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Market Intelligence

Aflac Incorporated NYSE:AFL

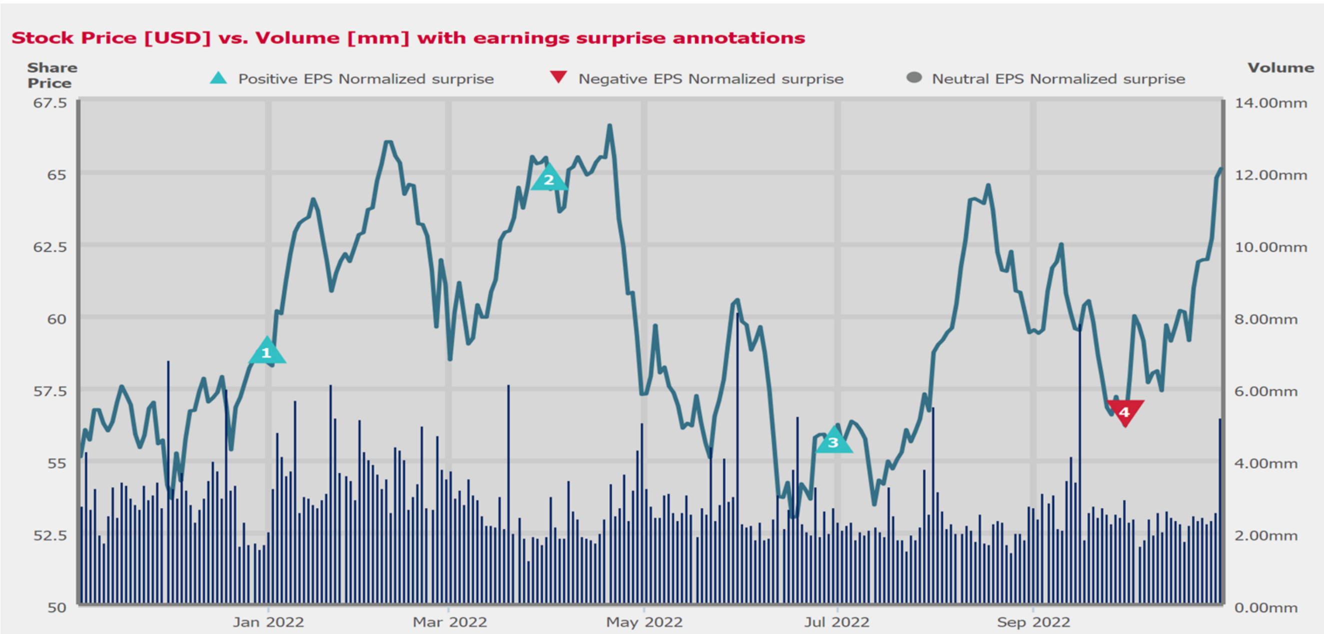
FQ3 2022 Earnings Call Transcripts

Tuesday, November 1, 2022 12:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2022-			-FQ4 2022-	-FY 2022-	-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.22	1.15	(5.74 %)	1.22	5.26	NA
Revenue (mm)	4583.04	4820.00	5.17	4530.21	18928.63	NA

Currency: USD
Consensus as of Nov-01-2022 9:26 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2021	1.26	1.33	1 5.56 %
FQ1 2022	1.37	1.42	2 3.65 %
FQ2 2022	1.28	1.46	3 14.06 %
FQ3 2022	1.22	1.15	4 (5.74 %)

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Call Participants

EXECUTIVES

Albert Angelo Riggieri
Senior VP, Global Chief Risk Officer & Chief Actuary

Daniel Paul Amos
Chairman & CEO

David Young

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

Frederick John Crawford
President & COO

James Todd Daniels
Executive VP, Director & CFO of Aflac Life Insurance Japan

Koichiro Yoshizumi
EVP of Sales & Mrkt. and Director of Sales, Mrkt., Alliance Strategy - Aflac Life Insurance Japan

Masatoshi Koide
President, CEO & Representative Director

Max Kristian Broden
Executive VP & CFO

Teresa Lynne White
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Citigroup Inc., Research Division

Nigel Phillip Dally
Morgan Stanley, Research Division

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

Suneet Laxman L. Kamath
Jefferies LLC, Research Division

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Wilma Carter Jackson Burdis
Raymond James & Associates, Inc., Research Division

Presentation

Operator

Good day, and welcome to the Aflac Inc. Third Quarter and Total Year 2022 Earnings Call. [Operator Instructions] Please note this event is being recorded. I'd now like to turn the conference over to David Young. Please go ahead.

David Young

Thank you, and good morning. Welcome to Aflac Incorporated's Third Quarter Earnings Call. This morning, we will be hearing remarks about the quarter related to our operations in Japan and the United States from Dan Amos, Chairman and CEO of Aflac Incorporated; Fred Crawford, President and COO of Aflac Incorporated, will then touch briefly on conditions in the quarter and discuss key initiatives.

Yesterday, after the close, we posted our earnings release and financial supplement to investors.aflac.com, along with a video from Max Broden, Executive Vice President and CFO of Aflac Incorporated, who provided an update on our quarterly financial results and current capital and liquidity. Max will be joining us for the Q&A segment of the call, along with other members of our executive management, including Teresa White, President of Aflac U.S.; Virgil Miller, Deputy President of Aflac U.S.; Eric Kirsch, Global Chief Investment Officer and President of Aflac Global Investments; Brad Dyslin, Deputy Global Chief Investment Officer; Al Riggieri, Global Chief Risk Officer and Chief Actuary; June Howard, Chief Accounting Officer; Steve Beaver, CFO of Aflac U.S.; Charles Lake, Chairman and Representative Director, President of Aflac International; Masatoshi Koide, President and Representative Director; Todd Daniels, Director and CFO of Aflac Life Insurance Japan; Koichiro Yoshizumi, Executive Vice President and Director of Sales and Marketing and Alliance Strategy.

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

As I mentioned earlier, the earnings release is available on investors.aflac.com and includes reconciliations of certain non-U.S. GAAP measures.

