S&P Global
Market Intelligence

Aflac Incorporated NYSE:AFL

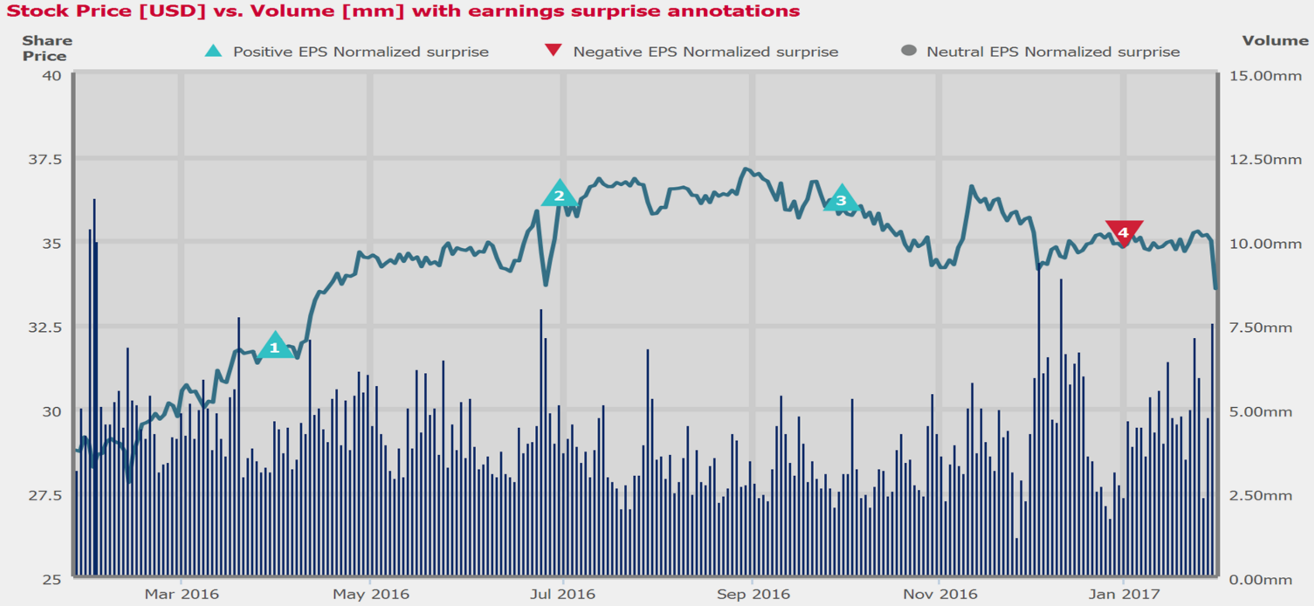
FY 2016 Earnings Call Transcripts

Wednesday, February 01, 2017 2:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2016-			-FQ1 2017-		-FY 2016-			-FY 2017-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	SURPRISE	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	0.81	0.77	(4.94 %)	0.82	3.70	3.42	3.40	(0.58 %)	3.22
Revenue (mm)	5698.67	5955.00	4.50	-	-	22447.67	22559.00	0.50	21266.12

Currency: USD
Consensus as of Feb-01-2017 12:57 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FY 2016	3.42	3.40	1 (0.58 %)

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Call Participants

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Senior Vice President, Investor & Rating Agency Relations

[Audio Gap]

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 Chief Global Investment Officer. Also joining us from Tokyo is Hiroshi Yamauchi, President and COO of Aflac Japan; and Koji Ariyoshi, Executive Vice President and Director of Sales and Marketing in Japan.

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

The earnings release is available on the Investor page of aflac.com and also includes reconciliations of certain non-GAAP measures.

So now I'll turn the program over to Dan, who will begin this morning with comments about the quarter and the year. Kriss and Paul will follow with an update on the operations in the U.S. and Japan, respectively. And Fred will discuss our financial performance for the quarter and the year before we start taking your questions. So we'll begin with Dan.

Daniel Paul Amos
Chairman & CEO

Thank you, Robin. Good morning, and thank you for joining us. Let me start off by saying 2016 was another great year for Aflac. What's been an advantage for more than 6 decades and what sets us apart from every one of the competitors is our distinct product focus on voluntary and supplemental insurance in both the U.S. and in Japan. That focus has been a major factor in our success, and I believe it will continue to drive 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 4.7%. I think this is especially worth noting given the historically low interest rate and the disciplined investment in our U.S. and Japan platforms with the goal of driving future growth and operating effectiveness.

Because we're reporting year-end results, you'll hear from Teresa and Paul today about the 2 operating segments: Aflac U.S. and Aflac Japan. But let me first say that I'm pleased with the overall results of 2016 and I'm proud of the hard work and accomplishments our management team, the employees, our sales distribution in Japan and the United States. I believe both business segments are well positioned to achieve the performance goals communicated on the December outlook call.

Turning to the capital management and deployment. Fred will provide more details shortly, but I will share a few highlights. First, as we've said, we view growing the cash dividend and repurchasing our shares as the most attractive means for deploying capital, particularly in the absence of any compelling alternative. Our plan for 2017 is to repurchase in the range of $1.3 billion to $1.5 billion of our shares. As I said last quarter, 2016 was the 34th consecutive year in which we've increased the cash dividend. Our objective remains to grow the dividend at a rate generally in line with the increase in operating earnings per share on a diluted basis before the impact of foreign currency.

You've heard me say that my job is a balance of the interest of all stakeholders. I think we did a good job in 2016, just as we have in the past, and I believe we're going to do that in 2017 by delivering on our promise to the policyholders and enhancing our shareholder value.

Now I'll turn the program over to Teresa, who will give you an update on Aflac U.S. Teresa?

