Aflac Incorporated NYSE:AFL

Earnings Call

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Call Participants

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President, Chairman & CEO

David Young

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Masatoshi Koide
President, CEO & Representative Director

Max Kristian Broden
Executive VP & CFO

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Virgil Raynard Miller
President of Aflac U.S.

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Suneet Laxman L. Kamath
Jefferies LLC, Research Division

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

Presentation

Operator

Good day, and welcome to the Aflac Incorporated Fourth Quarter Year-End 2023 Earnings and 2024 Outlook Call. [Operator Instructions]

Please note, this event is being recorded.

I would now like to turn the conference over to David Young, Vice President of Investor and Rating Agency Relations for Aflac Incorporated. Please go ahead.

David Young

Good morning, and welcome. This morning, we will be hearing remarks about earnings for 2023 as well as our outlook for 2024. First, Dan Amos, Chairman, CEO and President of Aflac Incorporated, will provide an overview of our results and operations in Japan and the United States. Then Max Broden, Executive Vice President and CFO of Aflac Incorporated, will provide an update on our financial results and current capital and liquidity as well as our outlook for 2024. These topics are also addressed in the materials we posted with our earnings release and financial supplement on investors.aflac.com.

In addition, Max provided his quarterly video update, which also includes information about the outlook for 2024. We also posted, under financials on the same site, updated slides of investment details related to our commercial real estate and middle market loans.

For Q&A, we are also joined by Virgil Miller, President of Aflac U.S.; Charles Lake, Chairman and Representative Director, President of Aflac International; Masatoshi Koide, President and Representative Director, Aflac Life Insurance Japan; and Brad Dyslin, Global Chief Investment Officer, President of Aflac Global Investments.

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 can give no assurance that they will prove to be accurate because they are prospective in nature. Actual results could differ materially from those we 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 turn the call over to Dan. Dan?

Daniel Paul Amos
President, Chairman & CEO

Thank you, David, and good morning, everyone. We're glad you're joining us.

Reflecting on 2023, it was a very good year. Our management team, employees, sales distribution have continued to work tirelessly as dedicated stewards of our business. This has allowed us to be there for our policyholders when they need us most, just as we promised.

Aflac Incorporated delivered a very strong earnings for the year. Net earnings per diluted share for 2023 were $7.78. Adjusted earnings per diluted share was $6.23. We're the best in the company's history despite the weakening yen and the impact of the reinsurance retrocession late in the fourth quarter.

Beginning with Japan, Aflac Japan generated solid overall financial results in 2023. For the year, total adjusted revenues declined 3.6% to nearly JPY 1.5 trillion, largely reflecting the impacts of reinsurance and paid-up policies. But this was largely offset by a 7.3% decrease in total benefits and adjusted expenses.

Pretax adjusted earnings increased 6% to nearly JPY 457 billion for the year. As a result, Aflac Japan produced an extremely strong profit margin of 30.5%. I am pleased with Aflac Japan's 10.9% year-over-year increase in sales, which was largely driven by a 26% increase in cancer insurance sales, with very significant contributions from Japan Post Company and Japan Post Insurance as well as other alliances, Dai-ichi Life and Daido Life.

As you may recall, Aflac Japan aims to have a product lineup to meet customers' needs during any life stage. Our latest medical insurance is designed to appeal to younger policyholders' basic needs, and older and existing policyholders who want additional or updated coverage.

While our medical insurance sales were off for the year, they increased 6.5% year-over-year in the fourth quarter, following the introduction of our new medical insurance product in mid-September. Similarly, Aflac Japan refreshed ways in child endowment in 2022 as a way of acquiring younger customers and also introducing opportunities to sell our core third sector products to them.

Since the launch of our refreshed WAYS product, approximately 80% of our sales are the younger customers below the age of 50. The level of concurrent third sector sales remains above 50%. Given Japan's demographics, our product strategy is to fit the needs of the customers at any stage in life. Acquiring younger customers is critical to our success along with our intense focus on being where the customer wants to buy insurance. We have a broad network of distribution channels including agencies, alliance partners and banks. This reach continually optimizes opportunities to help provide financial protection to the Japanese consumers.

We are working hard to support each channel. While the market presents challenges, we expect to reach JPY 67 billion to JPY 73 billion of sales in Japan by the end of 2026.

Turning to the U.S. We also generated strong overall financial results in 2023. Total adjusted revenues increased 2.1% to $6.6 billion. The decline in total net benefits and claims was slightly offset by the increase in adjusted expenses.

Pretax adjusted earnings increased 10.4% to an all-time high of $1.5 billion for the year. As a result, Aflac U.S. produced an extremely strong profit margin of 22.7%.

