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Market Intelligence

Aflac Incorporated NYSE:AFL

FQ4 2022 Earnings Call Transcripts

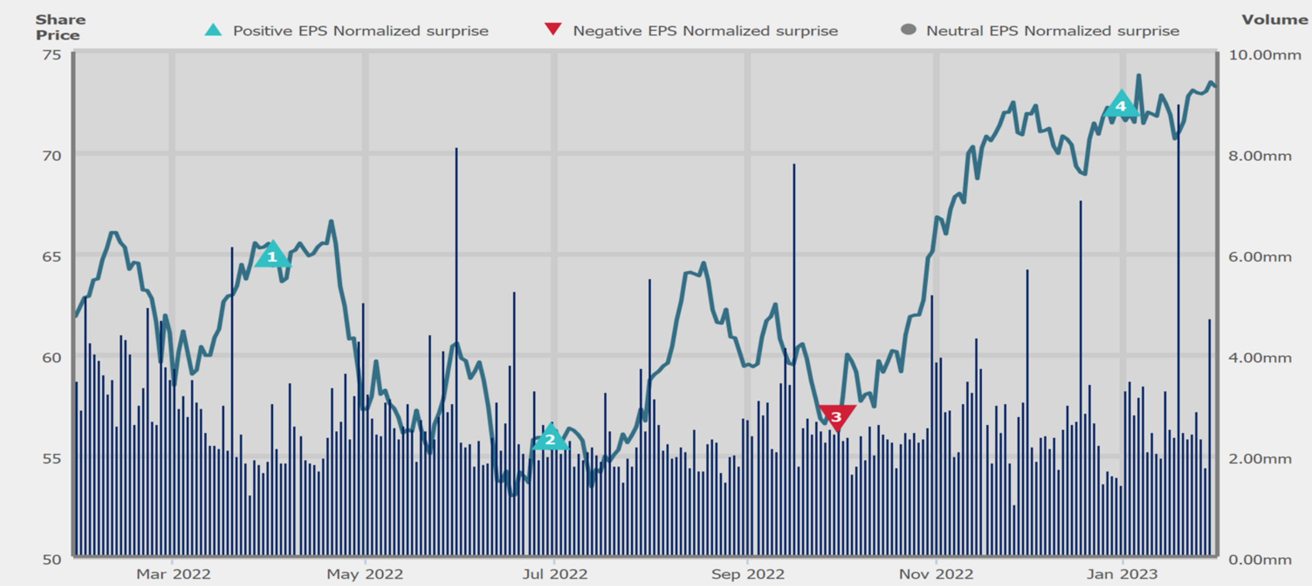
Thursday, February 2, 2023 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2022-			-FQ1 2023-	-FY 2022-			-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	1.21	1.29	▲6.61	1.40	5.24	5.33	▲1.72	5.71
Revenue (mm)	4485.15	4010.00	▼(10.59 %)	4643.13	18981.92	19502.00	▲2.74	18470.68

Currency: USD
Consensus as of Feb-02-2023 8:30 AM GMT

Stock Price [USD] vs. Volume [mm] with earnings surprise annotations



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2022	1.37	1.42	▲1 3.65 %
FQ2 2022	1.28	1.46	▲2 14.06 %
FQ3 2022	1.21	1.15	▼3 (4.96 %)
FQ4 2022	1.21	1.29	▲4 6.61 %

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Call Participants

EXECUTIVES

Bradley Dyslin

Daniel Paul Amos
Chairman & CEO

David Young

Frederick John Crawford
President & COO

James Todd Daniels
Executive VP, Director & CFO of Aflac Life Insurance Japan

Koichiro Yoshizumi
EVP of Sales & Mrkt. and Director of Sales, Mrkt., Alliance Strategy - Aflac Life Insurance Japan

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Presentation

Operator

Good morning, and welcome to the Aflac Incorporated Fourth Quarter 2022 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 of Investor and Ratings Agency Relations and ESG. Please go ahead.

David Young

Thank you, Andrea. Good morning, and welcome to Aflac Incorporated's Fourth Quarter Earnings Call. This morning, we will be hearing remarks about the quarter related to our operations in Japan and the United States from Daniel Amos, Chairman and CEO of Aflac Incorporated. Fred Crawford, President and COO of Aflac Incorporated, who is joining us from Japan, will then touch briefly on conditions in the quarter and discuss key initiatives.

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

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

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 assurances that they will prove to be accurate because they are prospective in nature. Actual results could differ materially from those we discuss today. And 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-GAAP U.S. measures. Please also note that after we file our 10-K, we plan to post on our investor site a recast quarterly financial supplement, showing the effects of the new long-duration targeted improvement accounting standard, had it been applied to the 2022 and 2021 fiscal years.

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. Reflecting on 2022, our management team, employees and sales distribution have continued to be resilient stewards of our business, being there for the policyholders when they need us most, just as we promise. From an overall standpoint, pandemic conditions impacted operations in Japan, especially in the first half of 2022. But they are gradually improving. Meanwhile, pandemic conditions in the U.S. have largely subsided.

