S&P Capital IQ

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Aflac Incorporated NYSE:AFL

FQ4 2013 Earnings Call Transcripts

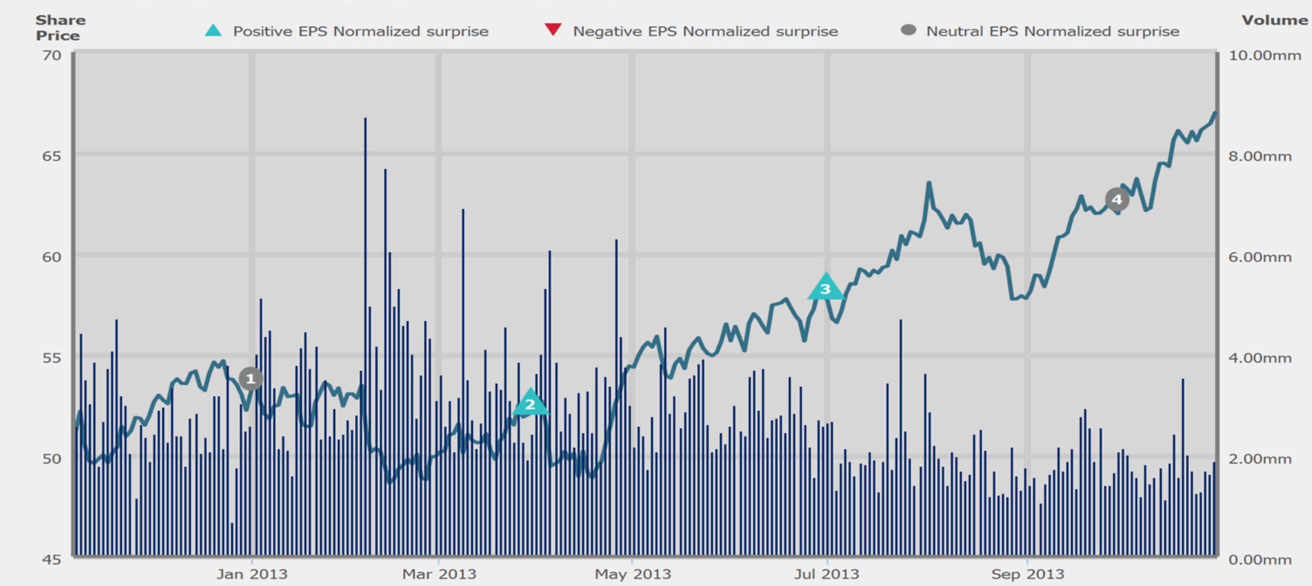
Wednesday, February 05, 2014 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2013-			-FQ1 2014-	-FY 2013-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	1.39	1.40	▲0.72	1.59	6.17	6.18
Revenue (mm)	5899.30	5801.00	▼(1.67 %)	5806.35	23750.66	23939.00

Currency: USD
Consensus as of Feb-05-2014 1:04 PM GMT

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



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2012	1.48	1.48	❶0.00 %
FQ1 2013	1.62	1.69	▲4.32 %
FQ2 2013	1.51	1.62	▲7.28 %
FQ3 2013	1.47	1.47	❹0.00 %

Call Participants

EXECUTIVES

Daniel P. Amos
Chairman & CEO

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

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

Kriss Cloninger
President & Director

Paul Shelby Amos
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Robin Y. Wilkey
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Presentation

Operator

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

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

Good morning, everyone, and welcome to our fourth quarter conference call. Joining me this morning is Dan Amos, Chairman and CEO; Kriss Cloninger, President and CFO; Ken Janke, President of Aflac U.S., Executive Vice President and Deputy CFO, Aflac Incorporated; Eric Kirsch, Executive Vice President and Global Chief Investment Officer; also joining us today from Tokyo are Paul Amos, President of Aflac; and Toru Tonoike, President and COO of Aflac Japan.

Before we get started, let me remind you that some statements in the teleconference are forward-looking within the meaning of Federal Securities Laws. Although we believe these statements are reasonable, we can give no assurance that they will prove to be accurate because they're prospective in nature. Actual results could differ materially from those we discuss today. We encourage you to look at our quarterly release for some of the various risk factors that 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 the year, as well as our operations in Japan and the U.S. I'll follow-up with a few financial highlights for the quarter and the year, and then we'll be taking your questions. Dan?

Daniel P. Amos
Chairman & CEO

Thank you, Robin, and good morning. I'm very pleased that we met, and in many cases exceeded, our financial targets for the quarter and for the year. Let me begin today with an update of Aflac Japan, our largest earnings contributor. Pretax earnings in yen were up 16.9% for the quarter and 13.6% for the year, reflecting a stronger dollar. Sales of our third sector products were up 15.7% for the quarter; and for the year, third sector sales increased 4%, which was at the high-end of the annual sales target of flat to up 5%.

The increase in third sector sales largely reflects a favorable response to our newest EVER medical product introduced in August, and innovative advertising promotions of this product. As anticipated, our largest medical policy has proven especially popular with consumers in their 20s to 40s. Given our under penetration of this demographic, I'm especially pleased that of these efforts to appeal to consumers in their 20s to 40s have yield very positive results for us.

Consistent with our expectation, Japan's new annualized premium sales in the fourth quarter declined 33.3% for the quarter and 29.1% for the year. These results are largely attributable to the significant decline in the sale of WAYS product following the repricing of first sector products in April.