Teresa Lynne White
President of Aflac US

Thank you, Dan. 2016 was the most profitable year in Aflac U.S. history in terms of pretax earnings. This was particularly notable as we invested over $20 million in our group technology platform. We've begun to see our platform investments pay off in the form of improved persistency and customer satisfaction. 95% of our policyholders who use One Day Pay say they're likely to refer other people to Aflac, which will continue to differentiate and reinforce our strong brand and policyholder's trust.

We've also increased our career agents' adoption of our everwell enrollment platform, which, in turn, has increased accounts and attrition in our accounts with less than 100 employees.

Despite our progress and profitability, I am disappointed in the U.S. sales results for 2016. While we wrote almost $1.5 billion in new premium, we did not achieve our 2016 sales growth target of 3% to 5%. The career agent channel underperformed for the majority of 2016. Sales to groups with less than 100 employees, which is a focus of our career agents, were relatively flat for the year. However, over the past 18 months, I've witnessed the positive correlation between sales and compensation, so those sales leaders who've done really well have been rewarded, and those who've not done well have caused significant turnover. This results in a short-term disruption. However, these changes are better for Aflac in the long run.

Moving into 2017. We'll continue to focus our career sales agents on groups with fewer than 100 employees. I believe this market is Aflac's to grow because our carrier sales agents are best positioned within the industry to reach and therefore, succeed with these smaller employers.

We'll also continue on improving the productivity of new recruits as we did in 2016. Recruiting fell more than we would've liked, but I continue to believe that this approach will not only continue to improve the productivity of our recruits but also their retention. Ultimately, our efforts will lead to longer, more productive Aflac careers.

Looking to broker business. While we did have an increase in the broker business, the broker pipeline did not materialize as we expected. Sales in the middle market, or groups of 100 to 999 employees, were negative, whereas broker sales to groups with 1,000 or more employees experienced double-digit percent growth in 2016.

In the end, the final few weeks of December were just not strong enough for us to achieve our sales goals. Based on this success that we've had in the large account market, we plan to expand our broker team by 25% by adding more than 30 positions in 2017 to include additional roles designed to focus on that mid-market space. This was an area that we struggled in, in 2016, especially as we made a conscious decision to be a bit more selective in the sale of our group product in smaller account segments. With the additional roles designed to focus on this mid-market space, along with process efficiency gains, we believe we can profitably grow this segment.

While disappointed in 2016 sales growth, we remain committed to the fundamental strategies designed to balance growth and preserve our margin. It's important to realize that fourth quarter 2016 was the second-largest sales quarter behind fourth quarter 2015 in absolute dollar terms in Aflac U.S. history. As we continue to evolve from one channel focused on the small case market to a multichannel operation with the emphasis on growing the broker channel, I'm reminded that it does take time. The broker channel has a 3-year compounded annual growth rate of 12%. However, it only represents 30% of our business. And sometimes, our size masks the progress that we've made in that channel. Our goal is to grow it fast while maintaining the stability of our career force.

In closing, I will reiterate that we continue to target the long-term compound annual growth rate of 3% to 5% that we provided in our December outlook call.

Now let me turn the program over to Paul.

Paul Amos

Thank you, Teresa. Next, I'll provide highlights from Aflac Japan's operations, which had a profitable year in terms of pretax earnings. We did, however, face headwinds due to the persistent low interest rate environment and absorbed a fourth quarter reserve adjustment, which impacted overall profitability. Fred will discuss the financials in detail later, but I would note that we anticipate that low interest rates will remain one of the biggest issues facing the Japanese life insurance industry in 2017.

I'm very happy with Aflac Japan's strong annual third sector sales increase of 4.1%, which is at the high end of the 2016 expectation of flat to up 5%. These results were impressive considering we upwardly revised our sales targets twice in

2016. Aflac Japan produced solid results across all channels and further affirmed its leading position in the third sector market.

On the product side, we're excited to report that cancer insurance sales were up 8.5% for the year. Second half sales results also benefited from the July introduction of a new third sector product called Income Support Insurance. As you'll recall, this product provides fixed benefit amounts should a policyholder be unable to work due to significant illness or injury. It was developed to supplement the disability coverage provided through Japan's social security system. Our Income Support Insurance targets consumers in their 20s through 40s, which is a segment of the population where we've been underrepresented. Income Support Insurance was received favorably and has the potential to gradually develop into a new product pillar over the long term.

Turning to the interest rate-sensitive first sector products. You'll recall that we proactively pulled products from select channels and aggressively repriced our WAYS and child endowment products, factoring in the reality of a prolonged low interest rate environment. Aflac Japan made notable progress in 2016 to limit the sale of first sector savings products. As planned, our actions prompted a 57% decrease in sales of first sector products in the second half of the year.

Regarding our distribution channels. Our traditional agencies have been and remain vital to our success, and this was certainly true throughout 2016. Our alliance partners also made significant contributions to our sales results. I am particularly pleased that in October, Japan Post began selling our new cancer insurance product designed exclusively for cancer survivors. Our traditional agencies started selling the product in March of 2016. We anticipate the sales of cancer insurance for cancer survivors will provide marginal benefit to our overall sales. But more importantly, it will bolster our brand, trustworthiness and reputation that we worked hard over the years to establish.

Being there for Japan's consumers when they need us most is our top priority. Our strategic alliance partners have been successful at selling Aflac products in 2016. Given current results that prompted intense focus on moving their own products to meet Japan's fiscal year-end goals, sales of Aflac's third sector products in the first quarter will be impacted. As we look ahead, Aflac Japan's focus will remain on selling our third sector products, which are less interest rate-sensitive, and on strengthening our leading presence in places where people make their insurance buying decisions.

