S&P Global
Market Intelligence

Aflac Incorporated NYSE:AFL

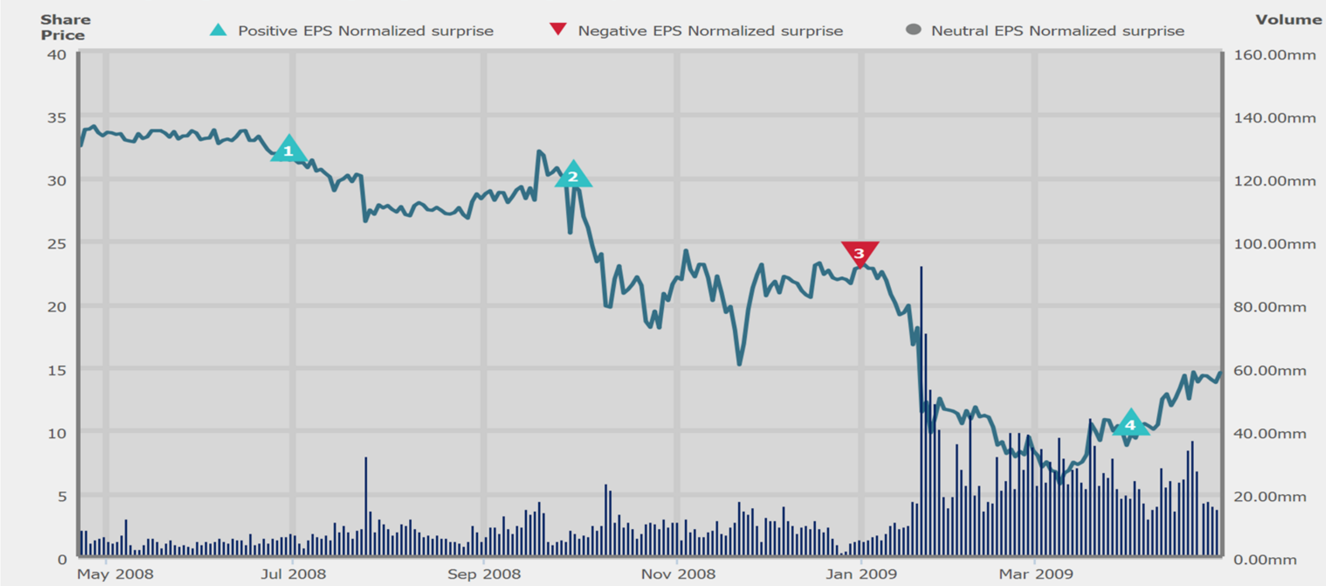
FQ2 2009 Earnings Call Transcripts

Thursday, July 30, 2009 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2009-			-FQ3 2009-	-FY 2009-	-FY 2010-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.56	0.60	▲7.14	0.58	2.34	2.56
Revenue	-	-	▲(7.90 %)	-	-	-
Revenue (mm)	4683.10	4313.00	-	4731.73	19019.49	19541.47

Currency: USD
Consensus as of Jul-30-2009 1:12 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2008	0.50	0.50	▲2.00 %
FQ3 2008	0.50	0.51	▲2.00 %
FQ4 2008	0.50	0.49	▼(2.00 %)
FQ1 2009	0.58	0.61	▲5.17 %

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Call Participants

EXECUTIVES

Dan Amos

Jerry Jeffery

Ken Janke

Kriss Cloninger

Paul Amos

Tohru Tonoike

ANALYSTS

Colin Devine
Citigroup

Darin Arita
Deutsche Bank

Eric Berg
Barclays Capital

Jack Sherck
SunTrust

Randy Binner
FBR Capital Markets

Shobha Frey
Putnam

Steven Schwartz
Raymond James

Suneet Kamath
Sanford Bernstein

Tom Gallagher
Credit Suisse

Presentation

Operator

Welcome to the Aflac second quarter Earnings Call. Your lines have been placed on listen-only until the question-and-answer session. Please be advised, today's conference is being recorded. I would now like to turn the call over to Mr. Ken Janke, Senior Vice President of Investor Relations.

Ken Janke

Thank you, Don. Good morning, everybody and thanks for joining us this morning. With me at Aflac are Dan Amos, Chairman and CEO, Kriss Cloninger, President and CFO, Paul Amos, President of Aflac and COO of our US Operations, Jerry Jeffery, Senior Vice President and Chief Investment Officer and Tohru Tonoike, who is President and COO of Aflac Japan, joins us from Tokyo.

Before we begin this morning, 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 statements are reasonable, we can give you no assurance they will prove to be accurate because they are perspective in nature.

Our actual results in the future could differ materially from those that we discussed today. I'd encourage you to look at the press release we released last night, and the various risk factors that could influence our future results.

Now, let me turn the program over to Dan, who will have some comments about the quarter and the outlook for Japan and the United States. I'll follow up with some financials and then we'd be pleased to take your questions. Dan?

Dan Amos

Thank you, Ken. Good morning and thank you all for joining us. I hope you had a chance to look at our second quarter press release. I'll be commenting on the operations in Japan and the United States, but first I'd like to talk about the financial results and our balance sheet.

