S&P Capital IQ

CONTENTS

Aflac Incorporated NYSE:AFL

FQ3 2013 Earnings Call Transcripts

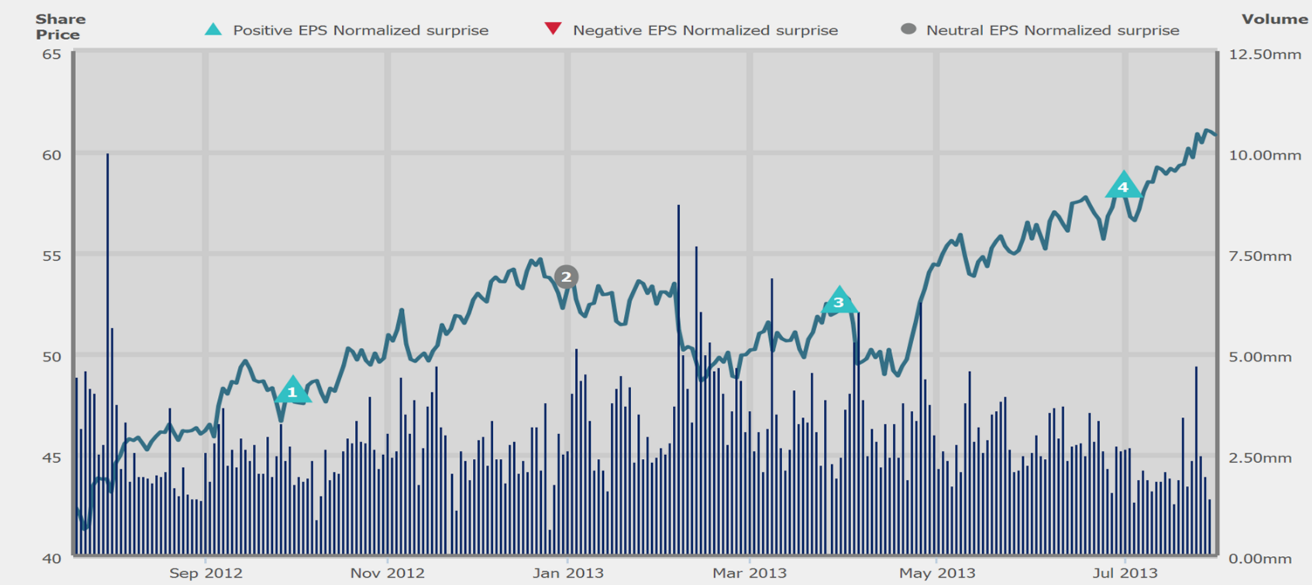
Wednesday, October 30, 2013 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2013-			-FQ4 2013-	-FY 2013-	-FY 2014-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.47	1.47	0.00	1.41	6.19	6.46
Revenue (mm)	5900.57	5886.00	(0.25 %)	5943.33	23765.70	24294.73

Currency: USD
Consensus as of Oct-30-2013 12:29 PM GMT

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



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2012	1.66	1.77	1 6.63 %
FQ4 2012	1.48	1.48	2 0.00 %
FQ1 2013	1.62	1.69	3 4.32 %
FQ2 2013	1.51	1.62	4 7.28 %

Call Participants

EXECUTIVES

Audrey Boone Tillman
Executive VP & General Counsel

Daniel P. Amos
Chairman & CEO

Eric M. Kirsch
Global Chief Investment Officer & Executive VP

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

Kriss Cloninger
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Paul Shelby Amos
Former Director

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

Tohru Tonoike
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Presentation

Operator

Welcome to the Aflac Third Quarter Earnings Conference Call. [Operator Instructions] Please be advised, today's conference is being recorded. I would now like to turn the call over to Robin Wilkey, Senior Vice President of Aflac Investor and Ratings Agency Relations. Ma'am, you may begin.

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

Thank you, Marianne. Good morning, and welcome to our third quarter conference call. Joining me this morning is Dan Amos, Chairman and CEO; Kriss Cloninger, President and CFO; Paul Amos, President of Aflac; Ken Janke, President of Aflac U.S., Executive VP and Deputy CFO of Aflac Incorporated; Eric Kirsch, Executive Vice President and Global Chief Investment Officer; and from Japan we have Toru Tonoike, President and COO of Aflac Japan joining us.

Before we start this morning, let me remind you that some statements in this teleconference are forward-looking within the meaning of Federal Securities Law. Although we believe these statements are reasonable, we can give no assurance that they will prove to be accurate because they're prospective in nature. Actual results could differ materially from those we discussed today. We encourage you to look at our quarterly release for some of the various risk factors that can materially impact our results.

Now I'll turn the program over to Dan, who will begin this morning with some comments about the quarter and operations in Japan. Then Kriss will join us and provide further details about our activities and 2013 and 2014 EPS guidance. Dan?

Daniel P. Amos
Chairman & CEO

Thank you, Robin. Good morning, and thank you for joining us. I'm pleased that we met and, in many cases, exceeded our financial targets for the third quarter. Notably, we believe we're well positioned to increase operating earnings per share by 5% for the year before the impact of currency. At that time, we anticipate operating return on equity will be strong in the range of 22% to 25% for the year before the impact of the yen. We'll spend some time talking about our financial and earning guidance this morning. But let me take a few minutes to give you a high level perspective on the operations and how I view our business.

I'll start with Aflac Japan, our largest earnings contributor. We continue to enhance our distribution opportunities and product offerings in Japan. I'm very pleased with the expansion of Aflac Japan's alliance agreement with Japan Post, which commenced in October. This agreement brings together the Japan Post, the largest nationwide distribution network in Japan, and Aflac Japan, the industry leader in cancer insurance. Both companies will be able to maximize numerous synergies by working together.

With respect to our products in Japan, I am pleased with our newest medical offering which successfully launched in August. We expect this product will continue to be popular with consumers. The combination of Japan Post and the new product rollout is a strong indication of our focus on our higher return third sector products.

