S&P Capital IQ

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Aflac Incorporated NYSE:AFL

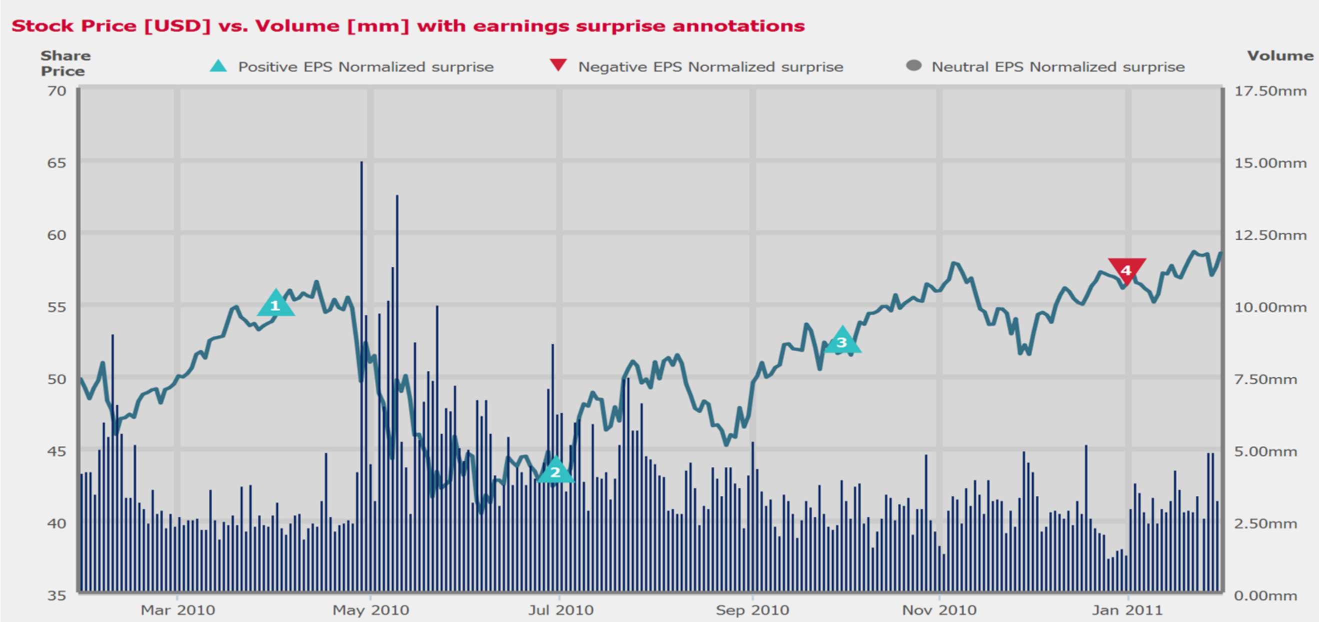
FQ1 2011 Earnings Call Transcripts

Thursday, April 28, 2011 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2011-			-FQ2 2011-	-FY 2011-	-FY 2012-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.51	1.63	▲7.95	1.53	6.18	6.67
Revenue (mm)	5547.43	-	▲2.68	5635.29	22615.94	23323.70

Currency: USD
Consensus as of Apr-28-2011 1:48 PM GMT



	- EPS NORMALIZED -		
	CONSENSUS	ACTUAL	SURPRISE
FQ1 2010	1.32	1.41	▲6.82 %
FQ2 2010	1.33	1.35	▲1.50 %
FQ3 2010	1.39	1.45	▲4.32 %
FQ4 2010	1.35	1.33	▼(1.48 %)

Call Participants

EXECUTIVES

Daniel P. Amos
Chairman & CEO

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

Kriss Cloninger
President & Director

Paul Shelby Amos
Former Director

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

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Presentation

Operator

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

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

Thank you, Diane, and good morning, everyone, and welcome to our first quarter conference call. Joining me this morning is Dan Amos, our Chairman and CEO; Kriss Cloninger, President and CFO; Paul Amos, President of Aflac and COO of U.S. Operations; Ken Janke, Executive Vice President and Deputy Chief Financial Officer; Jerry Jeffery, Senior Vice President and Chief Investment Officer; and Toru Tonoike, President and Chief Operating Officer of Aflac Japan, who's joining us remotely from Tokyo.

Before we start, let me remind you that some statements in this teleconference are forward looking within the meaning of federal securities guidelines. Although we believe these statements are reasonable, we can give no assurance that they will prove to be accurate because they are prospective in nature. Actual results could differ materially from those we discussed. We encourage you to look at our quarterly report for some of the various risk factors that could materially impact our results.

Now I'll turn our program over to Dan, this morning, who's going to begin with some comments about the quarter and our operations in both Japan and the U.S. I'll follow up with a few financial highlights for the first quarter, and then we'll be glad to take your questions. Dan?

Daniel P. Amos
Chairman & CEO

Thank you, Robin. Good morning, and thank you for joining us today. I hope you've had a chance to review our first quarter press release. I'll comment on our operations in Japan and the United States. But first, I'd like to discuss what's been going on in Japan over the last 6 weeks. Clearly, the earthquake and tsunami on March 11 and the subsequent nuclear situation presented Japan with one of the biggest crises it's ever faced. The whole world watched helplessly through television and social media as devastating pictures and news coverage of the disastrous situation unfolded. We've been operating in Japan for more than 35 years. If there's one thing we've found in developing such close ties in Japan, it's that the Japanese people are resilient. And when I visited Japan the week after the earthquake, I saw this resilience. Our employees are safe, our business operations are running, and we do not expect any material impact on claims or earnings this year. Life is moving forward for most Japanese citizens and so is our resolve to be there for our policyholders during their time of need by paying claims just as we promised.