As I hope you noted, we had a strong quarter from an operational earnings perspective. Operating earnings were $1.20 diluted share, up 18.8% over the second quarter of last year. Excluding the impact of the yen, operating earnings per share rose 13.9% for the quarter and 14.6 for the six months. These results put us in a great position to achieve our annual objective of a 13% to 15% growth before the effect of foreign currency.

Net earnings in the second quarter were influenced by realized investment losses. We sold our holdings of CIT in July, and recorded an impairment charge in the second quarter reflecting the sales price. In addition, we impaired the dated Upper Tier 2 securities of Communal Credit in the quarter. This Australian bank is in the process of restructuring and following the additional credit analysis, we concluded that the restructuring would decrease the likelihood we would receive the entire principal amount when the securities reached their maturities.

We also impaired some perpetual securities we owned because they were classified below investment grade. The after-tax impairment charge of $93 million was determined using the equity impairment approach under the General Accepted Accounting Principles.

The impairment of the perpetual securities did not affect our statutory financial statements, and we continue to believe that we will receive the interest in the principal payments that are contractually due. Just as we did in the first quarter, let me update you on the impairment outlook for the perpetual holdings.

Assuming the yen/dollar exchange rate and the pricing of the perpetual securities remain unchanged from June 30s levels, and no additional downgrades to below investment grade, then we expect to book

$265 million of impairments in the third quarter, and $109 million in the fourth quarter under the equity impairment method.

However, I want to remind you of two important points. First, these charges will not impact GAAP shareholders equity, because all the perpetual securities are already characterized as available for sale and carried to market of a balance sheet. Second and most important, we would not be required to record comparable impairment charges per statutory accounting purposes.

Even with the realized investment losses in the second quarter, our risk-based capital ratio remains high. As you saw in our press release, we estimate that the RBC ratio was 459% at the end of June. The decline since the end of March primarily reflected the affect of downgrades on the required capital.

I realize that many of you have been following the rating agency's actions with respect to perpetual for or so-called 'hybrids', and have wondered what impact further downgrades might have on our RBC ratio. If we assume all of the perpetual holdings were rated below investment grade at June 30, our RBC ratio would still have exceeded our internal target. We do not think this scenario is likely, however, we believe this type of stress testing helps demonstrate that our capital position is strong enough to tolerate significant down downgrades raids in our portfolio should they arise.

I know that many of you are aware of Banco Santander recently announced an exchange offer that included Abbey National perpetual securities we own. As we have done with previous offers, we closely evaluate the economics of the exchange offer. In this particular case, we concluded it was not in the best interests to participate in the exchange.

Banco Santander is a strong European financial institution, and we expect the bank to continue to make coupon payments on Abbey National securities. When they announced its exchange, it also commented that further redemptions will be made on a purely economic basis.

I'd like to point out that the first redemption date on Abbey National perpetuals we hold is not until January of 2015. It's certainly possible that five and half years from now, it will be in their best interests to redeem the securities. Actually, we do not have any significant short-term extension risk among our perpetual investments. For the balance of this year, we only have 163 million of perpetual securities that become eligible for redemption.

We have just $104 million of perpetual securities with redemption dates of 2010. As we've previously discussed, we have two issues that were redeemed earlier this year, although Deutsche Bank did not redeem a Tier One perpetual in late June. The book value of that security is only $16 million, and more importantly, Deutsche Bank remains current on the interest payments.

I think it's noteworthy that we have only one issuer who deferred the payment this year. Overall, I remain confident in the quality of the investments we hold, and the strength of our capital position.

Now, let me give you a brief update on the operations beginning with Aflac Japan. Aflac Japan performed well from an operational and financial perspective in the second quarter. We were particularly encouraged by the sales results. Total new annualized premium sales in yen were up 5% for the quarter. For the first six months, total new sales were up 2.3%. We believe these results solidly positioned us to achieve our goal of flat to a 5% increase this year.

Second quarter sales increase primarily reflected a favorable consumer response to the introduction of a new child endowment product we believe that we discussed at the analyst meeting in May. The strong initial sales of this new product significantly contributed to a 38.7% increase in ordinary life sales in the category.

During the quarter, we sold 17,900 child endowment policies, at an average premium of JPY143,900. Although the child endowment product has a lower margin than our health insurance products, its margins significantly exceed the margins of the fixed annuity coverage that we offer. Furthermore, we believe the profit margin is reasonable, particularly given the fact that it is viewed as the best child endowment product in the market today.

As we discussed at the analyst meeting, we believe the child endowment product as well as other life products called [GIFT] have potential to open doors for our third sector. In that regard, 15% of the individuals who purchased our child endowment plan from its introduction in March through June also purchased at least one of our other products. Offering new first sector products allows us to package the product with the cancer and medical products at the same time, it also gives us an opportunity to cross sell at a later date.

We were very pleased to see continued improvement in the bank channels in the second quarter, with a 39% increase over the first quarter. Compared with a year ago though, bank channel sales were up 106%. At the end of June, a total number of 346 banks represented Aflac Japan. Of that amount, 275 have been selling Aflac Japan's core products like cancer and medical, since the full deregulation of sales through banks in December of 2007.

We continue to have a significantly greater number of banks selling for us than any other insurer operating in Japan. We expect continued improvement in the bank channel sales through the remainder of this year and next. As you know, we began selling our market leading cancer insurance on a limited basis through Japan Post Network Co. beginning last October.

