S&P Global
Market Intelligence

Aflac Incorporated NYSE:AFL

FQ4 2020 Earnings Call Transcripts

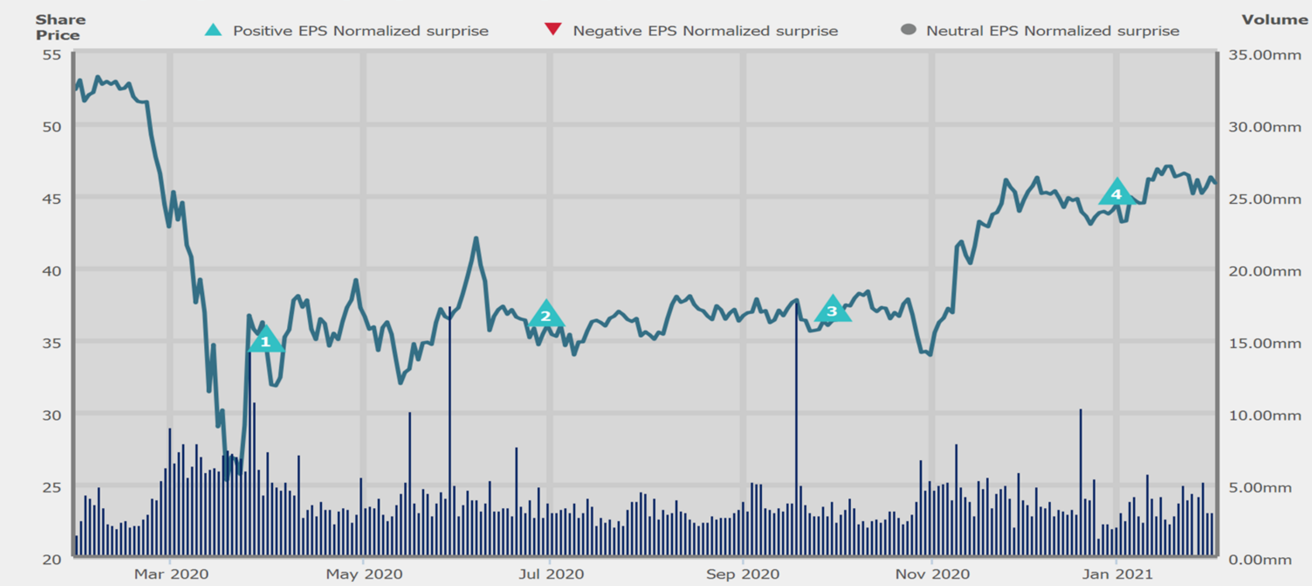
Thursday, February 04, 2021 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2020-			-FQ1 2021-	-FY 2020-			-FY 2021-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	1.04	1.05	▲0.96	1.23	4.90	4.92	▲0.41	4.92
Revenue (mm)	5493.97	5913.00	▲7.63	5467.15	22064.10	22147.00	▲0.38	21936.25

Currency: USD
Consensus as of Feb-04-2021 8:30 AM GMT

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



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2020	1.10	1.21	▲1 10.00 %
FQ2 2020	1.05	1.28	▲2 21.90 %
FQ3 2020	1.14	1.39	▲3 21.93 %
FQ4 2020	1.04	1.05	▲4 0.96 %

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Call Participants

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David A. Young
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Presentation

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Aflac Fourth Quarter 2020 Earnings Conference Call. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to your first speaker today, David Young, Vice President, Investor and Rating Agency Relations. Please go ahead, Mr. Young.

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

Thank you, Carol, and good morning, and welcome to Aflac Incorporated's Fourth Quarter Earnings call. As always, we have posted our earnings release and financial supplement to investors.aflac.com. This morning, we will be hearing remarks about the quarter and the year related to our operations in Japan and the United States amid the ongoing COVID-19 pandemic.

Dan Amos, Chairman and CEO of Aflac Incorporated, will begin with an overview of our operations in Japan and the U.S. Fred Crawford, President and COO of Aflac Incorporated, will then touch briefly on conditions in the fourth quarter and discuss key initiatives, including how we are navigating the pandemic. Max Brodén, Executive Vice President and CFO of Aflac Incorporated, will conclude our prepared remarks with a summary of fourth quarter financial results and current capital and liquidity.

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

We are also joined by members of our executive management team in Tokyo at Aflac Life Insurance Japan. Charles Lake, Chairman and representative Director, President of Aflac International; Masatoshi Koide, President and Representative Director; Todd Daniels, Director and CFO; and Koji Ariyoshi, Director and Head of Sales and Marketing.

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

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

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

Daniel Paul Amos
Chairman & CEO

Thank you. Good morning, and thank you for joining us. At this time last year, it would have been very difficult to foresee the gravity of what was soon to unfold for society and for the company due to COVID-19. I am proud of our employees, our sales distribution and Board of Directors for their decisive people-first initiatives we spearheaded early on in both the United States and Japan to protect our workforce and to be here for our policyholders throughout this trying time. We were able to reinforce our financial strength in operations as well as our distribution franchise with digital and virtual investments to the position of our company for the future growth.