I'll now hand the call over to Dan. Dan?

Daniel Paul Amos
Chairman & CEO

Well, good morning, and thank you for joining us.

Let me begin by saying that the third quarter of 2022 concluded a solid first 9 months for the company. Aflac Incorporated reported net earnings per diluted share for the third quarter of $2.53 and $6.25 year-to-date. Adjusted earnings per diluted share were $1.15 in the third quarter and 4.03% for the first 9 months. These results are solid despite the impact of significantly elevated COVID claims in Japan during the third quarter due to the industry practice of deemed hospitalization. Overall, I am pleased with where we stand at the beginning of the fourth quarter. We remain on track for another good year of financial results, and we expect continued sales momentum in both markets.

As we have communicated in the second quarter, we anticipated a sharp third quarter increase in COVID claims in Japan, and we experienced that increase. We are now seeing more normalized COVID claims during the fourth quarter. Reflecting on the third quarter, our management team, employees and sales force have continued to be resilient while being there for the policyholders when they need us most, just as we promised.

Looking at our operations in Japan in the quarter. Aflac Japan generated solid overall financial results with a profit margin of 21.6%. One of the key contributors to Aflac Japan's strong financial results is its persistency, which has remained consistently strong at 94.3% for the past 4 quarters. New annualized premium sales continued to improve in the quarter with the launch of our new cancer insurance product through agencies in late August, which drove a 32.6% increase in cancer insurance sales in the quarter. This contributed to an overall sales increase of 10.2%.

I just recently returned from my trip to Japan this year. As you'll recall, I traveled to Japan in June and had a successful meeting with the management at Japan Post Holding, Japan Post Company and Japan Post Insurance. This most recent trip in mid-October was geared toward connecting with our agencies, where I went to 5 different cities across Japan, and it was equally successful. As you know, we strive to be where consumers want to buy insurance, and this is accomplished through all the distribution channels, agencies, alliance partners and banks.

We continue to closely track how pandemic conditions are evolving, particularly because of its correlation with the opportunities for face-to-face sales, which is key to the recovery in sales. I arrived home from Japan excited by the energy at the agencies with whom I met and feel very good about our ability to sell new policies as we emerge from the pandemic.

As I mentioned, we have seen our benefit ratio normalize so far in the fourth quarter given the narrow scope of deemed hospitalizations introduced towards the end of the third quarter. We continue to expect stronger sales momentum in the fourth quarter, assuming that productivity continues to improve at Japan Post Group and that we execute on our product introduction and refreshment plans. We will start selling our new cancer insurance product through Japan Post Group in the second quarter of 2023.

Turning to Aflac U.S., we saw solid profit margin of 19.3%. I am pleased that we again generated sales growth with an 11.8% sales increase in the third quarter and a 15.2% increase year-to-date. I am encouraged by the continued improvement in the productivity of our sales associates and brokers with the strength of both channels approaching pre-pandemic levels, as we enter what trends, excuse me, to be our strongest quarter of the year. We are seeing success in our efforts to reengage better in sales associates. And at the same time, we are seeing strong growth through brokers. These results reflect continued adaptation of the pandemic conditions, growth in our core products and investments and build-out of our growth initiatives.

While Aflac Dental and Vision and Group Premier Life Absence Management and Disability Solutions, which we now call PLADS, a relatively small part of our sales, we are pleased with how they're contributing to our growth, and opening opportunities to sell our core supplemental health products. We continue to work toward reinforcing our leading position and generating stronger sales for the fourth quarter. I believe that the need for the products that we offer is strong or stronger than ever before in both Japan and the United States. At the same time, we know consumer habits and buying preferences have been evolving. We remain focused on being able to sell and service customers whether in person or virtual. This is part of the ongoing strategy to increase access, penetration and retention.

Turning to capital deployment. We place significant importance on continuing to achieve strong capital ratios in the U.S. and Japan on behalf of our policyholders and shareholders. We continue to generate strong investment results while remaining in a defensive position as we monitor evolving economic conditions. In addition, we have taken proactive steps in recent years to defend cash flows and deployable capital against a weakening yen.

When it comes to capital deployment, we pursue value creation through a balance of actions, including growth investments, stable dividend growth, and discipline and tactical stock repurchase. With fourth quarter's declaration, 2022 will mark the 40th consecutive year of dividend increases. We treasure our track record of dividend growth and remain committed to extending it, supported by the strength of our capital and cash flows. We have remained in the market repurchasing shares with a tactical approach. Year-to-date, Aflac Incorporated deployed $1.8 billion in capital to repurchase 30.3 million of our shares. Combined with dividends, that means that we delivered $2.6 billion back to the shareholders for the first 9 months.

With this approach, we look to emerge from this period in a continued position of strength and leadership. Keep in mind, in addition, we have among the highest return on capital and the lowest cost of capital in the industry. We have also focused on integrating the growth investments we have made. We are well positioned as we work toward achieving long-term growth, while also ensuring we deliver on our promise to the policyholders.

I am proud of what we've accomplished in terms of both social purpose and financial results, which have ultimately translated into strong long-term shareholder return. We also believe in underlying strengths of the business and our potential for continued growth in Japan and the U.S., the 2 largest life insurance markets in the world. Throughout the uncertainty of the last few years, I think we've done a good job in maintaining our focus on controlling the things that we have the power to control. We can and will control our efforts to build our business and take care of those who depend upon us, our policyholders, our shareholders, our customers, our employees, our distribution and the communities in which we operate.

In closing, you've heard me say many times this before of how I believe that 1 of my key roles as CEO in conjunction with the Board is to develop our leaders to lay a groundwork for strong succession planning. This approach enables continuity and expertise in strategic execution. You saw that succession planning in action recently with the 2 deputy positions moving to the next level. The announcement last week of Brad Dyslin, who will assume the role of Chief Investment Officer in January of 2023 as well as the August announcement of Virgil Miller, assuming the role of President of Aflac U.S.