Turning to our financials, when adjusting for material weakening in the yen, the company delivered another quarter of solid earnings results that rounded out a year of overall strong performance, as Max addressed in this quarterly video update. For 2022, Aflac Incorporated reported adjusted earnings per diluted share, excluding the impact of foreign currency of $5.67, which was the company's second-best year in the history following a record 2021. Aflac Japan generated solid overall financial results in 2022, with an extremely strong profit margin of 24.9%. One of the consistent key contributors to Aflac Japan's strong financial results is its persistency, which was 94.1% in 2022. As anticipated, our benefit ratio returned to a more normal level in the fourth quarter after seeing a spike due to the practice of deemed hospitalizations, the scope of which was narrowed last September.

Throughout the year, we continued to navigate the waves of COVID in Japan. We expected sales would pick up in the second half of the year, especially in the quarter, and that's exactly what we saw happen. Sales in Japan rose 10.8% in the second half of the year, including an 11.4% increase in the fourth quarter, which led to a full year sales coming in essentially flat. These results reflected the August launch through Associates Of Wings, our new cancer insurance products. They also reflected our first sector product updates in the fourth quarter that better positioned Aflac Japan for future long-term sales opportunities. Recently, Prime Minister Kishida announced that COVID would be downgraded to the same level as seasonal flu starting in mid-May.

While we're encouraged by this announcement as a sign of daily life in Japan returning to pre-pandemic conditions, we will see how this evolves, but look to continue building on our sales momentum in 2023. In April, Aflac Japan will begin selling through Japan Post Group, our new cancer insurance product, and subject to FSA approval, [or rather] for serious diseases, which was developed in collaboration with Japan Post Group. We expect this close collaboration to produce continued gradual improvement of Aflac cancer insurance sales over the intermediate term and to further position the companies for long-term growth.

Another element of our growth strategy is our intense focus on being there where consumers want to buy insurance. Our broad network of distribution channels, including agencies, alliance partners and banks continually optimize on opportunities to help provide financial protection to Japanese consumers, and we are working hard to support each channel.

Turning to the U.S. for 2022, we saw a solid profit margin of 20.4% in the fourth quarter. This result was driven by lower incurred benefits and higher adjusted net income, particularly offset by higher adjusted expenses. I'm pleased with the 17.4% sales increase in the fourth quarter, which reflected the largest amount of quarterly premium in the history of Aflac U.S. and continued to a 16.1% sales increase for the year. This reflects continued improvement in the productivity of our agents and brokers, as well as contributions from the build-out of our acquired platforms, namely dental and vision, group life and disability.

These are relatively small parts of our sales, but key elements of our growth strategy to sell in our core supplemental health policies. I'm encouraged by the continued improvement in the productivity of our sales associates and brokers. We are seeing success in our efforts to reengage veteran sales associates. And at a time, we're seeing strong growth through brokers. These results reflect continued adaptation to the pandemic conditions, growth in the core products and our investment and build-out of growth initiatives. I believe that the need for the products we offer is strong or stronger than ever before in both Japan and the United States. At the same time, we know consumers' habits and buying preferences have been evolving. We also know that our products are sold, not bought. As we communicate the value of our products, we know that a strong brand alone is not enough. We must paint a better picture of how our products help.

In the latest commercial featuring the Aflac Duck and the [indiscernible], the goat personifies the gap that people face when they get medical treatment. Fortunately, the Aflac Duck is the hero who helps overcome the problem. I know this helps demonstrate the need for our products, thus helping our sales opportunities. We continue to work toward reinforcing our leading position and building on the momentum into 2023.

Related to capital deployment, we placed significant importance on achieving strong capital ratios in the United States and Japan on behalf of our policyholders and shareholders. In addition, we have taken proactive steps in recent years to defend cash flows and deployable capital against the weakening yen. We pursue value creation through our balanced actions, including growth investments, stable dividend growth and disciplined tactical stock repurchase. With the fourth quarter's declaration, 2022 marks the 40th consecutive year of dividend increases. We treasure our track record of dividend growth and remain committed to extending it supported by the strength of our capital and cash flows.

Additionally, the board reiterated its first quarter dividend increase of 5%. Our dividend track record is supported by the strength of our capital and cash flows. At the same time, we have remained tactical in our approach to share repurchase, deploying $2.4 billion in capital to repurchase 39.2 million shares in 2022. Combined with dividends, this means we delivered $3.4 billion back to the shareholders in 2022. Keep in mind, in addition, we have among the highest return on capital and the lowest cost of capital in the industry. We have also focused on integrating the growth investments we made in our platform. We also believe in the underlying strengths of our business and our potential for [pretended] growth in Japan and the United States, two of the largest life insurance markets in the world.

We are well positioned as we work toward achieving long-term growth, while also ensuring we deliver on our promise to our policyholders. I'm proud of what we've accomplished in terms of both our social purpose and financial results, which have ultimately translated into strong long-term shareholder return.

Before I turn it over to Fred, you may recall that the financial analyst briefing in November that I mentioned how Fred would be increasing his focus on Japan and spending more time over there to delve deeper into learning about the operations there. As David mentioned, he is joining us today from Japan where he's on assignment for the better part of 2023. As President and Chief Operating Officer, he is also continuing to focus on Aflac U.S. as well. I'll now turn it over to Fred. Fred?

