S&P Capital IQ

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Aflac Incorporated NYSE:AFL

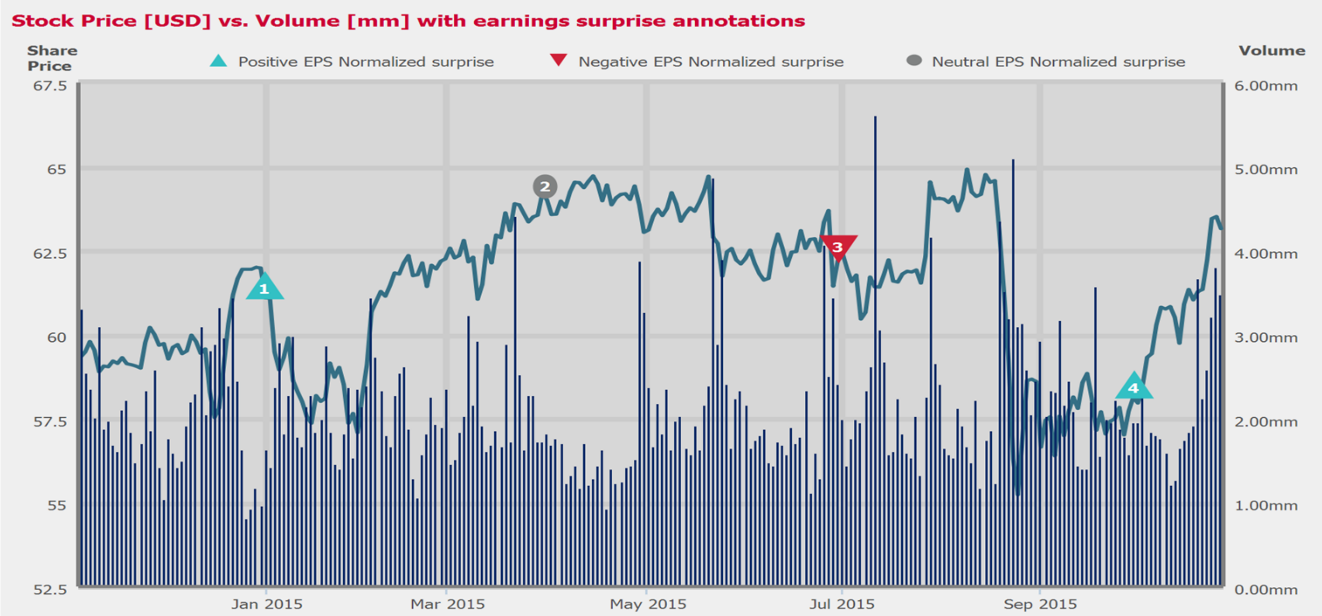
FQ4 2015 Earnings Call Transcripts

Tuesday, February 02, 2016 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2015-			-FQ1 2016-	-FY 2015-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	1.48	1.56	▲5.41	1.60	6.08	6.16
Revenue (mm)	5217.32	5319.00	▲1.95	5198.46	20922.18	20872.00

Currency: USD
Consensus as of Feb-02-2016 12:05 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ4 2014	1.28	1.29	▲1 0.78 %
FQ1 2015	1.54	1.54	●2 0.00 %
FQ2 2015	1.52	1.50	▼3 (1.32 %)
FQ3 2015	1.48	1.56	▲4 5.41 %

Call Participants

EXECUTIVES

Daniel P. Amos
Chairman & CEO

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Global Chief Investment Officer and Executive VP

Frederick J. Crawford
Executive VP & CFO

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Paul Shelby Amos
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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. You may begin.

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

Good morning, and welcome to our fourth quarter call. Joining me this morning from the U.S. is Dan Amos, Chairman and CEO; Kriss Cloninger, President of Aflac Incorporated; Paul Amos, President of Aflac; Fred Crawford, Executive Vice President and CFO of Aflac Incorporated; Teresa White, President of Aflac U.S.; and Eric Kirsch, Executive Vice President and Global Chief Investment Officer. Also joining us from Tokyo is Hiroshi Yamauchi, President and COO of Aflac Japan; Koji Ariyoshi, Executive Vice President and Director of Sales and Marketing.

Before we start, let me remind you that some of the statements in this teleconference are forward-looking within the meaning of Federal Securities laws, although we believe these segments are reasonable and we can give no assurances that they will prove to be accurate because they are prospective in nature. Actual results could differ materially from those we discuss today. We encourage you to look at our quarterly release for some of the various risk factors that can materially impact our results. Now I will 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. Following Dan's comments, Fred will follow up with brief comments about our financial performance for the quarter and the year. Dan?

Daniel P. Amos
Chairman & CEO

All right. Thank you, Robin. Good morning, and thank you for joining us. If we look back on 2015, Aflac 60th year of operations, let me start off by saying that the final quarter of 2015 concluded another great year for Aflac. What's been true for these 6 decades and what separates us from every other competitor is our distinct product focus on voluntary and supplemental insurance in both the United States and in Japan. That kind of direct approach has been a major factor in our success, and I believe it will continue to propel our leading position in the future. I'm especially pleased that our operating earnings per share growth before currency exceeded our expectations for the year, rising 7.5%. I think this is especially notable, given historically low interest rates, market volatility and economic uncertainty in the world. I couldn't be more proud that the hard work and accomplishments of our management team, employees and sales distribution in Japan and the United States. It is an honor to work alongside our team who are dedicated to enhancing our long-term growth of the company and who represent all that Aflac stands for, the Aflac Way.