Adjusted earnings per diluted share, excluding the impact of foreign exchange, increased 10.8% in 2020, while benefiting from a lower effective tax rate. We were pleased with the results when you consider the pandemic pressure on revenues, accelerated investment in our core technological platforms and the initiatives to drive future earned premium growth and efficiency. Investing in growth and innovation will continue to be critical strategic focus this year.

There is one central message that I've been emphasizing with our management team. It is imperative that we control the factors we have the ability to control. And what we don't have control over, we must monitor continually to be ready to adapt. Despite the fact that sales in both U.S. and Japan had been suppressed considerably due to the constraints of face-to-face opportunities, we did not sit still. We maintained forward motion as we absorbed accelerated investment in our platform while continuing strong earning performance.

In 2020, Aflac Japan generated solid overall financial results with a stable profit margin of 21.2% and extremely strong premium persistency of 95.1%. The relaunch of our new cancer rider drove a sequential improvement in both cancer insurance and total sales in the fourth quarter. As a result, total sales were down 22.2% for the quarter and 36.2% for the year.

In Japan, we introduced our new medical product in January, and even up against difficult comparisons of last January, pre -- that were pre-COVID sales, it is a positive launch, exceeding our expectations. We are encouraged by the reception of both the consumers and our sales force. While these sales results represent sequential improvements relative to last quarter, the effective reduced face-to-face activity are evident, and we continue to promote virtual sales. Our goal in Japan is to be the leading company for living in your own way. This is a declaration of how we tailor our products to fit the needs of customers during the different stages of their lives and reach them where they want to buy, through agencies, strategic alliance and banks.

Now turning to Aflac U.S., we saw a stable profit margin of 19.3% amid a year of intense investments in the future of our business and the global pandemic conditions. However, this backdrop continues to noticeably impact our sales results in this segment as well, largely due to reduced face-to-face activity. As expected, we saw modest sequential sales improvement in the quarter, with a decrease of 27.2% for the quarter and 30.3% for the year.

In the U.S., we continue to feel the impact of limited access at the work site, especially among our career agents who have historically relied upon face-to-face meetings to engage small business owners and their employees. However, we remain cautiously optimistic for continued modest sequential sales improvement, contingent upon the pace of the economic recovery, and as a result, expect to see a brighter second half of 2021.

Fred is responsible for acquisitions, and he will cover that shortly. But while these acquisitions may not have an immediate effect on the top line, they better position Aflac for future long-term sales in the United States.

As part of the VISION 2025 in the U.S., we seek to further develop a world where people are better prepared for unexpected health expenses. The need for the products we offer is a strong -- or stronger than ever has been. And at the same time, we know consumer habits and buying preferences have been evolving, and we are looking to reach them in ways other than the traditional media and outside the work site. This is part of the strategy to increase access, penetration and retention.

Even while working remotely for the greater part of the year, we remained true to our culture and identity as a socially responsible company. We stepped up our engagement with our employees through virtual town meetings and weekly touch-base letters. Additionally, diversity continues to play an important role at Aflac, as it has for decades. I have always believed that in order to accomplish our goals and serve the community where we have a presence, we must surround ourselves with a group of people who bring different perspectives to the table. We have done that for years.

At the end of 2020, nearly 50% of Aflac's U.S. employees were minorities. 66% were women. 23% of our U.S. senior officers were minorities and 30% were women. And then when you think of Aflac's Board of Directors, 36% were minorities and 36% were women. Diversity has always played an important role within ESG, and I've tasked Fred with executive oversight of our ESG efforts. He will provide greater detail on our 2021 key objectives.

I've always said that the true test of strength is how one handles adversity. While pandemic conditions are ongoing, I'm pleased that 2020 confirms what we knew all along, and that is that Aflac is strong, adaptable and resilient. We strive to be where people want to purchase insurance, that applies to both Japan and the United States. In the past, this has meant meeting face-to-face with individuals to understand their situation, propose a solution and close the sale. However, the pandemic clearly demonstrates the need for virtual means. In other words, non face-to-face sales to reach potential customers and provide them with the protection that they need. Therefore, we have accelerated investments to enhance the tools available for our distribution in both countries.

Related to capital deployment, we placed significant importance on continuing to achieve strong capital ratios in the United States and Japan on behalf of our policyholders and shareholders. When it comes to capital deployment, we pursue value creation through a balance of actions, including growth investments, stable dividend growth and disciplined tactical stock repurchase.

It goes without saying that we treasure our record of dividend growth. The fourth quarter's declaration marked the 38th consecutive year of dividend increases. Additionally, the Board approved a first quarter dividend increase of 17.9%. Our dividend track record is supported by the strength of our capital and cash flows. At the same time, we remain tactical in our approach to share repurchase, buying back $1.5 billion of our shares in 2020. We have also focused on integrating the growth investments we have made in our platform.