Aflac Japan generated strong results in the first quarter, and we're again pleased with the financial performance of our largest earnings contributor. Revenue growth showed continued improvement rising 3.7% for the quarter. In addition, our pretax margin continued to expand, resulting in solid earnings growth for the quarter. We were particularly pleased with the continued sales momentum in the quarter. In fact, Aflac Japan generated the largest first quarter production in its 36-year history.

New annualized premium sales exceeded our expectations and rose 12.6% to JPY 34.1 billion. With the expanding bank channel in mind, Aflac Japan has developed innovative products that align well with the product needs of banks. Bank sales in the first quarter posted another record with sales of JPY 7.9 billion, which represents an increase of 12.6% over the fourth quarter of 2010 and a 154% increase over the first quarter of 2010. I mentioned how we believe more banks, and mega banks in particular, would step up their efforts in selling Aflac's products, and that's exactly what we've been seeing.

At the end of March, Aflac Japan was represented by 364 banks and more than 90% of the total number of banks in Japan. While many banks have agreed to sell our products, turning that agreement from ink on paper into sales does not happen overnight, especially with more than 20,000 branches representing the 364 banks. It will take some time to facilitate training at all these locations but we're seeing sales steadily improving at many of these banks as training takes place and the banks expand their offering of Aflac products. In many of the banks, sales representatives had gained experience at selling our products, and their confidence level and their sales ability has grown. WAYS and child endowment products, which are both especially popular with banks, were key drivers to growth again in the first quarter. You'll recall that WAYS is a unique hybrid whole life product that's being converted to fixed annuity, medical coverage or nursing care benefit when the policyholder reaches a predetermined age. The real story can be seen in WAYS' phenomenal sales growth rate, which was an increase of 221%, compared to the first quarter of 2010. Consumers find WAYS attractive because of the guaranteed principal and the future flexibility of the benefit options. Banks like to sell this product because of its high premium and attractive commission, and Aflac's product margin on WAYS is significantly enhanced when policy holders elect to pay all the premium upfront through the discounted advanced premium. Importantly, 90% of the customers at the banks choose this payment option. As our banking channel becomes a greater contributor to our top line growth, we expect sales of this innovative and flexible product to grow significantly in 2011.

As I mentioned, the other strong driver to sales growth is child endowment product, which was up 58.9% in the first quarter. This product is primarily used to help fund the higher cost associated with child's entering high school or college in Japan. Child endowment policies have been very popular in Japan for many years. Aflac's strong brand, this product's unmatched return and our expanding presence in banks are competitive advantages that have helped make our child endowment policy the product of choice. You'll recall that the average premium for child endowment is much lower profit margin, but because it is wanted and needed in the bank channel and is about 3x the premium of the medical policies, the premium is a very solid contributor to top line growth. It's also helpful in enhancing our policyholder base, allowing us the opportunity to cross sell additional products like WAYS to consumers. Like WAYS, our child endowment offers a discounted advanced premium, and the profit margin on the child endowment more than doubles when the policyholders elect to pay premiums upfront using the discounted advanced premiums. About half of the consumers who purchase child endowment through the banks elect the discounted advanced premium method of payment.

As expected, cancer insurance sales were down 10.4% for the quarter as prospective policyholders and sales agents postponed cancer insurance purchases and sales in anticipation of the introduction of the new base cancer policy DAYS, which was introduced at the end of March. The enhancement of this new base policy speaks to the changing landscape in cancer treatment as well as our commitment to retaining the #1 provider of cancer insurance in Japan. Sales of cancer insurance accounted for 17.5% of total sales. Keep in mind that the foundation of our product portfolio has been and continues to be cancer and medical products. Importantly, we maintain our position as the #1 seller of medical products in Japan, which confirms the continued popularity and demand for our innovative policies. The solid platform we established with these 2 pillar products has allowed us to leverage our competitive advantages such as branding and administrative efficiencies to grow our product offering and meet the evolving needs of the consumers.

From top to bottom, Aflac Japan performed extremely well in the first quarter, especially in light of the natural disaster and tough sales comparisons to a year ago. But as I've told you, following 2 years of strong sales growth, the sales comparisons only get tougher as the year goes on especially in the fourth quarter of 2011. In addition, we believe the natural disaster has affected our sales, primarily in the affected regions, but I still believe we can achieve our sales target for the year in the range of down 2% to up 3%.

Now let me turn to the U.S. operations. We were very pleased and excited with Aflac's U.S. performance from both the sales and a financial perspective. For the first time in 9 quarters, Aflac U.S. generated positive sales growth, and new annualized premium sales were up nicely, generating a 6.3% sales increase. We were especially encouraged to see an increase in production from both new and veteran agents. In fact, we saw crossover where Aflac career agents embraced group products. To me, it all boils down to giving our customers a choice between group and individual products. As I've said before, I tell our entire U.S. distribution system that I don't care whether they sell group or individual products but I do care that they give the group or the individual platform options to the employers with more than 100 workers. That's because if they don't at least let these accounts know we offer the group options now, you can bet that someone else will. I truly believe that if the employer wants group products, and they know Aflac offers them, they'll choose Aflac over the competition.