Reflecting on the expansion of our distribution channels, we are pleased with our agreement with Aflac Japan and Japan Post Holding. I believe that in the coming years, cancer sales through Japan Post will steadily benefit our business.

You will recall that first sector sales, particularly WAYS, were very strong in the first 3 months of last year, leading up to the premium rate increase that took effect in April of 2013. As a result, we expect first sector products to be down 60% in the first quarter of 2014 due to very difficult comparisons to last year. However, the second through the fourth quarter of this year, we expect the sale of first sector products to be slightly down compared to last year.

Most importantly though, our focus this year will remain on growing the sales of third sector products. As such, we anticipate third sector product sales to increase 2% to 7% in 2014.

Now let me briefly discuss U.S. operation. Pretax earnings were down 1.3% for the quarter, but up 4.1% for the year. For the year, Aflac U.S., pretax operating earnings were ahead of our target. In the fourth quarter, which typically generates our largest sales production, Aflac U.S. annualized premium sales had a disappointing 10.4% decrease. This results contributed significantly to our full year sales decline of 4.3%.

In recent quarters, we have acknowledged the impact of Health Care Reform, especially to the accounts less than 100, most notably, accompanying confusion and problems associated with the federal exchange. We believe this kind of reoccurring uncertainty has lengthened the sales process as small businesses, especially are more hesitant to engage in changes to Health Care Reform.

They want to gain greater access, hence regarding the implementation of Affordable Healthcare Act and how it's going to affect them. Saying that, a sales decrease of 10% in a quarter is unacceptable to us. The one constant has been and continues to be the need for our products. There is no plan, not even the best major medical plan, that is designed to cover all out-of-pocket expenses. We will continue to drive home the need for our products to businesses and ultimately, their employees. You've heard us say many times in the past that part of our job is to gain access to employers to ensure our products are conveniently available to consumers.

I will remind you that about 98% of our products are sold through the worksite, and more than 90% of those sales come through smaller employers with 100 employees or less. As such, we are working on several key initiatives in 2014 that support our multifaceted distribution network in reaching out to business of all sizes.

With respect to our career agents, first, we are focusing on recruiting and training. Second, we are concentrating on performance management for the territory directors and sales coordinators. Third, we're in the process of piloting Aflac's proprietary exchange, which is geared to employers of 100 employees or less, but those of 50 or less are our primary target. Fourth, we're incentivizing the management of our career sales agents to focus on smaller businesses, while working with brokers to write larger businesses and to that end, in October, we are putting a strategic and tactical focus on businesses with less than 100 employees by aligning our recruiting, training, compensation and market incentives to encourage specific activity and sales in that segment.

Additionally, we are continuing to focus with brokers on a regional and national level to give us better access to mid and large markets. We've already represent more than 60 benefit administration platforms, sometimes referred to as exchanges, with various brokers.

I believe 2014 will be a good year for broker sales as we continue to push to segment our distribution. Finally, we will continue to seek opportunities to leverage our strong brand and relevant product portfolio in an evolving healthcare environment.

While some facets of the U.S. economy have shown signs of improvement, we continue to see a challenging economic environment in the U.S. Many small employers are still very guarded with respect to their business outlook, including their hiring plans. This can impact the universe of potential policyholders we have access to. Taking into account all the strategic initiatives designed to empower our sales force in 2014, along with the challenging economic environment, we expect Aflac U.S. sales in 2014 to be flat to up 5%.

When we look back over our investment performance in 2013, our decision to enhance and protect our SMR by allocating more new money to JGBs suppressed our new money yields. But despite taking a more conservative investment path last year, our average new money yields of 2.47% in 2013, was still slightly higher than 2012 results. As we enter 2014, we're reviewing our asset allocation strategy related to Japan new money investments. Based on current capital position and market outlook, we have resumed purchasing U.S. dollar securities for Aflac Japan's portfolio within ranges consistent with our asset and strategic allocation plans and product needs.

We will continue to evaluate the asset -- the allocation strategy based on investment market dynamics and capital and make tactical changes consistent with our outlook.

Turning to Aflac Incorporated, our consolidated financial performance was strong for the quarter. Excluding the impact from foreign currency, operating earnings per diluted share rose 6.8% for the quarter and 5.2% for the year. This results puts us slightly ahead of our annual expectation of a 5% increase in operating earnings per diluted share before the impact of foreign currency.

While policyholders are top of mind, we also strive to enhance shareholder value through repurchasing our shares and increasing the cash dividend. We believe these are important -- the most attractive uses of capital, and those are the avenues we will continue to pursue.

For the full year, we purchased $800 million of shares, which greatly exceeds our original target we set at the beginning of the year of $400 million to $600 million. As we said in the third quarter, we expect share repurchase in 2014 to increase over 2013 levels to be in the range of $800 million to $1 billion. Our bias for 2014 is to frontload our purchases. As such, we expect to purchase $400 million to $500 million of our shares in the first quarter.

I'm also pleased that we increased our cash dividend to shareholders last year. 2013 marked our 31st consecutive year in which we've increased the dividend to shareholders. Our objective is to grow the cash dividend at a rate generally in line with our operating earnings before the impact of the yen.

