S&P Global
Market Intelligence

Aflac Incorporated NYSE:AFL

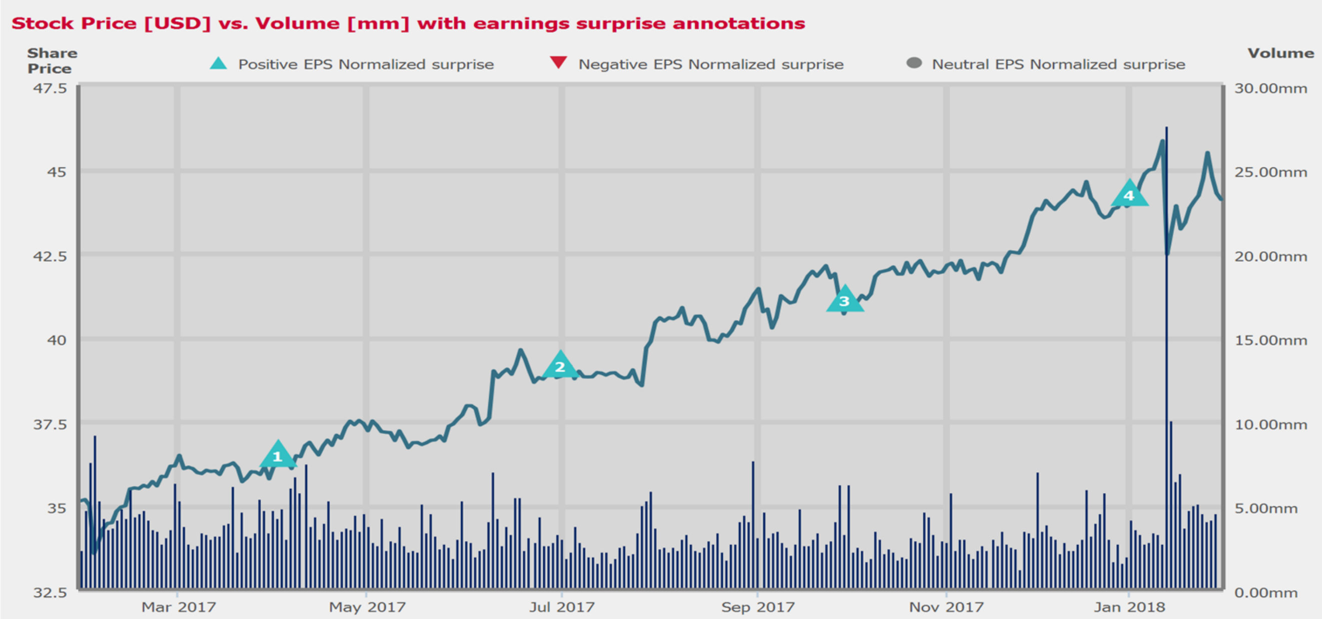
FQ1 2018 Earnings Call Transcripts

Thursday, April 26, 2018 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2018-			-FQ2 2018-	-FY 2018-	-FY 2019-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.97	1.05	▲8.25	0.99	3.94	4.10
Revenue	-	-	▲(0.26 %)	-	-	-
Revenue (mm)	5478.35	5464.00	-	5419.88	21710.37	21761.15

Currency: USD
Consensus as of Apr-26-2018 11:15 AM GMT



	- EPS NORMALIZED -		
	CONSENSUS	ACTUAL	SURPRISE
FQ1 2017	0.81	0.84	▲3.70 %
FQ2 2017	0.82	0.92	▲12.20 %
FQ3 2017	0.81	0.85	▲4.94 %
FQ4 2017	0.78	0.80	▲2.56 %

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EXECUTIVES

Daniel Paul Amos
Chairman, President & CEO

David A. Young
Vice President of Investor & Rating Agency Relations

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Executive VP & Global Chief Investment Officer

Frederick John Crawford
Executive VP & CFO

James Todd Daniels
Executive VP & Principal Financial Officer of Aflac Japan

Masatoshi Koide
President, Representative Director & COO of Aflac Japan

Richard L. Williams
Executive VP & Chief Distribution Officer

Teresa Lynne White
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JP Morgan Chase & Co, Research Division

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UBS Investment Bank, Research Division

Suneet Laxman L. Kamath
Citigroup Inc, Research Division

Taylor Alexander Scott
Goldman Sachs Group Inc., Research Division

Thomas George Gallagher
Evercore ISI, Research Division

Presentation

Operator

Welcome to the Aflac First Quarter Earnings Conference Call. [Operator Instructions] Please be advised that this conference is being recorded.

I would now like to turn the call over to Mr. David Young, Vice President of Aflac Investor and Rating Agency Relations.

David A. Young
Vice President of Investor & Rating Agency Relations

Good morning, and welcome to our first quarter call. Joining me this morning from the U.S. are Dan Amos, Chairman and CEO of Aflac Incorporated; Fred Crawford, Executive Vice President and CFO of Aflac Incorporated; Teresa White, President of Aflac U.S.; Eric Kirsch, Executive Vice President, Global Chief Investment Officer and President of Aflac Global Investments; Rich Williams, whom you may recall, joined us in September of last year as Executive Vice President and Chief Distribution Officer; Albert Riggieri, Senior Vice President and Global Chief Risk Officer and Chief Actuary. You may recall that Al was promoted to this position on April 3 of this year.