Now I will provide you some highlights related to our Japanese operations, where I believe we set the standard in many ways for other insurance companies in Japan. We are not only the pioneer and leading provider of cancer insurance, but we are also the #1 seller of medical insurance too. This is particularly impressive given our increasing competitive medical market for insurance has become in Japan. But our relevant products, trusted brand and diverse distribution are a powerful combination that's very hard to compete with and it propelled Aflac to insure 1 out of 4 households. I am thrilled with Aflac Japan's tremendous annual growth of 13.4% increase in sales for third sector products, which surpassed our original expectation considerably. Not only were our 2015 results impressive across all channels, but we pointed out in our release last night that third sector sales increase for 2015 is particularly phenomenal because that marked the second highest annual third sector growth in 10 years.

On the product side, it's exciting that sales of our founding [ph] cancer insurance were up a tremendous 40.6% for the year. As the pioneer of cancer insurance, this remarkable result underscores the importance of Japanese consumers' place on selecting a brand they know and trust.

Turning to first sector products, the actions taken by the Bank of Japan on Friday resulted in JGB yields decline, as well as additional weakening of the yen to the dollar.

As discussed on our December outlook call, we have taken steps to control the sale of first sector products as we enter 2016. Managing through the low-interest-rate environment is nothing new to Aflac Japan. The actions of the Bank of Japan simply reinforce our strategy, and we will continue to remove potential and further actions as the rate environment plays out. Fred will touch on the financial considerations in his comments.

Looking at our distribution side, our traditional agencies have been and remain vital contributors to our success, and this was certainly true throughout 2015. At the same time, I am pleased with Aflac Japan's significant strides in further developing our alliance with Japan Post throughout the year. We completed the expansion of the number of post offices and their agents selling their products to more than 20,000 outlets during 2015. With this expansion, we continue to ramp up our training of Japan Post employees to ensure they have the knowledge and tools to sell Aflac products successfully. The catch-22 of tremendous sales results is the difficult comparisons they create. As we indicated, we believe the sales of third sector products in 2016 will be down mid-single digits following another year of outstanding sales in 2015.

However, looking further out, we continue to view Aflac Japan's long-term compound annual growth rate as being in the range of 4% to 6%.

Now turning to Aflac U.S., 2015 was a year of building our business through our career and broker distribution channels. We not only enhanced our career sales management infrastructure over the last 1.5 years, but we also laid the foundation for greater opportunities within the broker market. As you saw in the earnings release, Aflac U.S. hit an all-time record for the quarter, with the premium amount of $497 million in new sales, which equated to a 9.6% increase. I'm especially happy with the fourth quarter, given that it followed a 14.1% sales increase in the prior year.

Our quarterly results exceeded our expectations and drove our total sales of $1.5 billion, which translates to a 3.7% increase for the year. Our sales results for 2016 exemplified that we have been communicating. Our sales are increasingly concentrated toward the end of the fourth quarter, and we believe this will continue to be the case. As you all well know, success and opportunities breeds competition. That combined with a clear need for voluntary products has resulted in a number of other companies that are in the voluntary supplemental insurance market. These have included insurance carriers who sell voluntary insurance as well as companies involved in various aspects of healthcare management. But keep in mind, Aflac's singular focus on supplemental voluntary products has greatly contributed to our dominant position in the worksite insurance market, and I believe will continue to drive our competitive edge.

One Day Pay remains a differentiator for Aflac. We will continue our promotion of One Day Pay to consumers, which we believe will help increase brand loyalty and account penetration. Here's an amazing statistic; in 2015, we paid 1.2 million claims, a 100% of the eligible One Day Pay claims submitted were paid within one day. I think we will pay over 2 million One Day Pay claims in 2016. In the minds of consumers, our already high integrity jumped by 22%, the biggest move ever and we believe it's because of One Day Pay. Paying claims in just one day translates to this statement from consumers. "If you are paying it in just one day, you must be a good company and with high integrity." Also, independent research continues to show that there is no doubt Americans consumers need cash quickly and paying claims fast and fairly sets us apart from the competition.

Even further differentiating Aflac, I am also proud that Aflac's Contact Center has been recognized by J.D. Powers for providing outstanding customer service experience. This recognition is based on successful completion of an audit and exceeding a customer satisfaction benchmark. It is these kinds of initiatives and feedback that demonstrate our commitment to delivering on our promise to our policyholders. While 2015 was a year of building, we see 2016 as the year of stabilization and growth. We continue to believe that Aflac U.S. annualized premium sales growth in 2016 will be in the range of 3% to 5%.

Turning to capital deployment, Fred will provide more details shortly, but let me just say that we view growing the cash dividend and purchasing our shares as the most attractive means of deploying capital, particularly in the absence of any compelling alternatives. Our plan for 2016 is to repurchase $1.4 billion of our shares, and we anticipate concentrating the majority in the first half of the year. As we indicated last quarter, 2015 was the 33rd consecutive year in which we have increased the cash dividend. Our objective is to grow the dividend at a rate generally in line with the increases in operating earnings per diluted share before the impact of foreign currency translation.

I will conclude by reiterating how proud I am of our teams in both the United States and in Japan, as they've worked hard to generate our 2015 results. I have been in the business for more than 40 years now and I'm truly excited today, more than I've ever been, about Aflac's future. So now, let me turn the program over to Fred for financial results and outlook. Fred?

Frederick J. Crawford
Executive VP & CFO

Thank you, Dan. You've all had a chance to review the details in our earnings release. As Dan noted in his comments, our fourth quarter and full year results exceeded the high end of our earnings guidance, driven by strong overall margins in both the U.S. and Japan. The only notable item to call out in the quarter was a favorable adjustment to certain retirement benefit liabilities as a result of refining our assumptions. These adjustments impacted our parent company only results and contributed approximately $13 million pretax or $0.02 per share to the quarter's earnings. Our Japan segment margins came in strong, driven by continued favorable benefit ratios. We had a few adjustments to reserves in the quarter, a result of our year-end actuarial work. These adjustments were largely offsetting and on a net basis contributed modestly to the outperformance in the period. Our expense ratio came in favorable to our expectations, as we are balancing investments with continued focus on expense managing. We would expect both our benefit and expense ratios to normalize within our outlook call guidance range as we move into 2016.