I want to thank Eric for his vision and expertise in building a world-class investment organization that has performed at a high level. I also want to thank Brad for his new leadership role. Brad has proven himself as a distinguished leader collaborating with Eric and the team to deliver strong results and enhancing the reputation of Aflac Global investment. I, also, am grateful for Teresa's 24 years of outstanding leadership and contribution to Aflac, most recently as President of Aflac U.S. for the last 8 years.

As Virgil assumes his role, I know he is well suited to lead Aflac U.S. with a seamless transition as Aflac continues to build on its path toward delivering efficiencies, innovation and growth.

These are great examples of how we place a high priority on ensuring that we have the right people in the right place at the right time. In doing so, we have continued our focus on building a strong, deep bench of leaders preparing to take on more responsibility.

Thank you all for joining us this morning, and I'll turn the program over to Fred. Fred?

Frederick John Crawford
President & COO

Thank you, Dan. Last quarter, I commented on how we are positioned as a company when considering current U.S. and global economic conditions. The impact of inflation does apply upward pressure to expenses. However, this is mitigated by rising rates and additional investment income.

In terms of the risk of recession, our morbidity-based insurance model is generally defensive in nature with relative stability in sales and earned premium through the economic cycles, low asset leverage, and exposure to risk assets. Finally, while certainly not immune to volatility in foreign exchange, we have put in place defensive measures to combat the economic impact of a weakening yen. Overall, we like how we are positioned and see no material adjustments to our operating or capital plans.

Turning to Japan. We witnessed COVID cases surging in what is now referred to as Japan's seventh wave of infections. Daily new cases in the quarter reached a peak of 260,000 in August with the wave concentrated in the July through September time frame, effectively running its course in the third quarter. Daily cases have now slowed to a 7-day average of roughly 40,000.

As we signaled last quarter, we experienced elevated COVID incurred claims, driven by its designation as an infectious disease and the industry practice of deemed hospitalization, which allows for payment of claims for care outside of the hospital. To give you an idea of the magnitude, before the seventh wave, our weekly COVID claims were in the 7,000 to 13,000 range. During the recent wave, we peaked at approximately 47,000 weekly COVID claims. Hospitalization remains low, and this lack of severity has resulted in the government of Japan changing the definition of deemed hospitalization. Effective September 26, the scope has been narrowed to the elderly, those requiring hospitalization and individuals more vulnerable to severe symptoms.

This change in policy, together with lower overall rates of infection will greatly reduce the volume of new claim submissions. While more volatile than usual, we have established reserves for claims incurred in the period, but not yet reported. Therefore, we expect pressure on Japan's benefit ratio to subside in the fourth quarter.

Dan mentioned his trip to Japan. I also traveled to Japan in the last few weeks. The general population remains very cautious with respect to the potential for COVID infection. For example, if you walk the busy streets of Tokyo, you'll stand out if you're not wearing a mask outside. While difficult to measure, we believe this remains a headwind for proposal volume and sales; however, our view is conditions are improving. Despite these conditions, we remain focused on the following: distribution recovery and productivity across all channels, core product refreshment and product line expansion, cancer and elderly care ecosystem development through Hatch Healthcare and digitizing paper and manual processes for greater operating efficiency.

We will develop these themes in more detail at our financial analyst briefing later this month.

Before I jump to the U.S., let me also extend my gratitude to Teresa White. She's been a trusted adviser to me and helped me acclimate into this new role of mine and getting educated on the U.S. platform, and I also look forward to working with Virgil as we're off to a great start in 2022.

Turning to the U.S. As Dan noted in his comments, we continue to deliver a balanced attack to the marketplace. Split by product class, group benefits were up nearly 28%, individual benefits up 4%. Split by channel, agent sales were up 6% and broker up 20%. With respect to our expansion businesses, Network Dental and Vision and Premier Life and Disability were up 120% and 39%, respectively, for the quarter.

Consumer markets continues to struggle down 13% and somewhat expected given the cost of lead generation and timing related to the rollout of new product. We remain bullish on this building business, having recently launched our direct-to-consumer dental and vision products as well as new alliances introducing senior and core Aflac products on third-party platforms.

Persistency has recovered in our individual business as labor markets appear to have stabilized; however, group persistency has been weak throughout 2022. Our group business represents about 15% of our U.S. earned premium and has traditionally lower persistency compared to individual. There are no systemic drivers, but this segment can be more volatile, and we have experienced the loss of a few larger accounts this year.

Our focus in the U.S. remains the following: recovery in our agent-driven small business model post COVID, maintaining momentum in our group voluntary business, building out our expansion businesses and realizing the halo effect in associated voluntary sales, and bending the expense ratio curve, transitioning from investment to benefit realization. Again, we will develop these themes at a briefing later this month.

Turning to global investments. Let me first add my sincere gratitude to Eric for his years of leadership and trusted counsel in managing not only our investments, but contributing to many of the key financial strategies that have positioned us well today. Congratulations to Brad. I can't think of a better prepared executive to ensure continuity and carry forward our record of strong investment performance.

In terms of investment conditions, with the rise in short-term interest rates, we are actively managing the interplay of net investment income and the cost of currency hedging. Given the material increase in LIBOR forward curves, we elected to lock in a large portion of our floating rate portfolio to protect against future rate declines. A portion remains floating and will benefit if rates continue higher. We believe this balanced approach to managing interest rate risk in our floating rate book positions us well for future rate volatility.

We maintain our traditional approach to rolling foreign currency hedges on a portion of our U.S. dollar portfolio in Aflac Japan. We also continue to hold options against our unhedged dollar assets, a strategy that protects our Aflac Japan capital position against a large weakening of the dollar. While hedge costs are on the rise and will impact Japan's segment earnings, the combination of floating rate investment income and offsetting hedge instruments at the holding company, serve to largely neutralize the impact to enterprise earnings.

Our alternative investment portfolio pressured results in the quarter, recording a $40 million loss from our third quarter valuation marks. This was anticipated given the natural correlation to the public equity markets and the lag in private equity reporting. Despite losses in the quarter, year-to-date, the alternative portfolio has generated $125 million in income following a very strong year in 2021. We expect continued pressure on alternatives in the fourth quarter as the markets remain volatile, but fully intend to invest through the cycle and capture the long-term return benefits of this strategy.