Joining us from Tokyo are Charles Lake, President of Aflac International and Chairman, Representative Director of Aflac Life Insurance Japan; Masatoshi Koide, President, Representative Director and COO of Aflac Life Insurance Japan; Todd Daniels, Executive Vice President and Principal Financial Officer of Aflac Life Insurance Japan, you may recall that Todd was promoted to this position on April 3 and now operates out of our Japan office; Koji Ariyoshi, Director, Executive Vice President and Head of Sales and Marketing for Aflac Life Insurance Japan.

Before we start, let me remind you that 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. The earnings release is available on the Investors page of aflac.com, and also includes reconciliations of certain non-GAAP measures.

Now I'll turn the program over to Dan, who will begin this morning with some comments about the quarter as well as our operations in Japan and the United States. Fred will then follow with comments about our financial outlook and capital management. Dan?

Daniel Paul Amos
Chairman, President & CEO

Thanks, David, and good morning. And thank you for joining us. Although we've just had one quarter under our belt, let me begin by saying that the first quarter of 2018 established a solid start for the year. Let me give you more detail, beginning with our Japan operations. Aflac Japan, our largest earning contributor, generated strong financial results for the quarter. As we anticipated, third sector sales faced challenging comparisons. You'll recall that in February of 2017, we launched our refreshed medical product. Additionally, we communicated our plan to introduce our new cancer insurance product after the conversion of the Japan branch to the subsidiary was completed on April 7.

Keep in mind, as the pioneer and leader of cancer insurance sales, when we announced that we will be introducing a new cancer product post conversion, much of our distribution felt compelled to hold out on the cancer sales until they could sell the new cancer product. The combined effort of launching a product in the first quarter of 2017 and delaying launch of our new cancer product until April of 2018 made the challenging quarter.

Aflac Japan generated sales results that were modestly weaker than our expectation. However, we expect third sector sales to build as the year goes on, and I am confident that we will achieve our sales target as outlined during our outlook call for 2018.

In addition, we remain on pace to generate third sector earned premium growth in the 2% to 3% range, reflecting Aflac's stable sales and stable persistency.

Regarding distribution, our traditional agencies have been and remain vital to our success. And we continue to rollout our model sales offices designed to increase productivity. Our alliance partners also made significant contributions to our sales results. Our extensive distribution network that includes Japan Post, 20,000-plus coastal outlets, furthered our goal to be where people want to buy insurance.

Our focus remains on maintaining our leadership position in the sale of third sector products along with building the sale of the first sector protection products. Both of these type of products are less interest rate-sensitive and have strong and stable margins. We will continue to refine our existing product portfolio and introduce innovative new third sector products to maintain our market leadership.

Turning to the U.S. operations, we are pleased with the financial performance and strong profitability of Aflac U.S. in the quarter, which is particularly notable because these results also reflect on our ongoing investment in our platform.

Our sales results were in line with our expectations, our anticipated productivity to improve across all distribution teams. We continue to expect full year sales growth of 3% to 5% with production performance building as the year goes on. Ultimately, we believe our investment in distribution and customer experience objectives will yield strong sales and stable persistency. We expect to generate an earned premium growth outlook in the 2% to 3% for the year.

As we discussed at our financial analyst briefing last September, we continue to expect higher growth in the broker sales for our industry. Our aim of broker sales professionals has made great progress in successfully deepening Aflac relationships within the large broker community. Our product partnering initiatives for True Group products is still early in its development but is already starting to take off.

As a result, Aflac is seeing a higher rate of growth through broker and strong sales growth in our group products. Aflac is different from our peers in that the majority of our sales come from our independent sales agents rather than brokers. These sales agents are important and are best positioned within the industry to reach, and therefore succeed, with smaller employers and groups with fewer than 100 employees. This segment, which we will continue to focus our attention on.

Brokers have recognized more and more that our clients need the type of products Aflac offers. This has increased the appeal and therefore the interest in doing business with Aflac. Brokers are looking for us to [assess] our strong experience and fulfill the capabilities.

Our field force and independent agents are experts, who have the ability to work with brokers and broker sales professionals to accelerate growth. We are seeing positive momentum in our ability to meet the needs of brokers through this sales approach. We characterize this collaboration as broker influence business. And as we look to the remainder of 2018, we continue to expect sales to skew to the fourth quarter as brokers and broker influence sales are a growing part of our business. We have also increased our career sales agents adaptation of the Everwell enrollment platform, which we continue to leverage to enhance our customer enrollment experience.

I want to briefly touch on One Day Pay because I believe it continues to differentiate and reinforce our strong brand [at] policyholder trust. More than 90% of the policyholders that have used One Day Pay say they are likely to refer other people to Aflac. I believe our dedication to pay claims fast and fairly will benefit future sales. This is especially true because of independent research shows that there is no doubt American consumers need cash quickly and paying claims fast sets Aflac apart. We believe investing in innovative solutions and industry-leading initiatives like One Day Pay will only further distinguish Aflac from the competition.

Turning to capital deployment, Fred will provide more details shortly. But first, I'll just make the comment that we remain committed to maintaining strong capital ratios on behalf of our stakeholders. At the same time, we're balancing our financial strength with increasing the dividend, repurchasing the shares and reinvesting in our business. We continue to anticipate that we'll repurchase in the range of $1.1 billion to $1.4 billion of our shares in 2018. As is always the case, this assumes stable capital position in the absence of compelling alternatives.

As I mentioned, we recognized that targeted investments in our platform is critical to our growth strategy and driving efficiencies that will impact the bottom line for the future. Benefiting from the December U.S. tax reform, we are leveraging the opportunity to accelerate our investment and initiatives that reflect our company's values and objectives. We expect to increase overall investments in the U.S. by approximately $250 million over 3 to 5 years. These strategic investments focus on 3 main categories: continued growth in the company's U.S. operation; enhance employee benefit and training programs; and investing in technology, innovation and digital businesses.