We'll continue to refine our existing product portfolio and introduce new innovative third sector products to maintain our market leadership. Near term, this includes the February 20 launch of our revised EVER and gift products. As we communicated on our December outlook call, we view Aflac Japan's long-term compound annual growth rate in third sector as being in the range of 4% to 6%.

Now let me turn it over to Fred.

Frederick John Crawford
President & COO

Thanks, Paul. First, let me say that I'm pleased with the overall financial results of the company for both the quarter and the year. Our earnings results for the full year exceeded our expectations going into 2016. Operating EPS on a currency-neutral basis was up 4.7% for the year and within the increased guidance range communicated on our third quarter call. Our earnings results are particularly noteworthy considering proactive investments in our business model, the Bank of Japan's actions early in the year and a fourth quarter reserve strengthening.

Turning to the fourth quarter results, there's a few items worth calling out that negatively impacted the reported earnings. First, as mentioned during both our third quarter call and our outlook call, we completed our year-end actuarial review of interest-sensitive blocks of business in Japan. There are 2 smaller blocks of legacy third sector business that have been subject to strengthening in the past years due to continual interest rate declines. The specific strengthening in the quarter was on a closed block of business we refer to as Super Care and resulted in a charge of JPY 6 billion or roughly $0.08 per share. It's important to note that this is a gap-only impact and does not affect FSA reserves, cash flow or core capital ratios.

Additional items that negatively impacted the quarter include corporate expenses, which were elevated as a result of stock compensation expense and accelerated amortization due to retirement eligibility. In addition, elevated interest expense related to our debt issuance in September, which prefunded maturities in February. Together, these items amounted to roughly $0.03 a share in the quarter. If you exclude only the reserve strengthening in Japan, our fourth quarter operating earnings per share were within the expected range provided in the third quarter.

Our Japan segment margins were solid when adjusting for the reserve strengthening. Benefit ratios, expense ratio and pretax margins were all in line with recent results and our outlook called guidance. I would note that going forward, our ratios and margins in Japan will reflect hedge costs on an amortized basis related to Japan's dollar investment portfolio.

U.S. benefit ratios continue to trend favorably for the quarter and the year, and our expense ratio was in line with our guidance and reflecting progress on certain strategic initiatives and increased promotional spend. Overall, our U.S. pretax profit margins exceeded our annual guidance range for the year coming in at 19.6%.

Turning to investments. Results for both the quarter and the year were aligned with our expectations as we continue to navigate the low yield environment in Japan and further diversify our portfolio. As we discussed during our outlook call, we successfully executed on a comprehensive plan to address strategic and investment challenges: First, as Paul mentioned, curtailing interest-sensitive premium flows by reducing the sale of first sector savings products; second, timely execution of a successful switch trade designed to shift our U.S. dollar investment strategy more toward floating rate assets in order to more effectively hedge and optimize investment income; and finally, we lengthened the duration of our hedge program through purchasing longer-dated forwards. This provides -- proves to be a good timing as we locked in 90% of hedge costs for 2017 and just over 30% of 2018 costs prior to an increase in costs coming off the presidential election. These moves result in lower investment income in Japan in the near term while we work to reinvest into higher-yielding and floating rate assets but are designed to reduce volatility in quarterly earnings, cash flow and capital ratios.

With respect to Japan's dollar program and hedge costs, our reported fourth quarter costs were $62 million pretax on an amortized basis. As discussed on the outlook call, we adopted an amortized approach in the fourth quarter to reflect a full year 2016 and to adjust the past periods. As mentioned earlier, we are moving these costs into our operating earnings definition for 2017. We are maintaining our guidance for 2017 pretax hedge costs in the range of $250 million to $270 million, assuming no change in our strategy.

In terms of our capital position. Despite market volatility in the quarter, we ended the year with strong capital ratios with SMR and RBC estimated in the mid-900% range and mid-800% range, respectively.

We ended the year with $1.5 billion of excess liquidity at the holding company, which includes $500 million of contingency capital. Overall credit conditions and asset quality remain strong with only a modest level of impairments in the quarter.

I'm pleased to say we continue to return a significant amount of capital to shareholders. Including dividends and share repurchase, we returned approximately $2.1 billion to our shareholders in 2016. As we mentioned on our outlook call, we expect to deploy capital in the range of $2 billion to $2.2 billion to shareholders in 2017. This includes $1.3 billion to $1.5 billion of share purchase with approximately $800 million to $1 billion of repurchase in the first half of the year. As is always the case, this assumed share purchase remains the optimal use of excess capital in driving long-term shareholder value.

Finally, I want to reiterate our 2017 earnings guidance of $6.40 to $6.65 per share on a currency-neutral basis. I would note that our final currency-neutral exchange rate came in at roughly JPY 109 to the $1, or JPY 1 lower than the JPY 110 we used on the outlook call. Similar to last year, we did not adjust the rounded range for the few pennies of additional annual earnings. To be clear, our planned earnings are essentially unchanged, and it's safe to assume we added a few pennies to our actual forecast accordingly. In addition, our sensitivities to a given change in yen were updated as we refined our modeling of the foreign exchange impact on locked-in hedge costs in preparation of installing into our reported operating earnings.

Looking ahead, we remain well positioned in terms of core margins and capital strength consistent with our December outlook call comments. I'll now hand the call back to Robin.

Robin Y. Wilkey
Senior Vice President, Investor & Rating Agency Relations
Thank you, Fred. Now we're ready to take your questions. But please, let me remind you that to be fair to everybody in the queue, limit yourselves to one initial question and only one follow-up that relates to your initial question. We'll now begin taking the first question.