As always, we are working to achieve our earnings per share objectives while also ensuring we deliver on our promise to our policyholders. By doing so, we look to emerge from this period in a continued position of strength and leadership.

I don't think it's coincidental that we've achieved our success while focusing on doing the right things for our policyholders, shareholders, employees, distribution channel, business partners and communities. In fact, I believe they go hand-in-hand. I'm proud of what we have accomplished in terms of both our social purpose and financial results, which have ultimately translated into strong, long-term shareholder return.

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

Frederick John Crawford
President & COO

Thank you, Dan. I'm going to touch briefly on conditions in the fourth quarter with respect to the pandemic. I'll then provide an update on key initiatives in Japan and the U.S.

Japan has experienced approximately 400,000 COVID-19 cases and 6,000 confirmed deaths since inception of the virus. While quite low as compared to other developed countries and the U.S., these statistics have more than doubled since the end of the third quarter. Earlier this week, the government of Japan extended their state of emergency for Tokyo and 9 other prefectures through March 7. This action includes the suspension of domestic tourism campaign and entry of foreigners into Japan. We have responded with, again, moving more of our workforce to working from home. Unlike the state of emergency declared last year in the initial stages of the virus, government restrictions are more balanced with economic recovery considerations, and we have not prohibited face-to-face consultations and/or closed our sales shops. Meanwhile, prime Minister Suga has announced a goal of beginning vaccinations mid-February.

Through the fourth quarter, Aflac Japan's COVID-19 impact totaled approximately 3,400 unique claimants with incurred claims totaling JPY 1 billion. We continue to experience a significant reduction in paid claims for medical conditions other than COVID-19 as Japan manages hospital capacity and discourages more routine visits.

Despite the recent rise in infection rates in Japan, we continue to track well below our stress assumptions. As Dan outlined, sales have clearly been impacted. But when looking at policies in force, the impact of reduced sales on earned premium has largely been offset by improved persistency with the reduction in reported revenue driven primarily by paid-up policies.

Finally, pandemic-related expenses in the quarter totaled JPY 1.8 billion. Which includes the rollout of virtual distribution tools, employee teleworking equipment and distribution support.

Turning to the U.S. There are nearly 27 million COVID-19 cases and over 450,000 deaths, as reported by the CDC. For Aflac U.S., in 2020, COVID-19 claimants totaled 23,000 with incurred claims of approximately $71 million in the quarter and $128 million for all of 2020.

We are now in a better position to back-test the correlation of U.S. rates of infection to paid claims in order to build an estimate for incurred claim reserves. It's fair to say this is still very difficult to estimate as IBNR often works from years of reliable data to establish trends. While our reserves assume elevated claims, we continue to see the length of stay in hospital and transition to ICU traveling below our expectations.

We have seen limited impact to our reported persistency numbers. However, we believe this is in part attributed to the combination of reduced sales, where lapse rates tend to be much higher in the first year and the state of -- state executive orders requiring premium grace periods. Executive orders are still in place in 11 states as of the end of the quarter, with 5 states having open-ended expiration dates. We have reduced pressure on lapse rates through proactive work with our policyholders, including converting from payroll deduction to direct bill and encouraging a review of wellness benefits.

Turning to key operating initiatives. 2020 was an important year in setting the stage for growth once we move clear of pandemic conditions. Beginning with Japan, after launching and promoting a simplified cancer writer in the fourth quarter, we successfully launched our refreshed medical product called EVER Prime in January. As Dan noted in his comments, it's early, and our associate channel is having to navigate pandemic conditions, but January medical sales are promising.

Introduced in October of 2020, we have technology in place to allow agents to pivot from face-to-face to virtual sales and an entirely digital customer experience. True virtual sales in Japan is relatively limited. In addition, the majority of applications are still filed in paper form, although digital applications have been adopted in face-to-face consultations. Excluding traditional non face-to-face means of distributing products, like work site, direct mail and call center sales, we estimate only 2% to 3% of our sales are currently digital end-to-end. However, we understand some of our agencies has significantly adopted virtual tools to supplement face-to-face consultations.

We have discussed our paperless initiative across all operations in Japan. This is a JPY 10 billion investment with approximately JPY 2.8 billion spent in the fourth quarter and JPY 4.8 billion spent in 2020. We are projecting another JPY 4.3 billion in spend planned for 2021. This investment has a 3-year payback and will reduce the production and circulation of over 80 million pieces of paper per year.

In summary, we expect the combination of product development, improved pandemic conditions and the return of Japan Post to distributing Aflac cancer insurance will drive growth as we look towards the second half of 2021.

Turning to the U.S., we focused our efforts in 2020 on setting the table for 2021, including a national launch of Network Dental and Vision, completing our Group Benefit acquisition and standing up our new direct-to-consumer digital platform.

On the operations side, we rolled out a new and upgraded enrollment platform called Everwell 2.0 in September, which requires time for full adoption and stabilizing the platform. 2020 was an important year to introduce digital tools, increase adoption rates and take on any corrective action before 2021.