Finally, taking into account the headwinds and tailwinds we've covered, I want to reiterate our primary financial objective in 2014, which is to increase operating earnings per diluted share 2% to 5% on a currency-neutral basis. We continue to believe that we are well-positioned in the 2 best insurance markets in the world. We're fortunate that we have the privilege of providing financial protection for more than 50 million people worldwide who count on us to be there when they need us most.

Now I'll turn the program over to Robin. Robin?

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

Thank you, Dan. I'd like to go through some fourth quarter and annual numbers this morning, especially as related to the yen impact, which was strong. I'll start first with Aflac Japan.

Beginning with the currency impact for the quarter and the year, during the quarter, the yen weakened against the dollar 19.5%; and for the year, the yen weakened 18.2%. In reference to topline in yen terms, revenues as reported were up 4.1% for the quarter; excluding the impact of currency, revenues were up 2.6%.

Investment income as reported increased 15.7%. Excluding the weaker yen in the quarter on Aflac Japan, dollar-denominated investment income, net income rose 5.5%. In terms of quarterly operating ratios, the benefit ratios to total revenues declined over last year going from 63.9% to 62% -- 61.2% in the fourth quarter. Excluding the impact from the reinsurance agreement initiated in the third quarter, the benefit ratio for the quarter would have been 60.8%.

Additionally, if you excluded the impact to the weaker yen, the benefit ratio for the quarter would be 62.1%.

Now looking at the expense ratio, it was up 18.9%, up from 18.4% in the fourth quarter of 2012. This increase reflected additional spending in line with our expectations. Reflecting the improvement in the benefit ratio, the pretax margin increased during the quarter going from 17.7% to 19.9%. Excluding the impact on currency, the pretax profit margin for the quarter would have increased 18.8%.

With the expansion of the margin, pretax earnings increased 16.9% in yen terms. Excluding the impact of the yen, pretax earnings in the quarter increased 9.3%. The reinsurance agreement from the third quarter had approximately an $8.2 million pretax income on earnings and a $5.4 million impact on an after-tax basis.

Now let me turn to Aflac U.S. Total revenues rose 1.4% for the quarter. Persistency for the year was 76.8% compared to 77.1% a year ago. And looking at the operating ratios, the benefit ratio for the quarter was 52.7% compared to 50.8%. This reflected various reserve adjustments made in the fourth quarter. The operating expense ratio improved going from 34.6% to 33.1%, reflecting less-than-anticipated spending in the quarter. The profit margin was 14.2% compared to 14.6% a year ago.

Reflecting the increase in the benefit ratio in the quarter, pretax operating earnings decreased 1.3%.

Now turning to investment activities for the quarter, let me first start with Aflac Japan. Approximately 94% of new cash flow was in invested in JGBs for an average yield of 1.37%. As a result, the total new money yield in Japan for the quarter was 1.5%, down 48 basis points from September 30 and down 121 basis points from a year ago. Portfolio yield was 2.8% at the end of December, down 18 basis points from the end of September and 7 basis points lower than a year ago.

In terms of U.S. investment for the new money yield for the quarter was 4.32%, a decline of 19 basis points from September 30. The yield on the portfolio at the end of December was 6.01%, down 5 basis points from September 30.

Turning to a few other items in the quarter, non-insurance interest expense was $51 million compared with $50 million a year ago. Parent company and other expenses was $17 million compared to $6 million in the fourth quarter of 2012.

On an operating basis, the tax rate was 34.4% compared to 34.1% a year ago. As reported, operating earnings per diluted share declined 5.4% to $1.40. The significantly weaker yen decreased operating earnings by $0.18 per diluted share for the quarter. Excluding the impact of the yen, operating earnings per share for the quarter would have increased 6.8%.

Lastly, let me comment and reiterate some of the statements that Dan's already made. We reaffirmed our objective for 2014 of a 2% to 5% increase in operating earnings per diluted share, excluding the impact of the yen. This year, we estimate that a JPY 1 move on the average annual exchange rate will equal approximately $0.03 to $0.035 per diluted share. Assuming the yen/dollar exchange rate remains at the 2013 full year average rate of 97.54, we would then expect 2014 objective of a 2% to 5% growth to be in the range of $6.31 per diluted share to $6.49 per diluted share.
Now we're ready to take your questions. [Operator Instructions] Now we're ready to take the first call.

Question and Answer

Operator

[Operator Instructions] Our first question is coming from Chris Giovanni from Goldman Sachs.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

First question is just around the outlook for the third sector sales in Japan. And I guess I'm wondering why the target isn't higher, given the momentum you've seen with the medical product and how under penetrated that the younger age cohort is? And then really no benefit at all to date from cancer and my understanding is you should get the post-specific product kind of on boarded here in the second half of the year.

Paul Shelby Amos
Former Director

This is Paul. I would tell you first of all, we do expect strong momentum in the first quarter and second quarter and that will be a continuity coming from the EVER launch in the second half of last year that drove extremely strong third and our fourth quarter third sector sales. It's because of that strong third and fourth quarter that we were up against difficult comparisons. Of course, medical product is going to sell at a higher level than the cancer plan in general, as well as the market is growing at a faster pace. That being said, we remain confident about our Japan Post partnership and our continuing ability to grow that. As we've said, it is a long partnership that is focused on growing it steadily. We have continued to expand a number of post offices, but doing so slowly and it will really be in the latter half of the year before we see a significant number of post offices begin to come online. As you stated, the cancer plan is something we're focused on revising at this point pending approval from the government and focused on selling that plan with a specific plan for the Japan Post system. At this point, however, we're still in the process of developing that plan with Japan Post, and can't go over the specifics of it, but we feel very optimistic about it. That being -- all that being said, all of that is modeled into the 2% to 7%. And we're -- I think that's where we are, and I think we're confident about the numbers and what we're going to see for this coming year.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

Okay, and then maybe one for Eric. Can you talk about the decision kind of to get back into the U.S. securities asset class? And then, how we should be thinking about with rates kind of backed down here, managing the volatility, the SMR when rates should rise again since this clearly isn't eligible for that PRM category?