For both group and individual products, we are driving sales through specific product pushes called smart launches, which are modeled after Aflac Japan's product launches that effectively focus on the entire sales force on selling one specific product during a specific period of time. Our first smart launch was in the first quarter, and it focused on the Dental product. The results were phenomenal. Our dental category generated a 37.1% sales increase and contributed 6.9% to the total annualized premium sales. We've also seen success with the Critical Illness product created for the group platform. While this product was only introduced in mid-2010, it has provided both our traditional sales force and brokers with valuable products to add to accounts that currently have cancer products on an individual basis. This is a good example of a product that helps career agents transition and expand their portfolio to include not only individual products but also group products.

On the distribution side, our strategy, we've said many times before that today's recruits are tomorrow's sales. With that in mind, in early January, we launched our first ever recruiting campaign utilizing national television advertising. It featured a commercial with successful agents sharing their story and generating phenomenal leads, which ultimately contributed significantly to our 13.5% increase in recruiting for the first quarter. As you can see, we've taken measures to better reach potential customers with some innovative products, benefit solutions -- and we've improved Aflac U.S. sales not only to reflect intense focus on supporting our field force with enhanced products but also reflects the better resources and training that helps our sales force better approach selling in the current environment. We will continue to help our entire distribution, new and veteran agents, as well as brokers, with ways they can provide and improve their performance because they are essential part of our strategy and our success. All of these elements are fundamental to the model that we've been following in the U.S. We call it "recruit, train, motivate and sell." For those of you who will be coming to the financial analysts briefing in New York on the May 17 and 18, we'll be sharing more about this model and the products that we're going to introduce.

We continue to believe the U.S. provides a vast and accessible market for our products, and we are building our business with that potential in mind. We also believe our expectations that Aflac U.S. sales growth for 2011 will be flat to up 5% is reasonable, and our first quarter sales are a good start toward achieving that objective. Given the state of the economy, we still remain somewhat cautious. In addition, this is a momentum business. Although our 6.3% sales increase is a great start, I would obviously like to see the momentum build for a few quarters. It is clear, however, that the addition of group product platforms and our growing broker initiative only serve to enhance our ability to leverage Aflac's brand and to reach more companies, large and small, across the United States.

Now let me update you on Aflac Inc.'s results. Overall, we're pleased with Aflac's consolidated performance. Operating per share diluted rose 15.6% to $1.63. Excluding the benefit of the stronger yen operating earnings per diluted shares rose 8.5%. We believe that our basic investment approach of effectively managing assets to policy liabilities is the most prudent approach for our policyholders and shareholders. As you've heard us say repeatedly since early 1990s, our greatest challenge is investing huge cash flows in Japan's low interest rate environment. To reiterate what we said in our year-end conference call, one of our top focuses in 2011 is concentration risk. While our largest exposures are predominantly a legacy issues, we have continued to look at ways to optimistically reduce some larger positions where practical. As I said last week on CNBC, we focused on growing our operating earnings while derisking to further enhance the quality of the portfolio. I don't think many of you fully recognize the extent of our investment portfolio derisking activities that we've been actively engaged in over the last couple of years, so I'm going to cover 4 major derisking actions that we've taken to remind you of what we've accomplished. For instance, as we began 2009, our holding of perpetual subordinated securities was approximately 13% of the portfolio. At the end of the first quarter, perpetual subordinated debt accounted for less than 9% of the portfolio, a 30% decrease. We also de-risked the portfolio by lowering our concentration in financial exposures. At the start of 2009, banks and other financials made up 41% of the total portfolio, and at the end of the first quarter of this year, the number had dropped to 33%, a 20% decrease. We've accomplished this by both selling assets as well as reducing the percentage of new investments allocated for the financial sector. We also reduced our exposure to the PIIGS countries. At the start of 2009, these sovereign and financial exposures made up approximately 6% of the total portfolio. At the end of the first quarter, that number has declined to 4%, a 33% decrease.

As I've already suggested, we are now focused on addressing some of our legacy issues, especially some of those highly concentrated positions. Within the PIIGS portfolio, we've started with lowering the exposure in 2010. And in the first quarter of 2011, we focused our efforts on reducing our exposure to Greek financial system. Today, our holding of Greek banks has been reduced by 82% from the beginning of 2011. This percentage decline also reflects the sale of one of the banks following quarter end. In addition to significantly reducing our exposure to Greek financial systems, we also focused on reducing some of our larger concentrated positions where practical. As such, we sold some of our holdings in available-for-sale categories that exceeded 10% of tax. We believe these actions to lessen the concentrated risk in our investment portfolio further strengthens our balance sheet. Our business continues to generate significant capital in the first quarter.

As we have communicated over the past several years, maintaining a strong risk-based capital ratio or RBC remains a top priority for us, and you'll recall that it remains a primary component of the management incentive plan for all Aflac officers. Our objective for 2011 is to derisk our portfolio while maintaining our RBC ratio in the range of 400% to 500%, with a target of 450%. Although we have not yet completed our statutory financial statements for the first quarter, we estimate our RBC fell within the range of 500% to 525% at the end of March. I believe our ability to maintain a strong RBC exemplifies our effective capital management strategies.