In addition, under Teresa White's leadership, we have reorganized the U.S., forming a group benefits and individual division. Rich Williams will now lead our group benefits division, which includes Aflac Voluntary Group, Aflac Network Dental and Vision, Argus, our Dental TPA, and our new Aflac Premier Life, Absence Management and Disability business. Virgil Miller will lead our Individual Benefits division, which includes Aflac's individually issued and small business-focused work site products and our new consumer markets business, targeting workers not at the traditional work site. Both divisions pull from shared service U.S. operating platforms.

This new alignment provides focus for each division within the U.S. business segment and allows Aflac to offer tailored products and services for our career agency teams and broker partners based on the unique markets they serve.

Like Japan, we have all the tools in place for agents to conduct business without a face-to-face meeting. However, most sales are being driven on a continuum of face-to-face and digital interaction. We estimate about 15% of our traditional individual sales are completed without some form of face-to-face interaction. This excludes digital direct-to-consumer, which is naturally non face-to-face.

Turning to more specifics on our key growth initiatives. On January 12, we announced the national rollout of Aflac Dental and Vision. Our dental and vision products are now available in 40 states with more coming online throughout the year. This is a broad launch that is available to large and small companies and distributed through agents and brokers.

In November, we closed on our Zurich Group Benefits acquisition. The new platform managed to contribute to sales in the quarter with $5 million in production. This is more of a turnkey launch, meaning products are filed, and we are open for business in 2021 under the Aflac brand.

Finally, we officially launched our new digital direct-to-consumer platform in the first week of January. We offer critical illness, accident and cancer and are approved to sell all 3 products in approximately 30 states with more states and products coming online throughout the year.

As highlighted during our investor conference, we are addressing expenses over 2 horizons. In 2020, we took actions to realize approximately $100 million of annualized run rate expense saves on a go-forward basis. Actions included restricting hiring, rationalizing distribution expenses and a voluntary separation plan that resulted in a 9% reduction to our U.S. workforce. Longer-term expense initiatives center on our Group division and the migration onto a new Administrative platform as well as integration of the Zurich Group Benefits business.

As you are all aware, we have adopted a conservative buy-to-build acquisition strategy. The build efforts taken together impacted our expense ratio in the fourth quarter by 160 basis points and is expected to impact the 2021 ratio by approximately 180 basis points.

Our global investments team remains focused on asset quality, monitoring economic conditions and sourcing new investment opportunities. Portfolio actions prior to and in the early days of the pandemic lowered our exposure to prolonged economic weakness, and we ended 2020 with a modest amount of asset losses. We continue to watch closely our middle-market loan and traditional real estate -- transitional real estate portfolios. While we have seen ratings downgrades, our portfolios are resilient, consisting of diversified first lien loans, conservatively underwritten to high-quality borrowers.

We have further refined our approach to managing the unhedged dollars in Japan, both lowering our hedge ratio and maintaining our out of the money protection for extreme moves in foreign exchange. These unhedged dollars provide diversification and income benefits as well as lowering our enterprise exposure to the yen.

As has been our practice, for 2021, we have locked in lower hedge costs with floating rate loan yields benefiting from LIBOR floors.

Finally, we are pleased with the performance of our strategic investment and alliance with Varagon Capital Partners during 2020, contributing to corporate investment income. We are working to establish even more strategic alliances that leverages the capabilities of our asset management subsidiary and further the performance of our insurance segments.

As commented on by Dan, we have refocused our efforts in key areas to drive tangible ESG incitatives in 2021. We are focused on the following.

Building off our published ESG investment policy, Aflac Global Investments is advancing a responsible investing framework that includes the establishment of a core ESG team and formal governance process. We initiated work with third-party experts to measure, draft and eventually disclose a formal plan to be carbon-neutral on or before 2040 and carbon net 0 emissions on or before 2050.

We pledged to continue hitting key milestones on our important women in leadership initiative as part of the diversity and inclusion in Japan and targeting 30% of leadership positions in Japan filled by women by 2025. In the U.S., we seek to advance our already strong diversity statistics by broadening our influence through identifying and providing capital to organizations that advance diversity and inclusion as well as social justice and economic mobility.

Finally, we pledged to advance reporting and disclosure framework in compliance with SASB and TCFD reporting standards. We'll provide further disclosures on ESG initiatives in our proxy material and on our ESG hub, esg.aflac.com.

Wrapping up my comments, we believe the investments made in the past 2 years and accelerated during the pandemic position us for future growth and efficiency in the face of what we believe to be temporary weakness in sales and earned premium.

I'll now pass on to Max to discuss financial performance in more detail. Max?

Max Kristian Brodén
Executive VP & CFO

Thank you, Fred. We finished the year with stable fourth quarter earnings in a year marked by significant mortality and morbidity events as well as continued low interest rates. For the quarter, adjusted earnings per share increased 3.9% to $1.07. And the full year EPS was a record $4.96, up 11.7% year-over-year. Adjusted book value per share, including foreign currency translation gains and losses, grew 19.1%, both for the quarter and full year. The adjusted ROE, excluding the foreign currency impact, was 12.1% in the fourth quarter and a respectable 15.1% for the full year, a material spread to our cost of capital.