Question and Answer

Operator

[Operator Instructions] Our first question is from Nigel Dally with Morgan Stanley.

Nigel Phillip Dally
Morgan Stanley, Research Division

First question is on guidance. Well, when the yen is at JPY 115, the midpoint of the EPS guidance, it seems that we have declined $0.09 from what you provided back in December. Just hoping you can discuss what drove that change.

Frederick John Crawford
President & COO

Yes. So a couple things, Nigel. So your comment is really relative to sensitivity. What's changed is in the course of working towards installing hedge costs into our operating earnings in 2017, we refined our model to reflect having locked in those hedge costs effectively prior to entering 2017. What happens is that has the effect of essentially locking in a dollar-based expense at the time of that transaction. And so the way our actual results end up playing out, because we've locked in those hedge costs, is effectively reducing the dollar coupon income, if you will, in Japan. This has the effect of increasing the relative yen earnings to dollar earnings and therefore, increasing the sensitivity. This is a very nuanced issue, but it has less to do with the nature of hedge cost and amortization and more really to do with the fact that we have locked in those costs with a fixed exchange rate that therefore, does not float throughout the year. So it has the effect of increasing our relative yen revenue and earnings, if you will, relative to our total. What I would tell you is this, both the hedge costs in our operating earnings as well as the strategy of locking in longer-dated hedges are both new strategies. And as we go through the year, we're going to watch very carefully these sensitivities. And obviously, as we see them move around, we'll adjust, if necessary, but this is our best estimate at the moment.

Nigel Phillip Dally
Morgan Stanley, Research Division

Okay, I got it. Then the follow-up is just on U.S. recruited agent. You touched on it briefly in the earlier remarks, but it seems to have dropped to the lowest level we've seen in many years. So just hoping to get some additional color as to what's going on there and whether that's also a contributing factor to the sales challenges.

Teresa Lynne White
President of Aflac US

And Nigel, specifically on recruited agents, if you recall in my comments last year, we talked about making sure that we drove agent productivity. So we're looking at this from a long-term perspective. What we saw as our focus was on productivity is an increase in the productivity of the agent. We saw an increase in new associate AP. We saw an increase in new accounts. And so those were all positive that we saw as it relates to recruited agent. What our data supports is that we know that we have a stronger -- a strong correlation between lifetime tenure with Aflac if the agents get started off and they get -- they start off well. And so that was really the focus there. We did have broker recruiting as well. We actually increased our penetration in our current brokers as well and so we focused on that. Now that's not to say, though, that in 2017 we have a focus on recruiting. But what we wanted to do is we wanted to fix that front-end funnel so that we could make sure that the people who are recruited in had a likelihood of staying with us, and we are seeing the retention of an agent coming in going to year 2 increase. And so that's really what we were solving for.

Operator

Our next question is from Jimmy Bhullar with JPMorgan.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

First, Fred, I just had a question on just if you could give us some color on your forward rate assumptions that you're using and the Super Care block in terms of reserves. And under what situation would you -- could the charges that you saw this quarter repeat? And just give us some idea on what you're assuming and how often you re-assess the reserves.

Frederick John Crawford
President & COO

Sure. So this is an annual process that, as you may recall, has gone on for years. And of course, I don't have the history, but many around the table here do and so do many of you as analysts. But for over the past 10 years or so, we've periodically added to reserves both on this block, but also on a dementia block and typically for similar reasons, the persistently lower interest rate environment in Japan. So to that degree, it's not unusual. These tend to be blocks we focus in on in low rate environments, not surprisingly. What we did more specifically is we took the long-term new money rate assumption down around 22 basis points. We took it down from roughly 175 to 150, 1.5%, and realized that the new money rate assumptions include both yen investments as well as the dollar program and also, in corporate hedge costs, which back off those dollar coupons. So it's really looking at the investment strategy. What's very unique about Aflac and somewhat a testimonial to the conservative nature of the company is that we also tend to have a practice of leaving those low rates long forever. In other words, we don't assume a recovering rate out into the future, which would make a difference in the level of charge. And we do that simply to be conservative but also to some degree, to put this type of risk behind us as we look at the assumptions. So that amounted to the charge. And so in other words, your portfolio yield eventually grades down to the 1.5%. In terms of future rate risk, of course, that's going to be dependent upon what we see going on in Japan. We'll do the same thing we do every year, which is test the reserves according to the rate environment. We've seen some very recent recovery. But as often the case, we tend not to be shifting around our assumptions based on short-term moves in rates, down or up. But we felt the Bank of Japan action earlier in the year was fairly significant. And it's somewhat recast a new rate environment for us, and so we felt it really prudent to recast our long-term rate assumptions. That's not always going to be the case. The only other thing I would tell you is I realized on this particular block, its 4% of our reserves. So back together with dementia, that's less than 10% of our reserves. And there is really no rate risk with the majority of business that we have in Japan. There's very little, if any, rate risk in the U.S. And that really, what we're talking about here is a gap testing process. While we do test statutory and FSA, the reserves are quite adequate there. The margins are strong, and we don't see risk in our core capital ratios. If that helps you out, hopefully, it gives you the information you need.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

Sure. And then maybe just for Teresa, what's -- there's a lot of talk, obviously, of changes in the health care landscape in the U.S. What's the risk that the whole uncertainty about what the changes are going to be pressures your sales this year as small businesses sort of defer the decision to add additional benefits? Are you seeing some of that in the market? And do you expect -- is that factored into your assumption for sales growth this year?

Teresa Lynne White
President of Aflac US

Well, I'll tell you, there's a lot of talk about it, but I don't have enough evidence to say whether it will impact sales or not. I have some meetings in the next couple of weeks with various broker partners, and I'm also talking to various folks in our field force to really just understand what they're hearing and what they're seeing. But at this point, I think it's still early yet, and I don't know that I can assign that as a cause or put any factor on that as it relates to U.S. sales.