Looking ahead, we believe our strong earnings growth will reflect the underlying earnings power of our insurance operations in Japan and the United States. It will also reflect our prudent approach to deploying excess capital in a way that balances the interest of all stakeholders. At the same time, it will reflect our dedication to delivering on the promises we make to the policyholders.

I'll just conclude by reiterating how excited I am about our company and our future growth and believe that it will continue.

I'll now turn the program over to Fred to cover the financial results. Fred?

Frederick John Crawford
Executive VP & CFO

Thank you, Dan. We are off to a very strong start to the year on the earnings front as results for the quarter exceeded our expectations.

For the quarter and accounting for our recent stock split, adjusted earnings of $1.05 per share benefited from strong pretax margins, both in Japan and the U.S. Our reported results were also impacted by a strengthening of the yen as compared to the 2017 period, contributing $0.03 per share to the quarter's results.

The quarter's effective tax rate of 26% includes the tax treatment of equity compensation under GAAP. When normalized, our effective tax rate of 26.5% came in as expected and represents a blend of Japan's tax rate of 28%, the U.S. rate of 21% and based on our current mix of earnings.

Adjusted earnings per share in the quarter benefited by approximately $0.11 from the 2018 adoption of U.S. corporate tax reform. Japan branch conversion costs in the quarter were $29 million. Through the end of the first quarter, we have recorded approximately $71 million in total conversion costs and expect to come in at the low end of our $120 million to $130 million original estimate. The majority of the remaining costs are expected to be recorded in the second quarter.

Turning to our Japan segment results, both our benefit and expense ratios came in favorable to our expectations, resulting in a strong pretax profit margin of 21.1%.

Our total benefit ratio came in at the lower end of our guidance range of 70% to 72% driven by a favorable third sector benefit ratio, which was positively impacted by results in our older cancer in-force block. When comparing the quarter's ratio to last year's results, the reduction was largely driven by the continued shift in business mix from first sector towards third sector, which carries a lower benefit ratio.

Our expense ratio in Japan also came in at the lower end of our projected range of 19% to 21% and is largely timing-related as we anticipate increased promotional spend with the launch of our refreshed cancer product in the second quarter. In addition, we anticipate stepped-up investment in product development, digital and IT initiatives, designed to drive future growth and operating efficiencies.

Investment income performance in Japan also contributed to our strong results. The quarter's outperformance was driven by favorable results in our U.S. dollar portfolio. We were opportunistic in accelerating the growth of our floating-rate portfolio and also benefited from higher floating-rate yields relative to our expectations heading into 2018.

Turning to the U.S. results, our overall profit margin in the quarter was a strong 21%. Our total benefit ratio came in below our guidance range of 51% to 53%. While generally consistent with recent claims trends and our mix of business, our quarterly results will fluctuate, and we expect benefit ratios for the remainder of the year will climb back within the range.

Our expense ratio in the U.S. came in as expected and reflects continued investment in our platform. As Dan noted in his comments, with U.S. tax reform, we announced our intent to invest up to $250 million over the next 3 to 5 years in our U.S. business. We have worked to identify specific areas of accelerated investment and estimate the impact to be approximately $0.03 per share for the remainder of 2018.

Before leaving the U.S. segment, it's worth noting, we transferred an investment portfolio totaling approximately $615 million in fixed income assets out of our U.S. segment to Aflac Inc. as part of shifting contingent capital to the holding company. Although it does not impact our consolidated results, this move has the effect of reducing net investment income in the U.S. segment and a corresponding increase in investment income in our corporate segment.

Together with strategic venture investments and other business activity at the holding company post conversion, we have added line item disclosures on our corporate and other segment in our financial supplement that we hope you'll find helpful.

We ended the quarter in a strong capital position. Japan's solvency margin ratio is estimated in the 1,000% range. Recall that as part of our April 2 conversion from a branch to a subsidiary, we expect an accounting driven decline in SMR. Based on our year-end ratio, we estimate the impact to be approximately 130 points and have plans in place to restore the SMR accounting impact within a 3-year period.

Our estimated U.S.-only risk-based capital ratio at the quarter end stands at roughly 870% and includes a partial adoption of U.S. tax reform by adjusting deferred tax assets to the new tax rate. It is our understanding the NAIC is still finalizing the precise timing of the full adoption of tax reform, which may move into 2019 and also incorporate proposed C-1 changes to asset capital charges. We will monitor and update accordingly, but do not expect any disruption to our U.S. excess capital drawdown plans.

We will proceed with the drawdown of $500 million in excess capital along with normal dividends as we move through the remainder of the year. We ended the quarter with over $2 billion of capital and liquidity at the holding company. We set aside $1 billion for contingent capital and $500 million for liquidity and support of holding company derivative positions. Overall, credit conditions and asset quality remain strong with only a modest level of impairments in the quarter.

We continue to seek balance in growth and platform investments while returning excess capital to our shareholders. Including dividends and share repurchase, we returned approximately $500 million to our shareholders in the quarter. We are maintaining our current range for repurchase of $1.1 billion to $1.4 billion in 2018. We repurchased 6.6 million shares of our stock for $296 million in the quarter and remain tactical in our approach, guided by relative returns on excess capital deployment options.

As we move through 2018, we are hard at work to optimize our post conversion capital and liquidity profile. This includes our plans to draw down U.S. RBC, assessing our approach to managing Japan's build in capital generation and optimizing holding company contingent capital and liquidity.