This quarter benefited from favorable marks on our alternative investment portfolio to the amount of $47 million pretax, above our long-term return expectations. A very good outcome on our building alternatives portfolio. We also booked a severance charge associated with our previously announced voluntary separation program, or VSP, in our U.S. and corporate segments, totaling pretax, $43 million, included in adjusted earnings.

Turning to our Japan segment. Total earned premium for the quarter declined 3.5%, reflecting mainly first sector policies paid-up impacts, while earned premium for our third sector products was down 1.9%. For the full year, total earned premium was down 2.8%, while total policies in force declined by a lesser rate at 1.2%. As policies in force are not impacted by the paid-up status, it tends to serve as a better indicator of the growth of the underlying business. Persistency has been on a positive trajectory, inched up slightly sequentially to 95.1%, up 70 basis points year-over-year.

Japan's total benefit ratio came in at 68.9% for the quarter, down 110 basis points year-over-year. And the third sector benefit ratio was 58.6%, down 150 basis points year-over-year. The main driver for the lower benefit ratio was a higher-than-normal IBNR release due to a sustained lower paid claims environment in 2020. We estimate that this lowered the benefit ratio by roughly 130 basis points compared to what we would deem a normal IBNR release to be.

For the full year, the reported total benefit ratio was 69.9%, up 40 basis points year-over-year. And our benefit ratio was 59.7%, also up 40 basis points year-over-year, mostly due to improved persistency.

The expense ratio in Japan was 23%, up 130 basis points year-over-year. The main driver was our paperless initiative, which kicked in at a higher gear as we digitized our operations and drove efficiencies throughout the value chain to a future state with significantly reduced paper usage. This investment increased our quarterly expense ratio by 85 basis points.

For the quarter, adjusted net investment income increased 11.9% in yen terms, led by strong returns in our alternatives portfolio, but also strong results from the loan book, like transitional real estate and middle market loans. For the full year, adjusted net investment income rose 4.4%.

The pretax margin in the quarter was 20.9%, up 110 basis points year-over-year, as the combined effect from the lower benefit ratio and higher expense ratio was still positive. For the full year, the pretax margin was a respectable 21.2%.

Turning to U.S. results. Earned premium was down 2.3% for the quarter due to weaker sales results. Persistency improved 160 basis points to 79.3%. This was driven by emergency orders in various states and by lower sales in 2020 as new policies lapsed at a higher rate than in-force policies older than 1 year. Removing these factors would result in a stable year-over-year persistency rate, and we view that as a good outcome to date, given the pandemic environment impact on our policyholders and reflecting our efforts to retain accounts and keep premium in-force. For the full year, earned premium was down 0.9%. Our total benefit ratio came in at 51.6%, which was 250 basis points higher than Q4 2019.

Pandemic conditions continue to be relevant when analyzing our benefit ration. Due to the recent increase in infection rate, we estimate incurred claims impact of $72 million, of which $58 million was an increase to IBNR, resulting in an impact to the benefit ratio of 5.1 percentage points from COVID-related claims. This is somewhat offset by favorable non-COVID-related claims activity generating an underlying benefit ratio of 46.5%. COVID and non-COVID related claims tend to have a negative correlation, which clearly can be seen in our quarterly results throughout 2020. We would expect this pattern to continue in early 2021. Going forward, we still expect the guided range of 48% to 51% to be a reasonable future benefit ratio.

Our expense ratio in the U.S. was 43.5%, up 360 basis points year-over-year. The severance charge for our VSP explains 220 basis points of the rise, while the residual is primarily driven by digital investments and the reduction in revenues. The full year expense ratio landed at 38.6%.

Adjusted net investment income in the U.S. was up 1.1% due to strong alternative investment income, while the portfolio book yield contracted 22 basis points year-over-year. Full year adjusted net investment income declined 2.1%.

As both the benefit and expense ratio rose, profitability did come under pressure, with a pretax margin of 11.6% in the quarter. For the full year, we still reported a solid pretax margin of 19.3%, in line with recent historical average.

In our corporate segment, the pretax loss widened to $47 million in the quarter compared to $9 million from a year ago. Lower net investment income on our short-duration holdco cash position, increased retirement expenses and $8 million of VSP severance expense were the main components of the delta. For the full year, the corporate segment pretax loss was $115 million.

Our capital position remains strong and stable. We ended the quarter with an SMR of north of 900% in Japan and an RBC of approximately 525% in Aflac Columbus. Holding company liquidity stood at $4 billion, $2 billion above our minimum balance. With a leverage of 23%, we continue to travel in the middle of our stated leverage range of 20% to 25%, offering ample debt capacity.