Effective July 1 of this year, the number of post offices selling our products increased from 300 to 1,000. Prior to this expansion, we've trained the personnel of an additional 700 outlets. On July 14, we announced we will begin introducing a revised 'EVER' product on August 21. This will be the first major revision that we have made to our popular medical product since its introduction in 2002.

The most notable change is the enhanced surgical benefit. In addition, the revised EVER premiums will be gender specific. Rates for female buyers will be lower than the original version of EVER at most issue ages, while male purchasers would generally pay less at younger ages and more at older ages. I want to emphasize that the expected profit margins for this product are comparable to our original EVER profit; and we think the revision benefits and premium structures will be well received by agents and consumers.

We preannounced the new product to provide our agencies with adequate amount of time to prepare for solicitation of large accounts. While this approach accommodates our enrollments, it also means that we expect some slowdown in medical sales between the announcement date, and the introduction date, as the sales force and potential customers wait for the new product.

As a result, our sales growth in the third quarter will likely be in line with the first quarter, but we anticipate a solid increase in the fourth quarter as the new medical product is rolled out. As I mentioned, we believe we can achieve our sales objective in 2009 despite the current economic conditions. As we look ahead, we are convinced that Japan remains a strong market for our type of products.

Turning to our operation in the United States, we were not surprised that Aflac US was again challenged to generate sales momentum amid the difficult economic backdrop. During the second quarter, total annualized premium sales were down 10.9%, and for the six months lower than a year ago.

Based on our sales results of the first half of the year, it is unlikely we will achieve our sales objective of flat to 5% increase for the full year. As we assumed in our financial projections for this year, the persistency rate for the US business declined compared to a year ago, but it improved over the first quarter of 2009. This means that we did not see any further sequential deterioration in the persistency of our business.

Our second quarter persistency was fairly consistent with our planned assumption. While a very weak economic environment has continued to impact sales, we remain encouraged by the basic sales-related activities of our US operation. The current labor market has provided a good opportunity for expanding our commissioned sales force because salaried jobs are harder to come by.

In the second quarter, recruitment of new agents was up 14.9% to 7,800 new sales associates, and 19.9% higher for the first half of the year. The average number of weekly producing sales associates was down 2.6% during the second quarter. However, the average number of new weekly producers rose 6.1% in the quarter.

We believe that suggests the training enhancements we've implemented over the last few years have been taking hold. Like the first quarter, new payroll account sales were strong, rising 9.6% over the second quarter of 2008 and payroll accounts opened by new agents was up 19.9% or almost 20%.

As you read in our release, we will be acquiring Continental American Insurance Company or CAIC in the fourth quarter for $100 million, which is approximately $67 million in excess of its year-end 2008 statutory capital and surplus. CAIC is a specialty insurer that focuses on selling voluntary group products at the worksite through broker distribution.

CAIC is a profit-focused operator with margins that are consistent with our expectation. The company is strongly capitalized and its RBC ratio is 569% at the end of 2008. In fact, in June, CAIC was upgraded by A. M. Best to an (A-) or Excellent, which is a significant accomplishment in this environment.

The reason for this purchase is very straightforward. For the last two years, we've been in discussions with broker distribution as one of the high priority initiatives in the United States. In pursuing this initiative, it became clear that some brokers preferred to offer group products rather than those that are individually underwritten.

To meet the product needs of the field force pursuing larger accounts, and the brokers, we evaluated our options. We could build the capacity ourselves, partner with another company or purchase the expertise. We concluded that it made the most sense to purchase the scalable platform.

After identifying and assessing many potential candidates, we determined that CAIC was clearly the best fit. We believe this purchase will send a clear message to brokers that we're serious about doing business in this market. Equally important, it will be helpful to our sales agents by providing yet another entry point that opens the door to large accounts.

I want to emphasize that this purchase does not signal a shift in our strategy. We are still focused on growing internally and not through acquisitions. However, by purchasing this group platform, our industry-leading field force will be equipped to take advantage of the vast opportunities in the US market.

We continue to work on marketing and administrative integration plans over the next few months as we prepare for 2010. Although it's too early to project the impact the acquisition will have on the US sales, we will be assessing the sales opportunities in the coming months, and our 2010 sales projection will reflect the combined outlook of Aflac and CAIC.

We expect this purchase will be slightly accretive to next year's consolidated earnings after expected integration costs. At a time when our financial businesses may be evaluating the viability of the business model, we have the financial strength to invest and build on Aflac's already strong business model. With the long term we see in the United States, we believe this is the right time to invest in this vast market.

Despite weak economic conditions, our earnings outlook has not changed. Our objective remains 13% to 15% increase in operating earnings per diluted share in 2009, excluding the impact of yen. For 2010, our objective is a 9% to 12% increase in operated earnings per diluted share before the impact of the yen/dollar exchange. However, I want to remind you that my number one priority is to maintain a strong capital position.

As you know, we issued $850 million of 10-year senior notes in May to assist in the refinancing of our 10-year senior notes we paid-off on April 15 of 2009. Simultaneously, we were also working on securing some private sources of yen denominated debt to broaden our source of debt financing.

On July 21 of 2009, we signed an agreement to borrow JPY10 billion or around 105 million from a leading Japanese financial institution at an interest rate of 3.6% for a term of six years. We're also in negotiations to secure an additional $5 billion from another source that we expect to complete in the near future. We intend to apply these proceeds to the repayment of the next maturing date obligation which is July of 2010.

