S&P Capital IQ

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Aflac Incorporated NYSE:AFL

FQ2 2016 Earnings Call Transcripts

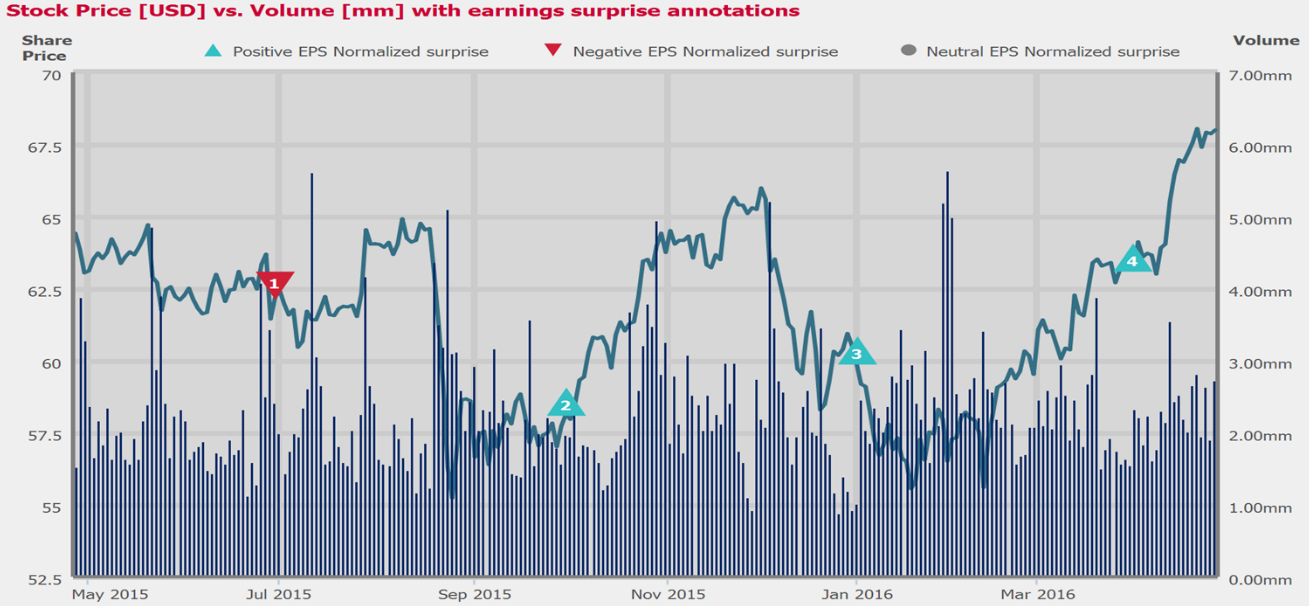
Friday, July 29, 2016 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2016-			-FQ3 2016-	-FY 2016-	-FY 2017-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.68	1.71	1.79	1.73	6.82	7.01
Revenue (mm)	5469.99	5437.00	(0.60 %)	5479.42	21769.67	22290.63

Currency: USD
Consensus as of Jul-29-2016 8:34 AM GMT

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



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2015	1.52	1.50	(1.32 %)
FQ3 2015	1.48	1.56	5.41 %
FQ4 2015	1.48	1.56	5.41 %
FQ1 2016	1.63	1.73	6.14 %

Call Participants

EXECUTIVES

Daniel P. Amos
Chairman & CEO

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

Frederick J. Crawford
Executive VP & CFO

Paul Shelby Amos
Former Director

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

Teresa Lynne White
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Presentation

Operator

Welcome to the Aflac Second Quarter Earnings Conference Call. [Operator Instructions] Please be advised, today's conference is being recorded.

I would now like to turn the call over to Ms. Robin Wilkey, Senior Vice President of Aflac Investor and Rating Agency Relations. You may now begin.

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

Good morning, everyone, and welcome to our second quarter conference call. Joining me this morning from Columbus is Dan Amos, our 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. Also joining us from New York, Eric Kirsch, Executive Vice President and Global Chief Investment Officer. Also joining us this morning from Tokyo is Hiroshi Yamauchi-san, President and COO of Aflac Japan; and Koji Ariyoshi-san, Executive Vice President and Director of Sales and Marketing.

Before we start this morning, let me remind you that some statements in our teleconference are forward-looking within the meaning of the 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 perspective in nature. Actual results could differ materially from those we discuss today. We encourage you to look at our quarterly release for some of the various risk factors that could materially impact our results.

Now I'll turn the program over to Dan this morning, who will begin with some comments about the quarter as well as our operations in Japan and the US. Then Fred will follow up with some brief comments about our financial performance for the quarter and outlook for the year. Dan?

Daniel P. Amos
Chairman & CEO

Thank you, Robin. Good morning, and thank you for joining us today. Let me begin by saying that second quarter rounded out a good first half of the year for Aflac. I'll lead off by providing an update on Aflac Japan, our largest earnings contributor. From a distribution perspective, our traditional agencies have been and remain vital contributors to our success. This was certainly true in the second quarter. Additionally, all of our alliance partners continued to produce strong results. I'm especially pleased with Japan Post and their 20,000 plus postal outlets selling our cancer insurance. Our goal remains to be where the customers want to buy in our various distribution outlets, broaden our reach to support this goal.

From a product perspective, our priority is to remain in step to the wants and the needs of the Japanese consumers and our distribution channels. Managing through the low interest rate environment is nothing new to Aflac Japan. This entails working through our tactical approach on several fronts, including strategies for product, investment and risk and capital management. Fred will cover more of the financial aspect, but let me expand on our efforts related to products.