The continued spread of COVID-19 leads us to remain cautious in how we manage our capital base, make investments and deploy capital to the benefit of the shareholder. In the quarter, we repurchased $500 million of our own stock and paid dividends of $196 million, offering good relative IRR on these capital deployments. For the full year, we paid $798 million of dividends and returned an additional $1.5 billion to shareholders in the form of share repurchases.

We will continue to be flexible and tactical in how we manage the balance sheet and deploy capital in order to drive strong risk-adjusted ROE with meaningful spread to our cost of capital. A recent example is the Board's decision to increase the quarterly dividend by 17.9% to $0.33 per share.

Before going into Q&A, I would characterize our 2020 financial performance as solid despite significant external challenges. As we look forward into 2021, we do not see any fundamental drivers causing us to change the outlook provided at our financial analyst briefing in November. In order to achieve these objectives, we remain laser-focused on executing on our growth initiatives, expense efficiency and continue to drive ROE at a significant spread to our cost of capital.

With that, let me turn it over to David to begin Q&A.

David A. Young
Vice President of Investor & Rating Agency Relations
Thank you, Max. Now we are ready to take your questions. [Operator Instructions] Carol, we will now take the first question, please.

Question and Answer

Operator

Your first question comes from Nigel Dally from Morgan Stanley.

Nigel Phillip Dally
Morgan Stanley, Research Division

I wanted to ask about Japan sales. You mentioned the new medical product [able] that improved demand. But Is that more just a first quarter phenomenon? Or should we expect that improved momentum to continue into the second quarter and perhaps [move on]?

Daniel Paul Amos
Chairman & CEO

This is Dan. I'm going to let -- Japan. But let me just say that it tracked, to me, more of what other products and past introductions have done. It's really too early to tell. It's really only been out 2 weeks. So to go ahead and forecast on 2 weeks is a little too early to tell. But I am certainly optimistic that the field force or our agents are excited about it, and the consumers seem to be excited about it, which means it's a good product, it's a good time to be introducing. Of course, we'll know much more details next quarter, but I would expect it to have the same pattern that we've seen with past introductions.

Koji?

Koji Ariyoshi
Executive VP, Director of Sales & Marketing and Director

[Foreign Language] Of this new medical product, it's been very much well taken by the agencies because of the new coverage and the functions that we offer. And this product also is designed to be able to be sold through the [enormous] group of agencies and be competitive in that market as well. So what we are expecting is that the sale of this product will increase in the nonexclusive market as we have taken a product strategy with a more competitive advantage with this product. So we do believe that this product will last for a long time as this product will be very popular among younger generation as well.

And although it only has been 2 weeks since the launch of the product, the actual number of new business policies coming in are increasing. And at the same time, AP per policy is also on the increase. I think we have been able to get a much better start this time under the current environment compared with the medical product that we launched in 2019 as a rider. And we are expecting to see improvement in sales this quarter, much more. And we have seen some improvements since the fourth quarter last year as well. But we're planning to have more improvement this quarter. And that's all for me

Nigel Phillip Dally
Morgan Stanley, Research Division

That's great. That's very helpful. The second question is just on U.S. sales. I understand broker-driven sales are holding in better than agency sales. Is it possible to get some quantification behind how much better? I think with brokerage and group becoming a much larger part of the strategy, investors would find it helpful to understand how the -- how sales are trending along distribution lines.

Frederick John Crawford
President & COO

I think it's probably best for Teresa and Rich to handle that. But your -- the premise of your question is correct. Broker group-driven sales will hold up better under this environment than agent-driven small business sales, for sure.

So Teresa and Rich?

Teresa Lynne White
President of Aflac US

Well, I'll let Rich answer, but I'll just make the comment that, yes, the broker sales are traditionally a lot more automated. We have a lot more digital presence in the broker environment just from the beginning. But I'll let Rich respond.

Richard L. Williams
Executive VP & President of Group Benefits Division

Thank you, Teresa. As Dan alluded to in his comments, we've seen reduced face-to-face activity, which certainly impacts agency sales. And then from a broker sales perspective, given that they tend to work with larger accounts, they are less dependent on face-to-face activity. And as a result, in particular, with our group business, our current business saw results in the single-digit decline, whereas our traditional businesses saw it at a larger decline. But all those comments, between Teresa, Fred and myself, I think, kind of speak to the question.

Operator

Our next question comes from John Barnidge from Piper Sandler.

John Bakewell Barnidge
Piper Sandler & Co., Research Division

Yes. I saw a headline the other day that Japan had banned [champing] and require masks in their preparation to try and host the 2021 Olympics. Assuming that were to go through, I know previously, you talked about joint marketing and product campaigns with Japan Post, is there the possibility of some increased marketing expenses in the mid year?

Frederick John Crawford
President & COO

Koji? Yes. We'll have Koji or Koide-san address that.

I would tell you that if what your question is, is do you expect to build some form of marketing campaign surrounding the Olympics, that is not in the plans and not normally what we would do. What we are doing, however, is building marketing campaigns around the launch of our new products and particularly taking advantage of a heightened awareness for supplemental health products in the COVID environment.