Frederick John Crawford
President & COO

Thank you, Dan. I'm joined here in Tokyo by our Aflac Japan leadership team led by Masatoshi Koide, President of Aflac Japan. Let me begin by saying 2022 was an important year of operational and strategic progress across the organization. Our U.S. growth platforms, dental and vision, group life and disability and consumer markets have moved from integration to full production, with comprehensive product portfolios that are broadly filed and marketed across the U.S. under the Aflac brand.

These businesses have modernized operating platforms built to support the scale we anticipate in the future and are now fully contributing to sales and earned premium growth.

In Japan, our refreshed cancer product is now further enhanced with the launch of our new [indiscernible] consulting support model after nearly a year of successful testing. We launched a revised and tactical approach to the sale of our WAYS and child endowment products, leveraging the strengthened product appeal to promote third sector cross-sell. While navigating difficult COVID conditions, we were proactive in addressing our expense structure, defending strong margins in the face of revenue pressure.

From a corporate perspective, we remain focused on risk management and capital efficiency. Two areas of focus included our approach to hedging the U.S. dollar portfolio in Japan and efforts to improve enterprise return on equity and Japan product competitiveness with the launch of Aflac Re, our Bermuda-based reinsurer. Finally, across the organization, we launched a coordinated effort to address the balancing act of investing in and delivering on growth, reducing expenses simplifying our business model and improving overall customer experience. This includes comprehensive project governance, a network of agile teams and regular reporting up to the Board level. The financial goal is simple: to deliver on the outlook provided at this year's investor conference with respect to growth and margins in the U.S. and Japan. We're proud of our efforts, but it's clear from our results that we have work to do in a few key areas. This includes addressing weak premium persistency in the U.S. and revitalizing our production platform in Japan. Furthermore, we need to address these issues while continuing to advance our technology and associated process improvement across the organization.

With that quick review, let's turn to current conditions and what we're focused on in 2023, starting with Aflac Japan. As Dan noted, claims recovered in the fourth quarter, as did the benefit ratio, on January 20th, Prime Minister Kishida announced plans to downgrade under the law COVID-19 to the same level of seasonal influenza, which will be enacted in mid-May. Importantly, this removes the immediate option to implement quarantine and other restrictive measures, such as state of emergency orders. We believe this move is designed to signal and encourage a return to normal, including business activity. While claims processing volumes remain high, this is driven by a natural lag in reporting of claims generated during Japan's 7th wave of COVID under the old deemed hospitalization rules. You can think of this as working the IBNR claims that were financially recognized in the third quarter.

Despite continued waves of COVID, we expect our team in Japan to improve on the performance in 2022 as COVID, like the common flu, appears destined to become a way of life in Japan and elsewhere. In that regard, we're focused on the following: First, in terms of distribution recovery and productivity across our channels, our powerful associates channel requires aggressive approach to training and development to drive new customers. Separately, we are working with Japan Post on a campaign surrounding the introduction of the new cancer product in the second quarter. As Dan noted, we have strong commitment at the top of Japan Post, and we are cooperating at levels throughout the organization. It should be noted, late this January, we also introduced the new cancer product in our Daiichi alliance as well as the financial institutions channel, both of which have performed below our expectations in recent periods.

Turning to core product refreshment. Our new cancer product will add a critical illness lump sum benefit rider in April, available on old and new cancer products and through Japan Post Group and our associates channels. Cancer ecosystem development is moving from launch to expansion. When analyzing current call volume, over 50% of the calls that are coming into our consulted related service platform relate to treatment, thus suggesting a value proposition beyond the pure financial benefit of paying a claim.

Our 2022 refreshed approach to first sector savings is yielding expected results, with approximately 80% of all sales representing customers who are under the age of 49 and approximately 50% of all new first sector customers purchasing a third sector product which is twice our target of 25% cross-sell.

Finally, in the face of increased competition and focus on selling the new cancer product, we have seen our medical sales decline and have plans to refresh our product in the fourth quarter.

When stepping back to consider these activities, we are and have been taking broad action across product and distribution with an eye towards returning to an JPY 80 billion production platform in the 2025 and 2026 period. The path to that level of production will build over time. But as we look towards 2023, we expect the continuation of our experience in the second half of 2022, where we generated consistent growth in production. Meeting our long-term targets will require strong execution on all fronts, as well as supportive market conditions and the cooperation of third-party alliances and partners to aid in driving productivity improvement.

Finally, while we have made progress, we seek further advancement in digitizing paper and manual processes for greater operating efficiency. This is not entirely an Aflac Japan issue, it's a Japan financial service industry issue. In recent years, we have moved from 30% to approximately 50% of our applications submitted in digital form, with only 10% of claims processed digitally. Over time, we seek to drive digital applications to 80% and digital claims processed to over 40%. This will allow us to take additional cost out of our operations, but requires the commitment of our distribution partners, their agents and customers to drive adoption.

I'm here in Japan in part, recognizing this is an important time for Aflac Japan. We are engaged in transformative activities that have long-term franchise implications as we seek to leverage our financial strength and leading third sector position. My focus will be partnering with our leadership team in revitalizing our distribution, incubating new product end markets and digital adoption to drive down expenses and improve customer experience.