In regard to Aflac U.S., the sales environment continues to be challenging. The U.S. consumer sentiment hitting its lowest level in nearly a year. Our job is to be multidimensional in our distribution to create a presence where consumers want to purchase our products. We are working to enhance our sales capabilities, both through our traditional sales force and brokers who operate in local, regional and national markets. In addition, we are currently piloting Aflac's private exchange platform, which we believe will provide us with even better access to smaller case market.

We're also creating products that respond to, and anticipate the needs of consumers and businesses, particularly in the current healthcare environment. With change, comes opportunity, and we are positioning Aflac in a way that we should benefit from healthcare reform.

Whether we're talking about our operations in Japan or the United States, as an insurance company, our primary mission is to fulfill our obligations to the policyholders. At the same time, we are listening to our shareholders and understand the importance of capital deployment. To enhance the predictability of that capital deployment, we fortified the level of SMR and taken steps to insulate the capital ratio against factors that could negatively impact it in the future. Doing so gives us greater confidence in our ability to target and deliver our profit repatriation amounts from Japan to the United States.

Once we know our customer obligations are satisfied, our objective is to enhance shareholder value through share repurchase and a growing cash dividend. As we said for many years, we believe those are the most attractive uses of capital. And those are the avenues we will continue to pursue. In fact, in 2013, we initially expected share repurchase to be in the range of $400 million to $600 million. We now anticipate purchasing $800 million of shares this year. That means we will be repurchasing more than $500 million of shares in the fourth quarter alone.

Previously, we had communicated our expectation of 2014 repurchase to be in the area of $600 million to $900 million for the year. We now anticipate next year's range to be $800 million to $1 billion.

I'm also pleased with the action by the Board of Directors to increase the quarterly cash dividend by 5.7%, effective with the fourth quarter 2013. This marks the 31st consecutive year of increasing our cash dividend. Our objective is to grow the dividend at a rate generally in line with operating earnings before the impact of yen. Overall, I'm pleased with Aflac's position in Japan and the United States, the 2 largest insurance markets in the world.

But let me leave you with this thought. You all heard me say my job is to balance interest of all stakeholders. I think we did a good job for that this year just as we have in the past. I believe we're going to do it again next year by protecting our policyholders with a strong SMR and returning significant capital to our owners.

So now I'll turn the call program over to Kriss. Kriss?

Kriss Cloninger
President & Director

Thank you, Dan. I'd like to follow-up with a few comments on how we delivered on those promises and what it cost. You may recall that in the second quarter conference call, I was asked if there was a sense of urgency to stabilize the SMR. My simple answer was, yes. And today, I can tell you that we completed several actions during the third quarter to fortify and enhance our SMR, as well as to protect FSA earnings and profit repatriation in the future.

Let me take you back to the second quarter of this year. The U.S. fed made comments that resulted in a spike in U.S. interest rates in May and June. Interest rates in Japan also increased. And by June 30, we have experienced a significant decline in the market value of Japan's assets categorized as available for sale or AFS. As a matter of fact, we went from a net unrealized gain position in the AFS portfolio at the end of the first quarter to a net unrealized loss position in the same category at the end of the second quarter. This mark-to-market decline was the primary factor that caused our SMR to decline by 101 basis points to 585 at June 30.

While that SMR result was still within our targeted range, we were concerned that another spike in interest rates, whether in the U.S. or Japan, would further lower the SMR and make our share repurchase activities more uncertain. The first thing we did was to begin using the policy reserve matching, our PRM accounting category in Japan. We used PRM to limit the mark-to-market risk on about $7 billion worth of our Japanese government bonds that were previously held in AFS.

While using PRM did not materially increase the SMR during the third quarter, it does provide significant SMR protection against further increases in yen interest rates. In addition, we executed derivative transactions to reduce dollar interest rate risk. Through the use of interest rate collars, we hedged approximately 25% of our total dollar exposure in Japan against the risk of rising interest rates. Then late in the quarter, we entered into a reinsurance agreement -- excuse me -- which generated an SMR increase of about 115 points and represented the majority of the SMR improvement in the third quarter. While the cost of the reinsurance agreement will lead to about an estimated nickel per share reduction of EPS in 2014, we believe it provided the most cost-effective means to increase capital in Japan.

Now let me discuss some other factors, primarily involving investments and other operating expenses that are affecting our 2014 guidance. These factors highlight the reasons while we expect our 2014 earnings growth rate to be somewhat lower than our 2013 growth rate. First, let me describe the investment headwinds. In the third quarter of 2013, we made a deliberate decision to move toward a more conservative asset allocation, revising our asset allocation to emphasize yen-denominated purchases. At present, we estimate that about 51% of our 2013 Japan cash flows will have been invested in yen with the balance allocated to the dollar-denominated U.S. corporate bond program. Because we anticipate continued volatility in financial markets for some time to come, we expect to allocate 80% to 90% of our estimated 2014 cash flow to yen-denominated securities with the balance going to dollars.

In addition, we continue to see very low investment yields in Japan. This change in investment allocation, along with assumed investment yields and less new cash flow, combine to negatively impact investment income growth by approximately JPY 6.9 billion before taxes, or about $0.11 in operating earnings per share.

Expense headwinds include an increase in commission expenses related to an increase in Japan's consumption tax rate beginning April 2014, which is expected to cost us about JPY 2 billion or $0.03 a share in 2014. In addition, we increased our commitment to a multiyear program, we referred to as the corporate value enhancement program or CVEP as we may later refer to it, which involves a major investment in our business systems and processes to strengthen our position as the leading provider of third sector products. In total, the increased expenses for Aflac Japan in 2014, excluding the cost of reinsurance agreement and consumption taxes on commissions will be about JPY 8.5 billion before taxes or about $0.12 per share.