As you'll recall, 2010 marked the 28th consecutive year of a dividend increase. Our objective remains to increase cash dividends generally in line with earnings growth before the impact of the yen. We will again evaluate a dividend increase later this year, but I am confident we will extend our consecutive annual dividend increases for 29 years. Additionally, you'll recall that we resumed the share repurchase program in the fourth quarter. We purchased 3.1 million shares in the first quarter and anticipate purchasing 6 million to 12 million shares for 2011. However, we will balance our share repurchase activities this year with the derisking opportunities that ultimately enhance our portfolio.

With the first quarter of the year complete, we continue to believe we are well positioned for another year of solid financial performance. We still believe our goal of increasing operating earnings per diluted share is reasonable and attainable. I believe we've also done a very good job in managing Aflac Japan and U.S. operations, especially the expense control. As the year progresses, we anticipate increasing our spending, particularly in marketing and IT initiatives. And we have said previously, given the continued low interest rate environment, especially in Japan for 2011, we expect to be at the low end of the 8% to 12% range for operating earnings per diluted share, excluding the impact of yen.

As you know, we historically announced our earnings guidance for the following year at our May analysts meeting. Although we have not yet finalized our projections for 2012, I can tell you that our expected rate of earnings growth next year will likely be lower than 2011 due primarily to the portfolio derisking activity and the continued low interest rate environment in Japan. After the effects of the derisking and the low interest rates in Japan and the United States have fully integrated into the financial results, we should expect to see the rate of increase in earnings begin to improve.

With respect to achieving our objectives, you've heard me say many times before that we manage this company for the long term. As such, we believe that derisking our portfolio is more important than the effect on one year's earnings, and in doing so, we'll ultimately enhance the shareholder value. Now I'll turn it back over to Robin. Robin?

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

Thank you, Dan. And as Dan said and you are all aware, the quakes and subsequent tsunami that hit Japan on March 11 had a devastating impact on the country, and they remain in our thoughts and prayers. But I'd like to go through some of the numbers to-date that reflect the magnitude of this event.

According to the official report by Japan's National Police Agency, as of April 28, total lives that were lost is 14,575, and there are still 11,324 who are missing. There are also 5,277 who are reported injured. We estimate that there will be a total impact of JPY 3 billion in claims, and of this amount, we booked a total of JPY 1 billion to incurred claims, and the remaining, approximately JPY 2 billion, will be handled through reinsurance plans we have and offsetting reserve releases. There was also JPY 0.7 billion of operating expenses resulting from the earthquake and tsunami. Now I'd like to go through some first quarter numbers for Japan.

Beginning with the top line, in yen terms, revenues were up 3.7% for the quarter. Investment income was down slightly 0.7%. However, excluding the effect of the stronger yen on Aflac Japan's dollar-denominated investment income, net income rose 2.7% in the quarter. Annualized premium persistency rate, excluding annuities, was 94.3% compared to 93.8% in 2010. In terms of quarterly operating ratio, the benefit ratio improved over last year, moving from 59.5% a year ago to 59.0% in the first quarter. The expense ratio for the quarter was 18.6%, down from 19.1% a year ago. As a result, the lower benefit and expense ratios to pretax margin rose from 21.4% to 22.4% in the quarter. With the expansion of the margin, pretax earnings increased 8.5% for the quarter in yen terms.

For the quarter, we invested our cash flow in yen securities at 2.36%, and including the dollars invested, the blended rate was 3.16%. As we discussed last year, part of our strategy to address the low interest rate environment in Japan, we made dollar-denominated purchases to extend the $1 billion we discussed in the fourth quarter of the year and the amount $290 million. That amount, purchase through the end of Japan for that objective, totaled $993 million. The yield on these investments was 4.26%. Our portfolio yield rose 3.56% at the end of March, no change from the end of December and 19 basis points lower than a year ago.

Now turning to Aflac U.S. Total revenues rose 3.1% in the first quarter. The benefit ratio was 48.8% compared with 45.5% a year ago. The rise in the benefit ratio reflected a return to a more normalized number in 2011 following the decline in the benefit ratio in 2010, which resulted from the loss of a large account. The operating expense ratio decreased from 35.4% to 32.0%, reflecting a delay in spending on several projects that will be incurred later in the year. Also driving the operating expense number down to the first quarter was a return in amortization to a more normalized number after the loss of the large account increased the 2010 debt number. The profit margin for the quarter was 19.2% compared with 19.1% a year ago. In terms of U.S. investment, the new money yield for the quarter was 5.77% versus 5.98% a year ago. The yield on the portfolio at the end of March was 6.84%, down 8 basis points from the fourth quarter and 22 basis points from a year ago.

Now turning to some other items in the quarter. Noninsurance expense for the first quarter was $41 million compared with $31 million a year ago. The higher interest expense primarily reflects our debt issuance in the second half of 2010 of $750 million. Our parent company and other expenses remained flat at $14 million compared to the first quarter of 2010. Total company operating margins rose, reflecting the improved profitability of Aflac Japan and U.S. Pretax margins rose from 20.0% to 20.7%. The after-tax margin increased from 13.0% to 13.5%. And on an operating basis, the tax rate remains relatively unchanged at 34.2%. Net earnings per diluted share for the quarter was $0.84 compared to $1.35 in 2010. Realized investment losses were $0.79 per share for the quarter compared to $0.06 per share in 2010. During the quarter, we realized investment losses of $376 million net of tax or $0.79 per diluted share, primarily as a result of the significant derisking activities in the quarter that Dan outlined. $115 million was attributable to our sale of holdings in the Alpha Bank, $258 million resulted from the impairment of 2 other Greek banks: National Bank of Greece and EFG Eurobank. We also lowered our holdings of other concentrated positions with smaller transactions and impairments, and these transactions altogether resulted in a gain of $16 million. The remaining $19 million loss is associated with derivative and hedging activity.