Offsetting our variable investment income results was a negotiated prepayment of a private security and large amount of associated make-whole income. This -- we call this out in our results as the event contributed a onetime boost of $84 million pretax to investment income. Our middle market and transitional real estate loan portfolios continue to perform well. We have reserves set up for these loans, which have increased modestly, reflecting potential softening of economic conditions.

We are closely monitoring the risk of recession. We maintain a defensive position to risk assets and feel good about how we're positioned. We continue to seek attractive opportunities recognizing the near-term risk of a global slowdown and do not have any acute derisking activity planned at this time.

I'll now hand back to David to take us to Q&A. David?

David Young

Thank you, Fred. We're ready to take your questions, but before we do, I ask please limit yourself to 1 initial question and 1 related follow-up to allow others an opportunity to ask a question, and you may get back in the queue as well. Jason, we'll now take the first question, please.

Question and Answer

Operator

[Operator Instructions] Our first question comes from John Barnidge from Piper Sandler.

John Bakewell Barnidge
Piper Sandler & Co., Research Division

My question, you announced in October Dental, Vision and Hearing plans available to individuals outside of the traditional work site. Can you talk about how you're going to meet the customer, how sizable an opportunity is and how you think about acquisition costs there, please?

Frederick John Crawford
President & COO

So the -- what we announced was the launching of Dental and Vision and Hearing on our direct-to-consumer platform. And so this is really what we mean by outside the work site is our direct-to-consumer platform is designed specifically to go after potential customers outside the normal work site payroll or W-2 employee environment, meaning the gig economy, individuals who are -- work outside traditional W-2 environment, self-employed, for example, and then also to some degree, the senior markets who are naturally concentrated outside the work site.

So this is really a strategy to enhance our product lineup the direct-to-consumer platform. We think the Dental and Vision piece of it is important really for 2 reasons. One is, of course, the ability to generate sales through that channel, but the other is Dental and Vision and Hearing is a heavier searched item by individuals. And by putting product on our platform that caters to more search activity, it offers up an opportunity to cross-sell some of our traditional supplemental health products, which are less searched for. So that's effectively the strategy, John. Did I answer your question? Or do you have a second question there?

John Bakewell Barnidge
Piper Sandler & Co., Research Division

Yes, Fred, that was fantastic briefly, the related follow-up, can you talk about the initial tech rollout of the group benefits package? I know the fourth quarter of '22 is the big rollout since it has pet insurance?

Frederick John Crawford
President & COO

So on the topic of pet insurance, we have, in fact, rolled out the pet insurance alliance. This is the Aflac Pet insurance powered by Trupanion. We have focused on the larger broker-driven case size for that product. We characterize that as our premier broker relationships, which tend to travel in the 1,000 employee and up case size. It is really just getting off the floor. I think we have been awarded 4 accounts so far and are in the process of building that out.

I would characterize this year as still somewhat of a proof-of-concept year in terms of getting out there with the product, successfully landing accounts, integrating those accounts between the 2 parties, our partnership with Trupanion and then making any tweaks or adjustments that we think are necessary to better compete as we roll towards 2023. But we are up running and launched. We're filed in all the states. The product is ready to go but concentrated in the large case market. So we will have, obviously, a fairly small level of sales this year.

Also be mindful of this is really earned premium and economics for Trupanion. Our play from a pet insurance perspective is to fill out our portfolio, as you suggest, to where we're able to offer a broader array of benefits to brokerage clients, who desire that plus also their end clients. Other than that, I would say our product upgrades have been relatively routine in nature, meaning natural upgrades, covering things like mental health and other dynamics that have become more important to the broker and the consumer this year, and we continue to do that as a normal part of our business activities.

Daniel Paul Amos
Chairman & CEO

This is Dan. Let me make 1 comment is that, for example, with Dental and Vision, it's not so much selling that product as it is open the door to sell our existing products. And for every 5 Dental and Vision products we sell, we sell an additional 3 supplemental health insurance products. So that's what we're really looking towards. The other is gravy of how we're doing those other things, and we like that, and I'm glad to have it. But it's being on the front page of the benefit section of the employers' HR that really makes the difference, and this is what we're counting on long term.

Operator

The next question comes from Nigel Dally from Morgan Stanley.

Nigel Phillip Dally
Morgan Stanley, Research Division

So I just wanted to start on the new cancer product. How long should we expect this product to boost at all. It seems like product life cycles have shortened, perhaps to only a quarter or 2. So we'll be interested whether that's consistent with the view for this product. And also if you can touch on additional product introductions you have slated for 2023, you mentioned the Cantor product for Japan Post. Are there other products also due to be refreshed next year?

Koichiro Yoshizumi
EVP of Sales & Mrkt. and Director of Sales, Mrkt., Alliance Strategy - Aflac Life Insurance Japan

[Interpreted] Thank you for the question. This is Yoshizumi. Let me answer your question.

Well, in terms of the cancer insurance, we have launched our new product in -- on August 22. The channel that we have launched, the new product is in the general agency's channel and [indiscernible] live channel. And the sales through these channels between August and September this year have been quite successful. The actual sales was up 50%, 5-0% year-on-year. And we are seeing a great momentum still in the fourth quarter as well regarding this cancer insurance. And we are seeing about 47% increase year-on-year at the moment.

And also from January 2023, we will start offering more comprehensive support related to cancer called [Yodiso] Cancer Consultation Service. This is a new service that would comprehensively support the patients or the policyholders from the time they develop cancer and up to the point they recover to their work. And this is the first of its kind in the industry. And this service will be able to respond to all the struggles and all the things that the patient as well as the family members have difficulties with.

This is a great differentiator against other cancer insurance. And regarding the sales to start in the Japan Post Group, we are hoping to have it launched in the second quarter next year. We are thinking of working closely together with the Japan Post Group to increase the actual sales channel or sales route as well as training.

And in terms of the other channels such as financial institutions and Dai-ichi Life, we are planning to launch the cancer product in January next year. And we will be actively and aggressively selling cancer insurance in the fourth quarter this year as well as the first quarter next year, and that's all for me.