Turning to the U.S., as Dan noted in his comments, we continue to deliver a balanced attack to the marketplace. Split by product class, group benefits were up 28%, individual benefits up 8%. Split by channel, agent sales were up 7% and broker up 25%. With respect to our expansion businesses, network dental and vision and premier life and disability sales were up 98% and 75%, respectively for the full year. The underlying signs of momentum are encouraging. For example, in our agent small business franchise, average weekly producers are up 3%, the second consecutive year of growth after a period of steady decline. Dental and vision is proving out our thesis of cross-sell as roughly $0.80 of supplemental health and life products are sold with every dollar of dental and vision. Our life and disability platform, not only has strong sales, but a successful renewal year, and recorded 97% premium persistency. Now fully integrated and expanding, we see 2023 as a year of leveraging this platform to both defend and grow voluntary group business.

While it was a difficult year industry-wide for direct-to-consumer sales, we are encouraged by consumer markets 5% increase in sales in the fourth quarter with new alliances coming online.

Finally, it was a challenging year for persistency in the U.S. Persistency has stabilized in our individual business. However, weakness earlier in the year continues to impact our trailing 12-month metric. Group Voluntary, a smaller contributor to earned premium, drove most of the 260-basis-point decline in overall persistency. Account persistency across the organization has remained relatively flat, but we lost a few very large accounts during the year. The industry has experienced weakness in voluntary persistency, which tells us there are also labor force dynamics contributing. We have stepped up our focus on persistency, establishing a dedicated office to drive and oversee a series of efforts, including product development, client service, technology solutions and incentive designs.

Turning to investment results. Investment income in the quarter was stable, with strength from higher yields on floating rate portfolios offset by increased hedge costs and anticipated weakness in alternative investment income. As expected and discussed last quarter, our alternative investment portfolio remained under pressure, posting a loss of $21 million in the quarter. By comparison, last year's quarter enjoyed $127 million in gains. This decline was anticipated given the natural correlation to the public equity markets and the lag in private equity reporting. Despite losses in the quarter, year-to-date, the alternative portfolio generated $103 million in income following an exceptional 2021. Throughout the year, we have refined our hedging strategy reducing $2 billion in notional currency forwards in exchange for options that reduced hedge costs while protecting capital against material moves in the yen.

Overall, as we look at 2023, we are staying the course with respect to our strategic and tactical asset allocations as we watch closely the risk of economic slowdown driven by Fed action to fight inflation. We are also watching the Bank of Japan as they introduce a new governor this spring, which many believe could lead to a change in policy.

Before turning the call back to David, it's worth following up on Max's recorded comments to reinforce how we are positioned with respect to potential for a period of U.S. or global weakness. Our morbidity-based insurance model is defensive in nature, with relative stability in sales, earned premium and profit margins through economic cycles. Among traditional life insurance peers, we maintain low asset leverage as defined by the ratio of general account assets to regulatory capital, particularly if you exclude our concentration in JGBs. We believe our portfolio is well positioned to weather the current economic uncertainty, recognizing we would anticipate some pressure on our $12 billion loan portfolios. We work closely with our external managers for middle market and real estate loans and have conducted a comprehensive stress test designed to apply recessionary pressure to these portfolios.

Our approach included a moderate and severe recession, applying loss rates consistent with past economic cycles. Both scenarios resulted in elevated but manageable losses, with no immediate need to change our disciplined approach to these asset classes and putting new money to work.

When looking at the impact of core capital ratios, we developed a market pricing, ratings migration and loss scenario that falls in between a mild and severe recession and includes the entirety of our general account assets. When applying these stress tests, our core ratios of RBC, SMR and ESR all came out the other side well above are minimum thresholds. While it is wide to proceed with caution

-- wise is to proceed with caution, we do not see recessionary conditions as disruptive to our capital deployment plans. I'll now hand the call back to David for Q&A. David?

David Young

Thank you, Fred. Now we are ready to take your questions. But first, let me ask you to please limit yourself to one initial question followed by a related question. And then get back in the queue to allow other participants an opportunity to ask a question. We'll now take the first question, Andrea?

Question and Answer

Operator

[Operator Instructions] Our first question comes from Jimmy Bhullar of JPMorgan Securities.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

So I had a question for Fred on long-term Japan sales outlook. I think you mentioned JPY 80 billion in the '25 period. If we look back historically, that's still -- while it's up a lot from here, it's still consistent with what you had in 2019 and a lower number than '18. So is it that the market opportunity is less than it was before? Or do you think -- or should we assume that your market share has declined?

Frederick John Crawford
President & COO

I think really -- so first of all, over the long run, that is beyond 2025 and '26, we obviously would expect to continue some level of growth pattern. We simply stopped the timing around that time frame as a reasonable forecasting period. But there's no doubt, in the short run, meaning the next 3 to 4 years, that one of the shortfalls compared to pre-pandemic levels was strength in the Japan Post distribution platform, including some very strong years of introducing new cancer in that platform. And it's clear to us at this point in time that while that platform is recovering, it's going to recover in a more linear fashion over time as opposed to a step function with dramatic increases. And that's because Japan Post is under a very diligent program of improving and investing in their platform, retraining their sales force and recovering from effectively halting and being out of the market for a period of time, as you know. So I think it's more of that gradual approach to the build that we expect that is playing on the slower growth rate.