We believe that successful conclusion of these financing activities, which will raise approximately a billion in total well positions our capital structure for the foreseeable future. Overall, I believe Aflac remains in strong position among the two best insurance markets in the world.

Even though the Japanese and the US insurance markets have many differences and couldn't be more geographically diverse, they both share a common basic human need for lifestyle protection no matter what the economic climate. They also share a common opportunity for growth. At the same time, our operations are performing well, and we have a strong balance sheet. Although we continue to face challenges, I have every confidence in the future of Aflac. Ken?

Ken Janke

Thank you, Dan. Before we get to your questions, let me take you briefly through some of our second quarter numbers, starting with the Aflac Japan segment.

In terms of the top line in yen, revenues were up 2.5% in the quarter. Investment income was down slightly, 0.2%, due to the impact of the stronger yen on Aflac Japan's dollar denominated investment income. Excluding the effect of the stronger yen, investment income would have been up 2.3%.

The annualized persistency rate excluding annuities for the first six months was 93.9%, which was unchanged from the first quarter of this year, however down from 94.5% in the first half of 2008. You'll recall from our discussions last year and earlier this year that we believe one of the influences on persistency is the large segment of the population reaching retirement age, which is a common lapsation point in Japan.

In terms of the quarterly operating ratios, the benefit ratio continued to improve over last year. It was 60.4% in the quarter, down from 61.9% a year ago. Excluding the impact from the stronger yen on investment income, the benefit ratio was 60.1%. The expense ratio for the quarter was at 19.9%, which was unchanged from a year ago, and reflecting lower benefit ratio, the pretax margin expanded from 18.2% a year ago to 19.7% this year. Excluding the affect of currency, it would have been 20.0%.

With the expansion of the profit margin, pretax earnings increased 10.7% for the quarter in yen terms and again, excluding the impact of the stronger yen, pretax operating earnings were up 13.1% in the quarter. During the quarter, we invested our cash flow in yen denominated securities at 3.14%. Including dollars, the blended rate was 3.34%.

The portfolio yield on Aflac Japan's holdings at the end of June was 3.85%, which is down two basis points from the end of March, and 13 basis points lower than a year ago.

Let me turn to Aflac US. Total revenues rose 2.7% in the quarter. As you heard, the annualized persistency rate for the six months was down from a year ago, but up versus the first quarter at 69.6%. The benefit ratio was 51.6%, compared with 52.8% a year ago. The decline in the benefit ratio reflected favorable claims trends on some product lines, as well as the affect of higher lapsation in the quarter compared with a year ago.

The higher lapses compared with a year ago also increased DAC amortization, which was up 21% for the quarter. Increased DAC amortization was largely responsible for the increase in the operating expense ratio from 31.3% in 2008 to 32.3% in 2009 second quarter. However, the profit margin was 16.1%, up from 15.9% a year ago. As a result, pretax operating earnings rose 4% in the quarter.

In terms of US investments, the new money yield for the quarter was 7.45% versus 7.29% a year ago. The yield on the portfolio at the end of June was 7.22%, which was up four basis points from the first quarter, and 18 basis points higher than a year ago. In terms of some other segments, the ratio of debt to total capital was 19% at the end of June, compared with 15.9% a year ago. That excludes the affect of FAS 115.

Non-insurance interest expense in the quarter was $17 million compared with $6 million a year ago, largely reflecting the $850 million of debt that we issued earlier in the year. Parent company and other expenses were $6 million in the second quarter compared with $11 million a year ago.

The pretax operating margins improved in the quarter, reflecting both better margins in the US and Japanese segment. The pretax margin rose from 17.2% to 18.2%, and on an after-tax basis, the margin increased from 11.2% to 12.0%. On an operating basis, the tax rate was 34.2%, down slightly from 34.7% in the second quarter of 2008.

As you heard, operating earnings per diluted share were up 18.8% to $1.20, which was better than the guidance we had communicated on our first quarter call. The stronger yen increased operating earnings by $0.05 for the quarter, and $0.14 for the first half of this year. Excluding the yen's impact, operating earnings per diluted share increased 13.9% for the quarter and 14.6% for the first six months.

Finally, let me comment on the outlook for operating earnings per share for this year. As Dan mentioned, our objective for 2009 is a 13% to 15% increase in operating earnings per diluted share, excluding the impact of the yen. Assuming we produce a 13% increase at last year's average currency rate, we would expect to report $4.51 in operating earnings per diluted share for the full year of 2009.

Although the yen has weakened a bit to the dollar since the end of the year, the average rate so far is still stronger than it was a year ago. Today, the yen has averaged approximately JPY95 to the dollar. If the yen averages JPY95 to JPY100 to the dollar for the full year, we would expect reported earnings to be in the area of $4.59 to $4.73. Under that same currency scenario, we would expect operating earnings per diluted share to be in the area of $1.19 to $1.22. The last time I checked First Call, I believe the third quarter consensus estimate was $1.16 for the third quarter.

Now, we'd be happy to take your questions. We do want to make sure everyone has an opportunity to ask a question. So please limit your questions to one if you can, so we can get to everybody.
Don, now I'll turn it back to you.

Question and Answer

Operator

(Operator Instructions). Your first question is from Suneet Kamath. Sir, your line is open.

