S&P Global
Market Intelligence

Aflac Incorporated NYSE:AFL

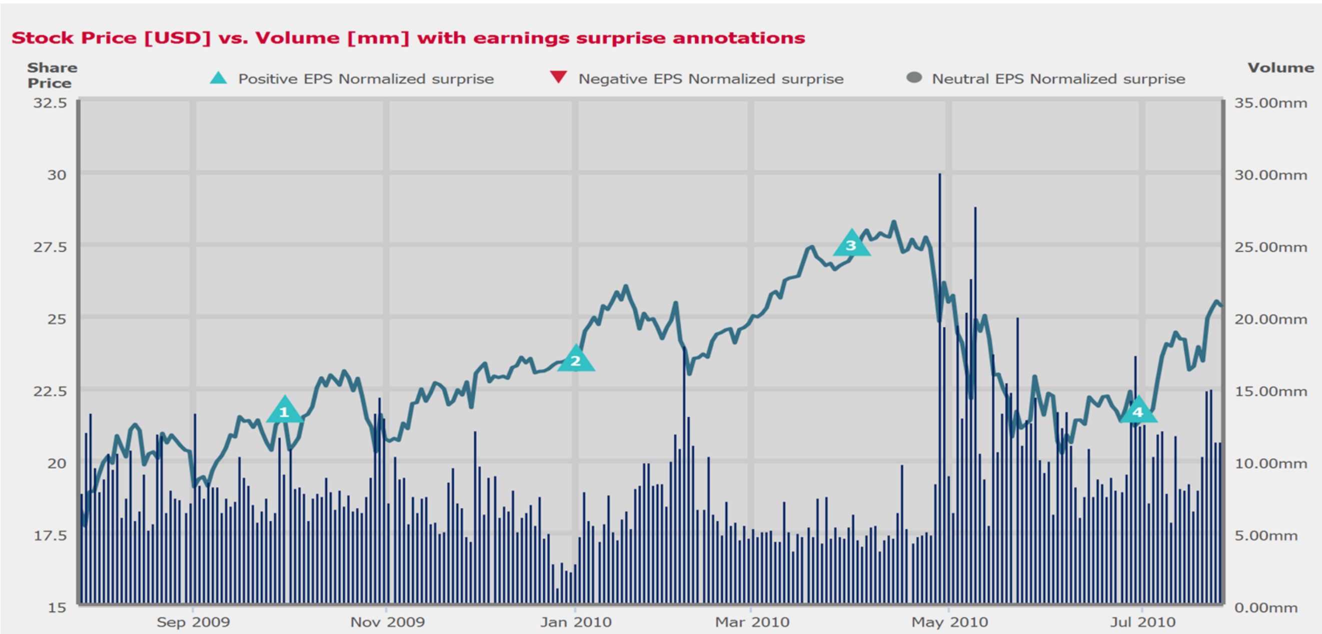
FQ3 2010 Earnings Call Transcripts

Wednesday, October 27, 2010 2:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2010-			-FQ4 2010-	-FY 2010-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	GUIDANCE
EPS Normalized	0.69	0.72	▲5.80	0.67	2.76	2.67
Revenue (mm)	5357.94	5394.00	▲0.67	5495.37	20995.38	-

Currency: USD
Consensus as of Oct-27-2010 2:13 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ3 2009	0.60	0.62	▲1 5.00 %
FQ4 2009	0.58	0.59	▲2 1.72 %
FQ1 2010	0.66	0.70	▲3 7.58 %
FQ2 2010	0.67	0.68	▲4 1.49 %

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Call Participants

EXECUTIVES

Dan Amos

Jerry Jeffery

Ken Janke

Kriss Cloninger

Paul Amos

Robin Wilkey

Tohru Tonoike

ANALYSTS

Darin Arita
Deutsche Bank

Ed Spehar
Bank of America Merrill Lynch

Jeff Schuman
KBW

Jimmy Bhullar
J.P. Morgan

John Nadel
Sterne, Agee

Steven Schwartz
Raymond James

Suneet Kamath
Sanford Bernstein

Thomas Gallagher
Credit Suisse

Unidentified Speaker

Presentation

Operator

Welcome to the Aflac third quarter earnings conference call. Your lines have been placed on listen-only until the question-and-answer session. Please be advised today's conference is being recorded.