Like Aflac Japan, Aflac U.S. is increasing its spending to strengthen service levels for our distributors and customers. This initiative will begin with significant improvements to our enrollment and billing systems. The additional expenditure on this project will likely total about $7.3 million before taxes or about $0.01 per share. We do have some tailwinds that will offset some of these costs. We recently modified our U.S. pension plan and retiree medical benefit plan, which reduces our liability and will result in lower expenses going forward. The change in both retiree medical and pension plans will lower expenses by about $24 million or about $0.03 per share in 2014.

As Dan mentioned, we have upwardly revised our expectation for share repurchase in 2013 and '14, both of which will benefit EPS growth next year. Additionally, we expect the majority of our share repurchase activity in 2014 to occur earlier than -- in the year. The incremental benefit to earnings from the expanded share repurchase program is about $0.12 per share in 2014.

We understand that many of the activities we are undertaking come at a price. And the price is a slightly lower rate of EPS growth in 2014. Taking all of these factors into account, if the yen average is JPY 95 to JPY 100 to a dollar for the fourth quarter of 2013 and continues on into 2014, we would expect 2014 EPS to be in a range of $6.28 a share, diluted share to $6.52, which is a growth rate of approximately 2% to 5% on a currency-neutral basis. It is important, we think, that absent all the items I discussed, the 2014 EPS growth rate objective would've been comparable with the 2013 EPS growth rate we expect to achieve.

More importantly, as we look to the future, we anticipate the headwinds we faced in 2014 will diminish significantly in 2015. We believe all actions we plan for 2014 will ultimately serve not only to protect our policyholders but also benefit returns to shareholders.

Now let me turn it back to Robin for some comments on the quarter.

Robin Y. Wilkey

Former Senior Vice President of Investor & Rating Agency Relations
Okay, thank you, Kriss. Before we begin with our Q&A this morning, I want to take this opportunity to remind you all that we'll be hosting our 2014 mini FAB meeting in Tokyo, Japan on Tuesday, September 16. So please mark your calendar, and we hope to all see you there. [Operator Instructions]

Question and Answer

Operator

[Operator Instructions] Our first question comes from John Nadel of Sterne Agee.

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

I have 2 questions and I guess maybe more directed to Kriss or Dan. They are centered around the 2 bigger items that are headwinds for 2014. I guess, the infrastructure projects that you're talking about, in particular for Japan, for next year, I'm just wondering if you had any discussion internally about redirecting, for example, some of the incremental spending that you expect to do in the fourth quarter of '13 around promotion spending, that sort of thing, toward maybe getting a head start on the infrastructure projects instead. In particular, it seems like you've got some real tailwinds around Japan third sector sales growth over the next 1 to 2 years, maybe even longer, given the medical product rollout, given the Japan Post arrangement and given there's also some increasing signs that the Japanese government may yet again adjust deductibles.

Daniel P. Amos
Chairman & CEO

Well let me -- I'm going to have Kriss answer this. But let me just say that it's an accounting issue. We can't prepay anything. We can only do it as we actually have the contract and are working on it and it takes time, but I'll let Kriss go into more detail.

Kriss Cloninger
President & Director

Well, as it relates to the so-called CVEP project, I'll make a couple of comments and then I'd like for Toru Tonoike to make some additional comments on this. John, this is a multiyear project. It's a significant long-term project that we've -- we initiated several years ago. For the first couple of years, we were able to absorb the cost, the incremental cost of doing the project planning and some of the initial work within our operating expenses in Japan within the normal earnings increased the guidance. We've reached a point though in the project where we have to ramp up the expenditures for a couple of years to be -- to really make solid progress on both the administrative, the marketing and the IT aspects of this project. I've identified what the ramp up is for 2014. We expect to spend a similar amount in 2015, but that won't incrementally affect earnings. So it's not as simple as moving some promotional expenses in the fourth quarter of '13 to offset the anticipated expenses for the project in 2014. Project is simply too big. Toru, would you like to make some additional comments on CVEP, and then we'd probably need to come back to the sales question.

Tohru Tonoike
Vice Chairman of Aflac Japan

Yes. First point about -- we have been developing the program during the last couple of years. And at the early stage of the program, most of our job is that, say, what I call the planning and less implementation or development of the programs. But during 2013, we have increased the level of the program -- development on the program. And then that activity will be higher in the 2014, and then it will be plateaued for the rest of the several years. So, yes, as Dan mentioned, the timing of the income and the expenses is tied to the volume -- the work we put into the program. So we discussed to move the timing -- to accelerate the work to the extent possible. But there isn't too much flexibility available to us on that. So this is as much as we could have done.

Daniel P. Amos
Chairman & CEO

But let me say one other thing. One of the things that's driving this project to cost more money is, if you remember how you all complained about we were slow in putting in rate increases, and our systems couldn't handle it. We now -- this is part of this new project, is that we can address that upfront and we're getting it done as quickly as we can for future. Not so much the past. We feel fine now what we've done in the past, but for the future -- and Paul is going to make some comments about sales because he has been over there a lot and will be moving over there in January.

Paul Shelby Amos
Former Director

Yes, John, really quickly I'll say that, obviously, the additional promotion expenses around pushing our third sector products. We've clearly deemphasized the first sector and emphasized the third sector. And we're trying to push those products well. We feel the launch of our new EVER plan has gone at or above expectation, and we feel strongly about where we're going to end up in the fourth quarter in the third sector side. So overall I think the coordination of our communication and promotion is critical to the success of the sales, and I feel very good about what we're going to do in that marketplace.

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

Okay. And then my second question related to the outlook for investment -- for the investing of new cash flows. I understand that 80% to 90% into JGBs for 2014, and I'm guessing that's obviously, going to reduce the new money yield pretty dramatically given where rates are right now. But I'm just wondering, you're 2 years into this build out of the new investment department with an eye toward a more balanced investment approach over time, and you spent a lot of money on that and it appears the outcome -- and maybe this is more market driven, I'd appreciate your comment, but it appears the outcome, after all that spending and build out is that you're still going to end up investing very similarly to the way you did a couple of years ago.