In the U.S., benefit ratios were considerably better than last year's quarter, but fairly consistent with our strong performance throughout 2015 and at the favorable end of our outlook call guidance range. As with Japan, our quarterly and year-end actuarial work resulted in certain reserve adjustments that were largely offsetting. Our expense ratio in the U.S. was elevated in the quarter. This is not unusual in the fourth quarter and roughly in line with last year's quarter and, in part, reflects a conscious decision to accelerate certain investments in our platform.

Turning to investments. Throughout 2015, we were successful in defending net investment income, recognizing that, as higher yield in securities mature, we are investing new money into a low rate environment and need to proceed with caution given market volatility. As we noted during our outlook call, this dynamic represents a natural headwind to investment income in 2016. We continue our efforts to build a position in diversified asset classes, helping to support higher long-term returns. Our capital and liquidity position remain strong. As is typically the case, we have only estimates on SMR and RBC at this time, but expect both to remain strong and consistent with recent periods. Between dividends and repurchase, we returned just over $400 million to our shareholders in the quarter and achieved our guidance of 1.3 billion in repurchase for the year.

Before I turn the call back over to Robin for Q&A, I'd like to comment on recent market volatility, the relative strength of our financial position, and our outlook. The month of January has certainly been extraordinary, with the return of credit and equity market volatility, a continuation of the low rate environment in the U.S. and Japan, and a concern over energy and commodity prices and related exposures. In the case of Aflac, recent Bank of Japan actions draw a renewed focus on Japan rates and the yen. I think the following considerations are important and support the investment thesis that Aflac is well positioned to perform in the face of market volatility. First, our core franchise in Japan and the U.S. supplemental health markets remain strong with natural demographic and economic catalysts driving core underwriting margins and favorable trends. These core franchise growth and earnings drivers are largely unaffected by recent market volatility. Second, as with the rest of the industry, we are carefully monitoring interest rates. As Dan mentioned in his comments and consistent with Paul's strategic outlook in December, the recent move in Japan rates simply reinforces our strategy to actively manage down the sale of lump sum first sector products, focusing on appropriately priced level premium product in support of our high return third sector business and our core agency distribution network.

From a financial impact standpoint, we have concluded all of our year-end actuarial work, including review and testing of core assumptions and maintain very strong margins across all material blocks of business and have very little liability and balance sheet risk associated with very low, for very long, interest rates. In terms of Investment Strategy, we are only in the beginning stages of building our growth asset portfolio, thus, we have modest exposure to naturally volatile asset classes. In some cases, we now have an opportunity to enter these asset classes at better valuations. With historically low JGB yields, the success of the dollar program, and expansion into new asset classes, we have naturally lightened our new money allocation to JGBs and that will continue into 2016.

In addition, we pre-brought approximately 60% of our JGB budget prior to the BOJ easing announcement of late last week. In terms of the dollar program, we carefully watch our hedging costs, but have been proactive in modestly extending the duration of our hedge positions to reduce exposure to short-term spikes. While our long-term view is for hedging cost to rise, we remain comfortably within our tolerances and continue to drive significant value over and above JGB rates.

Finally, in terms of credit exposure, like the rest of our peers, we are carefully monitoring our exposure to energy sector, along with metals and mining. We have a $6.6 billion energy portfolio measured at book value that is well-diversified and high quality. Only 7% of the portfolio is below investment grade and effectively all in the BB category. As of the end of January, our below investment grade energy holdings were in an unrealized loss position of only $140 million. As we analyzed security by security holdings, we do not see acute default risk, but do note that downgrade risk is present and pricing is under significant pressure on select names, which could result in accounting-driven impairments as securities trade at deep discount for prolonged periods.

In summary, core margins are expected to remain strong and largely resilient to market volatility. Balance sheet exposures to low for long rates in the U.S. and Japan are modest. And our general account assets are defensively positioned with limited exposure to naturally volatile asset classes, and we are well positioned in terms of our energy and energy-related exposures. We, therefore, have made no adjustments to our earnings per share guidance of $6.17 to $6.41, assuming an average exchange rate of roughly JPY 121 to the $1. And capital deployment guidance provided in our December outlook call remains the same. Based on our capital conditions, earnings and cash flow stability, we are maintaining our repurchase target for 2016 at $1.4 billion. Having repatriated additional excess capital in the fourth quarter, we are front-end loading approximately $1 billion of repurchase in the first half of the year. Our performance in the fourth quarter certainly bodes well for 2016, but it is obviously very early in the year, and we will update accordingly.

Thank you, and I will now hand the call back to Robin to begin Q&A. Robin?

Robin Y. Wilkey
Former Senior Vice President of Investor & Rating Agency Relations
Thank you, Fred. Before I turn it over to Q&A, I wanted to mention that you will be receiving an e-mail soon regarding our May 25 Financial Analyst Briefing, to be held in New York and if you have any questions, please give us a call on that. Now we are ready to take your questions. But first let me remind you that to be fair to everybody, please limit yourself for one initial question and only one follow-up that relates to the initial question. We are now ready to take the first question, please.

Question and Answer

Operator

[Operator Instructions] Our first question is from Mr. Randy Binner from FBR.

Randolph Binner
FBR Capital Markets & Co., Research Division

I just wanted to pick up on Fred's closing comments there, on the front loading of the buyback in 2016 that relied on a reinsurance transaction from last year and there were some questions about the kind of the outlook for further reinsurance deals on the December call. And it sounded like you are actively looking at different blocks and the market was active there. So I'd like to get an update on what that outlook looks like, because if we're going to continue to have high levels of buyback, kind of looking forward in 2017, it seems there needs to be another material reinsurance transaction at some time this year.