On the topic of optimization, we are working to refine our approach to protecting the U.S. dollar value of yen-denominated dividends out of our Japan subsidiary while lowering enterprise-wide costs associated with Japan's U.S. dollar investment hedging. We accomplish this by entering into offsetting hedge positions at the holding company. While not material to our results in the near term, the impact of this activity comes through our corporate and other segment in the form of additional income.

We are balancing the need to manage our Japan subsidiary capital and FSA earnings volatility while lowering our enterprise exposure to the potential of a weakening yen.

Coming off our successful conversion, we will further develop these optimization strategies and provide more detail at our September Financial Analyst Briefing in Japan.

In closing, while it's early in the year to be adjusting our outlook, we are off to a solid start in terms of our currency-neutral earnings per share guidance range and overall pretax margins in both Japan and the U.S.

I'll now hand the call back to David to begin the Q&A. David?

David A. Young
Vice President of Investor & Rating Agency Relations
Thank you, Fred. Now we are ready to take your questions [Operator Instructions]. We will now take the first question.

Question and Answer

Operator

[Operator Instructions] The first question comes from Humphrey Lee of Dowling & Partners.

Humphrey Lee
Dowling & Partners Securities, LLC

So you mentioned, in Japan's third sector sales, you talked about the rollout of the new cancer product. Can you talk about, at a high level, the reception of the new day 1 cancer product and kind of, I guess, the month-to-date sales?

Daniel Paul Amos
Chairman, President & CEO

We can't break out monthly sales, but maybe someone in Japan. Who would like to take that?

[Foreign Language]

Masatoshi Koide
President, Representative Director & COO of Aflac Japan

This is Koide from Aflac Japan. The new cancer product that we have relaunched has added a new coverage, not only just focusing on the treatment itself, but there are things, the benefits that we have added, such as appearance care or palliative care. And these are the things that we try to align with in changing of the diversification of the treatment as well as environmental changes. So we are offering extensive coverage through this product.

[Foreign Language]

And this also products caters to the needs of a broad range of customers in different ages.

[Foreign Language]

And not only that, we are offering new brands for brand-new customers, but we are also offering a special product or special benefit for existing customers.

[Foreign Language]

And also, those customers who are not able to take out cancer insurance due to their concerns relating to their health, we now have rates specifically for those customers so that these customers are able to take out our cancer insurance under a nonstandard rate.

[Foreign Language]

And we have started to sell this product with these sales points and appealing points with targeted customers. And our sales have been as expected.

[Foreign Language]

That's all from me.

Daniel Paul Amos
Chairman, President & CEO

I would say that, overall, as I look at the numbers, I've been pleased with the rollout of this new product. And as I've said in my comments, I do expect us to make our goal for the full year.

Humphrey Lee
Dowling & Partners Securities, LLC

Understood. My second question is related to the U.S. dollar invested assets in Japan, which increased by $3 billion in the quarter. And then, your hedge ratio is now down to 36% from your target of 40%. I was just wondering what was the driver for the increase in the U.S. dollar-denominated assets in Japan? And then, also in terms of the lower hedge ratio, it is just a timing issue? Or is it a shift in your strategy?

Frederick John Crawford
Executive VP & CFO

There's not a shift in our strategy as it relates to what we provided in the way of our outlook call. There will be timing issues related to the development of both the U.S. dollar portfolio and the hedge ratio as we go through the year, but we're still targeting, overall, a 40% hedge ratio on an increasing U.S. dollar portfolio. I think our projection is to have the U.S. dollar portfolio built to the roughly the level of $25 billion to $26 billion, perhaps right in that range. So you're seeing our notional level of hedges right now, for example, at not quite $10 billion, I think, roughly $9.5 billion to a little better than $9.5 billion. And that will build up to more the $10.5 billion range. So that's why you're seeing our hedge costs are slightly lower than the run rate expectation, which is similar to last year's hedge cost range of roughly $240 million to $250 million-type range. So the build in the U.S. dollar portfolio is really what I mentioned in my comments, and that is, we accelerated -- we were able to opportunistically accelerate investment in particularly floating-rate assets and even more specifically transitional real estate. This was somewhat related to the announcement related to NXT, where we purchased an outright portfolio to accelerate the build. But more pronounced than that was simply seeing a lot of good opportunities come our way to invest more proactively. So we jumped out of the gate with a little higher investment in floating-rate, which is a U.S. dollar initiative and so the build in U.S. dollar. And you'll see the hedge ratio catch up a little bit as we go through the year.

Humphrey Lee
Dowling & Partners Securities, LLC

So basically -- so right now the U.S. dollar program -- the U.S. dollar investment asset -- the investment program is around $27 billion. So it’s a little bit above your $25 billion to $26 billion. So you're just going to let it sit there and as you -- to let your overall general account grow to that level?

Frederick John Crawford
Executive VP & CFO

Yes, we jumped out a little early to build the U.S. dollar portfolio because of the opportunity, and we would expect to stay in that range.

Operator

Next question comes from Tom Gallagher of Evercore.

Thomas George Gallagher
Evercore ISI, Research Division

Fred, I want to ask you about the optimization program you were referencing. And I'm not asking you to front run your -- what you're planning on talking about in September. But can you just give at least a broad idea for what you're approaching with this? Like, is this more about risk management? Or is there a potential carrot at the end here? Whether it's capital or whether it's better cash flow or earnings? What is the potential? Or can you dimension this a little bit?