Daniel P. Amos
Chairman & CEO

Well, that is true right now for the short term. But taking into account all the things that we've been doing so far, we have addressed the issues with Europe, we have done the collars, we have sophistication now that we were -- we would not be able to handle, if we are not staffed up. Is the staffing up for us to write -- to buy 80% to 90% of our business in JGBs, the answer is, no. Our staff up is to have a diversified portfolio. But we have to take what we're dealt at the time we've been dealt, and we felt the most important thing is to -- again, hearing it loud and clear from all of you, make sure you get the profits out of Japan. And we have had to firm up that SMR, which cuts down the volatility with the JGBs. But don't take this as we like it. We would much rather be much more diversified. We would much rather be doing the things that we told you we're setting up for. But I promise you that this new department that we have set up has capabilities and monitoring that we have to have in place before we can take on some of these. So I'm going to let Eric talk about it, but I didn't feel it was fair for Eric to have to defend what I'm responsible for originally setting up and why we set it up.

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

And Dan, very well taken. Excellent response.

Daniel P. Amos
Chairman & CEO

Here is Eric.

Eric M. Kirsch
Global Chief Investment Officer & Executive VP

I would just add to that. Thank you, Dan. When you think about the investment in the group, it just simply can't boil down to is your return higher than it used to be, because Dan went over so many critical issues that were important to the health and the future of our balance sheet that we were able to address through this investment. But I will also add, when you look at these returns, it's a long-term, right? It's not what you did this quarter or this 6 months. It's a long-term. So I would offer to you since the build out of the team, the fact is, we have instituted parts, not all, but parts of our strategic asset allocation. We have $11.5 billion in what we call the hedged corporate bond program that was not there before, and if not for the build out, we probably would've had that money primarily in JGBs. So if you just look at that bucket, and I -- just a net estimate on an annualized basis. If you look at the incremental yield of those hedged corporate bonds, taking out the price we pay for the forwards, the incremental expense of the investment team, which again, is spread out over many different things but just focusing it on this, we're looking at a net of about $125 million or so of an annuity stream of income. And that's just after 2 years of building out. Not that I got here and started with the 50 extra people. We had to hire them. We were in the middle of instituting a new technology platform. And throughout that period, we've addressed and reacted to the things that have happened in the market that are critical for the overall company. So I would offer we've accomplished a lot for that investment and there's more to come. But certainly from a practical standpoint, we'll always be careful to the markets and the needs of the organization.

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

And Eric, fair to say that, if the market gives you some opportunities over the coming months to tactically adjust that allocation, you'll respond, I assume?

Eric M. Kirsch
Global Chief Investment Officer & Executive VP

Absolutely. The teams are thinking about the markets and have different options all the time. And one last comment as well, and Dan touched on this, it shouldn't be lost that the reduction in our private placements, which is the biggest risk bucket we have, is significant. I think when I got here, we were close to 50%. We're now just under 30% of the overall portfolio, and that bucket of private is in much better shape than it has ever been which helps us have confidence in the future health of the balance sheet.

Operator

Our next question comes from Yaron Kinar of Deutsche Bank.

Yaron Joseph Kinar
Deutsche Bank AG, Research Division

You touched upon the Japan Post deal again this quarter, and I wanted to dig into that deal a little further if I could and maybe better understand the opportunity there. I understand that there are 20,000 branches that you now have access to. But at the same time, looking this is -- the cancer product has roughly 15%, 16% penetration in Japan already, you have a 50% market share of new sales. So how does that opportunity really play out over the next few years. If you could add some color to that?

Paul Shelby Amos
Former Director

Yes, I'm going to turn it over to Toru here in just a second to talk to his perspective on Japan Post. This is Paul. But I will tell you that, as Dan called it, at the last conference call a game changer. We want to make sure you understand that everything that happens in Japan happens in a methodical and very pragmatic pace. We have announced that we're opening up 1,000 additional post office locations beginning in October. We believe that through the middle to end of next year, we will potentially be looking at products and how we will enhance our cancer plan to effectively sell through the Japan Post channel. But we believe over time that product will be pushed through that channel in a highly effective manner. We believe it's something that can be a benefit. We're not ready to commit to any particular numbers based on what are continuing and ongoing negotiations with Japan Post about how that will both be rolled out in terms of the number of branches as well as what the sales targets will be. But, Toru, if there are any additional comments you want to make, we just continue to believe that this is a significant deal for the company and will have a material impact on our cancer sales.

Tohru Tonoike
Vice Chairman of Aflac Japan

Yes, Paul. Thank you. And one thing I'd like to point out is that the Japan Post network is a huge network. And that network happens to have the least overlap with our existing distribution network. Nevertheless, we have been very good in the promotion of the business in the large metropolitan areas, but relatively not so good in the rural areas. On the contrary, Japan Post network is spread all over the Japan, including very rural areas. So we are hoping that having that Japan Post network will help us increase the sales in the areas which we have not been so strong in.

Yaron Joseph Kinar
Deutsche Bank AG, Research Division

Okay. And one follow-up on that, if I could. Looking at the guidance for 2014, basically you're saying without the specific headwinds that you discussed, earnings growth would still have been in the mid-single-digit range. And, I guess, I was a little surprised to see that, that earnings would not have come in stronger than that given the new emphasis on third sector sales and maybe ACA being less of a headwind next year. I just want to hear your thoughts on that.

Daniel P. Amos
Chairman & CEO

Let's repeat that again.

Yaron Joseph Kinar
Deutsche Bank AG, Research Division

Okay. So if I look at the guidance for 2014, my understanding is that without the specific headwinds that you detailed, earnings or EPS growth would've been in the 4% to 7% range. And my question is, why wouldn't it have been higher, again, without the headwinds, given the fact that you're emphasizing the more profitable third sector products in Japan and maybe ACA becomes less of a headwind next year as well. Why won't we see earnings come in a little higher than that?