Aflac U.S. sales increased 5% in 2023, which was at the lower end of our expectations. As you know, we've been focused on increasing persistency to grow profitable earned premium. In addition, we continually evaluate new business to ensure that it is profitable.

During the fourth quarter, we made some tactical decisions to avoid sales opportunities to certain less profitable larger accounts like those of high turnover. At the same time, we focused on updating our products to ensure that our policyholders continue to realize the value of our products provide.

As part of our efforts, we introduced our new cancer protection insurance policy in the second quarter of 2023. Since that time, our cancer insurance have increased nearly 25%. We know that when people experience the value of our products, it increases persistency, which benefits our policyholders and lower our expenses. I believe that the need for the products and the solutions we offer are as strong or stronger than ever before in both Japan and in the United States.

We are leveraging every opportunity in Avenue to share this message with consumers, particularly given that our products are sold, not bought.

As we communicate the value of our products, we know that the strong brand alone is not enough. We must paint a better picture of how our products help address the gap that people face, even when they have major medical insurance. Knowing our products help lift people up when they need us most is something that makes all of us at Aflac very proud and propels us to do more and achieve more.

We continue to reinforce our leading position and build on that momentum. We are confident that the successful execution of our strategy will lead to sales of at least $1.8 billion in the U.S. by the end of 2025.

I'd like to end on addressing our ongoing commitment to prudent liquidity and capital management. We have taken proactive steps in recent years to defend our cash flow and deployable capital against a weakening yen.

At the end of 2023, we had nearly $2.8 billion of liquidity at the holding company, which was more than $1 billion over the minimum balance.

As an insurance company, our primary responsibility is to fulfill the promises we make to our policyholders while being responsive to the needs of our shareholders. We remain committed to maintaining strong capital ratios on behalf of our policyholders and balance this financial strength with the tactical capital deployment. We intend to continue prudently managing our liquidity and capital to preserve the strength of our capital and cash flows. This supports both the dividend track record and the tactical share repurchase.

2023 marked the 41st consecutive year of dividend increases.

We treasure our track record of dividend growth and remain committed to extending it. Last quarter, the Board put us on a path to continue this record when it increased the first quarter of 2024 dividend, 19% to $0.50.

We also remain in the market repurchasing our shares through 2023 at a historically high level of $700 million per quarter. We have remained tactical in our approach to share repurchase, deploying $2.8 billion in capital to repurchase nearly $39 million of our shares in 2023. Combined with dividend, this means we delivered over $3.8 billion back to the shareholders in 2023, while also investing in the growth of our business.

At the same time, we have maintained our position among companies with the highest return on capital and the lowest cost of capital in the industry.

Overall, I think we can say it's been another strong year.

I'll now turn the program over to Max, who will cover more details of the financial results for this year and provide an outlook for the key drivers of earnings in 2024. Max?

Max Kristian Broden
Executive VP & CFO

Thank you, Dan. This morning, I'm going to address our 2023 results before providing an outlook for certain drivers for 2024 that were included in the slides with our earnings materials filed yesterday with our 8-K.

Aflac Incorporated delivered very strong earnings for the year as adjusted earnings per diluted share rose 9.9% to $6.23, the highest amount in our company's history. This result included a $0.19 negative impact from foreign currency and variable investment income was $0.14 per share below our long-term return expectations.

In addition, our annual results included remeasurement gains of $0.51 per share, a $0.20 per share noneconomic loss in the fourth quarter under U.S. GAAP related to the innovation of a reinsurance treaty with a third party seeded back to the company, and a $0.04 per share write-off of certain capitalized software development costs in the third quarter.

Our liquidity remains strong with unencumbered holding company liquidity being $1 billion above our minimum balance. Likewise, our capital position remains strong and we ended the year with an SMR above 1,100% in Japan.

At the end of 2023, we estimated our internally modeled ESR to be above 250% and we expect the FSA to provide final guidance on the ESR later in 2024. We also estimated our combined RBC in the U.S. to be greater than 650% at the end of 2023. These are strong capital ratios, which we actively monitor, stress and manage to extend credit cycles as well as external shocks.

In addition, impairments have remained within our expectations and with limited impact to both earnings and capital.

Our adjusted leverage remains below our leverage corridor of 20% to 25% at 19.7%. And this will fluctuate with the yen dollar rate, since we hold approximately 2/3 of our debt denominated in yen as part of our enterprise hedging program to protect the economic value of Aflac Japan in U.S. dollar terms.

In 2023, we repurchased $2.8 billion of our own stock and paid a dividend of $245 million in Q4, offering good relative IRR on these capital deployments.

We will continue to be flexible and tactical in how we manage the balance sheet and deploy capital to drive strong risk-adjusted ROE with a meaningful spread to our cost of capital.