Frederick J. Crawford
Executive VP & CFO

So first of all, Randy, just a couple comments. You're correct. So we repatriated an additional JPY 60 billion, as you know, in the fourth quarter, roughly USD 500 million. That has built up a liquidity position at the holding company, which we are now spending down in the form of front-end loading and repurchase of approximately $1 billion of our $1.4 billion target in 2016. You are also correct to note that over the past few years we have benefited somewhat from elevated repatriation and cash flow related to these reinsurance transactions. I would note, however, that we have had a balanced approach to the use of proceeds, if you will, or freed up capital from reinsurance, roughly 40% or so dedicated to shoring up our SMR ratio and protecting the capital strength of our insurance franchise. The remaining 60% then repatriated only after being comfortable with our capital ratios. That is roughly the same type of approach that we would take going forward, if we did in fact continue to entertain reinsurance transactions. Right now, we are out there with a long-range guidance of 2015 to 2017 of excess capital of $6.3 billion to $7.5 billion. We remain consistent in that number. The difference between 6.3 and 7.5 is tied up in excess capital, some of which is in Japan and could be unlocked via reinsurance. Our basic approach to that, Randy, is that to be opportunistic and defensive. Meaning, if there are compelling opportunities to unlock and go through the exercise of unlocking that excess capital for redeployment at higher returns, we'll entertain that. We also, though, want to be defensive as we make our way through market volatility and watch things unfold over the next year or 2. We want to be equally careful to recognize that excess capital needs to be held in some cases to defend the balance sheet. So it's a balanced approach. We don't have any reinsurance dialed into our estimates for 2016, as I mentioned on the outlook call, but we'll continue to watch markets unfold and look for opportunities.

Randolph Binner
FBR Capital Markets & Co., Research Division

So just a couple of follow-ups. I mean, one is -- would you -- can you just characterize how good the conversations are with reinsurers? I mean, broadly speaking, the global reinsurance market is over capitalized. So I'd be interested then to see your characterization on how that's going? And then, I guess the capital absorption in a downside scenario, is that -- are you thinking like low -- your thinking kind of further moves by the BOJ on Japanese interest rates? Is that the main shock you would be looking at? Or are you thinking more on the credit side -- what would that main concern be there?

Frederick J. Crawford
Executive VP & CFO

Yes. So first part of your question, we continue to maintain healthy reinsurance relationships. And in fact, we have even got commitments, if you will, for unfunded reinsurance that allows us the flexibility to pull down reinsurance, if necessary, for either defensive or offensive moves. And that's largely a healthy approach because we are talking about health businesses and morbidity risk, which is an attractive type of risk to take in the capital markets these days by reinsurers. And because it's unaffected by capital market volatility, it tends to be something we can count on with reliability. So I'm not at all concerned about the nature of the discussions with reinsurers and our access to reinsurance. The issue is more whether or not it make sense from a capital strength standpoint or an opportunity standpoint to entertain any of those transactions. And then in terms of the second part of your question, as I mentioned in my comments, we are very well positioned relative to low for long interest rates, and that is not my concern relative to balance sheet. It's an issue relative to watching our earnings trajectory going forward, as I have mentioned, but it's not a balance sheet issue as we have very little relative liabilities exposed to low for long rates. The bigger issue is whether or not we are entering into the early stages of a credit cycle and being careful about that. All eyes are on, of course, the energy market and commodities, but more broadly, we need to be careful about whether or not a mild or moderate credit cycle is in front of us and so it's a good time to be careful. I think spreads have widened, which is usually a signal, downgrades are outpacing upgrades modestly right now, even beyond the energy sector. So we have to be careful to watch that, but as I said, we are particularly well positioned and we naturally have a defensive general account, because we haven't been as aggressive as many in the industry in terms of entering into more volatile asset classes, we're just starting to begin now.

Operator

Our next question is from Mr. Nigel Dally from Morgan Stanley.

Nigel Phillip Dally
Morgan Stanley, Research Division

So I wanted to ask about the hedge portfolio. Given we've got higher short-term U.S. rates and lower Japan rates, can you discuss the impact that is going to have on your hedge cost? You mentioned that it'll be going up by how much? Also, provide some more details as to what's been done to mitigate that incremental cost. And also just discuss the logic behind putting the hedge cost below the line, given that it's really an ongoing expense item.

Frederick J. Crawford
Executive VP & CFO

In terms of the hedge program, maybe I will ask Eric to make some comments on kind of where we stand relative to the cost structure.

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

Sure. Well, as everybody knows, we have been expecting hedge cost to go up and, in fact, that's the case about a year or so ago, they were running about 60 basis points. Now, they are running about 130 to 140 and that's including the actions by the BOJ the other day, which increased the hedge cost around 10 to 15. Having said that, we were planning for hedge costs in 2016 to be upwards of 180, 190 basis points, based on where markets were back in the third quarter, meaning look at what the Fed was going to do for potential rate hikes, this new information from Japan. And even at that level, of 180 basis points to 200 basis points, we still deem our portfolio to be very profitable versus buying a portfolio of JGB's, which is what we measure it against. And part of that is because new investments on the U.S. dollar program were going in at higher yields and higher spreads. We did take advantage, through asset allocation, of some of the dislocation in the high yield in the bank loan market, which get us higher yields. And we have continued to see JGB yields go down. So that creates a wider spread. But importantly, relative to the program, the fact is that monetary policy around the globe continues to be easy; i.e., the Bank of Japan, but the Federal Reserve is unlikely to raise 4x unless there is really strong economic growth in the U.S. So when you look at things like forward curves, the 180 to 200 that we thought it was going to go to is unlikely to be realized this year. It most likely will continue to be lower. Nevertheless, we have programs and analysis that looks at this continually and the tools that we have are either: find higher-yielding assets, and to Fred's point earlier, as we are starting to explore growth assets, those have higher yields and returns than fixed income; continue to modify the types of hedges we have, again, Fred mentioned that we've lengthened the duration of some of our hedges which has helped us to lock in some lower cost. So those are the parameters we continue to look at to improve the performance of the program, but it's holding up much better than we would have expected and monetary policy is in our favor right now. And Fred, maybe you want to talk about below the line?