Starting with first sector products. We're encouraged that the actions that we've taken throughout the second quarter to limit the sale in first sector products has been yielding the desired results. First sector product sales decreased 24.7% in the quarter. These actions include a combination of product caps, commission restructuring, product repricing in select cases and product discontinuance. Recognizing that many of these actions were initiated in the second quarter, we continue to anticipate a sharp decline of at least 50% in first sector sales in the second half of the year compared to the second half of 2015.

Turning to the third sector products. You'll recall that last quarter, we introduced a cancer insurance product designed for those who have previously been diagnosed with cancer and have been cancer-free for 5 years. This is similar to the product we offer in the United States. Last quarter, we also introduced an enhanced nonstandard medical product. We are pleased with the reception of both products in the marketplace. You'll recall from the May Financial Analyst Briefing that we anticipated sales of third sector products would be in the range of down 3% to up 2%, and that's still the case. With Aflac Japan's third sector products up 11.2% in the quarter and 6.4% year-to-date, we're running ahead of expectation for third sector sales. But there's no one single aspect of the business that has contributed to our outperformance. It's simply stronger-than-expected productivity across the majority of the distribution channels.

Keep in mind, sales in the bank channels has been moderate by restricting our sales of the first sector products. We continue to believe that the long-term compound rate of third sector products will be in the range of 4% to 6%. We will continue to be innovative in providing options that millions of Japanese consumers are looking for as they struggle from financial burden of higher medical expenses.

Turning to Aflac US. As we indicated before, we see 2016 as the year of stabilization and opportunities as we continue to execute on our strategies. Our efforts are focused on enhancing the relationships we've established with brokers and providing our career agents with the tools to increase productivity. While sales in the second quarter were below expectations, keep in mind that sales in the second half of 2015 contributed to 55.6% of the total sales. Our projections show that we're still on track to achieve our target of increasing Aflac sales 3% to 5% for the year.

I do want to emphasize once again that we anticipate our sales will be increasingly concentrated toward the end of the fourth quarter, though what we've achieved prior to that time lays the groundwork for our overall success. As you all well know, success creates competition. U.S. healthcare reform has been highlighting and clarifying the need for the products we sell. This has resulted in a number of other companies entering the voluntary supplemental insurance market such as traditional major medical carriers and companies that sell voluntary insurance. As a result, we are executing on strategies designed to set Aflac apart and further enhance our awareness and relevance to the employer, the employees and brokers.

Aflac's single focus on supplemental voluntary products have greatly contributed to our dominant position of selling voluntary insurance at the work site, and I believe it will continue to drive our competitive edge. Keep in mind that so far this year, we've written more business than the other 2 competitors combined.

One Day Pay also remains a key differentiator for Aflac. We will continue our promotion of One Day Pay to the consumers, which we believe will help drive increased brand loyalty, account penetration and production. Here is an amazing statistic. In 2015 and continuing through the second quarter of 2016, 100% of the eligible One Day Pay claims submitted were paid within 1 day. We have processed, approved and paid over 1 million One Day Pay clients in the first 6 months of 2016. And get this, 96% of our policyholders that use One Day Pay or SmartClaim, as we call it, said that they are likely to refer other people to Aflac. I am convinced that this will result in more new sales going forward. Paying clients fast and fairly sets us apart from the competition.

Turning to capital deployment. Fred will provide more detail shortly, but let me just say that we continue to view growing the cash dividend and repurchasing our shares as the most attractive means for deploying capital, particularly in the absence of a compelling alternative. We believe the capital strength positioned us to repatriate in the range of JPY 120 billion to JPY 150 billion for the calendar year 2016. Despite market volatility, our capital position remains strong and reinforces our plan to repurchase $1.4 billion of shares of our stock with the majority being concentrating in the first half of this year.

One of the message I'm sending as CEO is we are laser-focused on leveraging opportunities for the future. I'm letting everyone know that innovation and change are vital aspects of the business environment here at Aflac Japan. And that's what will continue to propel our long-term growth and our success. We have maintained our focus on controlling the things that we have the power to control. We can and we will control our efforts to build our business and to take care of our customers, our employees and our distribution network. By doing this, I believe we will continue to enhance shareholder value while delivering on our promise to our policyholders.

Now I'll turn the program over to Fred, who will cover the financial results. Fred?

Frederick J. Crawford
Executive VP & CFO

Thanks, Dan. You've all had a chance to review the details in our earnings release. As Dan noted in his comments, the second quarter represents a continuation of the strong financial results we reported in the first quarter and executing on key initiatives covered at this year's Financial Analyst Briefing in May.

Second quarter showed continued progress towards achieving our full-year 2016 earnings guidance. Our results were driven by strong overall margins in both the U.S. and Japan, and there were no notable earnings items to speak of in the quarter. Our Japan segment margins were solid with both benefit and expense ratios coming in as expected and generally in line with our guidance. In the U.S., benefit ratios performed within our expected range after seasonally strong performance in the first quarter. Our expense ratio was modestly favorable in the quarter. Consistent with previous years, we fully expect our expenses to pick up in the latter half of the year as we progress on certain strategic initiatives and increase promotional spend entering the enrollment season. In both Japan and the U.S., we would expect our benefit ratios, expense ratios and overall margins to trend within our December outlook call guidance ranges for the remainder of the year.

Turning to investments. New money rates in Japan were understandably down in the period as we navigate the low yield environment, but also influenced by a tactical strategy of temporarily investing in low-yielding but high-quality and liquid securities, pending development of more attractive long-term investments. We continue to be on plan in terms of Japan's net investment income for 2016.

U.S. new money rates were influenced by an increased allocation to corporate investment grade purchases, which served to lower new money rates in the quarter. You may recall, in the first quarter, we had elevated new money rates as we concentrated investments in higher-yielding middle-market loans. So to some degree, the second quarter purchases are balancing out our allocations.