Nigel Phillip Dally
Morgan Stanley, Research Division

That's great. Then just as a follow-up, I saw a bit of a step up in the pace of buybacks this quarter. I just wanted to understand what was behind that. Your excess capital position seems to be at a level where you could easily continue at that pace, conversely with the risk of recession, maybe you want to hold on to some more capital. So just some comments as to how we should be thinking about buybacks.

Max Kristian Broden
Executive VP & CFO

Thank you, Nigel. It's Max. So $650 million in the quarter, and as always, we look at our capital levels, the capital generation, current and future that we expect from our subsidiaries in the overall enterprise, as well as the opportunity set that we see in terms of deploying capital, that being through dividends, buybacks, opportunistic deployment, et cetera. And that's really what sort of drives how much of buybacks we are doing at any point in time.

And generally speaking, we want to deploy capital where we see good IRRs, and the buybacks that you saw in the quarter was a reflection of that. In terms of looking forward, we feel good about our overall capital position and liquidity as well despite the very significant movement that we've seen in the yen.

Operator

The next question comes from Jimmy Bhullar from JPMorgan.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

Teresa and Eric, good luck in the future. So first sort of question just on policy usage in the U.S. The benefits ratio has been lower than normal through the pandemic, and it was fairly low in 3Q as well. Do you feel that you're still benefiting from low usage in the U.S.? Or is the benefits ratio reflective of what you expect it to be going forward?

Max Kristian Broden
Executive VP & CFO

Yes. It's Max again. I would just say that overall claims utilization continues to be at a relatively low level in the U.S. And especially on some lines of business, like accident, hospital, et cetera, we have been a little bit surprised that we haven't sort of come back to the full normal levels, as well as cancer that have not gone sort of above the pre-pandemic trend. We would expect that to actually happen for a short period of time, simply because there's some catching up to do in terms of cancers that should be detected and also some severity come through as well.

We have not seen that yet. We do expect that in the cancer lines of business, but overall, we have seen favorable claims utilization in the quarter and throughout the full year so far. And I ask the U.S. team and Teresa and Virgil to sort of fill in with your comments as well.

Teresa Lynne White
President of Aflac US

Yes. I'll just add to that. You're absolutely spot on with your comments. We are seeing lower hospital benefits as well coming out of the pandemic and more outpatient-focused therapies wherever possible. So we're seeing first occurrence benefits to rebound to 2019 levels, but hospitalization has lagged. That's really all I wanted to add to that.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

And Fred, you had commented in your prepared remarks about, I think you implied that people wearing masks, is still a hindrance to sales in Japan. Are you seeing lower appointments than normal? And are there other things besides just masking, like social distancing, people not coming back to work full time that are also weighing on sales results?

Frederick John Crawford
President & COO

Yes, I think there's a couple of things going on. One is, yes, there is a general headwind to face-to-face communication unless necessary. And so that persists in Japan, although as I mentioned, it is improving. And in fact, the actual government of Japan is now coming out and encouraging people to open up a little bit and get back to traditional business. So it's not at pre-COVID levels of activity. And that's what I mean by remains a headwind, but it certainly is improving.

I think the other dynamic that we mentioned last quarter that remained the case during the third quarter is when you have a high level of cases and a high level of infection rates of COVID, you naturally are going to have actual agents that are infected and impacted and are pulled out of the field, so to speak, unable to meet with clients or meet effectively with clients. And so that has played into it. You're talking about our distribution model through third parties has several thousand agents that we sell through.

And so when you have something as widespread as the third quarter level of COVID cases, you naturally will see less feet on the street, so to speak selling. Again, we think this will naturally improve for the same reasons we see our benefit ratio and claims activity improving in the fourth quarter.

Daniel Paul Amos
Chairman & CEO

And Fred and I have discussed this, but 1 other point is, just remember, Japanese were wearing the mask before COVID. So I don't think I went anywhere that I saw anyone that did not have on the mask, but it begins to look more normal. And so we'll have to wait and see. But everyone's -- I hardly ever see anybody with mask, except at hospitals and other places in the U.S., but they're still wearing them, but they're beginning to function. And I think that's the point that we're both making is, is that things are moving back to normal.

But if you take a snapshot, you're going to see everybody with mask on and you're going to say, oh, well, it's awful. Well, it's their culture too. So don't not think about that as you're a little going forward.

Operator

The next question comes from Suneet Kamath from Jefferies.

Suneet Laxman L. Kamath
Jefferies LLC, Research Division

Just on the Japan cancer sales. Can you give a sense of what percentage of the sales were lapse reissue and how that compares to prior product launches?

James Todd Daniels
Executive VP, Director & CFO of Aflac Life Insurance Japan

Suneet, this is Todd. I think I'll take that. It takes time for us to look back and know exactly how to identify the lapse and reissue. We don't see it until the lapse actually is processed. So right now, we're seeing slightly higher lapse and reissue rates over 50%. And we believe that this could go higher as we look backwards, but this is within our expectation.

Suneet Laxman L. Kamath
Jefferies LLC, Research Division

Okay. Got it. And then I guess, just curious on the timing of when you're going to start sales through Japan Post in the second quarter. I think that's probably the start of their fiscal year. So maybe that's the reason. But any color on what the client overlap is between Japan Post and some of your other distribution channels?

Frederick John Crawford
President & COO

I don't know if you'll see Yoshizumi-san or Koide-san have any color they can provide on the overlap.

Koichiro Yoshizumi
EVP of Sales & Mrkt. and Director of Sales, Mrkt., Alliance Strategy - Aflac Life Insurance Japan

[Interpreted] So this is Yoshizumi once again. In regards to the Japan Post sales of new cancer, we are thinking of it to start in the second quarter. And in other channels, we are thinking of having the product launched in January such as in bank channel or the Dai-ichi Life channel. And I'm not quite sure whether I'm answering to your question or not, but because of the overlapping of the channel's launch or the timing difference of the launch in each channel, there will be smooth launching of products from 1 channel to another.