Frederick John Crawford
Executive VP & CFO

Yes, I will definitely look to dimension this and provide greater detail as we move towards September. And that's really consistent with a lot of the work streams we have going on, Tom. But at a high level, I'd characterize the approach as follows: We have purposely built up a fairly good amount of excess capital in the system, and that's because we're going through a year of transformation in terms of the conversion of the Japan branch to a subsidiary. And so they really fall into three categories. Category one you know a lot about and that is the drawdown of excess capital and actually the geographic movement of excess capital out of our U.S. platform. That's well underway. We started into that last year materially, and we continue through this year and next year. And that's the drawdown of RBC. Now a question I often get is, can we bring that down below our targeted 500%? And I think that's possible to do. But I think it's very sound for us to first settle into our structure, start producing statutory statements on a U.S.-only basis, make sure we have a handle and full assessment around not only our performance on a U.S.-only statuary basis, but also we've got to watch the moving target of the NAIC and how they're playing around with both tax reform and C-1 charges.

I don't expect that to be disruptive to our plan. In fact, I think we may find as much opportunity as we do anything else once all that settles in just by nature of our business model. But the question becomes, can I bring or further optimize U.S.? Second big area is SMR in Japan. We've done a lot of work to calm down the potential volatility of SMR in Japan. And we've also done some work over optimizing the trade-off of hedge costs and hedge ratio and absorbing a certain amount of capital and increased volatility. And as we've dialed that in, we're starting to look more carefully at the quality of our increasing FSA earnings or the capital generation, which has been increasing in recent years, and we expect that to continue. And then how we dial in a more normalized SMR ratio, given the risk profile of our business. This is, by the way, a much easier conversation to have with both a regulator and a rating agency when you're a subsidiary status and not a branch status. And so we're going to come off of this conversion and really sit down and go through those mechanics. And then last but not least is the holding company. As I mentioned, we're carrying a bit north of $2 billion at the holding company but have sort of a standby level of capital of $1.5 billion, both contingent capital and liquidity. The issue is, if we're carrying upwards of $500-plus million of additional available capital at the holding company, how best do we utilize that? How do we best put that to work for our shareholders? And how confident are we that we can put it to work and not run any risk? So those are the 3 big categories of where we're holding capital. And as we've said all along, the key element on opening up the door for this was completing the conversion of the Japan branch to subsidiary. That now opens us up to be much more efficient in optimizing our gameplay.

Thomas George Gallagher
Evercore ISI, Research Division

That's interesting. I appreciate the thoroughness there. I guess, the -- my one follow-up is, you also mentioned the 130-point negative impact from the conversion from the branch to a sub and restoring -- a plan to restore that SMR back to, I guess, 1,000%. That would seem to be at odds a bit with being able to be more efficient with capital, if you're going to have to restore SMR percentage. Or unless there's a more of a financial engineering mechanism to get you there. Can you comment on that?

Frederick John Crawford
Executive VP & CFO

Yes, it's very important to understand what that 130 points is. That is a -- I use the terminology, that is an accounting-driven reduction in our SMR. And what I mean by that, you'd have to reflect back on some of the early days of our announcing the conversion. When we convert from branch to subsidiary, we effectively transfer retained earnings into other capital accounts. And that is just an accounting -- an FSA accounting dynamic. And when you do that, you lose the tax gross-up impact to SMR from moving out of retained earnings. As we go forward, our intent is to pay dividends out of those capital accounts. Therefore, as we earn money or bring retained earnings to the table, we build more quickly back up that retained earnings to the levels prior to conversion. And with that comes the tax gross-up benefits. So that's what I mean by the restoration of just that accounting drag. And it's important just to note that, that was not some sort of economic loss of capital. It's simply an accounting issue, and we have plans in place to restore it.

Operator

Next question comes from Suneet Kamath of Citi.

Suneet Laxman L. Kamath
Citigroup Inc, Research Division

I wanted to go back to Japan and the new cancer product. Can you give us a sense of what you think the ramp would look like in terms of distribution channels? In other words, at what point do you think you'll have that new product in Japan Post, Dai-ichi and your other channels that you distribute through?

Daniel Paul Amos
Chairman, President & CEO

Koji, would you take that?

Masatoshi Koide
President, Representative Director & COO of Aflac Japan

[Foreign Language]

This is Koide, again.

[Foreign Language]

The new cancer is offered through all our channels, including Dai-ichi Life and Japan Post.

[Foreign Language]

Well, that's it from me.

Suneet Laxman L. Kamath
Citigroup Inc, Research Division

In other words, is it -- it's currently being offered through all the channels? There's not like a ramp-up in terms of, particularly, the Japan Post branches?

Masatoshi Koide
President, Representative Director & COO of Aflac Japan

[Foreign Language]

And as I mentioned, the new product that we've launched in April is already being sold through all our channels.

Suneet Laxman L. Kamath
Citigroup Inc, Research Division

Okay, got it.

Daniel Paul Amos
Chairman, President & CEO

But there is -- in all cases, when we deal with these affiliated partners that we have, we don't have the control that we have with our field force. So your question dealing with how excited they are about it is something that we have to work toward getting them to do. But we do expect it to pick up in the second half of the year. Not so much the second quarter because it still -- they have actually put it out to the people. But when you're dealing with associates that have sold another way or another product, it just takes a little time. So from that standpoint, I don't want you to think that all of the sudden it's just going to take off. It'll be more of the second half than the first half.

Suneet Laxman L. Kamath
Citigroup Inc, Research Division

Got it. And then -- and just I guess for Fred in terms of how we account for the new sales. To the extent that you sell to an existing customer, let's say, existing customer upgrades the product, what gets reflected in the new annualized premium? Is it just sort of the incremental premium? Or is it the full sale, and then there's maybe an offset in the persistency?