Let me comment for a moment on market developments since our FAB Meeting in May and its influence on our investment strategy as we look forward in 2016. Specifically, the negative rate environment in Japan and movement in hedge costs supporting our U.S. dollar investment strategy.

Post-Brexit announcement, we experienced another move down in rates as JGBs and U.S. Treasuries continue to be the world's flight to quality currencies and investments. While having modestly recovered in the past few weeks, we have seen 30-year JGBs grind down to near 0 at times. Curtailing interest-sensitive premium flows is essential, and as Dan noted, we are taking further action to reduce the sale of first sector savings products, namely eliminating the sale of product in certain channels and accelerating pricing actions. We will continue to sell repriced savings products in support of our exclusive relationships where the ratio of third sector to first sector sales is significantly in favor of third sector.

Specific to investment strategy, we remain in good position for 2016 asset flows and defending net investment income, but we are undertaking a review of our strategic and tactical asset allocation and associated risk limits in preparation for 2017 flows. We hope to provide additional color at our September FAB Meeting in Japan. But at a high level, the plan explores developing alternative high-quality yen investments, a measured entry back into yen private placements, and U.S. dollar investments where we can hedge effectively in optimizing investment income consistent with our risk limits, ALM and capital objectives.

Turning to U.S. dollar program. Our hedge costs in the second quarter were essentially flat with the first quarter at $0.08 a share. However, hedge costs have continued to increase in recent weeks with market volatility and speculation on BOJ and Federal Reserve actions. At our May FAB Meeting, we guided to realized hedge costs of 110 basis points on $13 billion notional investment in forwards, assuming no movement in pricing or change in our hedging strategy. In the weeks leading into Brexit decision, post-Brexit and anticipation of last night's BOJ announcement, 1-year forward pricing is now closer to 160 basis points.

As you know from our previous comments, the rise in hedge costs was fully expected as recent years have experienced abnormally low costs relative to historic norms. Note also that we currently record the full cost of forwards upfront in the quarter purchase instead of amortizing the cost over the life of the hedge, thus the timing of what is rolling on and off the program can make a difference in our reported cost.

In addition to market pricing, as we move into the second half of the year, we intend on executing on a couple of tactical moves that will result in an increase in our reported hedge costs. First, we have done some rebalancing and have moved to hedge additional dollar asset classes and expect to increase our net notional forward position by roughly $2.9 billion, including $1.9 billion in bank loans hedged in July. Bank loans are ideal to hedge as these are floating rate and better match for shorter-dated forwards. In addition, we will look to cover a building equity and commercial real estate loan portfolio under our hedge program.

Importantly, hedging these additional U.S. dollar asset classes, along with other related rebalancing activities, are expected to strengthen our SMR ratio once completed. We estimate in the range of 30 points to 50 points at a net cost of approximately $10 million to execute on the overall strategy. Isolating the increase in the cost of hedging and our move to cover additional asset classes increases our hedge cost to the $215 million range for the year.

Finally, we have seen the forward pricing curve flatten, thus making it more economical to lengthen the weighted average tenure of our forwards. Together with our house view that hedge costs may rise, we are exploring lengthening the average maturity of our forwards by rolling a portion into longer-dated positions. This strategy may increase our estimated cost in the $40 million to $60 million range, recognizing our current method of reporting cost at the time of purchase. This strategy may evolve as markets move, and we will continue to guide accordingly as we proceed through the year.

While increasing our reported cost, these moves are favorable from a risk and capital management standpoint. Importantly, the dollar program overall and expanded asset classes continue to perform well, even when considering rising hedge cost and when compared to low-yielding yen alternatives. This is why we've seen a surge in dollar and currency programs among Japanese insurance players over the past few quarters. As we move forward, we will update our guidance accordingly. And as is always the case, our guidance could change based on precise asset flows and market conditions.

Turning to capital. SMR remains in the mid-800% range with unrealized gains up significantly in the quarter. RBC remains strong despite FX impacting the ratio negatively with the yen strengthening and realizing our Japan branches embedded in our U.S. statutory results. Impairments in the quarter were modest and primarily related to our Japan equity portfolio where market declines have triggered impairments in accordance with our internal accounting policies. Overall credit conditions remain stable, and we have seen a recovery in energy names, including our below-investment-grade holdings. We do not see any immediate risk with respect to Brexit and our European holdings.

Overall capital liquidity conditions are strong and support our continued return of deployable capital to shareholders. Between dividends and repurchase, we returned $570 million to our shareholders in the quarter. Depending on the overall capital conditions, we expect to repatriate 80% to 100% of FSA earnings in 2016 or roughly JPY 120 billion to JPY 150 billion. We continue to spend down excess capital held at the holding company and are on pace to achieve our $1.4 billion of repurchase for the full year. We have made no adjustments to our earnings guidance of $6.17 to $6.41 per share assuming the same average exchange rate as last year, which was roughly JPY 121 to $1. Given strength in the yen during the quarter, we have provided, in our press release, an EPS range for the third quarter assuming the yen to dollar of JPY 100 to $1.10.

When analyzing our performance year-to-date, we are poised for strong performance in 2016. However, we are midway through the year, and we need to be conscious of the low rate environment, headwinds to investment income and associated actuarial review of select interest-sensitive closed blocks of business in Japan. In addition, from a corporate perspective, postretirement benefit liabilities are sensitive to long-term rate assumptions, and we typically review these corporate liabilities in the fourth quarter. Overall, we remain well positioned in terms of our core margins and capital strength.

Thank you. And I'll now turn the call over to Robin to begin Q&A. Robin?

Robin Y. Wilkey
Former Senior Vice President of Investor & Rating Agency Relations
Thank you very much, Fred. And as Fred just said, we are ready to begin Q&A. So we're ready to take the first question, please.