Adjusted book value per share increased 10.1% and the adjusted ROE was 13.8%, an acceptable spread to our cost of capital. I'm also pleased with our continued development of our Bermuda reinsurance platform, which resulted in 3 transactions during 2023. We will continue to utilize this platform to better manage risk and improve the capital efficiency across the enterprise. And we expect these transactions to be part of a serious that will improve our run rate adjusted ROE by 100 to 200 basis points over time, all things being equal.

Overall, we are very pleased with these results, especially when normalizing for onetime items.

Turning to Aflac Japan. Its total benefit ratio for the year was 66%, down 140 basis points from the prior year. Throughout the year, we continue to experience favorable actual to expected on our well-priced large and mature in-force block. We estimate the impact from remeasurement gains to be 130 basis points favorable to the benefit ratio in 2023.

Long-term experience trends, as it relates to treatment of cancer and hospitalization have continued to lead to favorable underwriting experience. Persistency remained solid with a rate of 93.4% and was down 70 basis points year-over-year, reflecting elevated lapse as customers updated their cancer and medical coverage with our latest cancer and medical products.

Our expense ratio in Japan was 19.8%, down 50 basis points year-over-year, driven primarily by good expense control and to some extent, by expense allowance from reinsurance transactions.

For the full year, total adjusted revenues in yen were down 3.6% to JPY 1.5 trillion. Net earned premiums declined 5.9% to JPY 1.1 trillion, reflecting the impact of reinsurance transactions, paid up policies and deferred profit liability.

When excluding these 3 factors, net earned premiums declined an estimated 1.7%. On this same basis, we would expect net earned premiums in 2024 to decline 2.5% to 1.5%. When taking into consideration, the impact of reinsurance, paid-up policies and the deferred profit liability reclassification.

Adjusted net investment income increased 4% to JPY 365.6 billion, as we experienced higher yields on our U.S. dollar-denominated investments and related favorable FX. This was partially offset by transfer of assets due to reinsurance. Pretax earnings were JPY 456.9 billion or 6% higher than a year ago.

For 2024, we would expect our well-priced in-force to show greater stability in terms of the benefit ratio, excluding unlockings and to be in the range of 66% to 68%. This is a function of both favorable morbidity experience and improved mix of business.

With the current trend in revenues, we're actively reducing our expenses. We are taking both tactical efforts as well as more long-term transformational initiatives, and we would expect our expense ratio to be in the range of 19% to 21% going forward.

The pretax profit margin for Japan for 2023 was 30.5%, up 280 basis points year-over-year, a very good result. With approximately 30% of the Japan portfolio in U.S. dollar assets, the strength of the U.S. dollar versus the yen has increased the proportion of net investment income as a component of our pretax profit. With a greater contribution to profitability from net investment income in yen terms, our pretax margin is naturally pushed up. In addition, having transitioned to option-based currency hedging, we expect quarterly hedge costs to remain roughly in line with what we experienced in the fourth quarter of 2023.

In combination with a lower expected benefit ratio, we expect a pretax profit margin of 29% to 31% in 2024.

Turning to Aflac U.S. Our 2023 total benefit ratio came in well below expectations at 42.8%. We estimate that the remeasurement gains impacted the benefit ratio by 500 basis points in 2023. Claims utilization has stabilized. But as we incorporate more recent experience into our reserve models, we unlocked assumptions and released reserves during the year.

Persistency increased 130 basis points year-over-year to 78.6%. This is a function of poor persistency quarters following out of the metric and stabilization across numerous product categories.

Our expense ratio in the U.S. was 40.6%, up 90 basis points year-over-year, primarily driven by our growth initiatives and higher DAC amortization. We would expect the U.S. expense ratio to decrease over time as these businesses grow to scale and improve their profitability.

For the full year, total adjusted revenues were up 2.1% to $6.6 billion. Net earned premiums increased 1.9% to $5.7 billion in 2023. Adjusted net investment income increased 8.6% to $820 million, mainly driven by higher yields on both our fixed and floating rate portfolios.

Pretax earnings were $1.5 billion or 10.4% higher than a year ago, driven primarily by the lower benefit ratio, which was largely impacted by the third quarter unlock and only partially offset by the higher expense ratio.

For 2024, we would expect net earned premium growth to be in the range of 3% to 5%.

Profitability for the U.S. segment was solid, with a pretax margin of 22.7%, driven primarily by the remeasurement gains from unlocking.

Looking forward at 2024, as we grow products with a higher benefit ratio and lower expense ratio, like group life and disability and network dental and vision, you should start to see those changes reflected in our ratios over time. In 2024, we would expect to operate with a benefit ratio in the range of 45% to 47%, and an expense ratio of 38% to 40%. This translates into an expected profit margin of 19% to 21%.