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

Sure, my pleasure. Well, going back at the last couple of quarters when the volatility hit last year and we changed the asset allocation, you recollect, I had said that we were going to spend significant time on recalibrating our SMR given the reinsurance, how the capital position went up, to the risk factors we're exposed to in particular in the AFS category. And those risk factors being yen interest rate, dollar interest rate, currency and credit spreads. So a great body of work has been completed on that, which was our goal during the fourth quarter. So that we could go into the year with a much clearer path. And given the higher capital levels that we have and all of our modeling, we can sustain, if rates should increase, that negative impact to SMR of credit spreads should rise. Yen yields should rise. So we could still be within the SMR levels that management wants us to be in. So SMR is now at a comfortable level where when those things happen in the market, we can absorb an SMR, those impacts, from unrealized gains and losses. The other thing I would comment on as well, there's a correlation effect between these factors. So when U.S. rates are going up, suggesting strong economic growth here, the dollar is strengthening, the yen is weakening. But we have currency exposure in our SMR. So those are risk factors that kind of offset each other. So with all of that modeling and our view of the capital markets, that allowed us to go into the year with the view that we could get back on our path of the original strategic asset allocation from Goldman. However, we're going to be much more tactical on how we implement that. So the second part of your question is, as we're looking at the year, a few things with respect to our U.S. allocation that are based on today's outlook and the capital position. One, we've turned on the program. Secondly, we're not going to think of it just as corporate bonds. It's a bucket of U.S. assets, and we will use our discretion within my investment group to swap, if you will, between maybe U.S. treasury securities and corporate securities based on typical relative value analysis. So as an example, as you all know in the corporate world, the fundamentals are very rich. On corporate, they're very healthy, but credit spreads are at their tightest, almost at all-time lows. So we're not expecting a lot of tightening. We're also not expecting this year, given our economic outlook for the U.S. that credit spreads are going to widen out a lot. But I don't really want to overweigh the corporate allocation when corporate spreads are so tight, but I like the yield differential between U.S. rates and Japan rates. So within that U.S. bucket throughout the year, we'll use our discretion from a relative value standpoint and how to allocate within the U.S. bucket. And the other thing I should mention as well, the U.S. program last year was targeting more or less a 10-year duration. We're targeting a lower duration now in light of the fact that our view is throughout the year, rates will rise and certainly in January, we saw rates come down quite a lot because of the volatility in the emerging markets. But by putting any new money into a short duration bucket of U.S. assets, we're in essence, building up protection to the event that rates rise, so unrealized losses won't be as great. But over the long-term from an economic perspective, we're very bullish that these are very positive for the long-term health of our balance sheet and our earnings streams.

Operator

The next question is coming from Yaron Kinar from Deutsche Bank.

Yaron Joseph Kinar
Deutsche Bank AG, Research Division

Dan, I think you briefly mentioned progress on the EVERWELL platform and now [ph] the brokerage exchanges in the U.S. I was wondering if you could give us a little more color on the EVERWELL progress. I think on the last call, you talked about testing 6 states. So where does that stand today? And then on the broker exchanges, I think you had mentioned being on 60 today, which seems significantly greater than where you were a quarter ago. So if you can give us any thoughts on both.

Daniel P. Amos
Chairman & CEO

Let me make a couple of statements and then I'm going to have Ken talk a little bit more detail as we're all working together to do this. The one thing I think is important that all of you understand is we introduced a major change with our field force. As you know, we're probably the only company out there that is concentrated so heavily on a accounts of 100 or less. It's always been our bread and butter. It's always worked very well for us. Our agents have also rolled accounts of 100 or more. But what we have seen is we have seen those accounts of 100 and more, shift more to dealing with brokers. So as we started several years ago, we started seeing the brokers coming in. We started putting them in our market to some degree, but what we did in October is we made a conscientious decision to introduce to our whole management team that we were going to pay for performance by trying to get our agents to concentrate more on the accounts of 100 or less. Well, 90% was already there, so it wasn't that big, but psychologically, tell them we really wanted them to concentrate there and not doing the 100 or more. The old timers don't like it. That's why new recruits are so much better because they understand that's the way it will be done. Now we're not saying you can't do it, we're just paying to move you that way. We're then working with the agents to where these agents will work with brokers to try to enroll what I would call the local brokers more. And then through our plans with Aflac Group, we're doing the national brokers. So this is a major shift that all occurred in the fourth quarter. And at the same time, we're now getting ready as you talked about, to move to EVERWELL with the small businesses, which especially will 50 and less. And of course, we got the delay with the ObamaCare that now it won't go into effect till next year.

So all those things kind of hit at the same time, which I think accounted for part being our problem, part being that we ride more small business. But all in all, unacceptable numbers in my case. So I'll let Ken talk a little bit about specifically your EVERWELL and what we're doing there and then if Teresa wants to follow-up with any comments, she's welcome to. Ken?