Question and Answer

Operator

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

Nigel Phillip Dally
Morgan Stanley, Research Division

Fred, with the hedge costs, you enter a number of different changes, increasing the size of the program, changing the costs given by conditions, extending the duration. Putting all those together, what do you expect to be the overall negative impact on earnings for 2017? And also why not report these costs on an amortized cost basis rather than all upfront, which seem to be a more economic way of reporting them?

Frederick J. Crawford
Executive VP & CFO

Sure. So a couple of comments. Let me handle the last -- second part of your question first. We are, in fact, putting under review our definition -- really our non-GAAP definition of hedge cost and how we want to report it in our definition of operating earnings. And in fact, it's very likely, Nigel, that we go to exactly what you're talking about. And that is more of an amortized cost approach, very similar to how you would expect coupons on bonds to behave or interest costs on debt. And so that's really where we're going to move. We will give more detail on this -- more precise detail on this during our outlook call, along with recognizing that we'd have to some degree adjust, if you will, our previous year results so that you can see really the comparables year-over-year. But ultimately, the goal is exactly what you're alluding to, and that is we want to get to a definition of hedge costs that moves logically with how you would expect. If pricing is increasing, we would expect hedge cost to go up. If we're lengthening the tenure and it's a steep curve, they would go up and vice versa. And of course, if we're doing more volume, covering more notional, they would go up or down depending on the strategy. What we want to avoid is what we're seeing right now as we don't want any marked-to-market noise, nor do we want the sheer timing of what rolls to influence it. Now to your first question. As we roll into '17, of course, what I just talked about will play into what I'm about ready to say. But you'll generally find a more smoother and logical approach to the cost. So a good way to think about it is if we are covering now, moving from roughly $12.7 billion notional or forwards to upwards of $5.7 billion -- or $5.6 billion notional forwards, you would expect, as you move into 2017, to roughly apply the pricing or average -- weighted average pricing you would expect on those forwards. Now the pricing depends on the market. So it's very difficult for us to estimate what that would be. As I mentioned in my comments, we've seen pricing rise a 1-year forward, for example, right now if you went out and purchased it, would be 160 basis points. What you could expect is that when we get to our outlook call, we will provide these types of details and ranges and sensitivities as part of our operating earnings. That will give you, I think, a little color.

Nigel Phillip Dally
Morgan Stanley, Research Division

Fred, sorry, I just wanted to correct something. It's, at year-end, $15.6 billion of forwards. I think you said $5.6 million.

Frederick J. Crawford
Executive VP & CFO

I don't know. I thought I said 15, but sorry, my apologies.

Operator

Our next question is from Eric Berg of RBC.

Eric Noel Berg
RBC Capital Markets, LLC, Research Division

What would you say would be the general trajectory for? I realize they're not going to project your statutory earnings, but what would you say would be, given the growth of the in-force at this point, both here and in Japan, would you expect statutory earnings to continue to increase? And if so, in the absence of strong premium growth, strong in-force growth, why would that be the case?

Frederick J. Crawford
Executive VP & CFO

So statutory results is an interesting conversation with us, right, because really what you're talking about is bifurcating between Japan and the U.S. So in Japan, you're talking about essentially FSA earnings. And you can -- sort of implied in our guidance, if you will, where we talk about repatriating 80% to 100% of FSA earnings or that being JPY 120 billion to JPY 150 billion, that gives you an idea of our expectation around FSA earnings for this year. Okay? So what are the types of things that will cause trend lines in those statutory earnings? You'd mentioned a couple of them. Growth rates realized over time because we are seeing growth in third sector, which would weigh down on FSA earnings. We're also seeing a gradual decline, obviously, and frankly more than a gradual decline in first sector sales, which would really promote or help, if you will, FSA earnings. So I expect those would probably largely level out. Now you do have some other things playing into FSA earnings. You do have foreign exchange that plays into it as we convert dollar-based coupon income, if you will, in Japan back into yen. You'll see some headwinds, if you will, related to a strengthening yen from that perspective. We have some of that factored into our guidance as you can imagine, but nevertheless, that plays a weight on it. And then hedge cost. I always remind folks, hedge costs are, in fact, brought through FSA earnings. And so as those rise, they could be weighing down on your FSA earnings as well. I would note, however, that interestingly enough, even with the rise in pricing here, this year, we actually had planned for hedge cost coming in right around where we're seeing them or projecting them today. So I don't see the recent rise in hedge cost as having implication for our 2016 cash flow. When you roll over to the U.S., it's a bit of a different matter, right? So starting with just isolating the notion of U.S.-only statutory income. We don't drive a U.S.-only statutory income. So it ends up being sort of excess cash flows produced in the U.S. And those have remained relatively steady. I would say we are seeing some growth rate in the U.S., and we're also investing in the U.S. platform in the form of technology improvements and infrastructure. So some of those are headwinds to statutory earnings, but otherwise, our sheer margins in the U.S., generally favorable benefit ratios, expense ratios generally under control, have been really helpful to stat earnings. So I don't see any sort of, what I would call, capital-related or growth or lack thereof related pressures on statutory earnings in the U.S. I would see it more to do with the pace of investment in the platform.

Operator

Our next question is from Ryan Krueger of KBW.

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

I had a follow-up on the hedge cost. Fred, you talked about 160 basis points for a 1-year forward, but then I think you were talking about potentially extending the duration of the book. Can you give a sense of how much more it costs on kind of the longer duration hedges you're potentially considering?