Frederick J. Crawford
Executive VP & CFO

Yes. I think the decisions around reporting hedge cost below the line were largely predicated on the notion of these costs being highly sensitive to short-term interest rate fluctuations, as you pointed out, Nigel, on your comment. So that sort of mark-to-market, if you will, fluctuation and cost, we felt, was better depicted below the line. But most importantly, we are transparent and created a line item around it because we realized that, in this particular case, we are making a judgment call as to the definition of our operating earnings and you are now free to model it and track how those costs are moving. So that's fundamentally our position as to why we treat it below the line.

Operator

Our next question is from Mr. Jimmy Bhullar from JP Morgan.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

So I just had a question on Japan sales, just your reasoning for the expected decline in sales. I realize comps are tough in the first half of the year, but I would have assumed that you would have an ongoing tailwind from greater production through the post offices, especially from recently added branches. And also, I think you are adding new products later this year. So just discuss what you think will drive the weakness or the decline in sales in Japan, and also maybe give a little bit more detail of -- a few more details on the new product initiatives in Japan later this year.

Daniel P. Amos
Chairman & CEO

I'm going to let Paul take that. Paul?

Paul Shelby Amos
Former Director

Sure. Jimmy, let me begin by saying that the 13.4% increase in sales last year creates your first hurdle. You are correct, we are up against very difficult comparisons and that's going to persist throughout the year. We do believe that we'll have a strong year, but without a product launch of one of our major core products, that being a complete revitalization of either our cancer or medical plan, we are in a year where we're going to have what we consider to be more moderate product launches and, therefore, we believe that the sales comparisons, especially against such a large year, will be difficult. We have some product launches, smaller in nature, that we'll look for in the first half of the year. And then as I mentioned on the outlook call, we'll be launching a completely new product line that we believe will enhance the second half of the year. That said, as is in the case in Japan, when you do things that are brand-new to the company, they tend to have a much slower adoption rate as well as a much slower rate of usage by different channels as we both negotiate with those channels as well as teach them the process for sales of that product. And so we expect 2016 to be a year where we are enhancing our products and opening up new potential growth, but we expect the majority of that growth to happen beyond 2016. Unfortunately, I can't go into the specifics about the products themselves, but we feel very comfortable with our plan and our plan for '17 and '18 beyond that.

Daniel P. Amos
Chairman & CEO

And Jimmy, I want to add one thing. This time last year, where we thought we would be in 2016 is actually going to be there or even a little higher, because if you combine the 13% last year and then the down this year, the combined is still higher than where we thought it would be. We just happened to have been able to have enrolled and penetrated the market for Japan Post even faster than we thought we would. And so I think that's part of the reason.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

Okay. And then just a follow-up on the previous question, on the hedging cost, and Fred, your answer makes sense, but I was just wondering how do you -- your hedging cost in the most recent quarter, I think, were around 8% of your earnings. So how do you think about hedging cost in the context of your earnings power and your ROE, as you look at results internally?

Frederick J. Crawford
Executive VP & CFO

Well, the hedging costs obviously factor into what we would call the net yield on our dollar program, as compared to investing in other alternatives, JGBs and the like. And so those hedging costs factor into our thinking about the relative attractiveness of the dollar program. It also can factor into how much of the dollar investment program we want to leave unhedged at times, based on our view of the markets. So it factors into the investment strategy predominantly. I would also add that those hedging costs also play into even our actuarial testing work. And so we also embed, for example, hedge costs, including rising hedge costs into our long-term cash flow testing and gross premium valuation work. And as I mentioned earlier, we are quite comfortable in terms of margins. So it does play in, but I think the way we look at it, Jimmy, is more from a net yield perspective is, really sort of an NII driven view of those costs as opposed to maybe a conventional operating cost.

Paul Shelby Amos
Former Director

I might just add, you'll recollect at the last FAB, I put up a chart where we actually showed you the -- to Fred's point, the net -- the gross performance of the program and the net performance of the program, taking out the hedge cost as well as any opportunity cost from settlements versus a portfolio of JGB's, because remember these are our assets on behalf of Aflac Japan. The liabilities are in yen. So that's our natural benchmark and that program has been very, very profitable versus JGB's since inception and we monitor that on a year-to-date basis, inception-to-date basis, a monthly basis; to continue to make those relative value decisions between dollars to the dollar program or investing in some other asset class.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

No, I think that make sense that you are – it is overall beneficial to invest more in dollars and hedge it than we're just buying JGB's. The only point I was going to make is that it seems like, if that is going to be the case going forward, your operating ROE and operating earnings would overstate the economics of the business to some extent. That was the point I was trying to make.

Operator

Our next question is from Seth Weiss from Merrill Lynch.

Seth M. Weiss
BofA Merrill Lynch, Research Division

Fred, just curious if you could comment a little bit more on U.S. expenses. You mentioned investments in infrastructure. You had mentioned this on the December outlook call. Just curious if any of this is front loading of some of those investments you are planning on making in 2016, and if this at all changes the expense guidance you gave for the U.S. for this coming year?