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

Yes, let me start on the EVERWELL exchange. We are right in the middle of the pilot. We had orchestrated an extended pilot from October 1 through the end of March of this year. It's actually in 3 states, one of which we have -- our appointed agents in that area have access to not only our products, but major medical as well as vision, dental and life. And then in the other 2 test states right now, they're limited to all the products -- they have all the products but not a major medical. Because it is such a sweeping change in how we may be enrolling these small businesses in the future, we wanted to take a very pragmatic and conservative approach to this. So we'll evaluate, after we finish the pilot in March, we'll evaluate our rollout plans. We currently anticipate that we'll be rolling the platform out to the majority of our states throughout the balance of this year. But the exact timing of that rollout is going to be dictated by our assessment of the pilot and we're not quite done. They're in a position to make that assessment. I can say that generally we're please with what we've seen so far. We have seen higher penetration rates than we've seen in our traditional business for accounts of the same size, which was one of the success metrics that we're focused on. Over the longer term, we'll focus on things like retention of accounts, as well as distributors. But we do expect that it will go well and that we will be in a position to rollout. That said, we don't expect for it to have much of an impact on sales in 2014. But if our rollout plans meet expectations and we're able to roll it out as we currently anticipate, we should start to see an impact in '15 and beyond. With respect to the benefit administration or exchange platforms that you referenced, we've actually had those in place for some time now, but they're basically, I'd call them kind of one-off arrangements with distributors and accounts, and their overall impact to sales last year was not really material. But in thinking through our exchange strategy for the larger case market, that's something that you'll largely see come out of the core broker and then our large national broker efforts through Aflac Group in Columbia, South Carolina. The first step of which, and our major focus right now is to build our distribution at Aflac Group. We're in the process of expanding the number of employed salespeople that we have that will bring relationships to us with brokers or establish relationships with brokers so that they can convince those national brokers on the case for voluntary products and more specifically, that we should be the provider of choice for those voluntary products. And then we'd look at the most efficient way to enroll those clients and that would likely be through an electronic platform like an exchange. But the first step right now, we're really focused on building out the sales capacity at Aflac Group so that we are in a better position to reach the brokers and then get on those exchanges.

Daniel P. Amos
Chairman & CEO

And Ken is concentrating, of course, on combining the 2, both Aflac Group and Aflac Columbus. But Teresa, may want to make a couple comments on Columbus because that's still 90% of our sales. And so Teresa, you have any comment?

Teresa Lynne White
President of Aflac US

Well, I'll just echo what Ken said with regard to EVERWELL. Currently, we have a couple of other platforms that we use today, our SmartApp unit, that you all are familiar with. The majority of our activity is basically driving the multi-distribution strategy, handling the sales operating guidelines, making sure that we have all of the alignment with compensation and sales targets so that we can migrate everybody to this new EVERWELL exchange.

Daniel P. Amos
Chairman & CEO

Does that answer your question?

Yaron Joseph Kinar
Deutsche Bank AG, Research Division

It does. And one quick follow-up on that if I could. On the national exchange or the national brokers, do you think that the investments you're now making in sales and into platform will be ready to bear some fruit for 2015 enrollment coming October, November of this year?

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

Well, we're really positioning this for better growth out of the large case market for group products in '15. This is really a build-out year of sorts. Again, we're increasing our ability to reach those broker distributors. And as you know, there's a very long lead time to large cases, so we're really positioning this for what we would hope and expect to be much better growth in the group platform in 2015.

Operator

The next question is coming from Mr. Jimmy Bhullar from JPMorgan.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

On the U.S. business, maybe if you could talk about just recruiting and the growth in the producing agent count, because it's been weak for a while. Not sure if that's just a lack of finding good candidates, or are people not willing to give up unemployment insurance or what's going on that you're having a difficult time finding recruits in the U.S.? And then there's a question earlier on new money investments in Japan. I don't know if you mentioned how much of your new money you're intending to deploy in U.S. securities, whether it's corporate or treasuries?

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

Jimmy, let me start on the recruiting. We are really focused -- as Dan suggested in his comments, we're focused on a few very basic activities for our traditional sales force this year. We really want them to focus the majority of their efforts in the under-100 account size. We're also focusing on what we refer to as core brokers. It's really the local and regional brokers that Dan has mentioned. We're focused on asset management, which is a fancy way of saying we want our career sales force to make sure they're getting the most out of their book of business so that in effect, they're not leaving business on the table by really calling on their accounts and managing that business properly. And then the other one is recruiting. Recruiting has always been a core component of how we build our sales force. Newer agents tend to be the ones that brings us the new accounts where you have opportunities to really grow the business. I think one of the things that we've not only focused the activities squarely on recruiting, but also on the type of individuals we'd like our sales force to recruit because I do believe that there were some effort on our sales force that rather than recruiting the career agent that we've typically built this business on, they were trying to recruit brokers instead. So we've really refocused their activities this year on referral recruiting nominations and getting the type of sales associates that have long been known to build this business. We have seen a bit of a turn. I think it's too early to comment with certainty, but so far this year, with that new focus, we're pleased on the kind of recruiting activity that we've seen. It's still down year-over-year, but it has significantly lower rate of decline than what we've seen throughout 2013. So we are focused on that. By focusing on that and also the training and getting those new agents to focus on the small business area, the accounts with fewer than 100 lives, we think we'll also be successful in pulling up the numbers of producing agents.