Frederick J. Crawford
Executive VP & CFO

Yes. So one of the things that has happened in the marketplace is while we've seen hedge costs rise, they've also -- the curb has flattened. And so for example, in really just the last few months, the difference between a 6-month forward and an 18-month forward has narrowed by some 25 basis points. And so if it costs you upwards of 150 basis points to lock in a 6-month forward, it may cost you more in the 170, 175 basis point range to do an 18-month forward. And so as a tactical strategy, you may want to take advantage of some lengthening where you can, and that's what I was alluding to in my comments. The reason why that results in a more acute cost in 2016, this 40 million to 60 million range I mentioned in my comments, is recognizing that we would pull that whole 18-month cost right into the current period. And so, again, as Nigel pointed out, as we move to a more amortized approach, you won't have that type of fluctuation. And so that gives you an idea of the relative difference and curve difference of extension. Something to remember is that at FAB, we talked about 110 basis points, and remember that is a realized cost estimate, that was taking roughly $13 billion or so of notional and $140 million or so of expected cost. So when you think about $215 million of cost setting aside the duration extension, that's right around 140 basis points. So there's a difference between the actual pricing in the market and our realized cost because, of course, we've locked in certain costs and have this accounting issue.

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

Got it. And just to clarify, the $215 million, does that -- that does not include the $40 million to $60 million additional that would -- from lengthening the duration?

Frederick J. Crawford
Executive VP & CFO

That's correct.

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

Okay. And then just a follow-up on the 30 to 50 point benefit to the SMR from repositioning the portfolio. I guess a couple of question. Is that just due to lower risk charges associated with locking in the hedges there? And then was -- I guess, is this anticipated in the 3-year capital plan that you provided at FAB?

Frederick J. Crawford
Executive VP & CFO

Yes. So the answer to your first question is yes. And that is when you put those hedges on, you just gather more favorable SMR treatment, if you will, as opposed to not having it due to essentially what amounts to ALM-related issues, i.e. a dollar investment backing up potentially yen liability. So you gain certain benefits. We also are covering asset classes that could be of a higher charge order, such as bank loans, for example, which will tend to be lower rated, if you will, in general. So again, makes it even particularly helpful. And as I mentioned in my comments, what I really like about the bank loan coverage, which took some time to qualify, right? When you're talking about floating short-dated investments and short-dated investments that are being managed by third-party asset managers, it took some time to work through the system to qualify for all the appropriate hedge treatment. We were able to get that done here in the last couple months and so we could expand the asset class. So it's a particularly all-in beneficial asset class to hedge, and so we're really happy with the progress we've made there. But that's where you pick up the SMR benefits. In terms of it factoring into our capital plan, yes. Yes, in the sense that one of the missions of the hedge program, only one of the missions, is in fact to stabilize and secure our capital dynamics in Japan such that we can be as confident as we can on the steady repatriation of cash flows for deployment. So no matter what the magnitude, it is helpful to our capital plan. I would not view it though as some sort of just booster jump to the capital plan, more good -- playing good defense.

Operator

Next question is from Suneet Kamath of UBS.

Suneet Laxman L. Kamath
UBS Investment Bank, Research Division

I wanted to just move to sales, if we could. Just in terms of Japan third sector. You're reiterating your guidance for down 3 to up 2. Obviously, year-to-date, you're running above that as I think Dan mentioned in his prepared remarks. And I see that the comps get a little bit more difficult, but I don't know if they're dramatically difficult. So just curious if there's anything in the second quarter that maybe was particularly favorable that we should think about adjusting for as we think about the balance of the year in terms of third sector sales.

Paul Shelby Amos

Former Director

This is Paul. I'll follow-up and start on that and then I'll ask either Yamau-san or Koji to comment as well. First of all, as Dan mentioned in his comments, second quarter represented just an outperformance by almost all channels with the excluding of the bank channel, and strong performance in both the cancer and the medical lines of business. So I do not believe there's anything you should be removing, and you should just see the straight strong performance across our channels and a desire by Japanese consumers to purchase our products. In terms of the second half of the year, the comparisons are there, and we do have to go up against stronger numbers. That said, we are running ahead of where we expected to be. And I think at the mini FAB Meeting in September, we would be in a better position to comment on whether we thought sales would continue to trend better than they have. As you know, we launched our MIT product this past week. And so by the time we get to our mid -- mini FAB Meeting in September, we should be able to give you some idea about the receptivity of that product. But as I've told you in the past, with any new product line, we're always tentative about how we receive and how long it would take the Japanese agencies to adopt it and begin selling it. We are very -- seeing very favorable results out of both our cancer for cancer survivors insurance as well as our revision of our nonstandard medical plan. So I remain very optimistic. But at this point, we're not ready to change that range. Yamau-san or Ariyo-san, would you like to comment further?

Unknown Executive

[Foreign Language] Nothing particular to add. However, what I'd like to mention is that JP channel is selling as planned and as Paul just mentioned, our nonstandard medical is selling well.

Suneet Laxman L. Kamath
UBS Investment Bank, Research Division

Okay. And then I guess maybe a bigger picture question for Fred. Obviously, lots of moving pieces in terms of product mix shifts and hedging costs and all that. But if we just take a high-level view of Japan, in particular, and we think about your sort of new business returns or your marginal ROE, how would you say that compares to your in-force returns?

Frederick J. Crawford
Executive VP & CFO

Well, in-force returns have been very strong, and that's in part because what we had historically priced for, if you will, has moved over time favorable to our pricing expectations. So in general, this is, I think, part of the Aflac story, frankly, over the years, both in Japan and in the U.S. that we have a generally very profitable in-force overall. In terms of some of the new pricing, obviously, we tried to remain very disciplined on that front. I think in Japan, there hasn't been much movement on that. We've been growing the old-fashioned way, which is expanded distribution, new product launches, and we remain somewhat consistent, in my view, on our approach to pricing. One difference, of course, is really focusing in on first sector and first sector savings. I would say when you turn your attention to those products, not surprisingly from an in-force perspective, those products are a bit more under pressure because the opposite has happened. What we have priced for has not played out quite as well in terms of, obviously, yields and investment income on those products. So that certainly offsets my comments, and it's why we're taking significant actions to make sure that we reduce the flows and shift the balance of sales and eventually, in-force over time. So that's the way I would describe it. But obviously, from the in-force perspective on the third sector side and really the entirety of the U.S. platform, it continues to be a very strong story.