I would now like to turn the call over to Mr. Kenneth Janke, Jr., Executive Vice President; Deputy Chief Financial Officer of Aflac Incorporated.

Ken Janke

Thank you Laurel, and good morning everybody. Thanks for joining us today on our third quarter conference call. We are off site, and joining me this morning is Dan Amos, Chairman and CEO, Kriss Cloninger, President and CFO, Paul Amos; President of Aflac and Chief Operating Officer of our U.S. operations and Jerry Jeffery, Senior Vice President and Chief Investment Officer, Tohru Tonoike; President and Chief Operating Officer of Aflac Japan is joining us from Tokyo.

Before we begin this morning, let me remind you of the effect that some of the statements that we will make in this teleconference are forward-looking within the meaning of Federal Securities laws and although we believe these statements are reasonable, we can give no assurance that they will prove to be accurate because they are perspective in nature. Our actual results could differ materially from those that we discuss today.

So I'd encourage you to look at the various risk factors that we've disclosed in our quarterly earnings releases and SEC filings to see some of those risk factors that could materially impact our results.

Now, I'll turn the program over to Dan, who will begin with the discussion of our business in the United States and Japan and then Robin will follow up with some financial highlights for the quarter and the nine months and then we'll be happy to take your question. Dan?

Dan Amos

Thank you, Ken. Good morning and thank you for joining us today. I am pleased with Aflac's overall financial performance in the third quarter. With nine months of the year behind us, I'm confident in the progress that we've made toward our annual operating earnings growth and capital strength objective.

Let me start this morning's call with a recap of the insurance operations, beginning with Aflac Japan. Aflac Japan produced strong financial results and better than expected sales for both the third quarter and the first nine months of the year. I think it's important to know that Aflac Japan's strong sales has improved premium income growth.

In the first quarter of the year, Japan's premium income growth of 3.3% has improved to 3.8% by the third quarter. In addition, as expected, our pre-tax profit margin expanded resulting in solid earnings growth both through the quarter and year to-date.

I was especially pleased with Aflac Japan's strong sales momentum continued in the third quarter. Total new annualized premium sales in yen were up 15.5% for the third quarter to 34.6 billion yen, a record for the third quarter production.

For the first nine months of the year, Aflac Japan's total new sales rose 12.8%. I'm excited about these outstanding results. At the same time, my mind now shifts as worry about going against these increases in 2011, which will be difficult.

Our strong sales results are largely attributable to two primary factors-accelerated sales activities within the bank channel and innovative product development. Bank sales in the third quarter posted another record at 5.9 billion yen, which represents a 170.7% increase over the third quarter of 2009 and a 51.3% increase over the second quarter of this year.

At the end of September, Aflac Japan was represented by 360 banks or 90% of the total number of banks in Japan. While we've been successful in signing up a large number of the banks, the majority of these banks have not actually ramped up sales for Aflac products. As such, we have shifted our focus toward increasing sales penetration at the banks we already secured.

Make no mistake, we believe more banks, especially the mega banks, will expand their sales efforts as the word gets out about the momentum other participating banks are experiencing.

Banks have proven to be a natural fit in terms of selling our products. Total ordinary life sales emerged as the number one product category for Aflac Japan and represented 42% of the overall product sales in the third quarter. The child endowment product, which was first introduced in March 2009, accounted for about half of our ordinary life sales.

As you're probably aware, Japanese consumers place a high priority on the financial responsibility and education. Attribute to that has made child endowment policies very popular in Japan for many years.