Teresa Lynne White
President of Aflac US

And I'll just follow-up with 3 areas of focus. One area of focus, really trying to make sure that our people who are recruiting in our career channel, that those folks don't compete with trying to recruit brokers as well. So we basically focused the career recruit channel on really recruiting people for that career channel, and then we moved a lot of the market, the people who are recruiting for brokers into a core broker channel, which really supports the distribution channel or the channel segmentation and it also supports how the market has shifted as well. The other thing that we're doing is recruiting ads and you'll see some of those recruiting ads. They were very successful in the past for us with really getting interest for Aflac and with regard to recruiting. And so we decided to bring those back. The last thing is making sure that all of our goals for recruiting are aligned within the hierarchy. So any contest, any compensation is aligned across the hierarchy with regard to recruiting as opposed to 1 or 2 people holding a goal for recruiting. But their comp is tied to it. Eric?

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

It's Eric to answer the second part of your question around the percentage allocation of new money. Just a couple of factors that go into that allocation, one is when we discuss new money, what we're discussing is cash flow from operations and maturities and interest from existing assets. But we also consider sort of the target balance of our asset classes at year end, which ties back to these strategic allocation work. So with regards to U.S. assets, if you will, as a target, not necessarily meaning we're going to get there, 25% of the Japan assets would be our target for U.S. assets at the end of the year. When we calibrate what I discussed earlier, the new money statistics that we expect, SMR, we would currently expect no less than about 40% of our cash flows to be in U.S. dollars. But again, that would depend on market factors, SMR and one other factor is during the year, which has already happened this year, we may dispose of some securities like you know about Israel Electric for instance. Those proceeds came in January. We're invested into the U.S. program. But that's not counted as new money, but it would count towards our year-end target. So there's a variety of factors that go into that. And then finally, I would remind you, I can give you some of these estimates, but as I said earlier, we will be more dynamic with respect to the risk factors in the market, what's happening with spreads, what's happening with rates. So I think you'll see us be more opportunistic as well as conservative from a safety standpoint, depending on what's happening in the market, but certainly we'll report throughout the year on how it all panned out relative to our expectations.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

And the U.S. investments don't qualify for policy reserve matching accounting treatment, right?

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

That's correct. Those go into AFS.

Kriss Cloninger
President & Director

Let me point out that on the U.S. statutory basis, the assets are held at amortized costs as opposed to mark-to-market. So it's not a big factor in RBC.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

It's more the SMR would change though?

Kriss Cloninger
President & Director

Yes, the SMR for Japan is sensitive to fair value, all AFS securities, but in the U.S. we're not, on RBC, for the U.S. operations.

Operator

The next question is coming from Mr. John Nadel of Sterne Agee.

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

Just a quick follow-up on the investment side. I don't remember the exact amount out of Japan in terms of the new money investments in total from 2013. If memory serves, it was effectively an all-time record, given the very strong sales in the first sector channel. How much is that overall new money investment going to decline in 2014 given the continued shrinkage of the first sector, the fact that third sector sales are clearly require less from the perspective of the investment income?

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

It's Eric. I can give you the numbers from last year and the projections this year in total cash flows and then perhaps one of my colleagues want to discuss at that second level between sales. But to your comment earlier, last year's cash flows were JPY 1,118,000,000,000. But that's cash flow from operations, maturities and interest from the portfolio, so there's a lot of attribution within it. For this year, again, in total, the projections are JPY 771 billion.

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

Got it. Okay. And then I think the only other real question I have is as you've done all this work around SMR sensitivity and calibrating, especially post the shift to the PRM classification, can you give us some sense for how much the sensitivity of the SMR has come down, especially relative to changes in interest rates?

Kriss Cloninger
President & Director

This is Kriss. Let me say that we've done a lot of work on that. We intend to go into that in some depth at the FAB meeting. I didn't want to do it on this call. But let me just say that with our SMR at its current level in the mid 700s, we believe that we're well protected against the fall below the 500% to 600%, which is kind of our overall low level operating objective. The way I'm looking at SMR right now is that we want to -- we don't want to broach our fallback position, which I'll say is 500% to 600%. We feel like by staying at about 750 in today's market environment, there are very few scenarios where we're going to pierce below 500% to 600% for changes in U.S. interest rates, changes in Japan interest rates, changes in currency rates. So what we've done is to insulate ourselves against the low side of the SMR exposure due to volatility in those macro factors. And we believe that enhances our ability to give the investment team flexibility to pursue their plans without significant concern. And it just gives us more assurance that we'll be able to manage SMR levels in a way that will allow us to achieve our plans for profit repatriation, policyholder security and the like. So we feel like the work we did between the third quarter and fourth quarter last year has well positioned us to manage in a very flexible way in response to significant changes in macro conditions.

Daniel P. Amos
Chairman & CEO

I mean one of our main objectives here is to never act like we had to do onetime on share repurchase. We'd constantly be increasing it every year. And by having this bottom set, we feel comfortable that we can continue to increase it unless something just unheard of happens.