As reported, our operating earnings per diluted share rose 15.6% to $1.63. The stronger yen increased operating earnings by $0.10 per diluted share. Excluding the yen's impact, operating earnings per diluted share rose 8.5% for the quarter that was in our annual range of the low end of 8% to 12%. Lastly, let me comment on earnings outlook for 2011. As you heard, we have affirmed our objective for 2011 with an 8% to 12% increase in operating earnings per diluted share, excluding the impact of the Yen. But as we've previously said, given the low interest rate environment, especially in Japan, we expect to be at the low end of the 8% to 12% range for operating earnings per diluted share, excluding the Yen impact. Assuming an 8% increase in operating earnings per share growth, we would expect to earn $5.97 on a constant currency basis. If the Yen averages 80, 85 for the second quarter we would expect operating earnings to be $1.51 to $1.57 per diluted share. If we achieve our objective of that 8% growth, and the Yen averages 80 to 85 for the full year, we would expect EPS to be in the area of $6.09 to $6.34 per diluted share. As we mentioned in our press release last night, although we historically announce earnings guidance for the following year at our May analysts meeting, and our 2012 earnings projection is not finalized, we do anticipate that earnings for the next year, 2012, would likely be lower than 2011.

Let me take this opportunity to remind you that our annual analyst meeting will be held in New York City on May 17 and 18. We'll be there to provide you with further updates on our operations in both the U.S. and Japan along with our outlook for this year and the following year, so we invite you to please log in and register to attend. I'm now ready, Diane, to start taking questions. To be fair to everybody, please limit yourself to 1 question, and we'd be happy now to start with the questions.

Question and Answer

Operator

[Operator Instructions] Randy Binner, FBR Capital Markets.

Randolph Binner
FBR Capital Markets & Co., Research Division

Oh, great. Thank you. So I just wanted to ask a question about what happened with the RBC ratio in the quarter. I guess the 2 specific questions would be: one, if you could outline exactly how much of the RBC decrease was from ratings drift in the quarter, and if you can outline any credits that happened with; and the second piece is if you could disclose what liquidity was at the whole co[ph] at the end of the quarter?

Kriss Cloninger
President & Director

Okay. This is Kriss. RBC came down from about 555%. At the end of the year to, right now, we're looking at a range of 500% to 525%. A significant item in there was the downgrade to Israel Electric that S&P came through with after at the end of the year, and after the time we've closed our statutory books. And that -- because it's a concentrated risk caused our RBC to decline almost 20 points. So if you said, well, okay, that would have been 555% to 535% and then of course the other big piece was the impairments that we recorded in the first quarter. Whole co[ph] cash was around $700 million at year end, it came down to about $550 million. We paid a shareholder dividend order of magnitude $140 million. We repurchased shares for probably about $170 million and we had a dividend from the live company to the parent company, for about $120 million or $130 million. I don't remember the exact number.

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

$144 million.

Kriss Cloninger
President & Director

$144 million, okay. Robin knows the exact numbers. That will get you there.

Randolph Binner
FBR Capital Markets & Co., Research Division

That's very helpful. Just one follow-up on Israel Elec, is that a move from NAIC Level 1 to 2 or 2 to 3?

Kriss Cloninger
President & Director

2 to 3. Ken says it's moved from 2 to 3. NAIC 2, NAIC 3.

Randolph Binner
FBR Capital Markets & Co., Research Division

Okay, so it's in the below-investment grade market, then?

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

It's split rated. Randy, this is Ken. It's split rated and for GAAP purposes, it's still considered an investment grade asset. For statutory purposes, our rules are that we take the second lowest rating, which would be in this case since there's 2 ratings below investment grade and that's what moved it to a 3.

Randolph Binner
FBR Capital Markets & Co., Research Division

Understood. Thank you.

Operator

Joanne Smith, Scotia Capital.

Joanne Arnold Smith
Scotiabank Global Banking and Markets, Research Division

I want to switch gears a little bit and talk about the U.S. for a minute because I don't think many of us were expecting the turnaround in sales in that region. If Paul is available, could you talk about some of the data mining activities that you've been doing to try and drill down and find better ways to approach the markets in the U.S. and what kind of success you're having there because I think it's remarkable that we saw the results after 9 quarters of decreases? Thanks.