Daniel P. Amos
Chairman & CEO

Well, it would have been closer to the 4% to 7%, if not slightly higher than that. As I pointed out last year, it takes a little bit of time for the effect of the first sector products to earn their way through the financials. Even though we're writing about 60% to 70% less WAYS in 20 -- in the last 3 quarters of 2013 than we wrote in 2012, we still wrote a fair amount in the first quarter of 2013, and we're still writing a fair amount even though the percentage reduction is as high as the percentage reduction is. It's still a larger volume of business than the third sector products. In addition, you got some persistency differences between the first sector products, many of which were paid for with the so-called discounted advance premium program. And when people pay all the premium upfront, they don't tend to lapse because they don't have to make any more payments, but you still get premium earning out, so the persistency on that first sector business is better than -- still very strong persistency on the third sector business. Fundamentally, the guidance I gave at the FAB meeting for margins and benefit ratios, both between first sector and third sector, is holding up well based on our experience so far, and it's just a bit too early to have seen the change in margin toward the higher margin third sector products. So it just takes a while to play out. That's a bit of a long answer to a good question. But the 4% to 7% was kind of in line with the 2013 initial guidance.

Again, our guidance is usually on the conservative side, historically. We've usually have done a little bit better than that, so I'm not guaranteeing that, but I'm just saying, that's historically been a factor in our guidance.

Kriss Cloninger
President & Director

And I'd like to say one other thing about the life product sales. We are revisiting caps on sales because as the interest rates have gone down, we think it's something we need to consider, and we'll know more about it but we're certainly considering it for 2014 and we'll let you know more at the time.

Operator

Our next question comes from Nigel Dally of Morgan Stanley.

Nigel Phillip Dally
Morgan Stanley, Research Division

A quick follow-up on the systems cost. I think a lot of the investors are wondering why the CVEP costs weren't incorporated into comments back at Investor Day. You've been developing this program now for several years. Did you expect those costs to be able to be absorbed in your regular budget and you getting now more precise and how much is it going to cost? Any color there would be very helpful. And also just one another question on the U.S. I understand your private exchanges is in test mode but perhaps if you can also discuss a little longer term, you plan to perhaps to get your product on some other private exchanges like the [ph] brokers you're establishing.

Daniel P. Amos
Chairman & CEO

Nigel, I'll make some initial comments on the CVEP project. As I said initially, we have been trying to absorb the cost of that into our general operating expense, for as long as we could. During the early to middle part of 2013, we basically finalized a plan that had been through a couple of iterations, both with the project administrators and executors that we're using, as well as with outside consultants that we're using on this program. We finalized that plan pretty much during the middle part of 2013 and got a much better handle, on the plan we're going to use to proceed. And so we had a more certain estimate of costs after we completed the plan. And actually, that was a replan that we went through, so we've been doing a lot of work on this. We've been doing a lot of internal cross-examination to make sure we have the value proposition correct and that were committed to going forward with it, and now we're at the point where we do believe we have a value proposition correct. We do have good cost estimates going forward. Let me see if, Toru, wants to add anything to that. But essentially, that's it from my perspective.

Tohru Tonoike
Vice Chairman of Aflac Japan

Yes. The only thing that I can add is that, they are in that -- basically the planning stage, we have been able to absorb the cost within our general expenses. As Kriss mentioned, that it was that -- in the third quarter of this year when we finalized the plan for the whole program, at which time we became able to communicate our plans more clearly to the outside world. So, yes. So like I said, until 2013, we were able to absorb the cost within the general budget. But after that, the program going into the full implementation stage, that is the amount of the cost exceeded the range we can absorb.

Kriss Cloninger
President & Director

And Nigel, I do have this comment. We constantly reassess priorities and the ability to change the products and premium rates on the first sector products became a much higher priority, one that we felt like have the economic impact to justify the increased expenditure going forward. So from an investment point of view, we thought, okay, this is an investment we need to make to protect our future financial position.

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

Nigel, this is Ken. Let me comment briefly on your exchange-related question. Dan, had indicated that where in the process of piloting our -- the Aflac private exchange, which we referred to as EVER Well. It actually just started last week. So we've had several cases built in a very limited number of markets, but we don't have enrollments occurring yet. It was our decision when we began down this path to take a very conservative and pragmatic approach to the market with the rollout of the exchange. We want to make sure that it meets everyone's expectations: the agents' expectation, the expectations of the employer as well as the employee, and also us internally. So we prefer to go a bit slower as we launch this. So we're piloting in 3 states. If all goes well, we would expect a scheduled rollout next year. But the purpose right now is really for the 50 and under case size market. So it's a very targeted market for the Aflac private exchange. A couple of years from now, it will likely go up to 100. But the private exchange will primarily be for the small case market. Your question about Aflac products appearing on other exchanges, that is something that we're evaluating currently. But it's really taken, for right now, at least, a backseat to the efforts we're taking to get Aflac private exchange rolled out properly.

Daniel P. Amos
Chairman & CEO

And those states, Nigel, are Texas, Georgia and Illinois.

Operator

Our next question is from Jimmy Bhullar of JPMC.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

I had a question first on the reinsurance agreement that you signed in Japan. Could you just discuss the mechanism of the contract, how it works? And I don't think it affects FSA or GAAP results, but you could mention that as well. And then -- the potential for more and under what circumstances you might consider additional contracts? The only other one I had was on the U.S. business and there's been a lot of talk about healthcare reforms. How much do you longer term do you see this as more of an opportunity or a threat as it affects the supplemental products market in the U.S.?