Now having said that, we're doing a lot of different things. As you know, we're refreshing our cancer product. We're adding to that cancer product, competitiveness with our [indiscernible] consulting practice. We're also adding lump sum critical illness benefits, and we continue to focus on our other product development, including refreshing our medical product, particularly with an eye towards competing better in nonexclusive channels that are very competitive on the medical product, and we need to compete better there and build share.

And then we're excited actually about the developments with WAYS and child endowment, particularly with WAYS. While it is not as high a return product as our other third sector, we're very pleased with the cross-sell activity, and it's also serving to build a little bit of momentum back in our core associate channel who needs more product to generate more commission and have more opportunity to recruit and build the sales force. So, so far, it's very early in that program. We're only a few months into reviving the WAYS product, but so far, the data is very supportive of the halo effect, if you will, particularly cross-sell. So we're doing a lot of different things here in Japan. But ultimately, the reason you see muted recovery is when we look at the throughput of these new products and capabilities, meaning the throughput through agents at Japan Post, agents at Daiichi, agents and agencies in our associate channel, they're busy recovering from COVID, getting back out into the marketplace with face-to-face meetings. And of course, Japan Post is going through their own dynamics of recovery. So it's really the recovery in those third-party platforms that's causing us to be more cautious.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

Okay. And then on the change in classification of COVID as a seasonal flu beginning, I think you said mid-May, how should we think about the impact of that on your claims and potentially sales?

Frederick John Crawford
President & COO

I think from a claims perspective, you're seeing the recovery already, and that is we're expecting it to recover back to previous traditional levels of claims activity. I think I mentioned to you last quarter, a normal week in Japan for us is processing something in the neighborhood of 30,000 claims in our operating center. That rose to north of 90,000 claims a week during the deemed hospitalization period and 7th wave of COVID. So we've seen that dramatically come back down to normal levels with the exception of working the backlog that I mentioned in my comments. So I think the idea is to return back down to normal levels of benefit ratios, and that's the answer there.

In terms of new sales, we have Yoshizumi-san here and Koide-san and they can add their commentary. I think the trickier thing is, when you're talking about thousands of agents, some of whom were forced into quarantine conditions during COVID, the issue becomes not only are more agents out there able to produce and share numbers undisrupted by COVID, but will there be a recovery in face-to-face activity, which is more effective. This is still an extremely cautious society here. As we sit here today, we are all wearing masks on the way into work, on the way home from work, while at work and while walking the streets of Tokyo. So there's still some time to take place to recover the full normal activity. Yoshizumi-san, I don't know if you feel differently or have anything to add about COVID conditions.

Koichiro Yoshizumi
EVP of Sales & Mrkt. and Director of Sales, Mrkt., Alliance Strategy - Aflac Life Insurance Japan

[Interpreted] First of all, this COVID environment last year in the first quarter between January and March, sales have been severely impacted. And following that, the next peak, or the largest peak was between July and August, and many of the sales offices and branches were forced to shut down. However, the environment gradually changed. Of course, at the timing of cancer launch, the things have been changing. And at the same time, agencies and sales agent activities became much more active. And as you've seen in our sales results, you can see that our new cancer insurance sales is increasing, and there's been a great momentum in sales as a result. And the result is that compared with 2021, we have about 30% increase in cancer sales.

And also, our product strategy really was successful. For example, we were able to propose to customers more comprehensively of our products using WAYS. And as a result, third sector product sales increased because sales were done in a more cross-sell way. And as a result, we were able to exceed our second half 2021 sales in 2022. And as we enter this year, the COVID situation has been improving. And as a result, the agency's activities are even more active. And we are seeing that we now are gaining a really good momentum with our strategies related to products plus the channel strategy in this new environment and in this environment with -- in living with COVID. So what I am thinking now is that we are starting to really see an environment where we would like to be aiming for JPY 80 billion in 2025- or 2026-time frame. That's all from me.

Operator

The next question comes from John Barnidge of Piper Sandler.

John Bakewell Barnidge
Piper Sandler & Co., Research Division

My question is around the paperless initiatives that have been moved to digital and claims. You mentioned, I think it was 10% of claims digitally now moving higher, I think, it was %. Can you maybe talk about how this may impact benefits ratios over time for maybe a one-day pay style approach to digital?

Frederick John Crawford
President & COO

Well, I think that the primary benefit, there is certainly an ease -- customer ease element to moving to digital. But the primary motivation of moving to digital is increased agent productivity. Yes, ease of doing business with the customer and the agent. There is, in fact, speed of processing claims that would pick up. For example, imagine paper-based claims processing when your claims went from 30,000 to over 90,000 a week during the last 7th wave of COVID. Had we been -- frankly, as an industry, this is not an Aflac thing. Had the industry been far more digitized in the level of claims they process digitally, you would have had much greater speed of claims adjudication.

Normally, we'll pay a claim on average in around 3 days or so in Japan, sometimes 4 days. It had gone up to around 12 days during that peak level. It's now come down to around 5 days, so we've recovered quite a bit. But if you are in a digital environment, there's no doubt, John, that you could speed that up and also protect against elevated claims periods to keep the speed and turnaround time faster. But I will tell you, a big motivation on our part to move to paperless is taking cost out of our structure. So when you're dealing with paper applications and paper claims processing and a heavy call volume related to customer service activities, all of that adds to cost structure. And in order for us to get that cost structure down, we've got to move it to digital, and that's what we're on a path to doing.