Paul Shelby Amos
Former Director

Thank you, Joanne. We are very excited. I do want to tell you that I do not believe this is a sudden result. I think this is a plan that's been put in place over the last several quarters. Our sales and marketing teams are working more tightly together than ever. You could see that through the beginning of the effects with our first ever DRTV, or recruiting campaign, which helped drive up our overall recruiting by 13.5% this past quarter. At the same time, things like our smart launches, even though we used it on a smaller product line like dental, it was a direct effect of conferences that we put in place between the U.S. and Japan several years ago. We began to learn about the positive effects of what they were doing and then marrying up what was happening socially with how to drive product demand. In the U.S. this year, due to smart product launch, we were able to drive demand for dental by using our duck and leveraging it in our existing accounts to really help push specific product lines. We do hope that, that's something that we can continue to expand on in the future that will continue to help drive up our existing accounts sales as well as our veteran agents' sales. We've coined that term, our book of business. We'll be talking more about several of these items at our upcoming FAB meeting. I'm very excited about what we're seeing. I do think that this is the beginning of something positive. How quickly and how big is that, I think it's too early for us to tell. I think at the end of the second quarter I'll be better able to tell you whether the turn is completely in. But I think at this point, I'm very proud of our sales team and Tom Giddens, and our marketing team and Michael Zuna, and all the people who have worked very hard to make this happen. And I do believe that there's no fluke in the numbers here. This is just a great quarter of sales that has been long in place from a turnaround, good momentum by our sales force and a very strong balance between good broker sales and good career agent sales. But in the end, I do believe that probably the overriding factor in all of this has been Aflac Group. The fact is that it is not only been the sales that have happened in the group business but also the momentum that having the group business has brought to both our career channel and our broker channel. So that's a lot to say, but I think there are a lot of good factors happening, all of which are coming together for what was our best quarter in a long period of time.

Joanne Arnold Smith
Scotiabank Global Banking and Markets, Research Division

So Paul, this is a follow-up. Do you really think that the group is starting to gel now? Is this kind of a result of the integration and adoption of the practices you acquired with the Continental acquisition? Or is this efforts that you've had in place prior and then just added a little bit to the scale?

Paul Shelby Amos
Former Director

I think there was some pent-up demand among our career sales force for group products. I think you're seeing some of that happen now. I believe that's something that will sustain itself for some period of time, especially as we continue to go out and add suggestions to all of our existing accounts offering our group products. We still have not, we've only begun to see the beginning of that. In terms of what's happening for the company and CAIC, I believe it is now giving us the opportunity to go after the entire market. We were primarily focused on the small end of the market in the past, really employers of 100 and under. This gives us the opportunity to go after the larger employers in America and do so with a set of products that they really want as well as going after the brokerage community with a set of products that they desire. And as a result, we're beginning to see some momentum really build in those areas. It's still early but I am very excited.

Operator

Ed Spehar, Bank of America-Merrill Lynch.

Edward A. Spehar
BofA Merrill Lynch, Research Division

Thank you. I wanted to talk a little bit about the implied derisking that maybe you're sending a message on with initial comments about 2012. I guess if you did some quick math and you just assumed some sales and reinvestment at lower rates and some loss on sales, that it seems like for you to have a 1 point impact on EPS growth, it would require probably portfolio derisking of related to maybe a couple billion dollars of holdings. So I guess what I'm trying to get at is, is the message here that we should be looking for portfolio derisking over the next several quarters to potentially be at the kind of pace that we saw in the first quarter?

Kriss Cloninger
President & Director

I'll start out and Ken might want to follow up with comments. Really, Ed, it takes awhile for the cumulative effect of derisking to work its way through earnings. And over the last couple of years, we've had a substantial amount of derisking in addition to what we had in the first quarter. I think we've had about $1.6-or-so billion in realized losses over the last couple of years. We had another $450 million or so this quarter. We're going to have some more in all likelihood. And the numbers you guys have are not unreasonable there. But it's a cumulative effect of low interest rates and the fact that it takes say, 12 to 18 months to get the effects all the way through the financial results that lead us to be thoughtful about how we're going to project earnings. In addition, I'll say when we derisk -- there are several ways to derisk, some of which affect P&L more than others. Clearly, if you decide to sell a security that you believe you don't want to hold anymore and you take a realized loss, you've got a lower amount of funds to invest and then you've got decisions about whether to invest those funds in dollars or yen, and then what categories of yen assets you might be able to acquire. On the other hand, you might take an impairment and derisk just by reducing equity and the like, but not sell if you thought really the credit characteristics of the security were such that you didn't need to sell it. And then when you deal with concentrations, you're probably going to sell positions and you have to positions in concentration to reduce your concentration of those type securities. So we haven't fully concluded on exactly what steps we're going to take and there's just a level of uncertainty. But we think the net result is going to be a modest slowdown in earnings growth for some period to come. Ken, do you want to comment further on that, or you think that's enough?

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

The only thing Ed that I would add to that is that we clearly can't telegraph exactly what we may or may not be interested in derisking. And really at this point exactly, what we're thinking about in terms of capacity but I can tell you that we regularly review our capital position both from an RBC and a solvency margin standpoint to just see what kind of derisking we can tolerate from a capital deployment standpoint and again balance that against our interest in purchase and shares.

Daniel P. Amos
Chairman & CEO

The only other comment I'd make is remember that if derisking can impact also share repurchase and that could be a factor too in slowing down growth.

Kriss Cloninger

President & Director

That can be a couple of points in addition to the loss in investment income you cited.

Edward A. Spehar
BofA Merrill Lynch, Research Division

Okay, just one follow-up. I think you've had some success of recategorizing a large-held to maturity investment to available for sale with the Israel Electric, one rating going to junk, are you going to be able to recategorize? And just a broader question, even if you can't recategorize these things, who cares if you taint the portfolio and it all becomes available for sale, if it -- sort of increases your flexibility to derisk this portfolio?