Operator

Our next question is from Mr. Humphrey Lee with Dowling & Partners.

Humphrey Lee
Dowling & Partners Securities, LLC

Just to follow up on the U.S. sale. Can you talk about a little bit in terms of why you're seeing the weakness in the mid-case market?

Teresa Lynne White
President of Aflac US

Certainly. So we saw the less than 100 as relatively flat. Mid-case market, as you are aware, is really serviced by both our veteran agents, and we have a number of veteran agents, who have existing accounts in that mid-case market. But also, it's serviced by our broker partners. We've seen a lot more brokers move into that space. One -- a couple of things that we're doing in 2017. I explained that in 2016, our focus was on new and building that front-end of the funnel. And

I think that we took the eye off of that mid-case market, specifically from a veteran perspective. And so we're driving some incentives to the mid-case market from a veteran perspective to allow them to be able to go back into their existing accounts and drive sales there. But the other piece of this is that as brokers have moved into that mid-case market, what we found is we were really underpenetrated from a broker sales professional perspective. So we call the people who are salespeople for Aflac broker sales professionals, and we need to make sure that we actually can execute in that market. So we're going to increase the number of people, 25% increase in the number of people in that broker -- for -- at broker sales professionals to basically target the mid-case market. So I think it's really more about underpenetration in that area.

Daniel Paul Amos
Chairman & CEO

I'd also like to respond on that one moment. One of the things that we made a decision on, and Teresa note -- played a big role in this, is the 100 to 250. We made a conscious, anxious decision not to write that on the group platform. Now one reason we did is our manual -- so much of our systems over there is manual, and that's why we spent $25 million to invest in the future. We found out the 100 to 250, we were making basically 0 profits or losing a little bit. And it was also taking time away from our accounts of 1,000 or more from a service perspective. So she made the call to concentrate on the 1,000, and that's why you've seen a 12% compound growth in the 1,000 or more. So will we eventually go back to the 100 and 250? Yes, when these new systems are put in starting January 1 of next year. But we have moved away from that unless we have such a big block of business from a certain broker. And then we are taking that on as an entire block to keep them happy. But service is the issue there as well as profitability.

Humphrey Lee
Dowling & Partners Securities, LLC

Got it. And then maybe shifting to Japan a little bit. The cancer sales continue to be pretty strong in -- throughout 2016, and I know part of this is because of the new cancer survivorship product being well received. But how much is it -- would you consider is just because the reception being better than expected? Or will it be part of it because of Japan Post continue to be delivering better-than-expected production relative to your baseline assumption?

Paul Amos

Humphrey, thank you for the question. This is Paul. I will tell you that it's a combination of all factors. First of all, cancer sales are not up just because of Japan Post or just because of the new product. No doubt, the new product was additive, and Japan Post has continued to produce in a manner that is in line with what we would expect and more. We can't get into the specifics about any of their numbers. But what I can tell you is that the Japanese consumer continues to see cancer as a productive line of business that is positive for them and continues to see -- we continue to see across the board demand for the product. And so we remain optimistic, obviously, as the numbers on this particular product, in this particular launch of our cancer product over time will dissipate. But as you know, we always are looking to reinvent our products and launch new versions of those. And so just as we've announced on February 20, we'll launch a new medical as well as a new first sector protection product in our gift plan. We will look in the future to eventually launch a new cancer plan, and we have every belief that the long-term viability of cancer as a line of business remains extremely positive.

Operator

Our next question is from John Nadel with Credit Suisse.

John Matthew Nadel
Crédit Suisse AG, Research Division

A question on the U.S. market. And -- so clearly, a shift toward the larger cancer market. I'm just curious whether we should expect that the margin on sales generated to 1,000 lives or bigger groups should be similar or probably, I'm guessing, lower than the margins you will generate at the lower end of the market just given everything from competition at the upper end.

Teresa Lynne White
President of Aflac US

Well, this is Teresa. One of the things that we're looking at is we've said that the group would have slight -- it's probably very similar, but slightly less than our margins on the individual side. And today, as Dan talked about, what we're really trying to work on is the things that the press and the margin right now is more about administration. And so as we work on administration, I think we can move the margins back to where we price them.

Frederick John Crawford
President & COO

That's right. And I would just add to that, that there is a competitive landscape, no question, in the larger case market in general. And we'll have to be mindful of that, but realize that the types of returns we're generating are quite comfortably well above our cost of capital and additive. But Teresa is exactly right. What you'll find in a lot of companies is pricing for your aspirational expense base as opposed to pricing for your actual expenses, and Aflac's practice is to price according to what we're seeing in the way of administrative expenses. So many of the investments that Dan mentioned and Teresa just noted are designed around solving for a more efficient platform that creates the dynamic of improved returns going forward.

John Matthew Nadel
Crédit Suisse AG, Research Division

And just as a quick follow-up on that. How big is the differential right now in sort of price for margin?

Frederick John Crawford
President & COO

Todd, I don't know whether you've got a view on that in terms of the differential on margin. I'm going to say at least a few hundred basis points. Yes, that's about right. But -- I don't want to guess, but Todd's nodding, so something in the neighborhood of 200 to 300 basis points would not be unusual.

John Matthew Nadel
Crédit Suisse AG, Research Division

Okay, that's helpful. And then a question for Dan. Dan...

Frederick John Crawford
President & COO

Realize, by the way, that -- hey, John, realize, by the way, that's starting from a very high return base on our core business. And so it's not like we're talking 10% to 7%. We're talking about mid-teens and seeing 300-basis point differential in pricing.