A few distinct competitive advantages have contributed to Aflac's sales success with child endowment products including Aflac Japan's strong brand, this product unmatched returns and strong bank presence.

In June of this year, parents of children under the age of 16 started receiving a child subsidy from the Japanese government. We believe this prompted many of the parents to earmark this subsidy for a child endowment policy and Aflac's competitive advantage helped make our endowment policy the product of choice through banks.

The average annualized premium for a child endowment policy is about three times the size of a health product, meaning that it's a very solid contributor to the top line growth.

When consumers elect to pay premiums upfront for the child endowment policy it's a win, win situation for both Aflac and our policyholders. That's because the policyholders get a small discount on their premium amount or discounted advanced premiums. Aflac's profit margin on the policy more than doubled.

Importantly, almost 50% of the child endowment policies currently sold by our banks are issued using this discounted advanced premium method of payment, which means this product is also a good contributor to the bottom-line.

Another solid contributor to the third quarter ordinary life sales, particularly through the bank channels was WAYS, a product we first introduced in early 2006. This unique hybrid product starts as a whole life policy.

When the policyholder reaches retirement age, usually 60 or 65, they can choose to convert a large part of their life benefit to a fixed annuity, medical coverage or nursing care benefit. Consumers find this product attractive because of the various options and the future flexibility it affords. Banks like to sell this product because the premium is about three times that of the child endowment policy.

The discounted advanced premium payment option is also available with WAYS. About 90% of the customers at the bank choose this payment option. Consumers are provided a great value, while Aflac's profit margin increases significantly with this payment method.

As our banking distribution system becomes a greater contributor to our top line growth, we expect sales of this innovative product to grow substantially.

The medical product category represents 32.5% of sales in the third quarter. You will recall that in August of 2009, we had launched New EVER an updated version of the popular 2002 medical product.

Promotions of the New EVER features the Maneki Neko Duck the Cat-Duck advertising campaign literally became an overnight sensation in Japan and prompted an incredible sales surge that started in the third quarter of 2009.

Yet even on the heels of last year's phenomenal success, third quarter medical sales still posted an increase of 3.9%, exemplifying the continued popularity of and the demand for medical product.

As you may recall, we supplemented our diverse product line with two product introductions in June. Both are great examples of our ability to take an existing product line, break it apart and further segment the market to achieve greater penetration.

The first product introduced was called Corsage a female specific cancer rider that attracts to our base cancer plan coverage. Corsage is a rider that attaches to the base cancer plan with surgery benefits that addresses the high cost of treating female specific cancers.

In doing so, Corsage captured the attention and most importantly the business of a new targeted audience, in this case, the younger Japanese females in their 30s. This product launch leveraged the government rollout of various programs for mouth cancer awareness all across Japan.

The second product introduction was an enhanced version of Gentle EVER, a nonstandard medical product for consumers who cannot qualify for our base EVER plan. Gentle EVER contributed 16.6% of the medical sales in the third quarter, which was also in line with our expectation.

Clearly, as we look at our sales results through the quarter, we remain significantly ahead of our annual target of 0% to 5% increase in sales, but I want to remind you that the biggest hurdle we face is last year's fourth quarter sales increase of 14.9%.

Remember that last year's medical sales rose 57.7% in the fourth quarter and the month of December of 2009 was the largest December in Aflac Japan's 35 year history. Yet, despite the challenges, we remain confident that Aflac Japan will exceed its sales target for the year.

Now, let me turn to our U.S. operations. From a financial perspective, Aflac U.S. continues to perform at expectations, although weaker sales have slowed top line growth somewhat over the last few years, we've seen a steady improvement in persistency this year and a significant improvement compared with the year ago.

I also believe we've done a good job in managing our U.S. operations, including the budget and people resource, our benefit in expense ratios are lower than a year ago resulting in strong pre-tax operating earnings growth.