In our Corporate segment, we recorded a pretax loss of $425 million, compared to a loss of $218 million a year ago, primarily due to higher investment tax credits and the impact of the innovation of our reinsurance treaty with a third party.

Adjusted net investment income was $54 million lower than last year due to an increased volume of tax credit investments. Higher rates began to earn in and amortized hedge income increased. This tax credit investments impacted the corporate net investment income line for U.S. GAAP purposes negatively by $343 million, with an associated credit to the tax line.

The net impact to our bottom line was a positive $39 million. To date, these investments are performing well and in line with expectations. The impact from the reinsurance innovation was a onetime negative of $151 million.
Overall, we are very pleased with our 2023 results and our outlook for 2024. I'll now turn the call back to David, so we can begin Q&A. David?

Question and Answer

David Young

Thank you, Max. [Operator Instructions]

Betsy, we will now take the first question.

Operator

[Operator Instructions] The first question today comes from Tom Gallagher with Evercore ISI.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

One numbers question and then one on strategy.

Just the numbers question. I guess for the last several years, you've had better portfolio yield in Japan being driven by to pivot into USD portfolio. If I look at the last couple of quarters, that seems to be flattening out. So your portfolio yield has been more stable. Can you talk about what's driving that and what it means for 2024 NII in Japan?

And then, Dan, strategy question is, just given the growth headwinds in Japan, would you guys consider anything more meaningful on M&A strategically to help facilitate growth? I know you haven't really done this in the past, but there does seem to be an element of kind of unavoidable demographic headwind in Japan that you're fighting against here. So curious what you think on strategy there.

Max Kristian Broden
Executive VP & CFO

I'll kick it off and then hand over to Brad and then to Dan for the strategy question.

As it relates to our investment portfolio and net investment income, you're correct in noticing that our net investment income has increased over the last couple of years. A portion of that is driven by our increased allocation to U.S. dollar assets. And I do want to remind you that, that is primarily driven by the view that we have of hedging our economic exposure to the yen as it relates to the overall exposure that we have as a company to the yen throughout like Japan.

We have now reached what we view to be more of a steady state as it relates to our total U.S. dollar allocation. So from that level, I would expect a stabilization in terms of our total allocation between yen and dollars within the investment portfolio.

But as it relates to more of an outlook into 2024 for our NII, I'll turn to Brad and he can give you some more color.

Bradley Eugene Dyslin
Executive VP, Global Chief Investment Officer & President of Aflac Global Investments

Yes. The only thing I would add is just to remind you that our new money yield is both a blend of lower yen rates as well as the higher U.S. dollar rates. Most of our deployment is planned for U.S. dollar assets and that is to maintain the balances, as Max just described. But we do still like yen spread products when we can locate acceptable outlets. When that happens, then we will put them in the portfolio and that does result in pulling down the overall reported new money yield just because of the simple math of lower yen rates.

Daniel Paul Amos
President, Chairman & CEO

And Tom, in regards to strategy, that's been an issue we've had for several years. We feel like that one of the things we are addressing [Audio Gap] cancer or medical product to it by starting them off on an inexpensive savings plan that gets them to participate with us.

We also continue to look for new product. We have still not found that third product or third leg that we want to find. And we're continuing to try things.

But I don't know of anyone right now that I would trade places within Japan in terms of distribution and product that we have and believe we can continue to grow our business moving forward. Saying that, we have to be realistic that it is an aging population and it also is a position where it's not the population is declining.

But all in all, I still believe it's the best market in the country or in the world because of the persistency and our ability to continue to grow it. And so I think you're going to see growth for the next several years. We did lower that number to -- from JPY 80 billion just to be cautious, but we're encouraged.

Our Japan Post growth and what's gone there continues to do very well, and we've enjoyed our relationship there. It's our existing distribution system that was really hurt, both in the U.S. and Japan, by COVID, but more so in Japan because if you look back at COVID, it really lasted an additional year in Japan. And because our agents are commission-driven, our newer agents, when COVID hit, all of a sudden did not have an opportunity to go out and sell one-on-one. And as we've always said, our products are sold, they're not bought. And so we go out and make those presentations, and we couldn't do it.

And so people that were normally working for us on a commission basis tried to find other jobs that were salary in nature and that's what we've been fighting, but it is coming back both in the U.S. and Japan, and I'm encouraged by what I'm seeing there.

Operator

The next question comes from Suneet Kamath with Jefferies.

