q1 of 2023, it was a strong Q1 quarter for us. So this year, we knew we had a tough comparison. And so therefore, I would tell you we expect it to be slightly down. So

I'm not throwing off about the performance of Q1. I'm expecting us to rebound and continue to recruit, develop, convert, train and actually build up on average we can produce as going forward. Again, knowing the environment is tough, we just have to recruit differently. We're deploying different means to make sure we hit our expected numbers this year.

**Operator**

The next question comes from Suneet Kamath with Jefferies.

**Suneet Laxman L. Kamath**
*Jefferies LLC, Research Division*

I wanted to start with Japan sales. It seems like one of the issues, I think, that you're having is the mix of sales between exclusive and nonexclusive channels. So my question is, what percentage of your sales come from these nonexclusive channels? And relatedly, are you behind the industry in terms of the mix from that channel?

**Daniel Paul Amos**
*President, Chairman & CEO*

Hold on there. Let me -- guys, can you hear. Did you all hear the question, Koide?

**Masatoshi Koide**
*President, CEO & Representative Director*

Yes. We will answer to that question.

**Daniel Paul Amos**
*President, Chairman & CEO*

Hold on, just 1 second, they'll translate.

**Koichiro Yoshizumi**
*Senior Managing Exec. Officer and Asst. to the Director of Sales & Marketing*

[interpreted] This is Yoshizumi. I will be answering your questions. I'm sorry, this is translator speaking. I just needed to clarify what Yoshizumi said about the numbers that he mentioned. Here I go.

In terms of the number of exclusive and nonexclusive agencies, 60% are exclusive agencies and 40% are nonexclusive agencies. That is in terms of the number of sales agencies, but then when it comes to sales, it's 70-30, exclusive agencies, 70% and nonexclusive agencies 40% (sic) [ 30% ]. It's not that which is larger, which is smaller that really matters, but it is what it is.

In addition to explaining about our nonexclusive agencies channel, there are particular agencies that are called large nonexclusive agencies among the nonexclusive agency channel. And the sales from that large nonexclusive agency channel accounts for about 5% of our sales.

**Suneet Laxman L. Kamath**
*Jefferies LLC, Research Division*

The bigger question is, are you behind the curve here, right? It seems like the industry is moving towards these nonexclusive agencies. That's my sense. And if it's only 5% in terms of these large nonexclusive agencies, is that just going to be an ongoing headwind in terms of your sales growth? Or do you have strategies to gain share in that channel?

**Masatoshi Koide**
*President, CEO & Representative Director*

[interpreted] Let me start out. This is Koide from Aflac Japan speaking. So first of all, let me just clarify our agency structure, our agency purpose. Ever since our foundation in Aflac Japan, we have always had exclusive agency channel as our main channel plus the so-called nonexclusive agencies that sells mainly our product in cancer and medical insurance area. And these are the main agencies that we have been dealing with.

And this, in fact, is the strength of Aflac Japan. And because this just means that there are many agencies that are very loyal to Aflac. And as you know, other companies are entering into agency channel in recent years. Because they are new entries, they are not able to build their own exclusive channel anymore. So as a result, what they've been doing is to go into the nonexclusive channel, especially trying to deal with the large nonexclusive agencies to increase their sales.

So in other words, as we mentioned, the sales from large nonexclusive agencies is small in Aflac's overall sales. However, this does not mean that we are any behind other insurance companies because we have our strength. This is in fact, our strength because we have our own exclusive channels. But then at the same time, it is also a fact that the market of large nonexclusive agency customers is increasing because the main customers of large nonexclusive agencies is young and middle aged customers.

So however, as a result, what we need to do to grow Aflac Japan going forward is not just focus on exclusive agencies, but we also need to start focusing more on large nonexclusive agencies. And that has been the strategy for the past few years. And as a result of that, what we have done last year is to launch a new medical insurance product, which we have been able to sell a lot through our large nonexclusive agencies. Because we have targeted mainly young and middle aged customers who are using this medical insurance. So as a result of this, we have had a very large growth in our medical insurance sales in the first quarter this year.

**Daniel Paul Amos**
*President, Chairman & CEO*

Suneet, let me try to summarize, because I think it's important here. Number one is, in the nonexclusive area, this isn't something new. If you go back and you look, and you've been around a long time, you'll remember that there was this major agency that was independent and other competitors were selling for them, we ended up selling for them. They had been in the cell phone business and transferred over to the insurance business.

We found a way to get into that market. We ended up selling a lot with them. They ended up going a different direction. But the point being is, wherever the business is, we'll be there as the leader in the third sector product. And yes, we do have a strategy. And yes, we do plan on winning. But the point that I think Aflac Japan is making is the bread and butter of everything we do are the agencies that we've had since the inception. That along now with Japan Post has made a big difference. Again, Japan Post being only cancer. But all in all, it's what's dominated our business, and we will be ready to handle that. And it's really nothing new. It was going on 15 years ago.

**Masatoshi Koide**
*President, CEO & Representative Director*

[interpreted] Dan, thank you. And I would like to add a little bit more color to that. We are really truly working on the large nonexclusive agency channel right now. However, as Dan mentioned, we have Japan Post, we have exclusive agencies, we have nonexclusive agencies and as I mentioned, we have Japan Post channel as well as other business partners and bank channel. So we have this variety of channels that sell our third sector products. And so that is how we are going to be increasing and growing our sales.

**Koichiro Yoshizumi**
*Senior Managing Exec. Officer and Asst. to the Director of Sales & Marketing*

[interpreted] So this is Yoshizumi once again. Let me just add a little bit more information to your question. The large nonexclusive agencies, the main product that they sell to a customer is the first sector product. And Aflac, our main products are cancer and medical insurance products and the total number of policies of cancer and medical added altogether combined, we are #1 in overall Japan. So we truly believe that we will be able to increase the number of sales through other channels as well. And I do think that our driver will be our exclusive agencies.

**Daniel Paul Amos**
*President, Chairman & CEO*

Right, I think we've answered that question. If you need a follow-up, we'll be glad to do that. But David?

**David Young**

Betsy, I think that's our last call, correct?

**Operator**

Correct. I'd like to hand it back over to David Young for any closing remarks.

**David Young**

Yes. Thank you all very much for joining us this morning. And in the coming months, you'll get more information about our financial analyst briefing at the New York Stock Exchange on December 3. And if you have any questions that you want to follow up, please reach out to Investor and Rating Agency Relations. We will talk to you again. Have a great day.

**Operator**

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.
[Portions of this transcript that are marked [interpreted] were spoken by an interpreter present on the live call.]