As has been the case in the U.S. market for the last several quarters, we were not surprised that continued challenge held back sales, including difficult work site conditions, and decreased consumer and small business confidence.

Total new annualized premium sales in the third quarter were $324 million or 5.3% lower than a year ago. For the nine months, sales were 5.9% lower than a year ago.

As you likely know, businesses who are fewer than 100 employees have traditionally been our bread-and-butter, accounting for approximately 90% of the total accounts. Today, these small businesses have proved to be especially vulnerable to the ongoing economic weakness and both small business owners and their workers are understandably anxious about what the future holds.

Until 2009, small business optimism index reading consistently below 90 had been unprecedented in its survey, but since then those low readings have gone from being an exception to being the rule.

At the same time, consumer confidence, that was already low in the second quarter, declined even further in the third quarter. As a matter of fact, except for February of this year, the consumer confidence level in September reached a 2010 low.

In this time of uncertainty, workers of small businesses are holding back on increasing their spending for voluntary insurance products. Let me tell you what I found out after visiting more than 70 state operations over the last few months.

Things are tough, there's no doubt about it, but I also found that sales force is upbeat and optimistic about the future. They're excited about now being able to offer products to accounts with more choice. That means group products in addition to our traditional individually underwritten policy.

Another challenge we're facing in this environment is the difficult recruiting condition. Recruiting was weak in the third quarter compared with a year ago showing the continuation of the trends in the first half of the year. With uncertainty in the job market, it's tough to find people with salary jobs who are willing to take their chances in commission sales.

Furthermore, due to the extension of the unemployment benefits, people who lost their jobs and are collecting unemployment, feel hesitant to trade in that steady check for a commission-only sales job. We have never faced an extension like this before and we believe it is hurting our recruiting.

While these things may be beyond our control, there are some things that we can influence. To focus our field force on improving our recruiting results, we shifted our state and regional bonus criteria earlier this year from one that was based on sales to one that incorporates the people development component based on developing average weekly producers.

In addition to running the national recruiting contest and workshops, we are policing the new programs and are also benchmarking various practices to enhance recruiting. I will say that while these initiatives may not produce a quick fix, we believe this more methodical approach can help us improve recruiting over the long-term.

Beyond expanding the size and the capabilities of our traditional sales force, we remain excited about the opportunities to broaden our distribution by strengthening our relationship with insurance brokers. Although our entry into the broker distribution outlet is fairly recent, our efforts are translating into sales.

Total broker sales was up 34.9% in the third quarter. On a pro forma, which includes Aflac Group in the third quarter of 2009, broker sales were still up 7.2%. The broker products platform is an important part of our effort to broaden our product line portfolio.

On the one hand, brokers know, and therefore, prefer to sell group product, while our traditional agents are more familiar with the individual products. As I told our field force during my travels over the last couple of months, I don't care if you sell group or individual products, the key is to provide the account with an option. If we don't, someone else will.

Our competitive advantage is applied to both product platforms, a strong brand, great products and an excellent reputation for paying client. Although our sales outlook for Aflac U.S. remains cautious in the short term, our long-term view on the U.S. market does not change.

We believe the need for our products remains very strong and we are taking measures to better reach potential customers. We continue to believe the U.S. provides a vast, accessible market for our products and we are building on the business with economy recovery in mind.

Now, let me update you on Aflac Incorporated's results. Excluding the benefit from the stronger yen, operating earnings per diluted share rose 10.4% in the third quarter and 10.9% for the first nine months of 2010, which keeps us on track for achieving our earnings growth objective for this year.

We also remain pleased with the quality of our balance sheet and our strong capital position. Clearly, a lot of attention has shifted reasonably to the impact of lower interest rates on our earnings.

As you heard me say repeatedly since the early 1990s, our greatest challenge is investing huge cash flows in Japan, a low interest rate environment. To address this, we started increasing the amount Aflac Japan invests in dollar-denominated securities. This strategy, which we discussed at the Tokyo Analyst Meeting, produces two benefits.