Suneet Laxman L. Kamath
Jefferies LLC, Research Division

Just a couple on Japan. And the first one, Dan, just gets back to something you're just talking about in terms of the JPY 67 billion to JPY 73 billion sort of target down from the JPY 80 billion. Are you viewing that as sort of just a delay? And that, that JPY 80 billion is ultimately achievable, maybe a year beyond your original target? Just -- I wanted to think about it a little bit longer term.

Daniel Paul Amos
President, Chairman & CEO

Well, I certainly think it's the potential out there. I don't know what year because the COVID with such an anomaly, what I'd like to do is to let our people that are there on the -- Koide or whoever wants to take this particular question can do it. And then I'll follow up if there's any other part you want me to directly address.

Masatoshi Koide
President, CEO & Representative Director

Yes. This is Koide, Aflac Japan.

[Interpreted] So let me answer the question.

And the reason why we've changed our target from JPY 80 billion to JPY 67 billion to JPY 73 billion was because we knew that it would take a longer time.

So we do think that we are able to achieve JPY 80 billion if we look beyond 2026 or after.

Suneet Laxman L. Kamath
Jefferies LLC, Research Division

Got it. Okay. All right. And then I just had another question on, I guess, persistency in Japan. If I just think back to Aflac from years ago, it strikes me that part of the reason the persistency was so strong is because you sold at the work site and there just was very little job mobility in Japan so people just kept the products for a long time. And I guess the question is, as you're shifting now to new distribution channels outside of the work site and to a younger population, which seems to be the objective, should we just expect a natural decline in that persistency over time?

Max Kristian Broden
Executive VP & CFO

I'll kick it off and I'll let anybody add some commentary to that as well. As we sell to younger customers, that should actually improve the persistency because of the age-based pricing that we have in Japan, there's a very strong incentive to hold on to the product for a long time and maybe even for life. So as you sell into a younger population, that tends to reduce your lapse rates and improve your persistency.

Suneet, you are correct to -- when you look at the corporate agencies that you are referring to from the past that, that was -- had very strong persistency overall in that channel. And as that has become a smaller piece of our overall inforce, that have structurally reduced our persistency.

The other thing I would mention as well is that we have seen an aging of the block. And when you have an aging of the block, that naturally leads to higher lapsation and lower persistency as well. So you hear us talk about that we are trying to reach younger customers, that is partially to sort of fight these sort of long-term trends that we have going on in our inforce block to not only provide coverage and new coverages to the younger population, but also to improve the overall persistency of the block.

All of this is marginal from year-to-year, and it's very slow moving, but it's certainly something that we're watching closely.

Daniel Paul Amos
President, Chairman & CEO

Yoshizumi, do you have any comments you'd like to add? Our head of sales in Japan.

Koichiro Yoshizumi
Senior Managing Exec. Officer, Asst. to the Director of Sales & Marketing and Director

[Interpreted] This is Yoshizumi.

And regarding the persistency that was just asked and answered by Max, and as Max answered, by us focusing on young and middle-aged customers, our persistency is going to be higher, and that is our strategy. And that is actually represented by the medical insurance that was just launched on September 19.

And this product is very popular among the young and middle-aged customers whose ages are under 49 or 49 and under.

In terms of the number of policy count that we sold to these young and middle-aged customers, we actually saw a 46% increase year-on-year from the time that we launched in September to the end of the year last year. And these customers are for our middle and long-term growth of Aflac Japan, and these are the customers who will be our assets and our treasure going forward.

And the actual premiums that are being paid by young and middle-aged customers are lower. And we truly believe that by focusing on these younger customers and increasing these young customers would contribute to stable growth of our company. And at the same time, as I mentioned, the persistency rate will be higher and this is our strategy.

Daniel Paul Amos
President, Chairman & CEO

I just want to remind you all that the persistency rate is really high. And we can move it up a little bit, move down a little bit, but it is more than we ever dreamed when we first started doing business over there. So we're very pleased with it.

So -- but at the same time, we will improve because when you're writing younger people, of course, they'll live longer, and therefore, will be more persistent.

Operator

The next question comes from Jimmy Bhullar with JPMorgan.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

So first, a question on Japan. And if you think really long term, is it even realistic to assume that the business can grow given that the population shrinking, the population is aging as well? And then versus 10, 20 years ago, there are a lot more companies in the product lines that you're in? So if you could just comment on that, like -- and maybe on your -- the reduction in guidance on sales, how much of that has to do with just Japan taking longer to recover from COVID versus some of these demographic headwinds?

Daniel Paul Amos
President, Chairman & CEO

Well, my first comment is, you're correct in terms of a competitive environment. But what is in Japan or any other country that isn't competitive. So being competitive is nothing new to us, and something that we are understanding that we have to constantly look for ways to address how we can identify with consumers and show the need for our products even more.