Daniel P. Amos
Chairman & CEO

I'll take the first one. I've always believed that with change, comes opportunity. What better example than to go back to 2001 with Japan and realize that everyone thought we were dead, we were in trouble, cancer insurance was going to be taken away by the big life insurance companies. Three months after the initial deregulation, we were the #1 seller of medical insurance and still hold that till this day, and now have cancer insurance, have continue to be #1. We're positioning ourselves that we will be -- continue to be the #1 insurer with supplemental health insurance products. I believe our ability to be able to do exchanges, our ability to be flexible because of relatively low-priced products, I believe it's going to stand out more because of the different plans that are being offered: bronze, silver, gold. And I think it's pretty clear that the vast majority of people are going with the bronze plan. It's going to be offered. That means it's going to be a very defined amount of out-of-pocket expenses to consumers, which plays well with us. Also, our brand or name recognition now has hit 94%. No one that is in the market today, even though there may be other companies that have reasonable brand awareness, not to our level, but they are not seeing as being, quote, "supplemental health products." So I think we're in a great position. I'm excited about it. There is uncertainty, make no doubt, it's out there today. But that too will pass. And when it passes, we have to be ready to go in a way that, I think, will accelerate growth for us, and we're counting on that. When and where and how will do it? As I mentioned, consumer confidence is down, that hurts us. Other areas of people that want to procrastinate are always looking for excuses. They can use right now, I want to wait till everything is finalized with the national health plan. But all in all, I don't think I would swap places with anyone in the industry in terms of being prepared for healthcare as we are right now. Now the other question, who wants to take this.

Kriss Cloninger
President & Director

I'll take that. That's all about the structure of the coinsurance agreement and some related questions. Jimmy, the reinsurance agreement is coinsurance in nature with a third-party reinsurer that's authorized for reinsurance in Japan. We coinsured a portion, one of our more established, predictable, profitable blocks of business. We -- it's a no-cash transaction upfront. Going forward, we will see the portion of the premium income from that block, net of an expense allowance we'll received from the reinsurer, and the reinsurer will reimburse us, for the proportionate share of the claims on the business. So it's a pretty straightforward agreement. But because the reinsurance is permanent in nature, we are allowed to take a reserve credit in the FSA financials for the pro rata share of FSA reserves on the block. And the amount of those reserves we get a credit for, is approximately JPY 100 billion. There -- based on the difference between the premium we pay and the claims we expect to receive, there is a net cost associated with the agreement. And I indicated what that is. It's anticipated to be about $0.5 a share in the 2014 GAAP financials. As far as the U.S. statutory treatment, the reinsurer is not an authorized reinsurer in the U.S. So we will report our U.S. statutory earnings based on the coinsurance being an effective agreement in terms of seated premiums and claims, but we will not admit the reserve credits. So we won't get any surplus relief on the U.S. statutory statement or the risk-based capital measure. But that didn't trouble us because our RBC is already strong enough, and we didn't feel like paying the extra cost of -- that it would take to get the reserves back by letters of credit and authorized for surplus recognition in the U.S. And on a GAAP basis, no real, I mean, we're releasing some reserves but we're putting up a deferred profit liability, amortizing the cost in accordance with the accounting requirements, and again, the net cost is what I indicated.

You asked again about additional capacity, we believe we do have additional capacity. But I will say, that I view this as a sale of a portion of our business, and it's not an action we would enter into lightly compared to, say, a financial reinsurance transaction where you're basically getting a loan and paying it back over a period of time. This is more of a permanent transaction and not something that I would enter into routinely. Regarding capacity, I think we do have additional capacity, but it's not something we're going to look at quarterly and see where our SMR is and say, "okay, do we need another $2 billion reinsurance this quarter?" That's not what we're going to do.

Operator

Our next question is from Tom Gallagher with Crédit Suisse.

Thomas George Gallagher
Crédit Suisse AG, Research Division

First question is, Dan, did I hear you correctly that you said, you were reconsidering the limits that you have on WAYS sales? I just wanted some clarification on what you had mentioned there?

Daniel P. Amos
Chairman & CEO

That is correct. What I said is, is that with interest rates moving lower, we adjusted -- put limits last year and this year. We're looking at them again now, for '14. So even though our productions way down, we still could have limits even more so. So we're monitoring that and seeing what we need to do. And we're not the only ones in the industry doing that. So it's not limited to just us. Other companies are doing that as well.

Kriss Cloninger
President & Director

Tom. Basically, the price increase that we implemented for first sector products in effect became a production cap because banks were the primary distributors moved to other products. With interest rates declining again -- again in Japan, we don't want to repeat of 2011 where other companies put in production caps and all of a sudden we become most attractive product in the marketplace.

Thomas George Gallagher
Crédit Suisse AG, Research Division

And so you can still make this a good profit margin product investing in JGBs? So I assume the pricing is -- has been dramatically altered then?

Daniel P. Amos

Chairman & CEO

Well, it was dramatically altered April 1, when we increase the pricing of the product to recognize the 1% standard valuation interest rate in Japan. Would basically repriced first sector products, at 1.25%. But still, even at that level, though we got profits in it, we're trying to minimize the low-margin products, emphasizing the higher-margin third sector products.

Audrey Boone Tillman
Executive VP & General Counsel

And since April, the yields in Japan have declined further.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Great. And just 1 question related to your capital return program. Kriss, when we think about the -- I guess what annualize, you're almost at a $700 million or so level for common dividends and the buyback for next year expected to be $800 million to $1 billion. Should we think about that being a level, as you move forward into '15, '16. Is that just based on the way you've optimized things? Is that -- should that be a fairly consistent amount of capital return? Do you think that's going to go up materially? Or are you kind of overspending? How -- can you frame how we should think about what you've done now and what that would mean more prospectively?