First, we are funding the dollar purchases with the sale of Japanese government bonds. These JGB is scheduled to mature before the end of 2011 and we are capturing the gains for the purposes before they mature.

Second, we are investing the proceeds in higher yielding dollar-denominated corporate bonds at a meaningful spread. The current strength of the yen and the wider spread on the dollar bonds helps mitigate the currency risk associated with the strategy.

As part of this strategy, we plan to make dollar-denominated purchases totaling up to $1 billion through the end of the year. While our preference is to invest in yen-denominated securities, we view this as a short-term strategy that helps enhance our yield in a low interest rate period.

As we've communicated over the past several years, maintaining a strong risk-based capital or RBC ratio remains a priority for us and you will recall that it is also a priority component of the management incentive plan for all Aflac officers.

Our official objective for 2010 is to achieve an RBC ratio in the range of 375 to 475, but we would like to end 2010 with a ratio that's even higher than the end of 2009, which was 479. Based on preliminary third quarter 2010 statutory numbers, we estimate our RBC ratio will exceed 580%. This compares with an RBC of 560% at the end of the second quarter.

Historically, our strong capital generation has allowed us to increase cash dividends in line with our earnings growth before the effect of the yen and the repurchase of our shares.

As you probably saw in our August press release, the Board of Directors approved a 7.1% increase in the quarterly cash dividend effective with the fourth quarter payment. This marks the 28th consecutive year of increase. Additionally, we anticipate repurchasing up to 3 million shares as early as the fourth quarter of this year and 6 million to 12 million shares in 2011.

Our strong capital position and relative stability in the global credit market affirms these decisions. At the same time, I'm still convinced it makes sense to maintain a healthy degree of conservatism given the economy uncertainties around the globe.

The economy remains fragile and we need to be prepared. I think it's reasonable to see operating earnings per share increase 10% this year before the impact of the yen. That result will be consistent with our annual objective of a 9% to 12% increase in 2011. Our objective for 2011 remains an increase of 8% to 12% in operating earnings per diluted share before the impact of the Yen.

You'll recall that when we established the range in May that we lowered the bottom range from 9% to 8% due to the projected continued low interest rates in Japan. If low interest rates continue to pursue us through 2011, we would expect to be at the lower end of the range.

As I look to the balance sheet of this year and beyond, we continue to believe that Japan and the United States each have characteristics that make them ideally suited for the products we offer.

Our business is strong from an operational perspective and we have confidence in our business model and in our people. We also have the strength in our balance sheet that will allow us to continue to build the promises that we made to our customers and the expectations of our shareholders.

Now, I'll turn the program over to Robin.

Robin Wilkey

Thank you, Dan. Let me go through some third quarter numbers, starting with Aflac Japan. Beginning with the top line in yen terms, revenues were up 3.2% for the quarter and investment income was up 0.8%. The persistency rate improved in the quarter and annualized rate, excluding annuities, for the first nine months of 2010 was 94.1% compared with 94.0% a year ago.

In terms of quarterly operating ratios, the benefit ratio continued to improve over last year. It was 59.6% in the quarter compared with 59.9% a year ago. The expense ratio for the quarter was 19.2%, down from 20.1% in the third quarter of 2009.

Reflecting the lower benefit in expense ratios, the pre-tax margin rose from 20.0% to 21.2% in the quarter. With the expansion of the margin, pre-tax earnings increased 9.5% for the quarter in yen terms.

For the quarter, we invested our cash flow in yen securities at 2.14%, and including dollars, the blended rate was 2.45%. The portfolio yield was 3.64% at the end of September, down 7 basis points from the end of June and 16 basis points lower than a year ago.

Now, let me turn to some numbers on Aflac U.S. Total revenues rose 4.4% for the quarter. The persistency rate improved significantly and was up about 76.7% in the third quarter. The annualized rate for the nine months was 72.6%, up from 71.3% a year ago.