Now don't forget, we've seen copays and deductibles over many years. I don't know when another one will take place or what will happen. But as inflation, even though small in Japan, you have to take that into account, too.

So remember, our ability to convert and add more premium to existing policyholders always makes a difference and grows our block of business as well, and we especially think that with the younger people. Let me now turn to Japan and let them comment on it.

Masatoshi Koide
President, CEO & Representative Director

Yes. This is Koide, Aflac Japan.

[Interpreted] And it is true that Japan is being projected as having declining population. But at the same time, with the advancement of longevity in the 100-year life era, the need to prepare for longevity risk is expected to increase steadily.

And it's also expected that the aging population could increase the medical cost because as you live long, the probability of suffering from cancer and other diseases will increase.

And in Japan, the sustainability of the overall social security system is being discussed. And this would also include medical and nursing care. And this is being questioned, and the discussions are underway within the Japanese government to review how the benefits and burden should be balanced.

And given these circumstances, there is a way of thinking about helping themselves or self-help and preparing for the future as people become more aware of the situation. And as a result, although the population may decline, we do think that the third sector market will steadily grow going forward as well.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

Okay. And then on the U.S. business, do you have a better clarity on the tri-agency rule and its potential impact on your sales?

Virgil Raynard Miller
President of Aflac U.S.

This is Virgil, good morning from the U.S. We have been working with the tri-agency sales to talk about any potential impact we could see to those selling supplemental into the consumers out there. And we're waiting on a ruling. Thus far, they set a date to be on April 2024, you know and I know that a date may move. However, we remain encouraged that our policies and coverages are relevant regardless if that rule does come through.

We looked at our [indiscernible] sales from last year. We really didn't see any decline. We remain flat there. And again, regardless, even if there is a rule or not a rule, our coverage is relevant and we're not predicting any major impact going forward.

Operator

The next question comes from Wilma Burdis with Raymond James.

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

Could you talk a little bit about the outlook for capital generation, and if we should expect anything on an ongoing basis from internal reinsurance opportunities?

Max Kristian Broden
Executive VP & CFO

Wilma, if you think about the total capital generation that we've had recently and also going into 2024, I don't see any significant change to our overall capital generation on an organic basis. That remains in the $2.6 billion to $3 billion range.

On top of that, we know that we have opportunities that we can overtime unlock more capital through utilizing our reinsurance platform, and we intend to do so. We can't necessarily predict exactly when that will happen or what amounts that will be, but you've seen us in the recent past be quite active on that front. So I would expect us to do more. But on a pure, sort of run rate organic basis, I would have pegged our underlying capital generation at $2.6 billion to $3 billion annually.

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

And could you just talk more about the commercial real estate watch list? It's higher than a lot of the peers, and you guys have taken the key back on a few properties lately. So if you could go into that and what you're seeing there?

Unknown Executive

Sure. I think there's one primary thing related to our watch list relative to our portfolio that makes us different than peers, and that's the fact that the bulk of our exposure is in transitional real estate. Remember, that's a much shorter asset class. It's a much shorter maturity, generally a 3-year term with some options to extend out a fourth and fifth year.

So because of that, when you have a market downturn and you've got these maturities coming due and the liquidity is as poor as we're seeing in the market today, it naturally creates an elevated watch list and creates an elevated amount of potential foreclosures.

Now, we work very closely with our borrowers to address those maturities. We do our best to avoid foreclosure. But if they are not willing to work with us, if they're not willing to reset the loan to reflect current valuations and give us other protections, we are fortunate that we're in a position we can and will foreclose if we think that's the best route to maximize our recoveries.

We are blessed with a strong capital and liquidity position, which prevents us from being a forced seller here. So I think it's a combination of the nature of our portfolio, having shorter maturities relative to our total exposure. And then the fact that we are much more willing to foreclose and able to foreclose, if we think that's the best route.

Operator

The next question comes from Elyse Greenspan with Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

My first question, going back to just Japan sales guidance. Dan, I know you said you guys are being cautious in lowering the outlook there. But how do we think about -- how should we think about going from the JPY 60.7 billion of sales in '23 to the new JPY 67 billion to JPY 73 billion target? Should we think about that being even -- even over the next few years or maybe a bit more back-ended?

Daniel Paul Amos
President, Chairman & CEO

Japan? Okay. Well, we at this particular time are just evaluating what we think might happen for the next 2 years. And frankly, we've just tried to be conservative and give us some latitude on what would happen. But we have some very positive things coming out in 2024 that we think will drive sales and are encouraged about it and even some things as we're looking to 2025 that will be coming.

Let me make sure that Koide or -- they don't want to make any comments in that regard. Koide?

Koichiro Yoshizumi
Senior Managing Exec. Officer, Asst. to the Director of Sales & Marketing and Director

Yes. This is Yoshizumi.