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

John, this is Ken. Let me just add, the -- if you just look at the SMR sensitivity to yen interest rates, our -- as Kriss said, we'll talk more about it in our Analyst Meeting. It is significantly less than it would have been a year ago for a couple of reasons, number one, it's implementing the PRM category which insulated us from some yen rate risk. The other is that now we have more dollar assets, proportionately. So what does that mean? Well, we've got more exposure to dollar rate risk. So -- and we've taken some actions to try and mitigate that risk on SMR as well. When you think of the market risks that influence SMR, we're exposed to yen rate risk, dollar rate risk, credit spread risk and currency risk and the problem is those are somewhat correlated. You can't just aggregate one risk on top of the other and come up with an overall sensitivity. And that's why we're doing a little more work on it to give you a better indication of what kind of buffer we feel we should be maintaining to accommodate those risks.

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

Perfect. That's really helpful. If I could sneak one last one in, because it's related. It's just -- have you done any incremental hedging particularly around yen versus dollar as you look out to 2014 and beyond to insulate your expected profit repatriation from potential currency moves?

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

Yes, let me update you on that. Our current expectation is to repatriate about JPY 97 billion. The last time we spoke, we had hedged JPY 47.5 billion at a little over JPY 100 to $1. We've added another -- incrementally, another JPY 5 billion. So we have roughly JPY 52.5 billion hedged, again, a little over JPY 100 to the $1. We've elected to take -- use our yen cash flow from repatriation this year to service the JPY 34.2 billion debt that we have maturing. And so what that does is that frees up about $400 million that we had on the balance sheet that we had previously earmarked for share repurchase. So when you look at the JPY 52.5 billion plus the JPY 34.2, you're roughly JPY 10 billion or so that it remains unhedged. And I think it's unlikely that we'll do much more for this year but we have already started thinking about '15 and taking actions to insulate against currency risk on that repatriation.

Operator

Our next question is from Steven Schwartz of Raymond James.

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

I guess this all ties in. But I do want to ask about what is going on or what can possibly be done in reinsurance. I know -- I mean you kind of started it in, I think, it was May at the FAB meeting. Kriss stated that he thought that the FSA was really against doing in-force block types of transactions to free up capital. But you're sitting there with an SMR of 750. You've got PRM and you're doing some interest rate hedging. There's a lot of protection there. The reserves are way, way overstated in Japan relative to the U.S. which is probably overstated relative to reality anyway. You've got 1 competitor that's done -- an American competitor that's announced that they did a deal. RGA is saying that they're seeing a lot of companies do this. I'm wondering, Kriss, if you've thought more about this or looked at this more.

Kriss Cloninger
President & Director

Yes, we're continuing to evaluate it, Steve, and I don't necessarily agree with all your comments, at least -- maybe I do but maybe not in order of magnitude. But let me just say that the reinsurance we did at the end of September allowed us to achieve our objective of increasing the solvency margin substantially. We don't feel like we need to do additional reinsurance to accomplish that right now. We've got it in reserve in case we ever need to do it. What I do have my team exploring is the notion of doing a continuous program of reinsurance of those nature to alleviate, to some extent, the surplus stream we experience relative to new business. And what I think that would do, what it will do is to minimize the volatility of FSA earnings in responses to changes in production levels. And it would also allow us to monetize, to some extent, some of the differences between the economic reserves, which is how I'd characterized what you're trying to get to, and the regulatory reserves. Keep in mind though that reinsurance of the nature we did dose have a cost. You are selling a block of business in exchange for a premium, and it does have a cost and I've quantified the cost for reinsurance at 2014 at about $0.05 a share, about $30 million or so after-tax. So it's not like it's free. Now let me say that relative to other companies, we don't have an internal reinsurance subsidiary where we can do this program on an intra-company basis. We've never been a reinsurance user to any great extent. We haven't needed to. We don't have a reinsurance subsidiary. The deal is on an arms linked basis with other companies, which many companies do. So that's kind of a negative for us. That being said, we do recognize the possibility that we could establish a captive reinsurer and that's one thing that we're going to look at. That's not a short term thing, something that's easily achievable in 3 months. But it could be a cost-effective or cost-efficient way to do some reinsurance and we're going to investigate that further. So let me just say, we intend to evaluate the use of reinsurance. We can do more. We're going to use it to, again, protect profit repatriation and the like. And there will be more to come on that. But we're not just ignoring it, Steven. We're going to be using it effectively.

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

All right. Great. And then a follow-up to -- on the very, very large cases, I want to try to get a handle on what's changed here in the U.S. with the exchange. You say you're on the platforms, but you've been on the platforms for a while. I mean, my understanding has been at least for 1 year, maybe 2 years, all the big alphabet houses you've been with them, but the issue seems to have been then getting their people to use you. Is this really just the same situation they may be selling it differently but it's still the issue of getting the RAP[ph] , the AEGON or Marsh Mc to use you? Is that still the issue?

Teresa Lynne White
President of Aflac US

This is Teresa. Why, really, the issue is making sure that we build out, as Ken said, that W-2 salesforce that Dan Lebish is responsible for. We're building out because most of these large, brokerage houses, which you may know, they really go to market differently. And you don't -- it's not a product sale. It's really understanding how they go to market. And so the importance of those relationships is to really understand how each brokerage house deals with the market and then how Aflac fits within the context of that. And so the initial relationship or the initial interaction is more us understanding, Aflac understanding their go-to-market strategy, understanding and educating many of the brokers on voluntary product. And then there's a process of selling. What Ken referred to a while ago was a lot of the plumbing that was built for the 6 years or so exchanges are platforms that we have today. There were specific cases that wanted Aflac. They asked for Aflac and they happen to have brokers involved. Now that's some of it. But others are really where brokers have brought us in and utilized us against other competitors. So right now, that's why Ken is saying right now, what we've got to do is establish that work, that sales force at Aflac Group so that we can ensure that -- and we call those salespeople BDEs, broker development executives, and they'll be Regional Vice Presidents, they're managing that process. But at the end of the day, the relationship is what's important and Aflac understanding their go-to-market strategy and how Aflac product fits.