Suneet Kamath
Sanford Bernstein

Thanks. Good morning. My question relates to the US business. I guess in the prepared comments, Dan, you referred to differences in terms of productivity of the entire sales force versus the new sales force, and it seems like the new sales force is doing much better than the combined. I'm just sort of curious about that because I would think that the guys that have been around for a lot longer, obviously have seen various economic cycles, I would think that they would be in a better position to make your sales pitch in terms of product affordability much better than the newer guys. So, I'm just wondering what's going on there?

Is it a situation like we saw a couple of years ago where, you had a couple of good years of sales and the experienced sales people just said, I'm going to sit back and take my recurring commissions and just not generate as much new business as I otherwise might have? So any color you could provide there would be helpful.

Dan Amos

I'm going to let Paul answer that, but I think what you just said was part of it.

Paul Amos

The basic answer is that the vast majority of our veteran associates spend time reenrolling their existing accounts after a certain period of time. So, they build up a certain block of accounts, they then go in based on the growth and the turnover in those accounts and write those people in that existing account as well as servicing those accounts.

Unfortunately, for many of them, those accounts have not only, not increased in size, but have decreased dramatically, especially in the smaller account sizes. So for our veteran associates, it is not about their ineffectiveness of their pitch or their ability to sell Aflac products. In fact, you are right. Over time, I believe our Aflac associates continue to get better and better. However, if they are not focusing to some extent on newer accounts to supplement the decrease in employees at our existing accounts, then I think that it has hurt them.

As Dan mentioned in some of his numbers, our new recruits are up, our new accounts and new accounts from new associates are up tremendously. So, we are seeing our new accounts and the opportunity for our business to be sold go extremely well. So, I do believe that it is a problem that is within our existing accounts that is directly correlated to the economic impact that this economy is having on those businesses, and is therefore outside of the veteran associates' control.

Suneet Kamath
Sanford Bernstein

Thanks. Just one quick follow-up. It seems like the last time we went through this, it took a couple of years for the US to really turnaround. I know the new guys are doing better, but I mean is that ex the Continental acquisition that you're making. I mean, is your sense that it's going to take maybe into 2011 before we see the core business actually produce growth allowing the new guys to sort of mature?

Paul Amos

It's very difficult for me to tell what's going to happen until we see a turn in the labor market. That said, I will be extremely disappointed if we don't see a turn before then, but that is rhetorical. I hope that we will see a turn and I believe that we're putting initiatives and things in place to continue to sell, to open the minds of people to the products that we have, and we hope to continue to move in the right direction.

Dan Amos

One thing I'd say Suneet is, when you look back at that particular time you're talking about, we had not prepared our new sales people that way. We didn't have the training. The one thing I think I showed you from the statistics is that the way we're training our people and their production, it's going very well. So, I think the chance for recovery is faster because we have that added on top of it.

Operator

Our next question is from Steven Schwartz. Your line is open.

Steven Schwartz
Raymond James

Jerry, a question for you. Can we go over the hybrid portfolio again? I know you do this every quarter, but can you once again explain to us how you get to the fair values that you have given that there are, I guess you would say like, not private, but like public holdings that fair values are not quite where you've got your fair values? So, if you can go over that again I would very, very much appreciate it.

Jerry Jeffery

Sure. There are two ways primarily that we do it, and this applies to any investment that is below investment grade. We solicit prices on a monthly basis from individual brokers, and we take the average of those prices. We do look at the prices for reasonableness too. If one of the broker prices we feel is way off the mark for some reason or just plain error, then we throw it out and use the remaining prices.

For the lion's share of our investment grade securities, and this includes perpetuals, we use model pricing, which again takes in brokers price, and brokers provide input to our model, and we use that input in pricing our securities. I would also say that the check that we have for model pricing is all of our securities are actually hand priced by brokers, and that the lion's share of that is a check against the accuracy of our model prices. Is that what you need Steve?

Steven Schwartz
Raymond James

Jerry, what would be some of the key inputs that you would put in that model?

Jerry Jeffery

The key inputs will be maturity, sale, rating sale, level of subordination. Those are the primary inputs that go into it and sector. Sorry, sector as well.

Operator

The next question is from Colin Devine. Your line is open.

Colin Devine
Citigroup

Good morning. I've got hopefully a couple of quick ones. First, I appreciate your pre-announcing the realized losses you're going to be taking over the rest of the year, but if you know these bonds are impaired now, I've never seen a company that can do this, that doesn't impair them now versus waiting the next six months. So perhaps, Kriss, you could explain to me how that works under GAAP, because I've certainly never seen it before.

Second for Jerry, on the Santander tender, it's our understanding that was for all the outstanding hybrids, and that if you don't tender for it, then you're just left with illiquid securities, and I'm not sure what the sense of that is, and if you can talk a little bit more why you're not.

For another one, I'll turn to Dan, with all due respect to Paul. I appreciate all the comments about what's happening here in the US with the economy and that's the reason why sales are struggling, but isn't it factual to say, sales have been flat for three if not four years now, and that was certainly long before the recession started. So, I'm not so sure, what I'm looking is, you can't just blame it on the economy. It seems to me there's been a problem here for some time that didn't just come up in the last 12 months. Thanks.

Kriss Cloninger

Okay. Colin, I'll handle the first one, the question about why we've got impairments we say we'll take in the third and fourth quarter that we're not recognizing currently. First of all, let me say that these are impairments on the so-called, 'perpetual securities' that do not have a fixed maturity date, and that the SEC and FASD said, need to be recognized for impairment under an equity impairment method.