John Bakewell Barnidge
Piper Sandler & Co., Research Division

Okay. That's fantastic. And then my follow-up question, if we can stick with expenses. You had talked about a joint work with Japan Post for cancer launch. And then you talked about that backlog of claims from that 7th wave being the review mirror. But with that joint work on the cancer launch, are there any planned onetime expenses we should be thinking about?

Frederick John Crawford

President & COO

Not materially. I'm looking at Todd, Daniel's here, our CFO, and no, we wouldn't expect that. It's not unusual, however, when we launch a new cancer product in general and then launch in a major system that there is, in fact, a level of marketing expense that comes into play and launch expense. But quite candidly, while you may see it have modest implications to your expenses and expense ratio, it's not material and it's nothing I would characterize as a onetime thing that would pop out on our financials. It's just sort of normal way of doing business and normal business activity. So I wouldn't anticipate that, John.

Operator

The next question comes from Alex Scott of Goldman Sachs.

Alexander Scott
Goldman Sachs Group, Inc., Research Division

I just wanted to get an updated view on just capital management and capital management priorities. Just looking at even just in the U.S., I mean, how strong the RBC ratio is, I mean I think there's companies that run with around half of your RBC level. There's seemingly a lot of excess capital around the organization. So I was just interested in your views on that and how that's evolving?

Max Kristian Broden
Executive VP & CFO

Thank you, Alex. So we have, obviously, throughout the COVID times, we made an active decision to hold capital in the subsidiaries given that we initially didn't know exactly where our benefit ratios and underlying profitability were going to go. So we opted to hold capital at a high level, both in Japan and in our U.S. subsidiaries. Coming out of COVID obviously, realizing that we are now operating at a high level, especially in the U.S. with an RBC ratio, on a combined basis, north of 650%, we do agree that, that's an excess capital position and that, over time, we would expect to operate our U.S. entities closer to 400%. That means that there will be capital coming out of those entities over the next couple of years. But we will do it when we sort of need it, and we will hold capital where we think it makes the most sense.

There are times when it makes more sense to hold the capital centrally at the holding company, and other times when it makes more sense to holding at the subsidiary level. And we will, over time, optimize that.

Alexander Scott
Goldman Sachs Group, Inc., Research Division

Got it. And then the second question I had, I think it was mentioned earlier that Fred was going to be in Japan for some time. And I'd just be interested in sort of what the focus is for you, Fred, as you're over there? It sounded like maybe a year or something. What is your focus? What are your key objectives as you spent some time over there?

Frederick John Crawford
President & COO

Sure. Yes, this is the result of Dan and I sitting down in the few months or so leading up to the year-end, and why Dan signaled that fab that I'd be shifting a bit of my weight to focus a bit on Japan. To be clear, I'm spending effectively 2023 in Japan. It started mid-January and will run through mid-December. There'll be times where I'll be back in the States for critical activities and other Board-related activities, et cetera, in the U.S. So I won't be here entirely. And very importantly, I haven't changed any of my job description. And so, as Dan mentioned, I remain actively involved in driving U.S. activities. But the main reason I'm here in Japan is that it's a recognition that, at Aflac, this is very different in how we operate. Japan is not a subsidiary in what you would consider to be a normal global corporate company.

Japan is intertwined in the fabric of the entirety of Aflac. There's extremely coordinated and close activities, shared governance committees, shared intellectual capital around technology, digitization, product development techniques of going to market. We're really, in many respects, one company despite being 13, now 14 time zones away from each other. And so in order for me to do my job effectively, that is being President and Chief Operating Officer of this company, you've got to immerse yourself in understanding the Japan marketplace, our business model and the unique dynamics that drive this business. And you really -- you can do some of that making 4 to 6 trips a year for 1 week at a time or 2 weeks at a time, which I've done for 7 years, 8 years -- coming on 8 years now. But it's entirely different when you immerse yourself in living here and working day-to-day with the groups.

And where my focus is, is real simple. It's where you would expect when you look at our results. #1, it's partnering with Koide-san and Yoshizumi-san to help revitalize the distribution platform of this company. We need to make a leg up. We need to address certain parts of the distribution, and we're going to have to execute and deliver to bring back that path to JPY 80 billion. I think we have a wonderful opportunity to leverage the brand, our scale, being in one in four households where we can drive some of the new products and capabilities that we have been incubating in recent years. And so I'll be focused on that. And then this move to digital, realize this is a significant effort. This is not as simple as looking at your operations and moving away from paper and moving to digital. This is really not about the technology. The technology is in place. This is about partnering with third-party distribution partners, everything from Japan Post and Daiichi to our associate channel to banks to move them towards more digital adoption through campaigns and programs that increase that adoption.