John Matthew Nadel
Crédit Suisse AG, Research Division

Yes, I understand. And then -- and Dan, just had a question for you on the outlook for dividend growth -- common dividend growth. You've talked for a long time now about targeting increases in the dividend over time in line with the operating income growth ex currency. But I think by your own guidance for 2017 and certainly by our estimates, your operating income will be flat to down, EPS may be modestly up given the buyback. Should we expect that maybe 2017 is a year where the dividend is flat?

Daniel Paul Amos
Chairman & CEO

No. I think you should look for an increase in the dividend. Where or how, I'm not exactly sure where it'll end up. But as you know, we tend to be a little on the conservative side, and we always are very attuned to our individual shareholders. And that is, of course, we have much more institutions today, but they are still a part of our company and so we're always trying to find ways to make sure the dividend's growing.

John Matthew Nadel
Crédit Suisse AG, Research Division

Okay. And if I could follow up one more quick one. If you didn't hedge 90% of the costs -- if you didn't lock in 90% of the costs for the hedge program for 2017, how much higher today versus, preelection, would those hedge costs be running?

Frederick John Crawford

President & COO

I'll toss to Eric, on that, John, who can comment on what we're seeing.

Eric Mark Kirsch
Executive VP, Global Chief Investment Officer & President of Aflac Asset Management LLC

Yes. From election to now, I'd say it's about, on a 1-year basis, 20, 25 basis points. Keep in mind, the long end of the curve went up a lot since the election. The short end really has not moved all that much because it's still based on short-term rate differentials. And on that basis, with the Fed's actions that they did in December, were very much expected by the market. But the increase was more or less in line with our expectations in either of that.

Daniel Paul Amos
Chairman & CEO

One other thing I just want to mention. One thing also that drives our interest in that dividend is we're an elite group of people with going 34 years of continuing increases in the dividend. So I wouldn't want to stop it for that either.

Operator

Our next question is from Erik Bass with Autonomous Research.

Erik Bass

First, just for Teresa. You've given some of these numbers, but I was hoping you could just provide a couple more. In the U.S., can you just give the sales growth detail for group, I guess both the 1,000 lives as well as the mid-market, as well as what the growth was for the individual or small case? And then also, roughly how much does each channel contribute to your overall sales volumes?

Teresa Lynne White
President of Aflac US

The mid-market was actually -- are negative. We were in the negative there and -- negative single digits. Flat in the less than 100, and we had double-digit increases in the greater than 1,000. And I can give specifics offline. Now the other thing is the large majority of our business sits in the less than 100 category. So that's where we have the majority of our business, and then we go up to the mid-case and then the larger case. Our challenge right now is, from a broker perspective, whereas Aflac is very heavy 70% career, 30% broker production, most of our competitors are just the opposite. And so our base is a lot bigger as far as the core, which then drives us to have to overcome that big base. The other thing is just when you look at the -- or the 100 to 999, if you just pull that out and you look at 250 to 999, that was relatively flat as well. So there's a specific area within that 100 to 250 that we saw the level of decrease, and that's where we're really focusing. And we believe some of that was primarily the instance that Dan talked about, which was the 100 to 250 space, where we decided to be very selective in what we've sold from a group perspective in those smaller case markets.

Daniel Paul Amos
Chairman & CEO

It was self-inflicted, to a great degree.

Teresa Lynne White
President of Aflac US

Yes.

Erik Bass

Got it. And then just one follow-up for Paul. You mentioned the new EVER product you're coming out with. I don't know how many details you can give at this point, but do you characterize it as sort of a major revision or just minor tweaks to the product?

Paul Amos

Yes. This is more of a major overhaul. We traditionally -- over about a 3-year period, we'll do both minor revisions or additions of small riders as we did in about 18 months ago. We -- this particular revision is one that is more significant in nature. That said, as we talked about both at mini fab and otherwise, the competitiveness of the medical market continues to be strong. And so we feel that while this product will be additive to sales, I'm tempering excitement somewhat in the overall product launch. But I feel like that for most of our channels, it will be strong. Keep in mind, however, as we think about our strategic alliance partners, be it Dai-ichi, be it Japan Post, Daido Life and others, they don't sell our medical product. And such a large percentage of our sales continues to be focused on cancer, and that's something you have to keep in mind as you look at the product launch of EVER itself.

Operator

Our next question is from Ryan Krueger with KBW.

Ryan Joel Krueger
Keefe, Bruyette, & Woods, Inc., Research Division

I had one for Fred. Do you have an update on how much of the $2.5 billion floating-rate U.S. dollar portfolio that you've added so far?

Frederick John Crawford
President & COO

So -- yes. So I think you're referring to the switch trade that we did last year, where we sold out of U.S. dollar bonds, went into JGBs, and then now feathering our way back into a floating-rate portfolio. I'm assuming that's what your question is.

Ryan Joel Krueger
Keefe, Bruyette, & Woods, Inc., Research Division

Yes. Just how much have you done so far.

Frederick John Crawford
President & COO

Yes, yes. So very little, very little. It will build throughout the year. In fact, I'll answer -- give you some additional detail. Our estimate of the drag to net investment income in 2017 related to the switch trade is running right around $0.08 to $0.10 for the full year. And the difference in that range will have to do with the pace of putting that money to work. We're actively engaged in both qualifying and starting the process of preparing to fund as good loans come our direction. And really, emphasis on that last piece, and that is the pace of it is not -- we're not in a rush, if you will, to put money to work in ignoring, if you will, the credit fundamentals. These tend to be, by definition, BB-ish type investment credit ratings, and so you want to be particularly careful that you put it to work in a measured way. So we've been somewhat conservative and practical in that build the portfolio and expect it going throughout the year. Eric, if you've got something to add, please do.