So Koji and Koide-san, you can address it with more detail.

Masatoshi Koide
President & Representative Director

[Foreign Language] And this is Koide from Japan. And we are not planning on having any particular campaign around the Olympics.

Frederick John Crawford
President & COO

John, I don't know if that's the -- correct me here.

John Bakewell Barnidge
Piper Sandler & Co., Research Division

Yes, Fred, it addressed it.

And then the follow-up, the wellness program you started in 3Q '20, is that still at play? Because I would -- think last time, you said it would carry over a little bit. And how should we think about cost of that?

Frederick John Crawford
President & COO

Yes. It is still in play in the sense that there's sort of, I'll call it, a tail to it, if you will. In other words, we did the mailings. We saw, as you recall from last quarter, a spike in some of the wellness claims, which we want and anticipate, because we believe the payoff of that is not only persistency but also being able to come back into companies. Let me explain that for a second.

A lot of what our agents will do with their business clients is they will phone them up and say, "Based on our analysis, you've got a certain number of employees that have wellness benefits, and we can help with understanding whether they are fully utilizing those wellness benefits to get money back in their pockets." As you can imagine, particularly as a small employer, that's an attractive proposition these days, to get money in the pockets of your employees. And so that ends up lead or leading us into the account to talk about future enrollments and cross-selling and upselling, et cetera. And so that has been fairly successful. So it's a very important piece of our product features and one that we would continue.

If what you're asking is, what are we looking at in terms of ongoing, perhaps elevated, claims related to wellness. That's factored into some of our IBNR estimates, for example, where we'll set up those types of reserves in anticipation of a trend line of wellness claims. And so at the moment, I'll ask Max to give color, but I don't anticipate that being a mover for our benefit ratio.

Max Kristian Brodén
Executive VP & CFO

That's right, Fred. And John, as you remember, we did a -- we had a campaign in the third quarter. And obviously, we had the impact on our benefit ratio in the U.S. in the third quarter, both from paid claims, but also that we established in IBNR associated with that wellness campaign. As you then look at the impact on the fourth quarter, you did not really see any impact follow through into the fourth quarter because of the IBNR that we established in the third quarter.

Going forward, we would expect this to be more normal activity for us. There may be instances with any significant campaigns that could trigger an increase in claims temporarily, but generally be relatively small. But if you refer specifically to the campaign, the big campaign we had in the third quarter, that hit the benefit ratio in the third quarter, and we didn't really have much of a follow-through into the fourth quarter.

Operator

Our next question comes from Suneet Kamath from Citi.

Suneet Laxman L. Kamath
Citigroup Inc., Research Division

I wanted to go to the Japan benefit ratio. I think you had said that some of the improvement or the lower-than-expected result -- or better-than-expected result was due to reserve releases. How are you guys planning for benefit ratios as you think about a world where the economy opens up again? And maybe we see more people in Japan going to hospitals versus what we're seeing right now, which I understand is a sort of subdued level of activity.

Max Kristian Brodén
Executive VP & CFO

Let me kick it off at a high level. And I have Todd to fill in the blanks as well. Specifically, for the fourth quarter, we had a reserve release of about JPY 7 billion. That is higher than we would normally incur in a quarter. We estimate that, that lowered the benefit ratio by about 130 basis points in the quarter. And this is because of the paid -- claims pattern that we're seeing primarily to the non-COVID-related claims activity that Fred referred to in his prepared remarks.

Going forward, you could obviously see an impact on the benefit ratio temporarily from an element of the sort of pent-up demand for hospitalizations, like elective surgery, physicals, et cetera. I think that's much more the case in the U.S. than in Japan, where the Japan hospital system have been running at a more normal level than what we've seen here in the U.S. So you could see a little bit of a higher benefit ratio from that. But this has been taken into consideration when we gave you the benefit ratio range at [fair] of 68.5% to 71% in our outlook.

So I'll leave it at that. And Todd, please feel free to give some additional comments.

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

No, Max, I think you're right. Especially if you think about our hospitalizations, as it relates to accident hospitalizations, they won't come back, accidents that have happened and you've recovered. However, there could be a level of sickness hospitalizations that would increase in the future.

One other aspect of our benefit ratio that I'll mention. If we get our sales back to a more normal level and we start with introducing product and people refreshed product, that has a slight impact on the benefit ratio as well in the form of reserve releases on own policy. So last year, as you saw in our results, persistency increased, which led to a slightly higher net benefit reserve with those policyholders hanging on to those policies.

Suneet Laxman L. Kamath
Citigroup Inc., Research Division

Okay. And then just my follow-up is on U.S. sales. Dan, you had commented that you're optimistic about a recovery in the second half. How much of that is just due to sort of recovery in face-to-face sales versus some of the things that you're doing to try to improve the penetration of the direct-to-consumer or the digital, virtual sales?