Daniel P. Amos
Chairman & CEO

The one thing I would say that's very important here is it was somewhat murky in our organization of how brokers and agents and the new things were all fitting together. Now what we did in October is we defined exactly the direction we wanted everyone to go, and we cut out certain things like, for example, these big brokers. They don't want our agents calling directly on them. That irritates them, and they control the account and we've defined that better to stop that from happening. So these are things that are major in terms of how we handle it in terms of emotional and trying to motivate our existing field force, and we've done that through more commissions and shifted them. And so all of this is just part of something that's unfolding right now that I ultimately think will enhance our sales. I think we're going to be much stronger. I think anyone that thinks that we're not going to be strong in the small market is mistaken because we've done so well. I think anyone thinks that with the big brand we've got, which everyone knows us in the supplemental industry in the United States, will be mistaken when it comes to how well we're going to do with the brokers going forward. We've just got to let them know that we understand their needs, and we're going to fit products accordingly. And that's where South Carolina will come into play with our new President over there, our new Executive Vice President over there and how he handles it. And Ken will be coordinating those 2 efforts.

Kenneth S. Janke

Former Executive Vice President and Head of Corporate Finance & Development

Steven, I would actually argue, I think the exchange part is the easy part because that's enrolling the business. The hard part, what we have to work on is we have to have the relationships. We have to demonstrate to those large national brokers the value proposition for supplemental products, again, why we should be the provider of choice and how we can effectively enroll that business and service that business and get them paid quickly to have a pain-free experience. So the enrollment itself through an exchange, I don't see it that daunting. It's really the -- it's everything that's leading up to the enrollment that we really are working on.

Teresa Lynne White
President of Aflac US

Steve, and one other thing I want to comment on since we're talking about this new distribution strategy, as Dan referred to it. We're going to do a spreadsheet and try to outline the various aspects of this and it will be available online just like we have other spread sheets out there on investments and such to help you better understand the market segments, the channels, the products within those channels that they'll be offering enrollment conditions, et cetera. So that should be available on the website. Some time this afternoon, we'll have that up there. I think it will help everyone understand better this new strategy in the U.S.

Operator

The next question is coming from Mr. Tom Gallagher from Crédit Suisse.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Kriss, I wanted to come back to the comment you were making about exploring captive re, and I think the comments you used were to potentially stabilize JGB earnings and then dividend repatriation. Should we be thinking about this whole evaluation more as making sure you have stability? Or would there be a significant enhancement opportunity? For instance, the 1.3 billion to 1.4 billion of JGB earnings that you guys are run-rating right now, I mean is there the possibility from this kind of transaction that you could increase that 50% if you structured it the right way? Or is that not the right way to think about this? Is this more of a stability exercise than an enhancement exercise?

Kriss Cloninger
President & Director

No, there's an opportunity for enhancement, Tom. I think you have to be measured in thinking about how much enhancement. We're going to have to balance cost and the overall results and we always manage the business for the long term as opposed to the short term. So I'm not looking for a quick pop on profit repatriation and a quick pop on share repurchase. I'm more interested in what we can sustain over the longer term. But there is an opportunity for enhancement and that's one of our objectives.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Got it. But we shouldn't be thinking about as you said -- yes, okay got it. So more of a measured enhancement.

Kriss Cloninger
President & Director

Yes, if we got a 50%, it wouldn't be achievable year-to-year. If went up 50%, it'd probably have to stay at that level, assuming we could even get there, which, it might be achievable, but I doubt that I'm going to go that far.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Got it. And then just a follow-up for Eric, your comment that you were positioning into shorter durations, securities I guess, I think that was just related on the USD allocations, not sure if that also applies to what you're doing on the JGB side. My follow-up on that point though is should we be thinking about this more as short-term tactical because ultimately you have to match your liability and you have very long duration liability. So if you're shortening the duration today, how long would you be willing to deal with tolerance of the mismatch?

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

Sure. Thank you, good questions. And to your first one, yes. That was with respect to the U.S. securities, not our JGBs which are -- the JGBs are longer in duration and more closely matched to the liabilities. The second part of your question, yes, this is more tactical. And keep in mind, that shorter duration is for the new money. So the existing portfolio, which is quite large, particularly when you take the U.S. corporate program that we started as we called it, and what we used to call the Japan dollar portfolio, we're now thinking of that is 1 big bucket. So that big bucket is approximately a 10-year duration and we're not changing the duration of that bucket, but the incremental new money is going in tactically at a shorter duration, which will bring the overall duration slightly down. But we certainly have to have that focus on ALM and matching assets on liabilities. So it is more tactical for this year at this point in time.

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

Well, we reached the top of the hour. If anybody has any follow-up calls, David and I will be in the office. So please give us a call. Otherwise, we look forward to seeing everyone at our FAB meeting. The information is out there for you to register, and thank you so much for joining us this morning.

Operator
That concludes today's conference. Thank you for participating. You may now disconnect.