Now, the equity impairment method says that if a security trades below a certain percent of book for a specified period of time, then it needs to be written down to its current market value after that specified period of time. There is no consideration of the credit quality per se of that security other than in the case of perpetuals that they are rated below investment grade. So, what we've got are certain perpetuals that are currently rated below investment grade that will have been a specified percent below current book for a specified period of time ending in the third quarter or the fourth quarter, and that's how we schedule those out.

These are not regular debt securities where there's been a credit event, but they're just the perpetuals without the fixed maturity date that we had to change the accounting on in the third quarter of last year from the accounting we had previously had in place. So I hope that clarifies that?

Colin Devine
Citigroup

It does somewhat, Kriss, although it's still not clear to me, if you know they're impaired, why you don't just step up and do it now.

Kriss Cloninger

Colin, they don't meet the impairment test yet because the impairment test is based on the ageing of unrealized losses, and they haven't reached the schedule at this point.

Colin Devine
Citigroup

It's also based on, if you believe; they're impairment. That's what we are hearing.

Kriss Cloninger

No, this is not with the perpetual securities. They are being impaired under an equity impairment method which has nothing to do with the issuer's ability to pay, it has everything to do with the price and length of time at which they have traded below a certain level of book value.

Colin Devine
Citigroup

Your other peers were writing down their perpetuals in the case of Royal Bank of Scotland (inaudible) in $0.45 on the dollar in the first quarter. So, let's move on.

Jerry Jeffery

Your second question Colin I believe pertain to Santander, and decision not to tender. There were two elements in our decision. One is, we looked at the dollar securities, and the terms of our current dollar securities holdings, and we concluded today, we have far superior call protection, and a far greater income stream currently than we would get with the exchange, and also based on our evaluation of the financial strength of Santander, we elected to keep the securities that we have and it is our intend to hold it until the expected economic maturity.

In the case of the yen securities, the terms of the exchange as they were presented to us were to convert these into euro bonds which really would create an accounting nightmare for us. In addition to that, the specific call features of these bonds are very attractive if they don't call them to us. The coupons remain higher than current market coupons. So, in that case, we would certainly entertain a proposal from Santander to exchange for yen securities if that were forthcoming. We haven't heard anything. However, currently, it's just a far better proposition for us to keep what we have.

Dan Amos

In regard to sales, we were up 13.1% in '06, and we were up 9.5% in '07, which is a compound of over 10%. It was really the second half of last year when things started being a problem. So, we did have those compared to the US for four years and so that's it.

Operator

The next question is from Darin Arita. Your line is open.

Darin Arita
Deutsche Bank

Thank you. Turning to the US with the acquisition of Continental, can you give us the sense of the size of the broker market opportunity, and maybe what proportion of sales that could get to?

Paul Amos

Darren, I'm not prepared yet to talk about specific numbers, but I have been talking rhetorically over the last year and a half at our FAB meetings about us seeing the broker market as an opportunity. Really and truly, the vast majority of Aflac's accounts, 90% of them are [100 and less lives].

While our agents continue to do well in that market, they also continue to do well in the large account market, and we felt like that we had the individual platform, the best in the business, it continues to be what I believe is the platform that's best for the majority of accounts in the United States, but there are some accounts and some brokers who are demanding or wanting the features that come along with the group platform.

Therefore, we went out and made this acquisition, really as a platform basis as well as the strength of Continental American, and by adding those two together, the availability for us to offer whatever is needed or requested by the account itself.

In terms of growth in the broker market specifically, I think it's early for us to be able to determine what those numbers are going to look like. As you can imagine, the broker market only started reacting to this after the close yesterday. I hope and believe that that reaction has already started to be strong, and in a favorable manner, but I hope over the coming quarters I can give you a better number than I can today.

Darin Arita
Deutsche Bank

In terms of that market though, there are many other large competitors there. What will Aflac bring that's different?

Paul Amos

I believe Continental American today is winning and bringing a lot of accounts. The fact that they had a B rating prior to their recent upgrade prevented them from acquiring as many accounts as they would have otherwise. Their recent A rating has brought them into some strength. Of course, now we bring more to them with the Aflac umbrella and the Aflac brand. There are also many, many accounts that have come to us in the past and said that they would like to put in Aflac if we had a group platform.

Now, we immediately open up those opportunities for Continental, and so I believe it is something that provides synergy to both of us. The key is managing how we present ourselves to each client, and making sure we put the best products out for them based on their specific needs.

Operator

Next question is from Randy Binner. Your line is open.

Randy Binner
FBR Capital Markets

Hi, thanks. I apologize if I missed out, but I guess we're trouble just backing into how the RBC went down. The debt that was raised earlier this year that didn't go to the maturity, is that included in the RBC, the 459 you reported or is that above the subs? If you also just give some color on how ratings migration may have affected the RBC ratio; that would be helpful as well. Thanks.

Kriss Cloninger

Okay. The debt that we raised did not impact RBC in this quarter. We did use a portion of that debt to pay-off the intercompany loan between the parent and the sub that we had created to pay-off the notes when they were due April 15. But that was an admitted asset, and did not adversely impact RBC at the date we made that intercompany loan.