Looking at the operating ratio for Aflac U.S. in the quarter, the benefit ratio was 51.8% compared with 51.9% a year ago. Our operating expense ratio was fairly consistent, going from 30.6% a year ago to 30.5% this quarter. The profit margin for the quarter was 17.7% compared with 17.5% a year ago. As a result, pre-tax operating earnings rose 5.8% for the quarter.

In terms of U.S. investments, the new money yield for the quarter was 5.69% versus 7.36% a year ago. The yield on the portfolio at the end of September was 6.96%, down 8 basis points from the second quarter and 24 basis points from a year ago.

Turning to some other items for the quarter, non-insurance interest expense in the third quarter was $37 million compared with $24 million a year ago. The higher interest expense primarily reflected our debt issuances in the fourth quarter of 2009 and in 2010.

Parent company and other expenses decreased from $21 million to $11 million in the third quarter of 2010. Parent company expenses were higher a year ago due to pension adjustments and expenses related to the purchase of Continental American. In addition, the lower parent company expenses this year reflect lower realized foreign currency gains and increased parent company investment income.

Total company operating margins rose, reflecting the improved profitability of Aflac Japan and Aflac U.S. Pre-tax margins rose from 18.4% to 19.4%. The after-tax margin increased from 12.1% to 12.7%. On an operating basis, the tax rate was 34.6% compared with 34.3% a year ago.

Net earnings per diluted share for the quarter were $1.46 compared with $0.77 in 2009. Total net realized investment gains were $0.01 per share this year compared with a $0.48 loss per share in 2009.

Before the impact of ASC 810, we had a realized loss of $3 million. We also had several small security transactions and impairments that produced a $3 million loss or $0.01 per diluted share.

The impact of ASC 810 produced an after-tax gain of $9 million or $0.02 per diluted share. That gain was attributable to the valuation of foreign currency, interest rate and credit default swaps. This is a GAAP-only issue and has no impact on our statutory results. The bonds related to those swaps were in an unrealized gain position at the end of September.

As reported, operating earnings per diluted share rose 16% to $1.45. The stronger yen increased operating earnings by $0.07 per diluted share for the quarter. Excluding the yen’s impact, operating earnings per share increased 10.4% for the quarter.

Lastly, let me comment on the earnings outlook for 2010. As you heard, we have affirmed our objectives for 2010 of a 9% to 12% increase in operating earnings per diluted share, excluding the impact of the yen.

As was mentioned at our Analyst Meeting in May of this year, our expectation is that we will be close to a 10% increase for the full year before currency fluctuations. That would equate to $5.34 for the full year assuming no change in currency from last year’s average.

If operating earnings per share increased 10% this year and the yen averages 80 to 85 for the remainder of the year, we would expect operating earnings per share to be $5.52 to $5.57. Using the same foreign currency assumption, we would expect fourth quarter operating earnings to be $1.31 to $1.36 per diluted share. That compares with the First Call estimate that’s currently out there of a $1.36.
Now, I want to remind everybody to be fair, please limit your questions to one, identify yourself. And now we’d be happy to take your questions.

Question and Answer

Operator

Thank you. (Operator instructions) Our first question today comes from Jimmy Bhullar. Your line is open and please state your company name.

Jimmy Bhullar
J.P. Morgan

Hi, it's J.P. Morgan. Good morning. I had a question on the bank channel in Japan. I think banks were 17% of sales in the third quarter. That's up from about 12% in the second quarter. Just wanted to get an idea on long-term potential for the channel as a whole. And specifically, if you could comment on how much of your sales are coming from the mega banks, because I think historically most of your sales have been from the mid size and retail type banks, and how do you expect that to ramp up?

Tohru Tonoike

This is Tohru Tonoike. Let me answer to your question. You're right in saying that the share of the bank sales in our total sales is about 17% for the third quarter and that's I think growing over time and we expect that this trend will continue for the fourth quarter and beyond. The reason is, we are seeing that activities by the larger banks, particularly what we call the mega banks, have improved a lot.