Kriss Cloninger
President & Director

I wouldn't say it's overspending at all, Tom. We're not pulling down additional capital from Japan to invest in share repurchase. You know that, historically, our profit repatriation from Japan has been somewhat highly correlated with the FSA basis earnings basis, and we've been trying to make sure that we achieved some stability in those FSA basis earnings. On an average, probably, over the last 10 years, we've taken out about 80% of our FSA basis earnings as profit repatriation and a lot of that gets allocated to the share repurchase activity. In various specific years, we've gone around 50% or 60% of FSA earnings and in 1 year, we took out 100%. But in general, there's going to be high correlation between profit repatriation and FSA basis earnings. And our guidance is based on the notion that we're going to be able to stabilize FSA earnings, and the increased repatriation would kind of be a normal increase associated with recognized FSA earnings. And then the common dividend, the share repurchase, it roughly -- approaching $2 billion a year is what I consider kind of a normalized run rate, not excessive or not supplemented in any way by other than normal earnings.

Thomas George Gallagher
Crédit Suisse AG, Research Division

So approaching $2 billion, meaning, you could have another $500 million or so of upside, as you think about it, going forward?

Kriss Cloninger
President & Director

Well, we've given the 2014 guidance. But as you said, thinking about round numbers, I mean, we're between $1 billion and $1.5 billion. And what comes next, which in my mind, is $2 billion. So as I think about 2015, 2016, you'd probably head in that direction.

Daniel P. Amos
Chairman & CEO

Let's be clear. No one has to make it clear to us, that, that's what our shareholders want us to do. We got the message, and that's what we're doing. We're moving that way and that's why this call and these things that we're doing, this is our #1 priority because that's what our shareholders believe will ultimately enhance the value of our shares.

Operator

Our next question is from Joanne Smith of Scotia Capital.

Joanne Arnold Smith
Scotiabank Global Banking and Markets, Research Division

I just wanted to ask, if you could just clarify the last statement that you made, Kriss, in terms of the profit repatriation. Did you just say, that you were moving towards $2 billion?

Kriss Cloninger
President & Director

Not all profit repatriation by itself, but I was including the payout to shareholders, including common dividend, which is approaching $700 million and $1 billion, say, of share repurchase in 2014, which might be expected to increase somewhat over the next several years.

Joanne Arnold Smith
Scotiabank Global Banking and Markets, Research Division

Okay. I just wanted to clarify that.

Kriss Cloninger
President & Director

Probably never should've said the number, but in my mind it was kind in the range of where I'm shooting for.

Joanne Arnold Smith
Scotiabank Global Banking and Markets, Research Division

Okay. Next question is, on the U.S. sales and Japan sales, I guess, in the 2014 guidance, there was no guidance for what you're looking for in terms of sales growth in either the U.S. or Japan. With the weak sales in the U.S. in the third quarter, I was somewhat surprised that you did not change the 0% to 5% target for the full year. And with the pickup in sales in the third sector in Japan, I'm surprised -- a little bit surprised, that you haven't gotten more comfortable providing guidance for 2014. So can you just address those issues?

Daniel P. Amos
Chairman & CEO

I'll let Paul, do Japan, then I'll cover the U.S.

Paul Shelby Amos
Former Director

Overall, obviously, we don't know where we're going to finish this year. With a strong momentum that we have in the third sector due to the new product launch in the middle of August. It's hard for us to tell exactly how we're going to finish the end of this year. However, we do believe it's going to be at the high-end of the range that we've given of 0 to 5. But at this point, as Dan mentioned, there are quite a few factors going on with sales projections for next year. Whether we put in caps on first sector product, whether we -- what products we're going to launch in terms of next year and having in the third sector. We do feel third sector is going to continue to be the emphasis, but at this point we just can't give you a strong range. What we will do, though, is in the fourth quarter, at least, give you those numbers and that's what we've traditionally done. Even though we've given you the earnings release at FAB, previously we've given you the sales projection at the end of the fourth quarter. That's exactly what we plan to do to remain consistent with years past.

Daniel P. Amos
Chairman & CEO

And as far as the U.S. goes, I never like to say we're not going to achieve an objective, but I think the headwinds that we have hit regarding uncertainty in this fourth quarter gives me pause. So I would not say that I'm optimistic, but I do believe once this calms down, that again, when there's change, there's opportunity. And I believe that we're going to get it together. The main thing I'm trying to do right now is to concentrate on getting it right for healthcare reform. And Teresa, who is our Chief Operating Officer at Columbus, and Dan Lebish who we put as the Chief Operating Officer of Columbia with Group Insurance and Ken overseeing all of it, we're coordinating to make sure that we do these things right, to handle and be ready. So that has been my emphasis for the remainder of this year. Our Director of Sales, their quotas are still based on the numbers that we said, there's no lowering or anything. So they're all pushing as hard as they can. But as I said, I'm not as optimistic we will achieve that. But I'm never going to say never till the end because with group insurance and other things, big things can come through so we'll watch it and see.

Joanne Arnold Smith
Scotiabank Global Banking and Markets, Research Division

Okay. And then just one last final question. And that is on the deductible in Japan. What level of confidence do you have, that there's going to be structural changes that occur in Japan and that would include an increase in the deductible on the national healthcare program and what kind of timing would you be looking at?

Daniel P. Amos
Chairman & CEO

Well, you remember that, I said, it was going to 50% 10 years ago. I said, well, if it went to 0%, to 10%, to 20%, to 30%, I didn't see any reason it wouldn't eventually go to 50%. Well, my answer is, I'm already behind because I thought it would happen by now on some of it. Now Paul, is over there and maybe, somebody else wants to comment on.

Paul Shelby Amos
Former Director

I would just say that, obviously, is the third pillar of Abenomics, he's had great success in some of the implementation thus far. I think it's difficult to ever predict what's going to go through a political system, whether it's here in the United States or in Japan. The fact is, however, the population demographics continue to push in such a direction as well as the overall Japanese consumer sentiment about the healthcare program, in general. You've seen them already talking specifically about raising the co-pay for people ages 70 to 74. I don't know if, Toru, wants to chime in on this. But think in general, it's very difficult to us to commit anything that's outside of our control. Obviously, if it were to shift to a 40% to 50%, it would be a positive tailwind for us.