Frederick John Crawford

Executive VP & CFO

It depends on the nature of it. If there's just an existing client that simply enhances their current cancer product, it ends up just being incremental AP and the associated earned premium. If there is a situation where there has been essentially a replacement of the policy; in other words, a lapsation of the policy and replacing it with a brand-new whole policy, sometimes characterized as a conditional surrender, then that gets counted as a new sale. But it really depends on the situation. And I believe we've designed the product, the new cancer product, to encourage more of that upgrading of your existing policy because that ultimately, we think, plays better over long term economic value.

Operator

Next question comes from Jimmy Bhullar of JPMC.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

So I had a question on Japan sales, and I understand -- like cancer -- the weakness in cancer was sort of expected, given the product that you launched in April. What was surprising was the weak sales in the medical product. And I think even if you look at it on an absolute basis, they were the lowest that they've been in the past several years. So just comment on what drove that. Whether it's competition-related or it's just that the product that you launched last year sort of needs to be refreshed again?

Masatoshi Koide
President, Representative Director & COO of Aflac Japan

[Foreign Language]

Again, this is Koide from Japan.

[Foreign Language]

We had a tough first quarter this year in 2018 because we had a very large sale last year first quarter in 2017 because we had launched a new medical product.

[Foreign Language]

And then, in the first quarter 2016, we launched a substandard medical product.

[Foreign Language]

And so, even comparing against the first quarter 2016, we had a tough comparison in the first quarter 2018.

[Foreign Language]

That's it for me.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

And just on -- and I was more referring not to the growth as opposed to just the absolute level of sales, but I guess I could take it offline. On the U.S. business, the sales were weak, but it doesn't seem like there was much of an impact on your business because of all the publicity and the negative articles in press earlier this year. Is that your view as well? Or have you seen impact whether on sales or recruiting or persistency of the business?

Teresa Lynne White
President of Aflac US

Jimmy, this is Teresa, and I think no is the answer. We have not seen any impact at this point. Our sales for the first quarter met -- they were in line with our expectation. So again, as Dan said, our full year remained the same -- the full year plan.

Operator

Next question comes from Erik Bass of Autonomous Research.

Erik James Bass
Autonomous Research LLP

I had a question for Fred on the 2Q guidance, the midpoint of which seems to be [indiscernible] lower level than I would've thought, especially given the results this quarter. Is this just being conservative in terms of assuming higher claims and normalization in margins? Or are there other moving pieces in terms of expenses or seasonal items that we should be thinking about?

Frederick John Crawford
Executive VP & CFO

Well, what I would say is, in my closing remarks, I noted that we're off to a strong start relative to our currency-neutral EPS range. And we're also off to, obviously, a very strong start to pretax margins both in Japan and the U.S. Our guidance, for example, for Japan pretax margin is 19% to 21%, and we're right -- just to tick above 21%, the high-end. And, of course, in the U.S., we're actually traveling above our pretax margin guidance of 18% to 20%, coming into 21%. When you look at Japan, what I would expect is that the expense ratio will start to catch up more to the midpoint of our estimate, more in that 20% range as we go through the year. As I mentioned, we have a little bit of a delay, if you will, in some of the spend because of the promotional spend being more aligned with our cancer product launch. Benefit ratios came in at the strong end of the range at 70.3% in Japan. And that's -- there is some mix dynamic in that, first sector and third sector. But we continue to see strong trends and results, particularly in the cancer block of business in Japan, and that seems to be contributing to pushing us to the low end of the range. And yes, well, could that continue? Yes, it could continue. Of course, but benefit ratios can be volatile, and it's early in the year.

On the U.S. side, obviously we're seeing a tick up in the expense ratio, which you would expect because we're proactively investing in the platform. You noted, I mentioned incremental investment in the U.S., which will push us up towards the 35.5% to 36% range as we go through the rest of the year, so the upper end of that expense ratio range. But we continue to enjoy extremely strong benefit ratios. There is some volatility that does come into play in any particular quarter in the benefit ratio. But still underpinning that ratio in terms of being at the low end of the range, for example, is good, solid trends in that performance. We did see a little bit of volatility in our cancer block in the U.S. We had lapsation among older age cancer policies where you would have a disproportionate release of reserves. We estimate that, that may have contributed something in the neighborhood of 50 basis points or so to the positive results. It’s very -- from our standpoint, we would not naturally expect that type of dynamic to persist as we go through the year, but that certainly helped out the quarter. But still, even after adjusting for that, it's very, very strong start. So we're -- it's too early in the year for us to be adjusting guidance across the board. That wouldn't be prudent. But as I said, we're off to a strong start on margins and EPS.

Erik James Bass
Autonomous Research LLP

That's helpful. And then, given your increased exposure to floating-rate securities, can you talk about the sensitivity of your investment income to changes in LIBOR? And should we expect any material benefit from higher rates or will it be largely be offset by higher hedging costs?

Frederick John Crawford
Executive VP & CFO

We have Eric on the phone from New York to talk about that. But that is where the growth in the U.S. portfolios is coming from is on the floating-rate side, in that even though you are then exposed to any sort of new hedge instruments, it will tend to be aligned with higher yields on -- as LIBOR rates rise. And you might note that we're 80% -- we've talked about being 80% locked in on our hedge cost for 2018. The 20% that remains exposed has a lot to do with the build of the floating-rate, the natural role of floating-rate instruments. So yes, you experience higher hedge costs when you do that, but it's offset, we believe, by higher LIBOR yields, and we're actually seeing that.

Eric, I might invite you into the conversation. The other thing I would say is, earlier on in the Q&A, Humphrey Lee asked some questions surrounding our U.S. dollar portfolio size and hedge ratio. And Eric, I would just invite you that if you want to comment on this and then any comments on that portfolio, please, feel free to do.