Suneet Laxman L. Kamath
UBS Investment Bank, Research Division

Got it. And I just -- if I could sneak one more in, just a clarification. When -- I think, Fred, in your prepared remarks, you talked about the channels where you continue to sell first sector and I think you said the mix in those channels is skewed towards third sector. When you think about that mix, is that based on number of contracts or is that based on annualized premiums?

Frederick J. Crawford
Executive VP & CFO

I'll let Paul comment.

Paul Shelby Amos
Former Director

This is Paul. That's based on annualized premium. So we don't -- because of the relevant size of the first sector contracts and their strength, we are thinking about the ratio in terms of premium itself.

Operator

Next question is from Hung Fai Lee of Dowling & Partners.

Humphrey Lee
Dowling & Partners Securities, LLC

Shifting gear a little bit to the U.S., the productivity continues to see a good improvement on the year-for-year basis. Given the ongoing investments, how sustainable is the current pace of improvements and how should we think about that going forward?

Teresa Lynne White
President of Aflac US

This is Teresa. So I want to make sure I understand the question. You are speaking in terms of the productivity from a producer standpoint or profit standpoint?

Humphrey Lee
Dowling & Partners Securities, LLC

The profit standpoint, so the production divided by the agent count.

Frederick J. Crawford
Executive VP & CFO

Yes. So that would be agent productivity.

Teresa Lynne White
President of Aflac US

Okay. Okay. So I do still feel that there's opportunity with agent productivity. As I spoke about in May, I think in the May FAB Meeting, we're continuing to see a number of great indicators, new account growth is increasing, the productivity per producer is increasing. And the whole goal here is to ensure that when we bring new agents into the business, that we were able to get them trained, ensure that they stay with Aflac so that they can have a good career with us. So we're seeing that happen. We're excited about what we're seeing in the numbers. I am somewhat concerned about the recruiting as a whole. And I think our comparisons, we expected recruiting to be down for this quarter or this year. And really, I think a lot of that is some of the noise that were in the contracts last year as we change the contract this year to pay not for recruiting, but for producers. And so because that's how we're compensating our sales organization, I think we'll continue to see growth in productivity.

Frederick J. Crawford
Executive VP & CFO

And one thing I would kind of dial in. If to some degree, your comment was how does this all sort of drive down to the bottom line, just a couple of comments. One is, of course, when you're talking about sort of relative spend on distribution and productivity, you're now getting into sort of TAC-able [ph], if you will, expenses, and so you wouldn't see typically much in the way of big sort of bottom-line movements. I think from an overall investment in the U.S. platform, I would just call your attention back to our comments at FAB, and in particular, some comments and some projections we showed around the group business where we're actually investing in the platform and expecting there to be an improvement in profitability on just a group side over the course of the next 3 to 5 years. That continues on plan, continues on pace. There's been really no material adjustments from our comments at FAB.

Humphrey Lee
Dowling & Partners Securities, LLC

Okay. And then maybe more a strategy question for Dan. In your prepared remarks, you talked about a greater competition in the voluntary product side coming from other players. And I recall in the FAB Meeting, you guys talked about you may consider kind of providing a more full suite of group solutions in the U.S. Any update on kind of what you are thinking about? And what type of opportunities you're seeing?

Daniel P. Amos
Chairman & CEO

Yes. What I would say is that we're trying through our everwell platform, which is an enrollment platform, we're positioning ourselves to where we are trying to be the solution for the human resources department. And in doing so, for example, through this everwell platform, if it's an account under 50 in size and they want to go to buy Obamacare products, then they will be able to do that through our platform to go in and do that. So it also allows us to see everyone on a one-on-one basis. And so that ultimately should increase our enrollment. As far as other products, we are looking at other products. Teresa is studying that right now. We have not made any final decisions, but the type of products would be group-like. And if we did something along those lines, some of our competitors offer that, and we feel that we will either have to offer it as -- through to another company and bring it on in some form or fashion, but we want to make sure, because it's a lower profit margin product, that we don't have our sales force concentrating on it, but rather it is a product that opens the door for higher sales of our third sector products or -- I'm used to saying that because [indiscernible] is paying so much -- of our supplemental products in the U.S.

Operator

Next question is from Jimmy Bhullar of JPMorgan.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

The first question's on for Teresa on U.S. sales. So results are getting better. I think first quarter, you had almost a 4% increase in sales and this quarter, they got worse. So wondering if you could just give us a little bit of a detail -- a little bit more detail on what happened to U.S. sales and how that affects -- how the second quarter results affect your outlook for the rest of the year?

Teresa Lynne White
President of Aflac US

So I'll handle the last comment first. We continue to believe that the outflow, 3% to 5%, will materialize over the year. As Dan said in his comments, we do expect that to be closer to the fourth quarter, so skew there. One other thing, from the second quarter, what we're seeing is we thought really favorable comps for the -- not favorable comps but favorable performance in the broker business. We basically grew the broker business by about 15%. So we felt good there. The weak spot was our career side. And we are -- have some markets that had underperformed, and we are confident, though, that we have some -- the leaders -- the right leaders in place to address those issues that we have in those markets. But at this point, I feel good about the 3% to 5% for the year.