We have two events this quarter, I guess, that both negatively impacted RBC. The impairments of the CIT and the Communal Credit securities, both were realized investment losses that impacted statutory, and we didn't really anticipate them. Then, there were a number of downgrades from NAIC one or two, from one NAIC level to another NAIC level that carried a higher percent of required capital, so our required capital increased in an order of magnitude close to 10% that drove down the RBC ratio some.

Randy Binner
FBR Capital Markets

That's perfect. So just to clarify, the $4.59 is net, if you will, of all the new debt that came in?

Kriss Cloninger

That's correct. The new debt that came in did not impact the $4.59.

Operator

Tom Gallagher, your line is open.

Tom Gallagher
Credit Suisse

Thanks. Just had a question about the way I should think about margins playing out in Japan, I guess for Kriss. Kriss, if I turn to page 29 of the supplement, and I look at the difference between incurred claims and total benefits, and as a percent of total revenue, that gap has continued to narrow pretty sharply, and I guess I understand it intuitively because of the conservatism in the accounting and the reserves, but I guess what I'm trying to get my arms around here is that gap was 25 points going back two years ago, it's 15 points now.

Are we going to start to see a deceleration of the margin improvement if you look out a couple of years? And I say that because the product mix shift doesn't appear to really be explaining the margin improvement anymore. If I look at the products mix shift, it's actually been fairly stable between the short tail medical and the longer tail life and cancer products. So just curious if I'm thinking about that the right way or at what point we might start to see a deceleration of the margin improvement which has been real healthy as of late.

Kriss Cloninger

That's a good question, Tom. First of all, let me just make note on your observation of the shrinkage of the difference between incurred claims and total benefits. You know, as a block of business ages, particularly the cancer block, you're going to see more current claims come through as the policy holders age, and you're going to see either a lower increase or an actual decrease in the increase in future policy benefits. In the early years of the contracts, we hold back money to pay the claims that we know are going to be paid out later in the contract life. So, it's only natural to see the incurred claim piece or the paid claim piece go up, and the change in future policy benefits go down on a cancer block specifically.

Another thing you see there related to mix of business is that that the medical business, the EVER products, they tend to pay out more claims early in the contract life, and build up fewer future policy benefits than the cancer block does. So, to the extent that the mix is contributing more of the medical products to the total, you would expect the incurred claims to increase for the block measured as a whole. So, that's having an impact, too.

The final thing, Tom, which impacts margin quite a bit is the improvement in the number of days hospitalized on our old cancer block. The number of days in the hospital does drive the vast majority of our claims on the cancer block in Japan, and the decline in the number of days hospitalized for cancer has been a significant contributor to the decline in the margin, and that's continued on through today.

Everybody wonders when is the margin going to cease to improve, and I think the margin will continue to improve as long as we get an improvement or a decline in the average days per stay for cancer treatment, and it will slowdown once that trend starts to slowdown. Thereafter, the trend in the mix will rely more just on the straight mix between medical that tends to have lower loss ratios and cancer that tends to have higher loss ratios. So, those are the major factors in my mind that you're thinking about.

Tom Gallagher
Credit Suisse

That's very helpful. I don't know if there's a way to at least ballpark this, but if we think about the acceleration of the margin improvement which appears to be more based on improving the claim trends on medical, which would be the number of days hospitalized, could you quantify what you think that impact might be so we can sort of figure out when that does stabilize, what the sort of sustainable margin improvement would be?

Kriss Cloninger

It's partly going to depend on the actions the Japanese government takes on its healthcare financing practices. They've had in place for a number of year's incentives for hospitals to discharge patients earlier than they have in the past. They're working on declining the average number of days per stay, so they can minimize the healthcare reimbursements to the hospital. So, a lot of the answer to that question depends on what the Japanese government does in terms of managing the national healthcare costs in that country, and I'm not sure I'm a good enough predictor of Japanese political outcomes to give you a hard answer to that.

Operator

Eric Berg, your line is open.

Eric Berg
Barclays Capital

Thanks very much. My question is actually a follow-up to Tom's and directed to Dan. Dan, the gap or difference between the rate of growth that the company is earning and the growth of the in force remains quite substantial. I think the growth of the in force both here and in Japan was the lowest in recent memory. I think it's running about 3%. Obviously, you're not pleased with that, but my question is, are you comfortable with a business model that for the foreseeable future basically involves the company's earnings growth being driven heavily by this margin improvement that Tom and Kriss were referencing, and organic growth in terms of growth of the in force that is very modest? Is that okay, and is that what investors can expect for the foreseeable future?

Dan Amos

It beats not having it. I would say that what it allows us to do is it allows us an opportunity to find ways to build top line growth, and what we have to do is during these periods of time, is to look for better ways. I'm hoping that this acquisition will be one example of a way to ultimately help with top line growth in the US. I'm hoping in Japan and US, as the economy improves, we will be positioned well with all the new accounts that we've opened because of the shelf space that we've created.

I'm hoping in Japan that with the new distribution channel of the banks, which we'll have to see, it's still early to tell, but certainly the post office has potential, there are things that we can do, but I would prefer growing with top line. There's no doubt about that, but I'm glad that we do have this expansion that has taking place to give us an opportunity to do that. Frankly, we see this for several years to come. As you know, Eric, it's been going on for several years. It has made a difference.