Daniel P. Amos
Chairman & CEO

Toru?

Tohru Tonoike
Vice Chairman of Aflac Japan

Yes. This is Toru. I think, I agree with Paul about the prospects of the co-pay for the elderly people between 72 to 74.

Operator

Our next question is from Randy Binner of FBR Capital Markets.

Randolph Binner
FBR Capital Markets & Co., Research Division

Just on the buyback this quarter now is pretty significant at $500 million. So just want to clarify, that you've not executed on any of that so far when the blackout period for that is over and if you have any special execution plans to get that done this quarter, given the size.

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

Randy, this is Ken. We typically move out of the blackout period after -- in the afternoon of the daylight today after the conference call when we know all the news has been properly disseminated. We have evaluated not only our capital position but trading volumes and the restrictions that we have for purchasing on a daily basis, and we're confident that we can execute those purchases in the fourth quarter.

Daniel P. Amos
Chairman & CEO

We hadn't bought any so far, and after 12:00 today, 1:00, we can be in the market.

Randolph Binner
FBR Capital Markets & Co., Research Division

Okay, great. Yes, that would be good. And just one other quick one, just a follow-up on the reinsurance transaction. Is it, when you say it's permanent, how permanent is that? I mean, can you get out of it or is this -- I'm just kind of curious what the definition of permanent is there?

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

Well, there's no recaps or provision in there. I suspect if we negotiated with the assuming company we might be able to do something but that's not our intent. We intent to let it play out over time as I said, I view it more as a sale of a block of business than I do a shorter duration kind of reinsurance arrangement that can be recaptured.

Randolph Binner
FBR Capital Markets & Co., Research Division

This counterpart can we take it as the Japanese insurance company?

Daniel P. Amos
Chairman & CEO

That's an international insurance company that operates in Japan.

Randolph Binner
FBR Capital Markets & Co., Research Division

Okay. And then one just detail question. You outlined that it's $0.05 of EPS cost for the reinsurance deal. Does that -- where does the hedging piece, the rate collars fit in. Is that in that $0.05 or is that somewhere else?

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

It doesn't have anything to do with that. This is strictly a claims reinsurance, doesn't have anything to do with interest rate hedges on assets. There's no asset transfers involved. We remain responsible for all the expenses and the investment income on assets back in the block. It's strictly a claims relief in exchange for the payment of gross premium, net of an expense allowance.

Randolph Binner
FBR Capital Markets & Co., Research Division

Understood. I guess, what I'm trying to say what is the call-out then on the interest rate collars? Is there a cost in the kind of the list of headwinds is the '14 EPS?

Kriss Cloninger
President & Director

Maybe it’s a 0 cost collar, but there are settlements depending on where rates move to [indiscernible]

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

Marianne, as Randy, pointed out, we're past the top of the hour we're going to take one more question.

Operator

Our final question comes from Steven Schwartz of Raymond James & Associates.

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

Can we revisit CVEP, I just got a couple of follow-up, CVEP the $0.12 that you're -- the increased $0.12, what is the total amount that you're spending on this in '13?

Daniel P. Amos
Chairman & CEO

Toru, might be able to answer that. But what we're addressing here is the incremental cost over 2013. Actually, the way you measure cost, I've had a lot of discussions with Aflac Japan personnel and it's whether you go through a fully absorbed cost and all that kind of thing. I don't want to get into that on the conference call. So I'll just say that the EPS guidance is the excess direct cost that we intend to invest in the CVEP [ph] program over what we invested in 2013, however that number was derived.

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

Kriss, on the reinsurance agreement, in the long run, does the historical ratio of the amount that you can repatriate relative to FSA earnings, does that change at all because of this?

Kriss Cloninger
President & Director

Well, we're not -- we will get to count the reserve release as part of FSA earnings. However, we are leaving the reserve release in Japan as part of our capital base. We're not going to repatriate any portion of the profits triggered by the reserve release associated with the reinsurance agreement. So if you just look at reported FSA profits, they'll be significantly higher well by about JPY 100 billion than they would have been, without the agreement. And we don't plan to take any of that out. We plan to generate capital with this transaction and we couldn't achieve that purpose if we repatriated that portion.

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

Okay. How about in '15 and '16?

Kriss Cloninger
President & Director

I'm relying pretty much on routine FSA operating earnings which will not be benefited in any extraordinary way by the reinsurance agreement. There will be -- there'll be a routine cost in the FSA earnings approximately of the same amount that impacts U.S. GAAP earnings as I indicated. There'll be a difference between the premiums, net of allowances paid and the benefits received. That'll be probably a net cost of reinsurance that will go through 2015 FSA earnings in addition to GAAP and staff. But that's not material compared to what we're talking about on the initial reserve release associated with the transaction.

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

Okay and then one more, if I may. With Dan -- with Paul moving to Japan, what is the chain of command in Japan these days?

Daniel P. Amos
Chairman & CEO

Well, the operating will still be run by Toru. He's still the Chief Operating Officer and in charge. Paul is not going to be living there for the rest of his life. He's just moving over there for a period of time, 6 months to 1 year, whatever it ends up being just to better understand here. Paul speaks Japanese. He would just be over there, learning the culture more, being associated with them, building relationships with them and giving him a better understanding of exactly how it works. And they all get along very well, and I'm very pleased with how that's going, just as I'm pleased with Ken and what's going over there and the job that Teresa is doing. I think, all in all, this has been a very smooth transition and just allows flexibility for you to understand our management team and let them be able to -- be able to do cross jobs and do different aspects of it.

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

Marianne, thank you very much. We're about 15 after the hour. If anyone wants to follow-up after the call, please call Investor Relations and we appreciate your participation on the call. Thank you.

Operator
This does conclude today's conference call. You may disconnect your phones at this time.