Frederick J. Crawford
Executive VP & CFO

Sure. So just a couple of comments. I would not over read accelerated investment into the expense ratio in the fourth quarter that -- there was some acceleration of expenses into the fourth quarter but as my comments -- in my prepared remarks, we would expect our expense ratio in 2016 to fall back down within the guidance range that we provided for the year. You had a couple of things going on expense-wise. You had some acceleration of expenses. You had some miscellaneous items running through the expense line, which will happen from quarter to quarter and naturally fluctuate. One other item I would note is that we did have a bit more DAC amortization in the quarter and in fact, we believe this relates also to a modestly improved benefit ratio in the period and that; while lapse rates were not unusually outside our expectation, what lapsed, in terms of the mix of business that lapsed, tended to be policies that were carrying higher reserves and higher DAC balances. As a result, it tended to push up a better benefit ratio, if you will, or improve our benefit ratio, I should say, and pushed up our expense ratio a little bit. Estimates, in and around 100 basis points, but I would certainly say approximately, just to give you an idea. So on the expense side, we would expect to settle back down into our guidance. I do think you should expect what has been a natural seasonal pattern here at the company, that we tend to move through the year well within the ranges, but it's not uncommon for us to see a little bit of elevated expense ratio in the fourth quarter.

Operator

Our next question is from Yaron Kinar from Deutsche Bank.

Yaron Joseph Kinar
Deutsche Bank AG, Research Division

First, I wanted to go back to the BOJ action. And I think we talked about the investment impact, but can we also talk about the potential sales impact? I would think that, not only could it impact first sector sales in Japan, but maybe it could also influence competitive pressures and third sector sales as maybe reserve rates come down and competition gravitates into third sector products. So we just like to hear your view on that.

Paul Shelby Amos
Former Director

We'll be glad -- this is Paul. We'll be glad to talk about that. When we think about first sector products, as we've mentioned in the past, we really divide it into 2 categories: First is the lump sum products and second is more the level premium products. And with those lump sum products we believe that, especially given the low interest rate environment, it is not in our best interest to focus on those products and as a result, we've put strong pressure on those sales. We put caps in place and we believe that the lump sum will be down as much as 50% or more in 2016. As it relates to our level premium products, however, we believe those still are a strong enhancement to our portfolio, primarily because of the cross sale that we are getting with our traditional third sector product, with cancer and medical. And those products continue to be an overall positive for us, we believe the sales of those will remain relatively flat for the foreseeable future. In terms of the BOJ impact to our third sector products, at this point, we don't expect it to have a significant impact. The level of the overall competition in third sector products, especially in medical, remains high, but we don't expect there to be any short-term impact to expedite or make that much faster. I hope that answers.

Yaron Joseph Kinar
Deutsche Bank AG, Research Division

It does. And then my follow-up question is on the Japanese incurred claims ratio, which was, I think, the lowest I've seen in many years. And was hoping to get a little more color on what drove that abnormally low number?

Frederick J. Crawford
Executive VP & CFO

It's really predominantly just a continuation of favorable results. As you know, we have been traveling in and around that benefit ratio in Japan, of just 60% to 61% for a while here and so the fourth quarter was modestly favorable. I would say, outside of just trends continuing to be generally favorable, I mentioned in my comments that we did have some actuarial adjustments in the period, which are quite normal, frankly, every quarter, but also included some year-end adjustments. On a net basis, that contributed a bit to the positive outperformance. We didn't spike it out in dollar terms or basis point terms because some of these adjustments are quite normal each quarter, but we did benefit a little bit from actuarial adjustments on a net basis. As a result, I would expect that you should see our benefit ratios in Japan fall back into line with the benefit ratio guidance for 2016 we provided.

Operator

Our next question is from Erik Bass from Citigroup.

Erik James Bass
Citigroup Inc, Research Division

One follow-up on Japan sales. I think fourth quarter was the highest quarter for cancer sales in 2015. So can you just provide more details on what drove production this quarter? And I guess, is there potential that sales could hold up better than implied in guidance in 2016?

Paul Shelby Amos
Former Director

Well, I believe that the execution of our cancer sales was really about the leader of our sales force, Koji Ariyoshi, who is here on the call, continuing to guide our sales force in our different channels to continue to sell our product, because the launch of that product a little over a year ago -- a year and a quarter ago has continued to maintain strong momentum against the competition, and overall there is a high demand, both in our traditional channels as well as through Japan Post. And so I believe that is a potential positive that we will see continuation. However, the difficult comparisons that you come up against throughout this year do make us believe that there will be a downward trend in the overall sales, but we do believe that the product remains highly demanded and is still the best product in the market today.

Erik James Bass
Citigroup Inc, Research Division

And then if I can just ask one on the U.S. Can you just talk about where you are seeing the most traction from a sales perspective and where are the biggest opportunities, where you remain under-penetrated?

Teresa Lynne White
President of Aflac US

Certainly, the broker -- this is Teresa. Certainly, the broker market continues to be a market where we have not seen the penetration that we'd like to see, but we are going in the right direction there. The individual, less than 100 case market, as well, continues to be a great opportunity for Aflac. It's pretty much our bread and butter and we continue to work in that market. But I think that the market growth is in the broker market, and that's really how we are developing our strategies and plans.

Erik James Bass
Citigroup Inc, Research Division

Got it. Is there any way to quantify sort of the penetration levels in the broker channel at this point?

Teresa Lynne White
President of Aflac US

At this point, what we are doing is we are looking at the current brokers that we have, and we are driving penetration with those brokers. We have seen a 27% increase in our top 100 brokers, but right now, I don't have specifics that I can give you as it relates to penetration. Once we get -- gain a little bit more knowledge as to how we want to report that, we'll start reporting in our FAB, in the booklet.

Daniel P. Amos
Chairman & CEO

Let me just say one thing about sales and that is that there -- if you go back in the past, there was a real conflict between the brokers and our individual agents. And we probably are the, of all the companies out there, with that strong distribution network we have got, they are very important and you can't just forget them. And the thing I like about sales in 2015 is; we were able to keep -- our sales numbers for our core agents continued to grow, we had them concentrate more on less than 100, and we were up above 3 or 4 -- 3%, I think -- 2.5.