Masatoshi Koide
President, CEO & Representative Director

[Interpreted] Okay, this is Koide. Let me just add a little bit. And of course, in each channel, there are some overlaps of customers. And although I did mention that there are some overlaps of customers between channels, at the same time, each channel has its own specific customer base. Therefore, for example, in Japan Post Group, the other channels may start selling the product before the Japan Post Group, because the Japan Post will not start its sales until the second quarter.

However, because Japan Post Group has a very solid customer base on its own, there should be a great sales from there as well.

Operator

The next question comes from Wilma Burdis from Raymond James.

Wilma Carter Jackson Burdis
Raymond James & Associates, Inc., Research Division

My understanding of the 940 basis points of higher Japan benefits ratio from the hospitalizations, about half of that was reported, and the other half as IBNR. This feels a little bit conservative. I don't know if you agree, is it possible that some of this could be reversed in 4Q? Or is that -- just help us think about the benefit ratio in 4Q between releases and what's going on there?

Max Kristian Broden

Executive VP & CFO

Let me kick off, and I'll have Al or Todd sort of add their comments as well. So for the full year, we would expect to have a Japan benefit ratio in the range of 69% to 70%. And we were sitting at 69.8% as of the first 9 months. That obviously means that we are expecting a more normal benefit ratio in the fourth quarter if you then compared to where our underlying run rate has been more recently. So I'll stop there, and I'll have Al and Todd to sort of give their thoughts on the IBNR that we put up in the quarter.

Albert Angelo Riggieri
Senior VP, Global Chief Risk Officer & Chief Actuary

Yes. It's Al Riggieri. I'll give you a quick comment. I think it's much around the common sense on the IBNR. If you think about that peak in claims happening around August when you think about how long it takes for it to actually come through our peak infections during August coming through our financials. Approximately 60 days later, it's going to start really washing its way through. So the 50-50 split in the third quarter is pretty reasonable in the sense that half of the claims that you saw in the quarter are actually cash and the other half is sitting there and will be cleared during the fourth quarter, sort of a rough estimate of how that 50-50 will play out during the fourth quarter.

James Todd Daniels
Executive VP, Director & CFO of Aflac Life Insurance Japan

Yes. And this is Todd. Just to give you an idea of how the claims are coming through. Our peak of paid claims was in the middle of September. And for the last 2 weeks, we've been running at about 60% of that level. So we anticipate, as Al said, with the 6-week to 2-month time period, these claims will begin to come down. And then with the change of definition at the end of September, they should come down even further.

Wilma Carter Jackson Burdis
Raymond James & Associates, Inc., Research Division

Thank you. Another question. Could you talk about the potential impact of a recession on the group disability business and maybe talk about why this is or isn't a good time to get into that business?

Frederick John Crawford
President & COO

One thing that's important -- thank you for the question. Generally speaking, when you enter into weak economic conditions, you would find some weakness in loss ratios related to disability, short and long term. That has not traditionally been the case with our more voluntary sold, small business, short-term disability. And remember, even though we have acquired the Zurich business a few years ago, in terms of the amount of premium that we're running through that business, which I think is approaching $300 million, it is a relatively small business as compared to our total in-force business in the U.S.

Obviously, we're seeking to change that over time and are working actively to do that. But right now, we're not a company that is particularly exposed to the disability volatility that comes with a recession. And again, our voluntary business tends not to see that type of loss ratio behavior, at least by historical measurements.

Operator

The next question comes from Alex Scott from Goldman Sachs.

Alexander Scott
Goldman Sachs Group, Inc., Research Division

First I have a view is just a follow-up on capital deployment. When I think about your yen hedging strategy, a big part of it is a capital hedge. And at least my crude understanding of it is that the yen is weakening, your capital position in Japan is getting stronger. And so in my mind, to sort of offset the dilution in earnings, some of that capital has got to be redeployed. So when you answered the question earlier, I didn't gather from that response that there was a whole lot of incremental capital deployment being considered. So I just wanted to probe there a bit and see if you could help me understand the way that works. And is there a lag? Or am I thinking about it right that there would or should be more capital deployed as a result of that strategy in the yen weakening?

Max Kristian Broden
Executive VP & CFO

So Alex, you're right in your thinking that, generally speaking, given the significant dollar assets that we hold in Japan, that works relatively well as a capital hedge. And in fact, to your point, it strengthens the SMR ratio and the ESR ratio in a weakening yen scenario that we now have been in. That means that over time, the dividend capacity of Aflac Japan, all things being equal, is slightly higher than before. And you should then expect that over time more capital to find its way up to the holding company.

Now that is not immediate, and it's coming through over time. So over time, you would then see a liquidity and capital at the holding company build unless we were to deploy that. And obviously, if you want to have sort of a restored EPS trajectory, you would need to deploy that capital either through dividends, buybacks or an opportunistic deployment. And obviously, we try to deploy that as best as we can to obviously generate an IRR that is north of our cost of capital and preferably with a cushion significantly above our cost of capital.

Also, when you think about the capital hedge that is sitting at the holding company, the 2 components there, which is the first one, the yen debt that we have, that is currently, we hold about $3.8 billion of equivalent debt denominated in yen. Right now, our leverage then obviously has declined and it's below our leverage corridor of 20% to 25%. But I also know that the yen could strengthen and it could strengthen sharply and then all of a sudden, our leverage will move up sharply as well.

So we need to be quite thoughtful and sensitive to what our underlying and really look through debt capacity, yes. And I wanted to give you 1 number that I actually kind of look at and I find interesting. So if you take our leverage right now and you -- what sort of yen move would take us to the middle of the range, i.e., 22.5%. And that's roughly an immediate move of the yen dollar to $102. So that gives you a little bit of a sense for how we sort of think about what our debt capacity potentially could be.

And then the -- the last piece as well is the forwards that we have at the holding company. They are spread out in terms of maturities. And obviously, they are in a net gain position, so they will settle into cash, but that will occur over the next 24 months, and it's fairly spread out. So the increased cash flow to the holding company from a weakening yen is not immediate. On a mark-to-market basis, they are, but I don't count that until they have fully settled and we have received all that cash. That's when we move the cash to become unencumbered in terms of definition.