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

I'll start with the answer and see where it goes. We have looked at this. We look at it continually. We're not as concerned about tainting on a GAAP basis but that would also result in tainting on a Japan GAAP or FSA reporting basis. And you may remember from analyst meetings for several years that we have showed a chart that suggests our sensitivity, or the solvency margin sensitivity to interest rate changes. So if we were to move all of our held to maturity assets to available for sale, those bonds would be subject to mark-to-market accounting. And at the time when the FSA has modified the solvency margin calculation, which will effectively reduce the numbers for the industry in half, we don't think that it's prudent to expose our portfolio to the influence of mark-to-market accounting and what will likely be a rising rate environment.

Kriss Cloninger
President & Director

Do you want to address the specific reclassification we had this quarter?

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

Israel Electric would fall into that camp. It is split rated from a staff standpoint but it is still investment grade from a GAAP standpoint. We were able to move Tunisia from held to maturity to available for sale after going through a very extensive credit analysis that took a period of many, many weeks. And you'll see that in our financial supplemental disclosures that it's now categorized as below investment grade even though the actual rating agency ratings show it's still as investment grade. But it is now in available for sale, and it's fair value would be reflected therefore and included in the solvency margin calculation.

Kriss Cloninger
President & Director

That's one thing. Let me make another comment, Ed. There's a rigor around doing these reclassifications and the like and making decisions to impair or sell. You'll see when we put out our 10-Q, a discussion of the events that led to our conclusion that we needed to sell and impair our holdings in the Greek banks, and that required events that need to be documented to satisfy the SEC and the regulators, and the accountants and the like. It's not just a gut-feel type of decision that we make around here. And we had to go through a fairly rigorous process, too, to document and our conclusion that it's appropriate to move Tunisia from held to maturity to available for sale category in all of our categories in financial statements so that we avoided tainting the whole portfolio for reasons Ken discussed.

Operator

Our next question comes from Darin Arita, Deutsche Bank.

Darin C. Arita
Deutsche Bank AG, Research Division

Thank you. I was hoping to turn to Japan and was wondering if you could detail some of the sales activity following the earthquake.

Daniel P. Amos
Chairman & CEO

I think Toru's on the line. I'm going to let him answer that.

Tohru Tonoike
Vice Chairman of Aflac Japan

After the earthquake, basically, we have a lot of -- sales activity was affected in accordance with the situation. We have counted many of the TV commercials just refraining from making sales pitches to the public in that circumstances. And also we have activities of our agents were somewhat disrupted because of the disrupted transportation, or shortage of gasoline or planned blackouts. So our sales activities as a whole was reduced the latter half of March and a good part of April. But now it is going back to normal. And we are returning to the normal sales activities and promotions mode. So at this point, purely from the viewpoint of the sales promotion method, we are not doing anything very specific, we are just increasing our promotion activities in general.

Darin C. Arita
Deutsche Bank AG, Research Division

Can you quantify what the falloff was in the latter part of March?

Daniel P. Amos
Chairman & CEO

I'll respond to that. This is Dan. There's a difference between the U.S. and Japan. They don't use SMART Act in Japan like we do in the U.S. So there's a time lag so my gut is that, and it is a gut because I want to wait and see what April numbers look like. And we plan on telling you at the FAB meeting. We normally don't cover what sales numbers are for a month but we're going to give you April numbers when we got them. But I don't think March reflects what really happened, maybe the last week did a little bit, but it's hard to tell. And so at this point, we don't want to go out and make some statement then all of a sudden the next couple of weeks we see a difference. And as Toru talked about, pretty much everything is kind of getting back to normal now. And of course the area that was directly hit, it will be quite a time but that accounted for 5% of our sales. So that will kind of give you an idea of what to look at. So what I've tried to kind of analyze in my mind is in terms of these numbers, if you say that okay, sales in the first quarter were basically where we thought they would be. Because remember, we expected a good first quarter, a little bit better than what we thought, but we expect sales to be flat to down in the fourth quarter because of the tough sales comparison. So if you go back and say okay the first quarter, that area that was affected was 5% of our sales then say the second quarter, the number 0 and the third quarter is 1/2 and the fourth quarter is 1/2 then that means that our overall sales have been hurt by 2.5% over what our original projections are. And then say Tokyo was hurt for a short period of time but outside Tokyo nothing else was really that affected then we're actually increasing our sales objective in that the 2% to 5% still we think we can make yet down 2% to up 3% or 5% swing is actually a higher number because we got to make up the difference of what happened due to the tsunami.

Darin C. Arita
Deutsche Bank AG, Research Division

Got it. That's very helpful. Thank you.

Operator

Our next question comes from Nigel Dally, Morgan Stanley.

Nigel Phillip Dally
Morgan Stanley, Research Division

Great. Thanks. I just wanted to follow up on Darin's question with regard to Japan sales. Appreciate the comments you made, but couldn't we be looking at a situation where demand could actually meaningfully pick up in the aftermath of the disaster, like what you saw at a place [indiscernible]? Wouldn't that also be a factor which should help the sales result in the back half of the year? Any comments there would be very helpful. Thanks.

Tohru Tonoike
Vice Chairman of Aflac Japan

Yes. I think it is possible that could help our sales. But it is very difficult to measure the magnitude of that fact. So at this point we would rather not take that into account for our plan this year.