Teresa Lynne White
President of Aflac US

Actually 5.3% on the [indiscernible].

Daniel P. Amos
Chairman & CEO

At a 5.3% increase in the less than 99 sales and then overall, our individual agents were up about 2.5% and then our brokers were up -- the difference is the broker agents hasn't picked a number as of yet. But being able to manipulate, or maneuver, I should say -- maneuver in that space to where we can keep our agents happy and the brokers happy has been our challenge. But we are accomplishing that and it's slow and tedious because they were competitors at one time. Even though they weren't direct competitors, our agents were always calling on these big accounts even though they weren't landing them and the brokers didn't like that. Now they are working together as a team. And I think with time, there is enormous potential for that market continuing to grow.

Operator

Our next question is from John Nadel from Piper Jaffray.

John Matthew Nadel
Piper Jaffray Companies, Research Division

I guess, the question I have for you is, can we think a little bit more about the composition of the $497 million of sales that were generated in the U.S. in the fourth quarter? Can you give us some color as to how much of that came from the broker channel versus the agent channel? And if you have some sense for what the margin would look like for the brokers sold business versus the more traditional sold business?

Daniel P. Amos
Chairman & CEO

The profitability.

Frederick J. Crawford
Executive VP & CFO

Yes. So on the profitability -- what I would say, John, is we don't -- we have not really broken out at this point in time sort of segmented profitability metrics on group versus individual brokers sold versus agents sold. So I'm not in a position to bust that out for you. What I would tell you is that we certainly price the product with a notion of meeting our return expectations and, obviously, more than -- and comfortably covering our cost of capital. So the returns are good in our view and priced appropriately. I think we are right in line with competitive pricing in the marketplace. I don't view ourselves as being priced to drive business growth, I think we're doing it the old-fashioned way. What I would say is because we are in such a growth mode on the group side, we're obviously investing heavier in the group platform to absorb that growth and build for further growth. So because it has been a relatively recent tick up in brokered group sales, we are heavily investing and that weighs down on our reported, if you will, returns. But over the long time -- over long term, we would expect to achieve returns that are commensurate with what we have achieved individually.

Teresa Lynne White
President of Aflac US

And I will just mention one thing. One of the things I would like to make sure that we don't assume is that all brokers write group product, 60% of broker sales were individually written product, is our core individually written product, so just wanted to make that comment.

Daniel P. Amos
Chairman & CEO

And let me make one other comment about that. The reason it skews that way, it's not the major brokers. There is 2 forms of brokers. There is in Columbus, a small regional broker that maybe I do buy my property casualty insurance business from, and then there is these massive enormous brokers. And the regional brokers perform more like our sales agents, to some degree. And the big brokers, of course, are writing the big accounts and do it totally different. So that's why this skew is more towards 70% -- 60%, 70%.

Teresa Lynne White
President of Aflac US

That's correct.

John Matthew Nadel
Piper Jaffray Companies, Research Division

Okay. And I guess, I'm sort of -- I'm trying to understand the seasonality, right. Because you have said for some time that fourth quarter will now be, or you expect it anyway to be, the largest production quarter. I guess that has to really mean that we're looking at a much bigger proportion that is brokers sold, whether that's small regional types or more national players. So as you think about that $497 million, how much of that would you say was broker sold. Is it 75%, is it 50%, is it something much bigger?

Teresa Lynne White
President of Aflac US

So when we look at it, when we look at the skewing of business through the fourth quarter, what we saw is that from a traditional side, we did see a small lift and I think that primarily based on the Affordable Care Act and the dates that enrollments needed to be in place for the Affordable Care Act, because remember, they deal with small case brokers as well. But we did see a large skew of volume, especially group, as Dan said, the larger brokers -- brokerage houses basically will do group products. So from a group perspective, we saw 50% of the group business come in the fourth quarter, but 40% came in December. So we saw a huge shift of business, which has not been a shift that we have had before, from an Aflac perspective.

Daniel P. Amos
Chairman & CEO

What our risk officer and chief actuary just said, that 40% of our business in the fourth quarter came from broker, is that correct? Okay. That's your answer.

John Matthew Nadel
Piper Jaffray Companies, Research Division

Okay. That's helpful. And if I could ask one quick follow-up on the hedged portfolio. I think Eric had mentioned that the cost is running at about 130 basis points to 140 basis points, and that's post BOJ projections. Can you just remind us how big the U.S. dollar portfolio is at this point that we should apply that cost against?

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

Sure. The total dollar program is about $21 billion, but the hedges are on about $14 billion to $15 billion of that portfolio. Robin can follow up with the very specific numbers, but that's approximately right because some of that portfolio we do lead unhedged. It’s a hedge against our equity in the branch and about 14-plus billion is hedged.

Daniel P. Amos
Chairman & CEO

One last thing you might want to know. I just got this number from them. It's 33 for the year for broker and it's 40 for the fourth quarter. So you can figure it's 30 for the first three quarters and 40 for the fourth quarter.

Operator

Our next question is from Michael Kovac from Goldman Sachs.

Michael Edward Kovac
Goldman Sachs Group Inc., Research Division

I am wondering in the U.S., can you dive in a little bit deeper into some of the underlying drivers of the lower benefit ratio, '15 versus '14, and then more specifically, the even lower benefit ratio in the fourth quarter?