Eric Mark Kirsch
Executive VP, Global Chief Investment Officer & President of Aflac Asset Management LLC

Yes. I would just add a couple of comments. In our planning, because we are forming more partnerships with lenders, if you will, both for middle market loans and transitional real estate -- and I should mention that transitional real estate, by and large, is investment-grade versus the middle market loans that are BB. But in our planning relative to the guidance that Fred's previously given to you is an assumption that these start to fund by the end of the second quarter. To the extent we're able to get them online sooner, that will be a net positive to our earnings for the year. But we were conservative because, as Fred said, we want to be conservative on the underwriting. We like underwriting. We like credit risk. We think we do that well. But because it's a larger core allocation, we also have to be just as careful around onboarding and starting the process of more volume of those. So it's conservatively estimated, but it will be a net positive to our net investment income after hedge costs. So while we took a short-term decline in net investment income, long term, this is a very good relative value proposition for our program.

Ryan Joel Krueger
Keefe, Bruyette, & Woods, Inc., Research Division

And then one more for Teresa. I guess, you have a long-term U.S. sales target of 3% to 5% growth. Given some of the initiatives you're working on for 2017, do you think that's achievable this year?

Teresa Lynne White
President of Aflac US

I'm certainly still -- feel like we're still going to be within the range of the CAGR that we provided. So, absolutely. Now I'm going to tell you, we're going to have a tough first quarter. I do want to say that. But I feel pretty good about the -- what we've already talked about, the guidance.

Operator

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

Randolph Binner
FBR Capital Markets & Co., Research Division

I wanted to ask you a question about the benefit ratio and kind of loss margins in Japan. Those -- that benefit ratio is higher in our model than it's been several quarters just on a core basis. And my kind of understanding was that utilization trends have just been very favorable in Japan and that I kind of expected that benefit ratio to stay where it had been, maybe even work lower. So the question I have is, was there anything unusual in the kind of benefit and loss activity in the fourth quarter outside of the Super Care charge? And can I get an update on how loss trends and utilization is going in Japan? Hospital utilization is mostly what I'm referring to.

Frederick John Crawford
President & COO

Yes. I think -- I'll answer a couple of the questions, and then certainly welcome Todd Daniels to comment on sort of utilization trends if he has more color to add. But just a couple things, and you hit on it, Randy. So first, recognize that the reported benefit ratio to premium, the 74%, that if you adjust for the reserve strengthening, that comes down to around 72.5%, 72.4% and is actually consistent sequentially with what we recorded in the third quarter. Now it is a tick-up from the fourth quarter last year, but that's not unusual that you'll have those types of fluctuations as you're doing IBNR adjustments and the like every quarter, frankly. So that's what I mean by saying that, that core benefit ratio, when adjusted for the reserve strengthening, is in line with our expectations in Japan. In terms of utilization and overall trends that are driving the benefit ratio and hospitalization trends, they have, indeed, been favorable albeit that over time, they naturally start the process of plateauing a bit, meaning that you eventually start to see it stabilize, but at these favorable rates. So we do see pockets of improvement, but maybe not as material as there have been historically. But, Todd, do you have anything you want to comment on?

Todd Daniels

Yes. I'll just mention, too, that for the year-to-date benefit ratio when adjusting for the Super Care adjustment was 72.2% as a ratio to premium, and that's still trending lower versus what we saw in '14 and '15. And regarding the utilization, we are continuing to see hospitalizations trend in a positive manner, and so we are reflecting that periodically as we do our reserve testing.

Randolph Binner
FBR Capital Markets & Co., Research Division

Just as long as I have you on utilization, on the U.S. side, the margins were pretty good. Any update on utilization trends there? Because that's also been a tailwind, I think, last couple of years.

Frederick John Crawford
President & COO

Yes. And I think there is a slightly different story. There are those fundamental trends that have been positive, but there's also a mix of business dynamics playing into it. Todd, again, I'll ask you if you have any [indiscernible].

Todd Daniels

That's right. There's some mix of business playing into it. As Fred mentioned, I think in the prior quarter, we have tended to sell more products with these guarantee issue features. And as we went into some of these products, we were relatively conservative with these -- pricing these during these guarantee issued periods. And we've seen some favorable experience with that. So as our mix of business has shifted to more products with those features, we have seen the benefit ratio come down. I will say, as we look at things on an overall lifetime basis, we do see these ratios moderating a bit. I wouldn't expect an increase in 2017. However, I think we're still going to see a continuation of the benefit ratio we saw in 2016.

Frederick John Crawford
President & COO

I think one thing I would add. And again, I realize that any particular quarter does not tell that full story, but just don't lose sight of the fact that there is some level of correlation between record U.S. profits and profit margin and our sales progression. And that is one thing that we have not let our guard down on is really a couple things: One is pricing with a level of conservatism; focus on high-quality business. And we're not going to chase competitive dynamics in pockets where we think it's not the right kind of business for us. And so again, it's a long-term plan of that type of discipline that yields the kind of earnings results in the U.S., but there is a correlation.

Operator

Our next question is from Suneet Kamath with Citi.

Suneet Laxman L. Kamath
Citigroup Inc, Research Division

Just wanted to ask a couple more on the U.S. Teresa, in your prepared comments, you talked about some turnover disruption I think associated with the -- some of the senior leadership. How long do you think that's going to take to fix?