You have to realize this is not an Aflac issue. This is quite literally no different than what the rest of the financial service industry is trying to do. And so when we talk about moving from 10% to 40% of claims or 50% to 80% of applications, that's not just an Aflac issue to handle, it is attempting to move forward and beyond the rest of the industry that is plagued by paper. You don't realize this, but many insurance companies in Japan quite literally never went remote in their operating platforms because they couldn't during COVID. They had to keep bringing their people back in because they were tied to paper and processing. That was not our situation. We were able to go to 50% remote, but even 50% remote was a bit high -- a bit low, if you will, high in terms of bringing people in. So there's a real need to do this, and it's transformative. So anytime you use the word transformation on distribution and transformation on operations, it's very important for somebody like me in my capacity to be here on the ground spending time in Japan.

Daniel Paul Amos
Chairman & CEO

This is Dan. I want to make a comment is that actually, I wanted Fred to go in 2020. And of all things, as you know, that was the year he got promoted to Chief Operating Officer and then COVID hit. So the year really is behind because I just thought -- it was actually his idea to stay there. My idea was to go there and live 3 months. And so that just shows how committed he is to the company and doing well, and at the same time, working with the U.S. So I'm very pleased with Fred being over there. And that knowledge you cannot buy. It takes being over there, either the way I've been going for 40 -- over 40 years of the way Fred's been doing in the last 7. So thank you Fred and... David?

David Young

Next question, Andrea?

Operator

The next question comes from Suneet Kamath of Jefferies.

Suneet Laxman L. Kamath
Jefferies LLC, Research Division

On the Japan sales, can you give a sense of how much of those sales represent to the lapse and reissue? And when we think about the sales metric that you show in your supplement, is that a sort of a gross number? Or is that a net number when we think about policies that may be lapsing?

Frederick John Crawford
President & COO

When you look at sales, it's a gross number. So it includes the sale of policies to new customers or customers without the policies and replacement policies. At the same time, a replacement policy also counts towards lapsation. So in other words, yes, it counts as a sale on a gross basis, but also a replacement policy is considered a lapsed policy as well. So you end up having higher lapse rates and higher sales when you have replacement activity. That's why, in fact, you see our amortization expense pop up in the fourth quarter when we launch a new cancer product or a new medical product because you effectively have a greater level of lapsation. But there's nothing wrong with a replacement policy. It's really nothing more than going out to a customer and saying, you may benefit from an upgraded structure of benefits and pricing and other additive writers, et cetera., and there's nothing wrong with that. The issue isn't the lapse and replacement policy. The issue is when it's too much of what you sell, meaning you want to be driving more new customers and have the proportion of your lapsed and reissued or replacement policies be a lower percentage of your overall sales.

That's why you're seeing what we're doing, developing coming back out with WAYS, which attracts a younger, as I mentioned, and newer cohort of investors. Creating products like the disability or income products that are sold and now small businesses to employees who lack that type of coverage, and elderly care product, which is a growing market, albeit a slow growing market. All of this is designed to try to attract and develop new customers. And we believe we can make progress on that. But right now, the lapse reissue is naturally higher when you launch a new cancer product. And that's really typical of what we've seen in the past.

Max Kristian Broden
Executive VP & CFO

And just to add, Suneet, to how this impacts our P&L, it obviously impacts our benefit ratio and expense ratio as well. The benefit ratio was lower by about 90 basis points in the quarter from increased lapse and reissue activity, and our expense ratio was roughly 50 basis points higher because of higher DAC monetization that Fred referenced.

Suneet Laxman L. Kamath
Jefferies LLC, Research Division

Got it. I think last quarter, you had said that the lapse reissue is over 50%. Is that kind of still where it's running in Japan?

James Todd Daniels
Executive VP, Director & CFO of Aflac Life Insurance Japan

Yes, Suneet, this is Todd. It's still running around that rate. We saw it a little higher in the third quarter when we launched. And naturally, that rate starts to come down. So I think as a whole, over the first 6 months or so, we anticipate being around 50%.

Operator

The next question comes from Ryan Krueger of KBW.

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

Could you talk a little bit more about what you saw in terms of the elevated U.S. lab activity in the fourth quarter? And then also if you can provide any commentary on if that's continued into January or is it settled down?

Frederick John Crawford
President & COO

I commented in my script, this is Fred, about the lapse rates in the U.S., and it really mimics what I said. And there's really two categories to look at it. One is our individual products. You can think of these as our traditional products sold to small businesses, the largest portion of our in-force and sales. And that lapse rate was down around 1% and, honestly, down 1.5-or-so early in the year and then slowly recovered to where, by the fourth quarter, it was down more modestly.

Daniel Paul Amos
Chairman & CEO

Yes, Fred, Steve's got some numbers here on that, I think. Steve?

Steven Kent Beaver
Senior VP & CFO of Aflac U.S.

Yes, I would just add that Fred's script and talking points were spot on. We did see account lapses in the fourth quarter, particularly in our group business. not attributable to anything specific or systemic. We do have -- we did experience some large account lapses. We did pick up, as Fred highlighted, in the third quarter, some large accounts through the last half of the year. But net-net, we were down through the last half of the year at group. I would just add that looking forward into 2023, we are going to -- we have this office on persistency where we're going to approach this experience that we had in 2022 through product development, client service, technology solutions and incentive designs, but moderating that or modifying that to how the economy performs in 2023. That's an important thing for us to make sure that we use data to drive our actions in 2023 to get persistency back online.

Max Kristian Broden
Executive VP & CFO

Yes. We certainly expect the continued decent velocity of the labor force and so that will continue to be there. But at the same time, we do expect the recovery overall in our persistency going into 2023 relative to 2022.