Daniel P. Amos
Chairman & CEO

I'll make one other comment. As we told you at FAB and other places, our struggle is trying to bring brokers on in a -- we're probably the only organization to have such a -- well, I know we are, to have such a dynamic field force. And so we're trying to push our field force in deriving the accounts of 100 or less. The overlap is between the 100 and 1,000. And over 1,000, we tend to see brokers. Now our brokers are also using our field force as enrollers. So that doesn't break out exactly that way because that shows as broker productivity. But all in all, it's beginning to evolve in a way that will ultimately, I think, increase our production, but it has been a struggle. And Teresa's done an exceptional job in bringing those together. When that's really clicking, that's when you're going to see it take off. And that's what we continue to work on is that -- and the production being off a little bit is because of our field force. But we think with Everwell and our way of enrollments increasing dramatically, up to 40% if you go through that process, that's going to help our field force and the tools that we give them. So it's a delicate balance here, but we're getting closer and closer. And the thing that told me that was in a recent meeting I had when some of our managers at our field level said they wanted the managers at our broker level to be at their meetings. They didn't use to want to get together and now they're working together as a team, and I think it's only going to get better as we move forward. And I'm very encouraged about that, but it's slower than I like.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

And you've made a lot of changes in your field force, so I would have thought that as we get further and further away from the disruption because of those changes, your results would actually slowly trend higher. So -- I recognize it's 1 quarter, but it's a little surprising that they went in the wrong direction.

Daniel P. Amos
Chairman & CEO

I will say this again. It takes time with the field force and, again, trying to move them to -- you should look at the overall number. And the overall number, I understand what you're saying. But the field force will continue to make up the small accounts, but the big accounts are going to be coming in. And in the second quarter, our broker business was way up. So it was our field force that was down slightly. And of course, they account for 2/3 of our business. So that's the other thing that's dragging us back. But I think long term, we got a solution for that, and it will continue to improve.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

And then just one more for Eric on Japan new money yields. It dropped this quarter, and I'm just wondering if you could give us some details on what exactly it is that you're investing in the Japanese portfolio? How much are you allocating to U.S. dollar investments. And if JGB yields will remain where they are, what would you expect your allocation to be roughly as you look into 2017?

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

Sure. Thank you. No worries. There's a few different components to that. But obviously, as you know, yields have been trending down, both in the U.S. and Japan. So that's partially the decline for the second quarter new money yield. But the bigger attribution of the decline was, and Fred referenced this in his speech, as we're entering into new asset classes, such as infrastructure, commercial mortgage loans, those take time to fund, unlike when we buy investment grade bonds, we get into the market and fund those pretty quickly. Now since we're turning those asset classes on for the first time, we knew that there'd be a delay in funding them. And therefore, during the quarter, we had a buildup of cash because it is taking us a little longer for our first time entering those asset classes. When we're sitting on cash, that doesn't go into the new money yields in the way we've defined it. But nevertheless, sitting on cash is not optimal for us, and we didn't want to do that. So we did put a little over $1 billion to work during the second quarter into yen assets, mostly residential -- Japan residential mortgage-backed securities and some JGBs as a temporary home, if you will. So that when the infrastructure and commercial mortgage loans are ready to be funded, as our managers call us up and say, we've circled deals for your portfolio, we'll then shift that out of there and put it into those assets. But because we put that cash to work, and we did keep it in yen for now, we didn't want to move it back and forth between yen and dollars, that had the results of, on average, being invested at a 30 basis point yield or so. So for the quarter, that impacted the new money yield and brought it down. But as we redeploy that money in the future from yen back to dollars, later on, whether it be later on this year, early next year, you'll see the new money yield go in the opposite direction and be higher than it normally would be. I should also mention by putting that cash to work, we are earning, for this year based on estimates of timing of reversal, about $2 million extra in net investment income versus it just sitting idly in cash. So that explains most of the decline for the second quarter versus our planned new money yield. More broadly speaking, for the second quarter, about 50% of the assets that we had to invest in the second quarter, and I'm using Aflac Japan numbers, which was about JPY 224 billion, did go into yen assets because of that extra money that I just referred to. And the other half went into dollar assets, U.S. equity, investment grade, commercial mortgage loans, bank loans. The nice thing is, as you look at the mixture, we continue to diversify the asset base, which gives us, as investors, a multitude of choices, not only from a risk return standpoint, but in this very volatile environment, particularly of negative rates in Japan. As our SAA and our outsourcing program and our in-house programs build out, those choices are opportunistic for us to balance out those things. Then very lastly, in terms of the view of JGB yields and impact to next year's cash flow, let me say this, at net negative rates, which the 10-year is still negative, about 3 weeks ago, the 20-year and the 30-year JGB were both under 10 basis points. We've put a moratorium on buying JGBs. And if they should stay at those low levels, we would not be buying JGBs. But as Fred has mentioned, we are actively exploring other yen investments because we do need yen investments, certainly, from an ALM standpoint. Our liabilities, as you know, in Japan are in yen. And there are some promising things on that front, perhaps restarting our yen private placement program. But if we do, it will be in a measured pace and, obviously, with a global credit team with much stricter risk limits than we had in the past, bringing down our private placements to about 24% of the portfolio. We do feel that there's some capacity there, but we still have to test the market in terms of supply and whether or not the structure of those types of things will meet our requirements. There are yen corporate bonds that we could be looking at. There are some ratings, regulatory things we need to explore. But all of that is a way to say that the ultimate rate on those assets would be based off the JGB yield curve, but we'd be earning a credit spread. And that is something that we like because we are very bullish and confident of our credit analysis and ability to analyze credit and, therefore, get the right return for the risk we're willing to take. So looking at next year, this is just so early, but consistent with prior SAA, it would probably be about 30% to 40% yen assets, 50% to 60% dollar assets. But Fred mentioned earlier, we are right now reviewing SAA in light of negative rates and how that -- the implications of that to the programs. And then from a tactical standpoint, as we look at these new asset classes, that will bear into our ultimate decisions for next year. So very preliminary view and outlook for next year.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

In terms of infrastructure for the new asset classes that you're going into, both in Japan and the U.S., are you fully staffed or would these require either more spending on your part or are you using -- are you outsourcing some of the assets?