Teresa Lynne White
President of Aflac US

Well, I believe we've put in the performance management plan in the 2014, I think, is when we started it. So we had our full year in 2015, 2016. We basically are correlating sales growth with compensation. And those that are in those roles, we also had some retirements as well, so I need to say that. But our goal is to make sure that when people move into those roles, they understand the dynamics of the market, they understand how the market -- what they need to do within the market. And so obviously, when something is just -- is put in, you're going to have a cycle of more moves than you have ongoing. So we hope to stabilize within 2017 to see what we have. We've been seeing a lot more competitors wanting to come in -- come to our -- to join the markets as well, and so we're hoping to see that that's stabilized in 2017. But again, it's really all about whether this -- whether the performance is where it needs to be.

Daniel Paul Amos
Chairman & CEO

Let me make a comment about that. In the last 18 months, we've had a turnover at the MKD level, which would be equivalent to what we call in charge of the state of 50% of the people. As Teresa said, it was either due to retirements or it was due to lack of income that they were used to because their sales were not where they should be and therefore, they made a lot less money. Because of all these openings, we've had opportunities not only to fill them with our people, but we've had a lot of the competitors come our way and interested in those slots. And Teresa has filled those slots with some key people that are growing our business -- or that we expect to grow our business in 2017. But anytime you've got a lot of changes like this, it does take a little time. And as Teresa said, it makes a little bit harder the first quarter because of all these changes and so hopefully, we'll see it...

Teresa Lynne White
President of Aflac US

Stabilize through the year.

Daniel Paul Amos
Chairman & CEO

Okay?

Suneet Laxman L. Kamath
Citigroup Inc, Research Division

Yes, that's fine. I had one follow-up actually again, either for you or for Teresa, I guess. A couple years ago, we spent a lot of time talking about conflict between the brokers and the traditional agents. And some of the comments you made earlier, particularly in that mid-case market, it sounds like both of those distribution channels are participating in that mid-case market. So I guess the question is, are those channel conflict issues behind us now? Or is there still some of that stuff going on in the U.S.?

Teresa Lynne White
President of Aflac US

Well, I don't know that channel conflict will ever be totally behind us from that perspective, but it's not at a fever pitch. I think that our directors of sale, both on the career side, Andy Glaub, who's looking at it from a U.S. perspective but focused on the career side, and then Drew Niziak, who's on the brokers side, there's a tremendous amount of collaboration that's happening. And quite frankly, in various markets, we see that our brokers teams are working collectively with our career teams to enhance what we deliver to brokers as in rollers and et cetera. And so we've seen it work. We see it working. But are there still pockets where we have channel conflict? Absolutely, there are pockets. And really, I think that's where -- it really becomes a matter of understanding where the market is taking us and making sure that we deliver tools and services for each of those -- of the market sets so that we can -- so both of those markets, especially from a career perspective, can grow. And so that's what we'll continue to do.

Operator

Our next question is from Tom Gallagher with Evercore ISI.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Teresa, just a follow-up on what's going on, on the distribution side. Just to be clear, is the high turnover in some of the underperforming regions for the agency channel that you're referring to, is that because they're getting picked off and recruited away by competitors? Or are those people that you're firing that you're pushing out?

Teresa Lynne White
President of Aflac US

Well, the majority of the people that have moved out of those market positions have moved into sales positions. So many of them have decided to move back down into a coordinator-type position within Aflac. So I've not heard of many of them going to competitors if that was your question.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Yes, it is. And then -- so from the standpoint of this turnover and the impact on sales, was a lot of this happening later in the year and that's why 1Q is going to be affected? Just can you talk us through with it?

Teresa Lynne White
President of Aflac US

Right, right. So if you think about it from a sales perspective, we're looking at sales targets by quarter, and the -- most of the volume is hitting in the fourth quarter. And so many of the changes happened within the third and fourth quarter, where we started seeing that people were not going to meet objectives, some of them decided that they would retire, that type of thing. So yes, that's why we are anticipating a little bit more disruption in the fourth quarter as well as in the first quarter.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Got you. And then just, Paul, a question for you. You were referencing the strategic alliance partners in Japan pivoting to their own products into the fiscal year-end as being one of the reasons why 1Q is going to be softer. Can you just comment on your level of confidence that this isn't the beginning of a weaker trend with the alliance partners? That this 1Q dip is not the sign of some kind of signal for where those sales are likely to go in the subsequent quarters as well?

Paul Amos

Tom, I obviously can't get into specifics, but I can tell you I'm extremely confident. The reality is that for the -- their fiscal fourth quarter and of course, kicking off their year, the beginning of the first quarter for them is a second quarter for us, sales could be slightly light. But we know the second half of the year will be strong. We talk to our partners and make commitments internally on an annual basis. As I said, they outperformed the first 3 quarters of their year, ending in the end of last year. As I can't go into specifics, and I don't want to put us in any kind of a precarious situation. All I can say is that I think this is temporary in nature, and it's partly reflective on the success that we've had with our alliance partners, but it should, in no way, temper future expectations.

Daniel Paul Amos
Chairman & CEO

And I will make a comment that I've seen this with Dai-ichi Life. Once they make their numbers, they tend to focus on other things and then set the new numbers for the next year. So the way these numbers will fall out after the first quarter will be in new year. And so they'll be setting the numbers and making those, and that's just their way of doing business from a Japanese perspective.

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

All right. Thank you very much. We've answered all the calls that came in, so please let me just follow up with a couple comments. I want to share with you today, our calendar for 2017 is available on the Investor Relations page of aflac.com. I would also point out that our Financial Analyst Meeting that has historically been held in May has been moved to a September time frame. And this year, it will be held on September 28. That's September 28 in New York. Please feel free to call our Investor and Rating Agency Relations Department with any questions, and we look forward to speaking with you soon. Thank you, and have a good day.

Operator
And that concludes today's conference. Thank you for your participation. You may now disconnect.