Frederick John Crawford
President & COO

I think you have to put it in perspective, too. This was largely focused on large accounts, the loss of large accounts, which will happen from time to time in the group business and the group business represents 15% of our earned premium. So in other words, look at our earned premium. It was down 0.2% in the fourth quarter. It was down 0.8% or less than 1% for the full year. That's not what we want. We want growth in earned premium. But we can recover from periods of week persistency. We have to focus on it. We have to bring it back. But the largest lapse rates were in the group business, which currently represents a smaller portion of our earned premium and is the fastest-growing part of our company so generated tremendous sales, which helps make up for some of that lapse rate. So we're trying to hold the line on earned premium, which is the most important component to manage.

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

And then just one question on the critical illness rider that you're going to be operating in Japan. Can you help frame how big of an opportunity that is? And it seems like trying -- I know that Japan Post is in a gradual recovery mode, but it seems like that would be a fairly meaningful opportunity given that you can add it to the existing policies.

Daniel Paul Amos
Chairman & CEO

Yes, I'd like [Koide] to answer that or Yoshizumi to cover that.

Koichiro Yoshizumi
EVP of Sales & Mrkt. and Director of Sales, Mrkt., Alliance Strategy - Aflac Life Insurance Japan

[Interpreted] This is Yoshizumi. I will answer your question. We are currently planning to launch this lump-sum serious disease rider in April in Atria. But then that assumes that this product will be approved by the SSA. This product responds to customers' needs of having to want to prepare against, not only cancer, but also for cerebral cardiovascular diseases as well as heart diseases. And the Japan Post Group as well as with Aflac, we are trying to fully prepare to launch this product. And as you know, the Japan Post sales is gradually recovering. And what we are expecting is that this new rider will also help accelerate sales and recovery of the Japan Post.

Masatoshi Koide
President, CEO & Representative Director

[Interpreted] So let me just add a little bit here. This is Koide. And this new rider that is to be attached to cancer product was jointly developed by Aflac and the Japan Post Group as part of our strategic alliance collaboration. That's all from me.

Operator

The next question comes from...

Daniel Paul Amos
Chairman & CEO

Excuse me, let me just make one other comment. I don't think the rider is going to be that much premium. But what it does is it gives an opportunity to get with the salespeople and go back to everyone telling them what we've got, which will ultimately help sales of the cancer policy as well. So I would look at it that way. Now that's just my viewpoint. Thanks.

Operator

The next question comes from Will Maertas of Raymond James.

Wilma Carter Jackson Burdis
Raymond James & Associates, Inc., Research Division

This is Wilma. Maybe you could give us some color on how modestly higher interest rates in Japan will impact Aflac in the longer run.

Frederick John Crawford
President & COO

I think it may be good for Brad Dyslin to talk about that. It's largely an investment question.

Bradley Dyslin

Wilma, thanks for the question. We are expecting to see a little bit of volatility in [Yen] rates in first quarter. As you're probably aware, there is an expected change in the governorship scheduled for February. And there is a lot of expectation that, that could lead to a policy change. We saw a bit of a move in December when they widened the range on the 10-year JGBs by 25 basis points. So the magnitude of the opportunity is really going to depend on how much rates move. Remember, we are still at very low levels. And while a 25- or 50-basis-point move is certainly welcome, it's unlikely to result in a very big left or right turn on our asset allocation. But of course, yen assets are very important to us for the obvious asset liability management reasons, and we'll be keeping a close look as well as any opportunities to swap JGBs into higher-yielding yen credit assets.

Max Kristian Broden
Executive VP & CFO

And, Wilma, just a reminder in terms of the impact on our capital ratios, our SMR sensitivity to a 100-basis points shift in the yen yield curve is 35-point -- negative 35 points on our SMR. Our ESR, more importantly, goes the other way. And obviously, higher yen rates are positive to our ESR. So a 100-basis-point shift in the gain yield curve would increase our ESR by 34 points.

Wilma Carter Jackson Burdis
Raymond James & Associates, Inc., Research Division

And I guess could you give us a more specific examples of the lapses in the U.S. and some of the things you're doing to address it -- to address those?

Daniel Paul Amos
Chairman & CEO

Virgil?

Virgil R. Miller
President of Aflac U.S.

Yes, I'm sorry, this is Virgil Miller, coming off mute. So Steve talked a little bit about it, let me give a little bit more color though. At the end of the day, when Steve and Fred both mentioned the office of persistency, what we're really looking at is how do we drive utilization so that people understand the benefits they even acquired. When we're looking at selling our products, we do so making sure that our products are benefit-rich and -- but also that they're being utilized, so some of the things you'll hear us talk about is activity to make sure people have a knowledge and education around the benefits of how do we partner with our brokers, how we partner with our agents out there, and then with the employer to help drive utilization.

We know that when they actually use the benefits, they have more of a tendency to keep it. And so you'll hear us talk a little bit of share more results around activities like that.

Operator

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

David Young

Thank you all for joining our call this morning. And I just want to say, if you have any questions, please feel free to reach out to the investor and rating agency relations team. We look forward to speaking with you soon, and wish you all continued good health. Thank you.

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