Daniel Paul Amos
President, Chairman & CEO

Okay, Yoshizumi.

Koichiro Yoshizumi
Senior Managing Exec. Officer, Asst. to the Director of Sales & Marketing and Director

[Interpreted] Okay. Let me answer the question.

And as Dan mentioned earlier, it is true that COVID has impacted Japan way beyond our expectation. And as a result, the number of solicitors or sales agents have decreased significantly. And even if you were -- even if our agencies are able to hire the sales agents, we were not able to train them.

It was not until May last year in Japan that COVID has been reclassified at the same level as with influenza. So we had no choice, but faced really truly difficult situation in sales for a long time.

And at the same time, it is also true that it took us quite a bit of time to train those sales agents that have lower skill. But right now, what we are very much focused on is to really recruit and train that the solicitors or sales agents. Otherwise, we will not be able to train and grow those sales agents that are customer-centric.

Aflac sales agents must be those agents that are very welcomed by our customers. What I mean by that is that those sales agents must respond to customers' needs when they solicit policies, but at the same time, when the benefits and claims are paid. And I do believe that it is Aflac's mission to send out these kind of sales agents to the market appropriately. And that is the reason why we have set our sales target relatively conservative.

And we currently do have recruiting and development and training plan for our future, as Koide mentioned earlier, beyond maybe JPY 80 billion or even more in the future.

Max Kristian Broden

Executive VP & CFO

Elyse, I would think about the sales trajectory as being relatively linear, i.e., not back-end loaded.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

That's helpful, Max. And then my second question, you guys you pointed out, you obviously have a good amount of buffer at the holdco relative to where you've talked about running. How do you think about, I guess, managing that down? And how should we think about the level of potential buybacks in '24?

Max Kristian Broden
Executive VP & CFO

So we're obviously operating with a very significant capital levels in all of our subsidiaries at the moment. Over time, I would expect us to operate at slightly lower capital levels in terms of the ratios than where we are today.

I would reflect that in Japan, we are now going through a transition from SMR to ESR. So I wouldn't necessarily make any dramatic changes ahead of that.

In the U.S., we are looking to, over time, target in an RBC of closer to 400%, and we have active plans towards drawing that down.

At the same time, we have strong capital and liquidity at the holding companies. We always think about where is capital serving us the best at that very point in time, at the same time, making sure that we have capital available for deployment into dividends, buybacks, et cetera.

So overall, I would say that our capital plans remain solid. We've got plenty of capital around, and we try to place it where it makes the best use.

Operator

Your next question comes from John B. Barnidge from Piper Sandler.

John Bakewell Barnidge
Piper Sandler & Co., Research Division

I had a question of going back to the Japan sales target. I know you put out a press release in December about the Trupanion pet insurance partnership for Japan. Did that pivot remove any sales contribution from the JPY 80 billion assumption? And can you talk...

Daniel Paul Amos
President, Chairman & CEO

No, it did not.

John Bakewell Barnidge
Piper Sandler & Co., Research Division

Okay. Then can you maybe talk about the growth opportunity for that product in the U.S. that was called out in the pivot and commitment to ownership stake?

Max Kristian Broden
Executive VP & CFO

Pet insurance, we think, has a significant opportunity in the U.S. market because of the very low penetration of the product itself.

For Aflac, we act as a distributor where these premiums, claims, et cetera, do not hit our income statement. So it's an opportunity to -- for our distribution to earn additional commissions, so in that sense, it's very positive to Aflac.

We do, obviously, have an alliance and a partnership with Trupanion that is strong through the equity ownership that we have in the company, and we capture significant economics over time through that equity ownership.

Operator

Your next question comes from Joel Hurwitz with Dowling & Partners.

Joel Hurwitz

First, a question on U.S. expenses. So the outlook looks to be largely in line with prior year. You've talked in the past on bending the expense curve and getting closer to a mid-30% expense ratio. Can you just provide an update on those expectations and when we should start to see a more significant drop in the expense ratio in the U.S.?

Max Kristian Broden
Executive VP & CFO

So you are starting to see a drop in 2024, and I would expect that to continue. There are 2 forces at play here, both expenses and our revenues. Expenses, we have active plans to improve our expense efficiency and reduce expenses, both from a tactical and transformational standpoint. But also do not disregard the impact from revenues here. So as we have a number of businesses that are not at scale today, they will grow to scale. And when they do that, their expense ratios will drop significantly, and that will improve overall our expense ratio, i.e., push that down.

The last piece to all of this is also where is our future growth coming from. It is generally coming from low expense ratio businesses. Predominantly, the group life and disability business that operates at a significantly lower structural expense ratio than the voluntary benefits business.