So if I take all of this and sort of wrap it up, I would say that there is a lag in terms of the cash flow to find its way to the hold the company from all these capital hedges. And that means that you have a little bit of a lag in terms of capital deployment that would then ultimately lead to your sort of restored EPS capacity on a run rate basis. And we are currently in that sort of lag period, i.e., our reported EPS has dipped because of the weakening yen. But then we will -- if the yen stays at these levels, the capital hedges will start to kick in. And then over time, as we deploy that capital, that should restore our earnings power on an EPS basis going forward. That was a long answer, but I hope that was helpful.

Alexander Scott
Goldman Sachs Group, Inc., Research Division

Yes. No, that was very helpful. Second question I had is on net investment income. With your net investment income, there's some more ins and outs for us to think about in terms of hedge costs, 2 currencies, having a floating rate portfolio, offsetting some and so forth. So I was hoping maybe you could help us just think about when we think about all those different things, higher yields. What is your sensitivity to higher yields? I mean how would you think about the benefit in net investment income from increasing yields in the U.S. and how we should be forecasting that as we look into the future?

Frederick John Crawford
President & COO

How about Eric and Brad take that?

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

Thanks, Fred. Thank you, Alex. It's Eric. I'll start, and then Brad can supplement. In terms of higher yields, those are really good tailwinds for us. We do get the benefit in the floating rate portfolio. As Fred mentioned, some of that is hedged, a good portion of it is, but we're still enjoying the upside. Right now, our reinvestment yields are higher, more or less than our redemption yields. So it's really this interest rate environment and where we're investing is accretive to net investment income. Obviously, there are some offsets and headwinds as well, headwinds being higher hedge costs for next year that we expect, but those will be offset by higher income.

And of course, we have the offset of Inc. from the forwards that Max mentioned. And then variable net investment income, we'll just have to see. We expect some pressure in the fourth quarter given where public equity markets are, and we'll have to see for next year. If equity markets start to stabilize, we would expect to see a positive trend there again. I'll also mention, as was mentioned, we had that significant amount of call income this past quarter. So that's not going to replicate obviously. But net-net, higher rates are generally going to be accretive towards our net investment income.

The last thing I'll mention is the weakening yen, obviously lowers income in dollar terms. So that's a headwind for us as well.

Operator

The next question comes from Ryan Krueger from KBW.

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

I had a follow-up on Alex's last question. I guess, first on the floaters. Could you give us a sense of, how much is hedged? And then, and I guess, how much additional upside you could have from here based on the forward curve on the edges?

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

Sure thing. It's approximately 70%. That number can fluctuate based on market values and the movement in interest rates, but it's approximately 70%. In terms of the sensitivity, we still have upside, but I think when we get to fab, we'll be able to illustrate that better for you in terms of some sensitivities.

Frederick John Crawford
President & COO

Yes, realize when -- the 1 thing also to realize is that when Eric uses the 70% term, that's specific to the floating rate book, obviously, then 30% of it left free to enjoy upside or downside of rates. But in addition to that, we have a fairly good amount of liquidity at the holding company, which is not hedged or remains largely floating and enjoying our rate movement. So we look at both on a combined basis to just judge our overall enterprise exposure to floating and locking in.

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

And my follow-up is also related to this. Can you update us on where the yen hedge costs are running at this point? And then how to think about the offset to that from the forward of the holding company?

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

[indiscernible] and then Max, may want to make some comments as well. For this year, as you know, for 2022, we locked in most of our hedge costs at the beginning of the year. And if you go back to the beginning of the year, LIBOR and hedge costs were very, very low. So I think we're running this year around 80-some-odd basis points, if I recollect right. Now if you look at the market today for 1 year forward, you're in the neighborhood of high 4s, low 500 basis points. So there will be a significant pickup in our hedge costs in '23.

Having said that, remember for the Japan entity where our forward sit, we've got floaters against those. So that floating rate income is going up. And even though it's 70% hedged, as we said a moment ago, that 30% unhedged should track the amount of that -- those hedge costs increase, if not even exceed those. And then finally, for the enterprise, because at Inc., we have offsetting hedges, for the enterprise, the cost increase should be relatively neutral, not exact obviously, but pretty well offset.

Max Kristian Broden
Executive VP & CFO

Yes. Just adding to Eric's very good memory in terms of hedge costs. Just in terms of notional, the forwards in Japan that we are rolling into this higher hedge cost environment is $4.1 billion of notional. And then at the holding company, we have $5 billion of notional that obviously benefits from the higher hedge costs and that runs through as positive net investment income at the Corporate & Other segment. That will not be immediate as those are spread out and some of that have already started to earn in, but the real impact also at the Corporate & Other segment will sort of occur in the 2023 time frame.

But overall, this is also designed to make sure that we are not as an enterprise too exposed to any significant movements in hedge costs up or down, quite frankly. So net-net, we are actually $0.9 billion positively exposed in terms of the notional balance to the higher interest rate differential between the yen and the dollar.

Operator

The next question comes from Erik Bass from Autonomous Research.

Erik James Bass
Bernstein Autonomous LLP

Can you provide some more color on the group voluntary benefits case lapse as you alluded to about this quarter and year-to-date. Is there any common trend that you're seeing? And should we expect any more case movement during 4Q enrollment?

Frederick John Crawford
President & COO

Thanks, Erik. It's Fred. Yes, the -- as I mentioned in my comments, we've been seeing a little bit of weaker persistency on the group side this year, individual having recovered, but there's no systemic -- when we look at each of the case losses, we don't see anything systemic in them. They vary from -- 1 of the large cases, for example, that we lost, there wasn't really a loss to competition. The company in question simply decided to reduce the number of payroll deduction slots, if you will, for voluntary product, and so they eliminated some of their voluntary product holdings period.

And in another case, there was a merger of 1 large company and another and we ended up not being on the winning side of that merger, which will happen from time to time. And then normal competitive landscape will come into play. And so the themes are varied, but not, frankly, unusual. What can be unusual from time to time is it can be lumpy. There are years where some of the cases that lapse are not particularly sizable as compared to the cases won. There are other years where you might have lumpiness with the loss of a larger case.