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

Infrastructure would be outsourced. And as you recollect, we built our external manager platform team. So that's been built. And therefore, we get the leverage of being able to decide chi. We like an asset class, now let's go to market, find the best managers, do RFPs and those sorts of things. And we're in the final stretches of that and about to make some selections, which either by mini FAB or perhaps by the next quarterly earnings call we can tell you more about that. But we're committed to that, and that's in the final legs of going online.

Operator

Last question is from Tom Gallagher of Evercore ISI.

Thomas George Gallagher
Evercore ISI, Research Division

Fred, I just wanted to ask a question about how you're thinking about capital adequacy right now. I know your SMR ratio is quite strong, but I'm guessing with negative rates, SMR is no longer the best measure of capital adequacy here. And so in that regard, can you talk about just broadly, how you're thinking about evaluating capital adequacy? Are you using some type of internal economic capital model? And if so, what is it telling you right now?

Frederick J. Crawford
Executive VP & CFO

Yes. It's -- I would not discount SMR. It remains critical and really, arguably, the most critical measure in Japan. I think what's more important is be realistic about your understanding of what's moving SMR. In other words, there's a difference between SMR rising because of sheer retention and build of capital and SMR rising because of unrealized gains in your portfolio. So you know from following us, we're quite, I'll use the term sober, in terms of understanding that our SMR may go up at times, but it's driven by unrealized gains. That doesn't necessarily give way to the release of additional capital, et cetera. So we look at it on that basis, but pay careful attention to it. I think in addition to that, we look at just sheer cash flow performance, and I commented earlier on dynamics involving our FSA earnings. The reason why we have 80% to 100% of FSA earnings repatriation as a policy is that in times of stress, we may retain more capital. Right now, as I look at the risk as we go forward, I mentioned in my comments that we do have to be conscious of a couple small closed blocks of business that are more sensitive to low for long interest rates and actuarial sensitivity. I think it's really too early to tell at the moment whether we'll see any impact from that. We've, of course, got other blocks of business that tend to be somewhat "rich" with respect to reserves and IBNR and so forth. And so there could be offsetting issues. So at the moment, I think we're just being cautious in looking at those issues. I do think that -- if you think about where we are in the credit cycle, if you think about the interest rate environment in Japan and the associated volatility, I think it is in fact the time to be cautious about the notion of sizing, if you will, excess capital and deployable capital on a purely Japan basis. Cash flow remains good. I would not really move off of any of the comments I made at FAB, but we are more carefully watching it. Now contrast that with the U.S., where if you were to look at a U.S.-only basis, our business remains very strong, very stable. It's by definition a low-risk profile business. We run at very high RBC levels if you were to look on a stand-alone basis. And so I continue to promote the notion that while we're moderating our views of excess capital in Japan, we continue to be bullish on the notion of there being excess capital levels in the U.S. And we'll try to balance it out as we go forward.

Thomas George Gallagher
Evercore ISI, Research Division

Got it. And Fred, just a follow-up. Are you using some alternative measure, whether that's just for your purposes as another cut looking at the economics of your Japanese business or are you really relying on SMR now to determine capital adequacy?

Frederick J. Crawford
Executive VP & CFO

No. Tom, thanks for asking the question because -- let me just step back and say that everything sort of starts at the root of our capital planning with just our view of the risk, not a formula's view of the risk. And by that, I say we have developed, as you could imagine, certain economic capital approaches to stressing our business, looking at capital adequacy, both in Japan and the U.S., although more of an issue in Japan given the low rate environment. And very, very importantly, don't lose sight of the stress testing. We do pretty extensive stress testing, both in Japan and in the U.S., looking at all the variables you're accustomed to in terms of moving our ratios around. And under those stress tests, that can guide us to some degree on how much capital we carry. So I've got my partner, if you will, Todd Daniels, right next to me, and he is our Risk Manager globally. And he and I work in very close contact along with Eric in looking at these stresses, looking at economic capital-oriented capital ratios as well as the stated ratios. So you're right to ask that question, we do, do that, and it guides our behavior.

Thomas George Gallagher
Evercore ISI, Research Division

Got you. And even -- sorry, one last follow-up. When you consider economic capital, you still -- you feel like you're in good position, all things equal. Is that fair to say?

Frederick J. Crawford
Executive VP & CFO

Yes. If you look at -- if you follow Japanese insurance companies, you'll note that on their economic value analysis, that they've lost economic value related to the very low interest rate. Remember that their business models tend to be much more heavily weighted towards the types of businesses that will take it on the chin, so to speak, with respect to low for long rates. Now we're not immune from that. We have businesses, most notably, first sector savings-oriented businesses, that will get depressed, some of the longer duration businesses can get depressed related to low for long rates, even on the third sector side. So we're not any different than the Japanese companies in the sense that we've seen headwinds on those ratios, but realize on a relative basis, we tend to perform much better. We tend to model out more favorably because of the sheer strength and size of our third sector business and dominant positions. So no question, there has been headwinds to those type of, what I call, traditional economic capital positions. But we tend to do well on a relative basis and that helps us out.

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

Before we end the call today, I'd like to take the opportunity to remind everyone of our upcoming Tokyo Financial Analyst Briefing to be held on September 12. For further details, please don't hesitate to call us, and we look forward to seeing you there. And thank you again for joining us today for the call. Goodbye.

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