So if you take all of that together, we should have a trajectory that is going lower and we would expect to operate in the 35% to 37% over time.

Joel Hurwitz

Okay. Makes sense. And then just on the recapture. Any color on the economic benefit? And then are there other blocks that you could potentially execute something similar on?

Max Kristian Broden
Executive VP & CFO

So overall, we're very pleased with the economics. The -- in terms of the impact on future run rate results, they're relatively small, but they're obviously favorable. So there's a favorable run rate going forward.

In terms of the other blocks out there, I do deem that this is -- was the one that we really had out there. I wish we had more than we could do, but this was really the one that we had outstanding.

Operator

The next question comes from Ryan Krueger with KBW.

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

First, I just wanted to follow up on the U.S. expense ratio, given that the group products also tend to have higher benefit ratio. So just curious, as you continue -- as you do grow those business lines and the expense ratio comes down, would you expect, ultimately, for the margins in the U.S. is to increase? Or to what extent would that be offset by naturally higher benefit ratios on those products?

Max Kristian Broden
Executive VP & CFO

So I think that we have been in a structurally low benefit ratio period, which means that over time, I would expect our benefit ratios to increase. And you're right, Ryan, to acknowledge that the mix impact will also push our benefit ratios higher. So we're always going to see that mix impact, impacting both expense ratio and benefit ratios going forward. And that will have a slightly negative impact to the pretax margin going forward because of mix.

I'll kick it over to Virgil Miller to give his comments as well.

Virgil Raynard Miller
President of Aflac U.S.

So first, we're not pleased where we sit with the expense ratio. That is absolutely a focus for the U.S. And one of the things we're doing is making sure we have plans that are going to continue to be in that curve, and you'll see that happening over a period of time. And we're basically challenging all of the U.S. leadership to be accountable for that, and it is tied to our little compensation.

Now I'll go step further, though, I mentioned that when we talked about the actual sales growth this year, one of the things we mentioned -- you heard Dan mention earlier, is our strong underwriting discipline. We are making sure that we only put policies and business on the books that actually have better persistency and lower turnover rates with employees.

So the underwriting discipline itself will continue to help drive and bend that expense curve and drive up that benefit ratio, along with, as Max mentioned, the continued growth that we're seeing on [indiscernible], it would change the overall business mix in the U.S.

So just to conclude, it is absolutely a focus for us and that we are confident we've got the right plans in place to start bidding that curve starting next year.

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

And then on Japan internal reinsurance, you've done a transaction 2 years in a row. Is there any practical limitation on doing something like that kind of pretty regularly? Or is there anything that would commit your ability to do that?

Max Kristian Broden
Executive VP & CFO

So Ryan, over time, we would expect that we could see at about 10% of the Aflac Japan balance sheet to Aflac Bermuda. There are no real legal limitations to it, but at the same time, we got to acknowledge any sort of risks associated with internal reinsurance to make sure that we don't overexpose ourselves or we make sure that we can handle everything associated with it.

So over time, I would expect us to see something like 10%. And to date, we have done about 4%.

Virgil Raynard Miller
President of Aflac U.S.

And this is Virgil. Let me just go back to add, when I was talking about being on that curve, that starts this year, in 2024. I just want to make sure you got that. I said next year, but I mean 2024.

Operator

The next question comes from Josh Shanker with Bank of America.

Joshua David Shanker
BofA Securities, Research Division

Just a question as to whether or not the yen at JPY 140, JPY 150 to the dollar versus [110], does that change your hedging costs, your desire to hedge the strategy at all in your investment portfolio?

Unknown Executive

So obviously, the pricing of options will move and that impacts to some extent, the cost of hedging. And so obviously, every input that you would have to the pricing of options would impact that.

In terms of the level of the yen, the answer is no. We want to structurally protect the economic exposure we have to the yen. And we do that through the dollar allocation that we have in the general account. We do that through the debt that we issue in yen, and we do that through the forwards that we hold at the holding company, where we are long dollars, short yen. So overall, we do this in order to reduce risk, not necessarily to express an opinion on the yen.

Now, how we hedge and protect ourselves, we have all these different levers that we can pull, and the cost and return on capital associated with those can vary over time because of the capital markets. So that's why we will then dial up and dial down some of those associated with that. But it's not necessarily associated with the level of the yen-dollar rate. We are not FX traders. We're looking to protect ourselves long term.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to David Young for any closing remarks.

David Young

Thank you, Betsy, and thank you all for joining us this morning. If you have any additional questions, please reach out to the Investor and Rating Agency Relations team. We will be happy to talk to you then, and we look forward to speaking to you soon. Have a great day.

Operator

The 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.]