Nigel Phillip Dally
Morgan Stanley, Research Division

Okay. If I could follow-up on a different question, given that we're seeing the sales through the banks really pick up from having the child endowment and WAYS. Kriss, is it possible to comment on whether you're still comfortable with your benefit ratio guidance for the year? Or should we think about adjusting that given the shift in sales?

Kriss Cloninger
President & Director

Well, we had about a 50 basis point improvement in the quarter. And we had said that the 100 to 150 basis points -- quite frankly we were surprised but pleased about the level of production of child endowment and WAYS. I think they were somewhat above expectations. And as I previously discussed with the community, the investment community, starting last September, the mini FAB and continuing on in the fourth quarter discussions, child endowment and WAYS are going to slow down the improvement or the decline in the benefit ratio. We're still getting the same kind of decline in the cancer product from reduction in number of days in the hospital, though as I've told you that's moderating some. Once you get the numbers down to days in the hospital of around 20 to 22, you don't have as much room for improvement as when the average was say, 40 days per stay for a cancer treatment. So I've told you the improvement in the medical or the cancer line is moderating some. The child endowment and WAYS products will have the benefit ratio go up some but they'll have the expense ratio go down some, and they're going to drive revenue more than the medical products do. And at the analyst meeting, I'm going to show you an analysis that basically I'll just disclosed that early, I guess, but basically it tells you that if we write the same number of policies of medical and child endowment and WAYS, we produce somewhat more profit, just modestly more profit by producing the same number of policies with child endowment and WAYS than we do through the medical policies. And that's because they've got a higher average premium, they've got a lower average margin but the profits per policy come out somewhat higher. So there's a bit of a change in the composition of the way profits are produced. But the net effect is that you get about the same, if not slightly more profit by writing a policy of WAYS or child endowment than a policy of medical or cancer.

Operator

John Nadel, Sterne Agee.

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

Thank you. I was wondering, just thinking about Japan and I get the idea that there could be some modest pickup in sales activity over time. But I'm also wondering if you have a view on any potential likelihood that some level of austerity measures in Japan, as the government has to divert funds to reconstruction activities. Could that ultimately serve to, I guess reduce or remove the child credits that have clearly helped to spur the growth in the child endowment and WAYS products? Do you foresee anything on that front?

Daniel P. Amos

Chairman & CEO

Yes. It doesn't affect the WAYS product. It can affect the child endowment, but it doesn't affect the WAYS. And frankly, this year -- well in the second half of last year, we started emphasizing WAYS by changing the incentives to move the bank channel away from child endowment. Now if that product drives itself because, as you said, the government has that subsidy. But all in all, we're kind of moving that direction anyway. So it would be fine with us to do that. Of course, remember, for every 5 child endowment we sell, we add 1 new policy of another type to the new policyholder base. But all in all, we're kind of moving that way anyway.

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

John, this is Ken. The child subsidy was extended for another 6 months, meaning until September. And it will have to be debated and approved by the Diet in order for it to be extended beyond September of this year.

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

That's helpful. Thank you.

Daniel P. Amos
Chairman & CEO

Toru, do you have any comment about that?

Tohru Tonoike
Vice Chairman of Aflac Japan

The only thing I could add is that, yes, child endowment was very helpful for us to start selling, start marketing this product with the public at the bank. It was very good thing to start talking about child endowment policy -- I'm sorry I mean the child allowance payment. So it helps us a lot in a way that it made it easier for us to start talking about our child endowment policy with the possible clients. But now that this product is well known and a part of that regular products for the banks and their employees. So even if the child allowance is reduced or even terminated, the impact is not that big going forward.

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

Okay. Helpful. And then I guess the only other question I have for you, is there any contemplation of starting maybe a foreign currency hedging program? Given how strong the yen is relative to the dollar, any thoughts as to potentially trying to lock in some of that strength as you look forward?

Kriss Cloninger
President & Director

I'll say we haven't had substantial discussions on that topic. We've had discussions about doing some of the things that historically was done through the investment banks of investing in securities denominated in a currency other than yen and having an embedded swap. We've looked at possibly doing some of that ourselves but we haven't discussed in a meaningful way, say hedging P&L, if that's where you were headed.

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

Yes, I guess that is where I'm headed. I mean I assume that clearly, there's a cost to doing that and just wondering if the cost benefit makes sense or not.

Kriss Cloninger
President & Director

Well, we've done some modest review of that, and we've looked into and tried to analyze what some other companies with significant Japanese operations are doing. And we see that the net gains and losses from that kind of hedging program tend to be relatively modest. But they do create a risk exposure that we've been averse to over time. And our historical position of saying, okay, our shareholders are used to taking the currency risk on the current year's P&L and then do we tend to hedge equity into dollars through holding dollar-denominated securities and having yen-denominated debt. We're continuing to pursue those programs. And I'd say we're considering some of those things but generally we found that the risks outweigh what we perceive to be the benefits of those kind of activities.

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

And Kriss, what is the risk? Is it just more counter-party exposure to financial institutions?

Kriss Cloninger
President & Director

Well, that would be one risk. It would be the mark-to-market exposure on the hedge that creates volatility of earnings, the possibility of economic gains and losses.

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

Diane, we are at the top of the hour, so that's the last question. But I want to let everybody know that Tom McDaniel and I will be here today to follow-up on any questions you may have. So please, feel free to call us if there are any questions, and we appreciate everyone tuning in this morning.

Operator
This concludes today's conference call. Thank you for participating. You may disconnect at this time.