Eric Mark Kirsch
Executive VP & Global Chief Investment Officer

Sure thing. Thank you, Fred. And Erik, that's an excellent question because obviously LIBOR has been getting a lot of attention. And Fred has answered it accurately. From a conceptual standpoint, even with the rise in LIBOR, the strategy we set up was designed so that the asset side and the liability side would sort of be neutralized from any increases or decreases in LIBOR, since the income's going up and the hedge costs conceptually go up. However, I would note, LIBOR has gone up more than expected this year. And actually, we'll get a net benefit from that. And that's primarily because, generally speaking, on the floating-rate assets, which are 1-month or 3-month LIBOR, we generally want to match the hedges. But going into the year, we did do a tactical move where we, what we call, termed out our floating-rate hedges by buying 9- and 10-month hedges. Because we did have a belief, which I don't think anybody would argue with, that hedge costs and LIBOR were going to increase during the year. So in essence, for the majority, not all, of our floating-rate assets, we locked in 2018 hedge costs back in November and December. So even though LIBOR is higher today than the forward curves would have suggested, our hedge cost will be minimally impacted by that. On the other hand, our floating-rate assets, which we also projected in our income projection to go up, because LIBOR is higher than we all expected, the income side will get a little bit of a kick, if you will, and get an income benefit. So that's a tactical adjustment on the hedging strategy, which we believe is within the confines of our overall strategy, which we may do from time to time. But even if we hadn't done that, while our hedge costs might have inched up, again, as I just said, the income went up anyway so the net would have be neutral to perhaps slightly positive on a net income basis. And that's part of the beauty and design of that strategy.

Relative to the earlier comments from Humphrey. Humphrey, you were ticking off the correct numbers from our FAB supplement, but just -- when we're looking at the dollar program, we are looking at it in Japan terms, if you will, since it sits on the Japan balance sheet. So you're looking at converted numbers at the current exchange rate. But a bit more accurate, the dollar program is at about $25 billion, and the hedge ratio is at about 40% on an economic basis at March 31.

Operator

Next question comes from John Barnidge of Sandler O'Neill .

John Bakewell Barnidge
Sandler O'Neill + Partners, L.P., Research Division

My question is about U.S. sales. Short-term disability sales have now declined for 2 consecutive quarters for the first time since the beginning of 2014. Can you talk about the decline there and maybe what's causing that and expectations for the sale of that product going forward?

Teresa Lynne White
President of Aflac US

So this is Teresa. I'll just start out by saying, in 2017, we had increases in short-term disability sales, specifically because of an enhancement that we made to that product -- that individual product. So you're seeing the benefit of that in 2017. But then what you're seeing in 2018 first quarter is you're seeing a stronger broker sales, which really is muting some of the sales that you're seeing on short-term disability.

So we don't see any major concerns with short-term disability. But I'll switch it over to Rich, who might have additional comments that you might want to make.

Richard L. Williams
Executive VP & Chief Distribution Officer

Yes, Teresa. First of all, I agree. And you mentioned '17 compared to '18. I would also note that as our broker sales continue to increase, as Dan mentioned in his comments, that we're seeing significant acceleration in group product sales. So it's a little bit of just the broker-influenced sales driving more group product sales, having a little bit of effect. But the absolute dollar amount of individual STD sale is very much in line with prior periods.

John Bakewell Barnidge
Sandler O'Neill + Partners, L.P., Research Division

And then, my follow-up is also in the U.S. One Day Pay is clearly a great value-add for your U.S. products. Do you have any ability to maybe quantify by how many basis point this has led to an improvement in the benefit ratio since it was introduced because the quicker you close claim, the less the claim probably is over the long run.

Teresa Lynne White
President of Aflac US

I'll just say, One Day Pay, do I have something that quantifies that? It's more anecdotal in that what we're hearing from our sales force, what we hear from surveys, from our consumers, our policyholders is that One Day Pay is a differentiator for Aflac. So I don't have any quantitative, except for research that we've done that has been third-party research.

Frederick John Crawford
Executive VP & CFO

Yes, and we don't really see any material differences in what I would call the profit patterns and behavior of a One Day Pay scenario and any nonqualified One Day Pay claims process. So we're not seeing anything relative to those margins. It's really what Teresa is saying. It's about penetration and customer experience.

Operator

Next question comes from John Nadel of UBS.

John Matthew Nadel
UBS Investment Bank, Research Division

Fred, just a follow-up question on the investment spending. In the U.S. I think it's expected to be about $250 million over the next 3 to 5 years. I think you mentioned an additional $0.03 of spend for the remainder of this year. Is that -- should we be correlating that to this year's portion of the $250 million?

Frederick John Crawford
Executive VP & CFO

It's not going to work that elegantly. And what I mean by that is, when we talk about our U.S. platform, realize that you're talking about not just U.S., the segment in insurance but also corporate-related activities, such as our efforts to build out our venture investments and digital initiatives. Much of that investment actually takes place at the corporate and other and the holding company-level and not necessarily down in the insurance company. And so, you have to sort of be mindful of that. It's really about jump-starting and driving and accelerating growth in the U.S. overall. What I would say in terms of characterizing the spend, though, is a couple things. One is, a lot of what we're talking about here is an acceleration of investment and not just some sort of new run rate-level of spend. Tax reform gives us an opportunity to deploy cash flow in a way to accelerate our efforts, which we think are -- is beneficial. And some of the areas of that $0.03 a share that I mentioned, for example, include things like training and development, which -- training and development, I know it doesn't necessarily give you specifics, but one of the orientation around this is really helping the workforce essentially get -- embrace change management and move towards a more automated environment, which is very, very critical in the workforce today. As we look to do automation, we need a workforce that really is able to fold into that new automation.