However, as you pointed out, which I certainly see is, we have seen slowdown and I relate that a little bit to the economy, and hope that that will pick back up.

Paul Amos

One thing I'd like add to that Eric. The margin improvement has primarily benefited us coming out of Japan where persistency is a lot more stable than the US, and you're going to see, a quicker turnaround in US revenues or a quicker deterioration in US revenues because of the lower persistency of the US business compared to the Japanese business. It takes a lot longer to move the Japanese numbers than it does to move the US numbers. So, that's just something to factor into the equation. That is to say, you know, it gets worse fast in the US, but it can get better faster compared to Japan.

Eric Berg
Barclays Capital

You're saying that's a function of the differing persistency?

Paul Amos

Yes, sir.

Operator

Shobha Frey, your line is open.

Shobha Frey
Putnam

Hi. I just wanted to ask a quick question. You seem confident enough in your business to be spending $100 in the CAIC acquisition, and I was wondering if that confidence extends to resuming share buybacks next year and this is Shobha Frey at Putnam.

Dan Amos

I would say that, this was a strategic fit for us. Let me just say, the answer to your share repurchase, the quick answer is, we won't commit one way or another at this point. My position is that we're interested in keeping that RBC up to protecting capital and strengthen the balance sheet, and at this point in time, I'm not willing to go out on a limb and say what we're going to do.

I think to understand this acquisition; everything came in alignment in a great way because we truly believe this is kind of a perfect situation for us. We looked about building our systems internally and, frankly, it would have taken too long and cost too much, and it was no sense in inventing the wheel when it had already been created, a great wheel out there that we had an opportunity to acquire, and certainly a strong management team associated with that.

So, that's really what's doing it. Again, just to point out, remember that $100 million was the price, but we also got surplus of over $30 million, probably $33 million or so. So I just want to point that out.

Kriss Cloninger

The other thing is that capital Continental American, as a sub of the parent company; it won't be consolidated into Aflac US, and therefore won't have any direct affect on the surplus of Aflac, the life company. It will consume some capital of the parent company, but not a material amount compared to what we were spending on share repurchase in prior years.

Operator

Jack Sherck, your line is open.

Jack Sherck
SunTrust

Thank you very much. Jack Sherck with SunTrust. Just a couple of questions for you. First off, with the new recruitment of sales force in the US, with the luck you're having there of them performing better than your existing sales force or more tenured sales force, do you continue to hire there at kind of the same rate in the back half of the year, kind of in the mid-teens?

Paul Amos

If I have somehow construed that they're doing significantly better, it's really more that the newer associates are focused on newer accounts, where we continue to be successful. Our veteran associates are focused on accounts where they're losing people. It's not that one's making a better pitch than the other. But to clarify on your recruiting point, we have been very well on recruiting traditionally in a down economy. It gives us an opportunity to offer commission-only opportunity to a variety of people who would not have chosen this same career otherwise or may have not listened in the past.

So, I will say that our continued growth at this level really depends upon the labor market, but I hope that we do continue to grow in a strong manner. We're adding better talent than I've seen us add in my tenure here in worldwide headquarters, and I believe it is having a strong effect on our growth within the new account segment.

Dan Amos

I've noticed it's a younger group, which gives me a lot of excitement as I look in the future that that will help us with people.

Jack Sherck
SunTrust

All right. Then my other question was, I saw the other day that the Health Ministry of Japan is planning on upping their cancer screens to about 50% of the population, up from currently about 20 to 30 by 2012. Have they done something like that before or how long do you think it will take to have a positive impact on your business?

Dan Amos

Tohru?

Tohru Tonoike

I'm sorry. I couldn't hear your question. Can you repeat, please?

Jack Sherck
SunTrust

Sure. The other day I saw the Health Ministry for Japan increase their goal for cancer screening to 50% of the population, currently it looks to be about 20% to 30%, by 2012. Have they done something like that before and/or how long do you think for this to have a positive impact on your business?

Tohru Tonoike

That's a continuing effort by the government to get the goal a few years out, and I think that as the government makes efforts, the more local governments, the prefectures are taking similar steps to improve the number of the people who receive the cancer test. So, clearly people's awareness against cancer is rising, so I think that has already taken effect to some extent. But, I can't tell you how much increase I can get from that on the sales of the cancer policy, but I think it is beginning to take effect, and it will continue to do so for a few years continuously.

Dan Amos

I think your point is well taken, that it is very helpful to us. The more they talk about cancer in Japan, the better it is for us in terms of writing cancer insurance. So, it's productive to hear those things. The more they screen for it, the better it is too because, because we catch people in the early stages, and so that lowers our health care cost as well. So, we we've seen this focus.

Just to remind you, going back to the early days, in the early days, we would pay claims and we would not even tell the claimants. We told the family, but it was so taboo, you couldn't even tell people that they had cancer. We were told by the hospital not to tell them, but to tell their family members. Now, we're in a society where they're increasing, as you are pointing out, from 20% to 50% trying to get people involved, so that has changed, and I think it ultimately is very beneficial to us and the Japanese society.

Ken Janke

I'm showing top of the hour at this point. So, we'll go ahead and conclude the call. I hope were able to answer everyone's questions. If not, please take advantage of our toll-free number, either call Robin Wilkey or myself and we'll be happy to continue the dialogue. Thank you and we hope to talk to you soon.

Operator

This concludes today's conference call. You may now disconnect.