Frederick J. Crawford
Executive VP & CFO

Sure the -- a couple things. One is really just favorable claims experience in general. And so that has been the case for a while. While I think that aspect has been stabilizing, it's been favorable and remains favorable. The other dynamic that I mentioned is that in this particular quarter, we also had lapse rates played in, meaning not so much how much lapsed, but the nature of the product that lapsed in the period. The product tended to carry on average higher reserves and so there was a greater release of reserves, if you will, related to the lapsation. This also, as I mentioned, played into accelerated DAC amortization and weighed on the expense ratio. As we look at the year-over-year trend, as I mentioned earlier, we would approximate the impact of that dynamic to be in and around a 100 basis points related to benefit ratio improvements. Again, that's based on the actuarial information we have and analyzing the nature of products that's lapsed. So I think that mix of business in lapsation, that will go on from quarter to quarter; this is not an unusual quarter. The mix of business will be different from time to time. We will monitor it going forward, but right now, we hold to the benefit ratio guidance that we've provided on the U.S.

Michael Edward Kovac
Goldman Sachs Group Inc., Research Division

It makes sense. And then looking at recruiting in the U.S, it looked like not only was sales growth fairly strong in the fourth quarter, but we also saw some signs of agent recruiting picking up. Can you discuss some of the drivers there in terms of maybe the broader economy or maybe some Aflac-specific comments?

Teresa Lynne White
President of Aflac US

I think the driver, quite frankly, is the compensation. We basically are paying for performance with regard to U.S. and part of the compensation drive is the recruiting piece. We are seeing that recruiting in many of our markets has been a struggle in the past, but it's not been as much of a struggle right now and it's because, quite frankly, we're focused on recruiting.

Operator

Our next question is from Steven Schwartz from Raymond James & Associates.

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

Just one more follow-up on group sales in the U.S. Teresa, would you happen to know how much the group sales were up year-over-year in the fourth quarter? Maybe, that would give us a sense of what's going on with the alphabet houses?

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

Yes. That's for me.

Teresa Lynne White
President of Aflac US

Just a second. Let me make sure I get that number from my actuary. It's 32% increase in fourth quarter for group sales.

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

Okay, on the group sales. You said the 20, so -- and just to be clear, you mentioned 27% number that's total broker sales up, or the top 100 broker sales up?

Teresa Lynne White
President of Aflac US

That's the top 100 broker sales, absolutely.

Operator

Our next question is from Tom Gallagher from Crédit Suisse.

Thomas George Gallagher
Crédit Suisse AG, Research Division

First question just is a follow-up on these hedging costs, just to make sure I get what the punchline is here. So if we run the 130, 140 basis point hedge cost assumption through the 2016 P&L, assuming things remain roughly where they are today, Fred, the after-tax difference between operating and net income would be about $200 million, is that directionally about right, meaning net income would be about $200 million lower than operating?

Frederick J. Crawford
Executive VP & CFO

Tom, I would be reluctant to kind of give you -- opine to a number at this point in time. I'd have to look at it to be candid. So we'll take a look at it and, may be, take that type of analysis offline. It strikes me that you are trying to reconcile a model to get to the right number to think about and maybe we can work on that internally.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Okay, but conceptually, there is going to be -- that 140 basis points would be applied to the total portfolio, I believe, because you're going to have to roll the whole hedge program. It's not just the new money that's being invested, right, it's the total dollar portfolio where you're rolling the hedges. Is that clear? Is that conceptually the way to think about it?

Frederick J. Crawford
Executive VP & CFO

The reason I'm hesitating is you have got portfolio of maturities related to those hedge instruments that range in tenure from short to longer, as in 3 months to 18 months. We have been stringing it out, as I mentioned in my comments, which shelters us against sharp swings, if you will, and hedge costs in any given year. So I want to think about that...

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

Yes. I would add 2 comments, Tom. First, just to give some specific numbers to the question earlier. The dollar program in total is $21.6 billion. Of that, $14.2 billion is hedged. But it's also relevant to your question and ties into part of Fred's answer. Remember what I said earlier, we now have a portfolio of hedge instruments of different types, and we stratify the maturities of those. So when I say hedge costs are 130 to 140, those are current annualized hedge costs. Our realized hedge costs will most likely over time be lower than the annualized. So to Fred's point, to answer your question specifically requires a little bit of putting it down on paper, but also not all of our hedges are forwards, though those hedge costs pertain to forward contracts. Predominantly, we are in forwards, but we do use collars instruments as well and collars could have a settlement, but that will be more dependent on the level of the yen, where it settles versus how we strike the collars. And currently, we have about 1.2 billion-or-so of collars and the rest of forwards. So it's a little bit more complex to answer your question, but I would say this for today, your 200 number is overstating it.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Okay. So from a full year standpoint it would come in -- would you say meaningfully lower than the $200 million?

Frederick J. Crawford
Executive VP & CFO

It depends on the definition and meaning for you, but I suspect it's a number that's lower than 175 off the top today.

Kriss Cloninger
President & Director

This is Kriss Cloninger. I haven't said anything, but I want to help put this in perspective. We wouldn't have $14 billion of dollar investments, if they weren't hedged. I don't think it's appropriate to say what the hedge costs are without looking it what the additional net investment income associated with the underlying dollar investments are, relative to the yen investments. So taking it, I think conceptually, you're probably correct in employing 140 basis points to $14 billion and saying, yes, that's the annualized hedge cost. But keep in mind, we wouldn't have $14 billion of unhedged dollar investments unless we had this hedge program. So I think we've got to consider the net investment income differential between dollar investments and yen investments when you're talking about an economic evaluation of the deal.

Frederick J. Crawford
Executive VP & CFO

And I would just -- Tom, we were able to do some quick math here. Assuming 130 to 140, which I think I realized for this year will be lower than that, on an after-tax basis, we are probably looking at about $110 million and that's probably on the high side, because I think our realized hedge cost this year will be lower than the annualized cost where it is now.

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

We've reached 10 o'clock. So I'd like to thank everybody for joining us. And if you have any further questions, please contact us on Investor Relations. And again, I will remind you about our analyst meeting coming up in May and we hope to see you all then. Thank you very much. Bye-bye.

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