We are, in fact, starting to gain ground in larger case wins. And so we're starting to build out some larger cases on our platform, which is good. And we've won several large cases this year, as you can see in some of our sales results on the group side. And so with those larger cases, you'll naturally have some lumpiness realizing this is just 15% of our earned premium. So it doesn't take much in the way of a large case to move the lapse rate on the group side. But nothing systemic.

I would note 1 thing to, I think, Jimmy's earlier question around benefit ratio, realize that there is an interplay between lapse rates, benefit ratio and expense ratio. When you go through a period of higher lapsation, you will normally find downward pressure on your benefit ratio and upward pressure on your expense ratio. These are not big movers, which is why we don't call it out, but there is a relationship between the 2. It's not necessarily a profit loss or profit won dynamic, you usually on a lapse case, simply end up releasing reserves, but also writing off DAC for a somewhat net neutral impact to profitability, sometimes even a benefit to profitability, although that's not the design of what we like.

So it's not really a P&L or margin issue, but we are going to spend more time and make sure that we do what we need to do to improve persistency over time. That's a major focus of ours because we know it's something that represents opportunity.

Erik James Bass
Bernstein Autonomous LLP

And then maybe a follow-up on Alex' question a little bit. But based on the SMR sensitivities that you provided at last year's fab, it seems like the most challenging scenario would be higher interest rates globally, wider credit spreads in a strengthening yen. And year-to-date, we haven't really seen that because of the BOJ's actions, but how do you think about the potential scenario where the BOJ eases its commitment to yield curve control and JGB yields rise and the currency appreciates. Is that a risk? Or are there other mitigating offsets?

Max Kristian Broden
Executive VP & CFO

It's absolutely a risk and that's why we obviously run stress tests on our SMR ratio and capital base all the time, quite frankly, and we think about these kind of scenarios, and we manage our capital accordingly. Fred mentioned, for example, that we have a significant portion -- significant notional level of put options protecting us from any severe strengthening of the yen that could happen in the kind of scenario that you just outlined. And we have that in place in order to protect our capital base.

So it is real. And we always have to manage for that. We make sure that we always have a strong capital ratio, so we can continue to write business and capital does not become a constraining factor for our businesses.

Frederick John Crawford

President & COO

Something that -- on the topic of capital in Japan, something that will no doubt touch on at our investor conference, but you're starting to find the industry, not just Aflac slowly migrate and turn their attention more significantly to ESR and away from SMR. SMR will not fade to black or become insignificant for the industry anytime soon, but as we creep towards 2025 and the adoption of ESR, we're starting to pay more and more attention to that economic ratio, and that ratio is far less sensitive to these mark-to-market rate spread dynamics and will help with stabilizing capital position. As you know, we maintain a very strong ESR.

Operator

The next question comes from Tom Gallagher from Evercore ISI.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Just a question on Japan sales. If you're tracking up 47% quarter-to-date is what I believe I heard in an earlier response. And that was, I think, just for general agency and Daido Life. Can you just comment on what proportion of sales are those channels? And sort of taking that all together, would you expect a big increase in Q4 Japan sales overall? Any perspective there is appreciated.

David Young

Tom, this is David. I think we can say that those are mostly agency barrels.

Daniel Paul Amos
Chairman & CEO

In other words, the contribution from cancer.

Koichiro Yoshizumi
EVP of Sales & Mrkt. and Director of Sales, Mrkt., Alliance Strategy - Aflac Life Insurance Japan

[Interpreted] This is Yoshizumi. You're right. 47% is the agency channel sales. And we believe that we will be able to maintain this momentum in the fourth quarter as well. And that's all for me.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Any -- well, just a follow up on that. Any perspective on what this means for 4Q sales? And I'm not asking for a specific forecast, but are we looking at a pretty big sequential inflection in sales, because the launch of the new product was August, as you said. So I just want to make sure I'm understanding the numbers here correctly, if we're looking at kind of a big outlook for sales or is it not broad enough yet to move the needle overall?

Daniel Paul Amos
Chairman & CEO

I think -- this is Dan. I think what we're saying is that it is a significant increase, but it was expected. Our fourth quarter is our biggest quarter, we are expecting that as we go against the fourth quarter last year. But all in all, it's well within what we expected to do for the year -- for the quarter and for the year.

Operator

The next question comes from Mike Ward from Citi.

Michael Augustus Ward
Citigroup Inc., Research Division

Kind of similar to Tom's question, just wondering on U.S. sales. Growth still solid and recovering though, I guess, decelerating a little bit. Wondering if we should think about U.S. sales as maybe at pre-COVID levels yet? Or I guess, in addition, could you comment on any visibility into 4Q? I think that's the most important quarter.

Daniel Paul Amos
Chairman & CEO

Virgil, why don't you take that?

Virgil R. Miller
Deputy President Of Aflac U.S.

Okay. Thank you, Dan. This is Virgil. Yes, we are optimistic we will see continued momentum in Q4. I remember just because of seasonality, Q4 would be our largest sales quarter. But I'm also anticipating it'd be our largest in terms of growth -- percent growth. So overall, you can expect that momentum to carry forward and again, looking for a strong performance in Q4.

Michael Augustus Ward
Citigroup Inc., Research Division

Okay. Do you think we're back sort of at pre-COVID levels going forward?

Virgil R. Miller
Deputy President Of Aflac U.S.

Yes. I'll be specific on that. So we finished third quarter at 97% of pre-pandemic sales, and I'm expected to be over 100% in Q4, and that will carry forward throughout 2023.

David Young

All right, Jason. I think that's our last question in the line, and I appreciate everybody joining us today. I want to remind you that we will have our financial analyst briefing in New York on November 15 at the NYSE. There will also be a webcast for those who can't join in person, and registration is still open. In the interim, please reach out to Investor and Rating Agency Relations. If you have any questions, we'll be happy to help and look forward to talking to you soon. Take care.

Operator

Conference has now concluded. Thank you for attending today's presentation. You may now disconnect.
[Portions of this transcript that are marked [Interpreted] were spoken by an interpreter present on the live call.]