Daniel Paul Amos
Chairman & CEO

Well, I think it's a combination of both. And of course, you're going against much easier numbers, especially in the second quarter. And so that within itself makes it easier. But all in all, we have been working on trying to find ways to do less face-to-face and more virtual. And we've been preparing for that, and it just got accelerated. I will say the new norm today is much improved over 6 months ago in terms of ability to get around as the vaccines are getting out. So we are seeing some stability from that standpoint.

Teresa, would you like to make any comments specifically?

Teresa Lynne White
President of Aflac US

Yes. I'll make a couple of comments. I agree, it's a combination of both the virtual environment and as our agents and -- as our agents get better with adopting some of the virtual tools, I think we'll continue to see improvement.

But the other thing that I think that we are excited about is the idea of having new products that has been introduced, the dental vision product specifically in some of the broker and the small case market; as well as in the larger case market, having some of the life and disability products available as well. So we have a great opportunity in the second half to really start selling some of the newer products that we have out there. And so I think that's what gives us -- that's what makes us excited about the second half of the year.

Of course, vaccines, et cetera.

Operator

Our next question comes from Gregory Peters from Raymond James.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

I wanted, just big picture. You talked about risk-adjusted return on equities, and you look at your slide deck, and then you have a great track record of ROE. We've seen a number of other large insurance companies sort of get away from earnings per share guidance and focus on sort of setting ROE targets. So given all the changes and challenges you've dealt with last year and with growth being uncertain, at least in the near term, how should we be thinking about sort of the ROE objectives for your company for '21 and '22?

Max Kristian Brodén
Executive VP & CFO

Yes. So Greg, I think we will be operating in a fairly stable environment. We obviously are running at fairly high capital levels, and that is putting some pressure on our ROE as we go forward. So it makes it somewhat challenging to continue to sort of operate in the strong ROE levels that we have been in the mid-teens. Like for example this year, we came in slightly above 15% for the full year.

That being said, I do think that long term, one way to sort of think about our business is it's a fairly capital-light products that we sell, both in Japan and in the U.S. And over time, I would expect that we should sort of run in the sort of 600 basis points above our cost of capital, is a reasonable way to sort of think about where our ROE should be over time because we don't have a whole lot of interest rate sensitivity, but it does play a factor in terms of what's sort of driving the ROE as well.

Frederick John Crawford
President & COO

Yes. One thing, Greg, too, I would add is, yes, you're seeing a bit of a migration from EPS to ROE, but also from GAAP earnings to cash flow valuation. And the cash flow dynamics of the company remain extremely strong. Even further advanced than that, I think, particularly soon when it comes to Aflac, you're going to want to focus in on economic value. And what I mean by that is, if you think about our goal with the new businesses we've brought on, which is Network Dental and Vision; Absentee Management; Disability and Life, true group, if you will; and then the direct-to-consumer. These are businesses that we expect to combine, contribute upwards of $1 billion of earned premium over the next 5 to 7 years. And that earned premium will have a different GAAP profit dynamic associated with it because it's in building mode. And as you know, direct-to-consumer, you don't back expenses. And so by definition, you have a lower reported profit. At the same time, that business, if actuarially appraised, absolutely has value, and some would argue great value, as you can imagine.

So I think as we communicate going forward, it's not just communicating on EPS and ROE, but it's also communicating on cash flow and the economic value that we're driving in the company for the long run.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Got it. The second question is more in the weeds, but I know in your prepared comments, you talked about now that COVID -- you've got a year of COVID under the belt, you're looking at reserves and you're using the data to sort of set the reserve levels. And I'm just curious, both in Japan and in the U.S., how you're reconciling 1 year's results with the fact that there's a rollout of a vaccine, and that may cause data to shift entirely in a different direction over the course of the next 12 months.

Frederick John Crawford
President & COO

It's -- I commented a bit on this in my script, and Max commented on it. Look, it's a very interesting science right now for valuation actuaries, establishing reserves, particularly incurred but not reported reserves. These are practices that these models and so-called completion factors, if you want to use the technical language, are built off of years and years and quarters and quarters of information that gives, particularly for a stable business like ours, very high confidence in the level of IBNR to set up on a per product basis.

Here, you have pandemic conditions, but you also have not a linear dynamic but a convex dynamic of infections. And as you said, you've got these new wrinkles as in vaccination, the amount of vaccination that rolls out, the acceptance and absorption of the vaccination among the public, et cetera.

And so it is a tricky environment. But these are incurred but not yet reported claims, meaning it's our best estimate right now of what we believe to be claims coming in and in hand. It is still, however, an estimate, and it's an estimate under a convex environment. And so we'll have to continue to back-test, monitor and adjust our completion factors accordingly.

Operator

This concludes the Q&A portion of our call, and I'll turn it back for any closing remarks.

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

Thank you, Carol, and thank you all for joining our call this morning. We look forward to speaking with you soon. If you have any additional follow-ups. And I wish you all continued good health. Thank you.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect. [Statements in English on this transcript were spoken by an interpreter present on the live call.]