We're also spending money to jump-start the productivity of our organic distribution model in the U.S., while at the same time investing in technology that we think will develop expanded distribution opportunity. And so we've pinpointed some of those investments and accelerated it into the current period. And then, Teresa has talked about technology roadmap. We've got a long-term roadmap of improving and building out our technology or modernizing our technology. And we've gone into that roadmap and specifically plucked out areas of it that drive growth to accelerate that spend. So the screen we've put on the $250 million is a real simple screen. Dan and I have talked about this, and we have one major gating issue, and that is, we want all of that spend to be hardwired towards growth. That's the reason we're accelerating the spend and that involves all categories of investing in our people, investing in distribution, investing in technology, but it better be hardwired to a growth initiative in order to green-light the spend. So that's the way I would characterize the investment.

John Matthew Nadel
UBS Investment Bank, Research Division

Okay, that's very helpful. And then, I guess my second question is about sort of the distribution side in the U.S., and I think you guys have characterized, particularly last year, a four-pronged approach, sort of veteran agent productivity, conversion rate of new agents to veterans. And a couple of other components. I guess, Teresa, the question for you is, as you look at those 4 contributing factors, and I think each one of them was a positive contributor, the sales growth in 2017, early in 2018, how do you feel about those 4 items?

Teresa Lynne White
President of Aflac US

I'm going to pitch that to Rich and allow him to speak a little bit on that topic.

Richard L. Williams
Executive VP & Chief Distribution Officer

Thank you, Teresa. I think the answer is pretty much consistent. First of all, each of those 4 areas that you mentioned, we continue to see favorable progress, and we're executing there. And as Dan mentioned early on, our results for the first quarter were in line with expectations. And we plan to see continued acceleration throughout the rest of the year.

Operator

Our next question comes from Alan scarf of Goldman Sachs.

Taylor Alexander Scott
Goldman Sachs Group Inc., Research Division

I had a couple of questions on Japan. The first is, I think it was mentioned that some of the new sales were related to, I guess, replacements of sort of older policies. And just in light of the comments that suggested that third sector benefit ratios this quarter benefited, in particular, from older policies. Can you help us think about how quickly some of those older policies are rolling off? If sort of that new sales trend would accelerate that at all? And what the implications could be for sort of the trends for benefit ratios?

Frederick John Crawford
Executive VP & CFO

Cancer business, in general, in fact, all of our business in Japan has very high persistency. And so that tends to be fairly consistent. Realize, by the way, that cancer is -- in Japan is age-banded. So it's not just sort of automatically the case that if you have an old cancer product, you just upgrade because, of course, you are presumably much older. And you're going to be priced differently. And so it's got to take a very unique dynamic for that to be somehow attractive to you as a consumer and have the right value proposition. Really, what we're seeing in cancer, quite candidly, is a continuation of what we've been seeing for a while, and that is a lot more outpatient treatment, which means a lot less days in the hospital. So outpatient trends. We're seeing continued advancements in cancer treatment really played 2 roles. One is, it requires us to upgrade our cancer product periodically. So as I mentioned earlier, some of the major reasons you upgrade a cancer product every 3 to 4 years is because of the technology and treatment advancements and now being able to cover those treatments for the consumer. But those same advancements in early detection and treatment are also working to calm down the claim space activity, particularly on older block. So we're just simply seeing a continuation of what we've been experiencing, and it's obviously helping out our results.

Daniel Paul Amos
Chairman, President & CEO

Anybody or anything from Japan?

Taylor Alexander Scott
Goldman Sachs Group Inc., Research Division

Yes, so we had -- I had one more question. Just on the WAYS product and the selection customers are making. I mean, I noticed a little bit of shift in policyholder benefits sort of from incurred claim -- or to incurred claims from increase in policyowner benefits. Could you just talk about like the trends and the selections the customers are making and any impacts that, that would have on either FSA earnings or just benefit ratios in the segment?

Frederick John Crawford
Executive VP & CFO

We have Todd on the phone, and Todd, you may want to answer that question. I think you've got a couple different questions embedded in there. You take a shot at it.

James Todd Daniels
Executive VP & Principal Financial Officer of Aflac Japan

Yes, I'll go ahead, Fred. I think what you're saying with the WAYS product is 2 different buckets of money I'll call it. So you've got your policyholder reserve that's being released when policyholders actually take their cash surrender value. And we're seeing that pretty consistently when these policies become paid up. And you also have an annuity settlement option that has the same effect of reducing your NVR and moving the reserve, I'll call it, up to an incurred claims line. And every time we pay an annuity payment, a claim is paid out of that reserve. So that's the geography. The overall impact of the benefit ratio on a GAAP basis is negligible because the money that's staying in the system is still on the benefits -- in the benefits line and overall. From an FSA perspective, it's a similar dynamic. You don't see an impact of those products going straight to the bottom line when they lapse.

Operator

I will now hand the call back to Mr. David Young. Sir, you may proceed.

David A. Young
Vice President of Investor & Rating Agency Relations

Thank you, and thank you all for joining us today for our first quarter call. Before we end, I'd like to remind everyone about our financial analyst briefing to be held in Tokyo on September 26. We will be sending out communications with more details in the coming months. We hope you'll consider joining us there in September. And please feel free to contact our Investor and Rating Agency Relations department with any questions you may have. We look forward to seeing and speaking to you soon. Thank you.

Operator
Thank you. That concludes today's conference. Thank you for participating. You may now disconnect.