So, for the third quarter, there are only four mega banks, represents about 30% of the total bank sales and 40% of the regional banks and 30% shrinking banks. So, going forward we expect more sales by the mega banks and less sales by the shrinking banks in terms of the percentage.

Jimmy Bhullar
J.P. Morgan

How many of the mega banks do you have relationships with? I don't think it's all four, is it two?

Tohru Tonoike

All four. We do all four.

Dan Amos

Jimmy, two of the banks are really the ones that are pushing it right now. We feel like the other two will pick it up. Actually, one is selling more than any of them, but we think that it's gotten around how well they're doing and the others are going to begin to do it, and we've already seen the second one and we believe the third one and the fourth one are coming on line to do more.

Jimmy Bhullar
J.P. Morgan

Are these exclusive relationships or you're one of several providers?

Tohru Tonoike

Our relationship is not exclusive with any of the above four banks. So, we are one of the several.

Jimmy Bhullar
J.P. Morgan

Okay, thank you.

Operator

Our next question comes from John Nadel. Your line is open and please state your company name.

John Nadel
Sterne, Agee

Hi, good morning. It's Sterne, Agee. I have a question on margins. If we go back to the May Investor Day, I may have this wrong, but I believe the expectation was that pre-tax margins in Japan and U.S. would continue to expand. I think it was around 75 to 100 basis points annually for the next few years. I guess I'm just interested in whether there is any change in that outlook that we should be thinking about, especially given I guess the relative strength of sales in Japan and the relative weakness of sales in U.S.?

Kriss Cloninger

Well, this is Kriss. In Japan, we expected to continue to expand our margin on our health products somewhere between, I think we said, 125 to 150 basis points, primarily through benefit ratio reduction. We did say at the time depending on how well child endowment did and whether we were able to successfully introduce WAYS, those life type products would have a lower margin, but they have higher premiums per policy.

Child endowment is three times the average premium per policy as a health product, and even though because they provide benefits that are definitely going to be paid, the benefit ratios are going to be somewhat higher than the typical health product.

Net, net, we get an improvement in the bottom line. Those products all significantly provided the returns that are significantly in excess of the cost of capital and therefore, they add value to the company. Even though they might slow the growth in the profit margin for Aflac Japan, by itself, they are going to increase the rate of growth in overall profitability.

With respect to Aflac U.S., I'd say margin expansion might be more modest. I think we might have predicted maybe an increase in margin of 0.5% or 1%, but that's not a major, major factor in the growth of Aflac U.S. So it's not part of our operating strategy. I think the U.S. margin growth, let me check it here, it's been relatively modest. We were 17.7% of revenues in the third quarter this year versus 17.5% last year and the first two quarters were somewhat higher, by about 2% of revenue, but that was due to some unusual circumstances related to changes in large accounts and the like. So overall, I am not counting on big margin improvements in the U.S.

John Nadel
Sterne, Agee

Okay. Very helpful. Thank you very much.

Operator

Our next question comes from Thomas Gallagher. Your line is open and please state your company name sir.

Thomas Gallagher
Credit Suisse

Sure. Credit Suisse. Two quick ones, if I may. First is just on the WAYS product. Can you get into why you expect sales momentum to come from that particular product? What is it about that product that you think is appealing to customers?

The second question is just on the investment, the $1 billion allocation to U.S. dollar investments in Japan, can you talk about what's driving that decision? Is it because you think the yen's likely at a top and you think that's attractive risk reward from a currency standpoint or is it because you have more room now in terms of dollar assets from a risk limit standpoint?

Kriss Cloninger

Let me take the second question first, and then Tohru might be able to comment on WAYS, if that's okay with you, Tohru. At the meeting we had in Tokyo in September, I talked a little bit about the shift between what we call the net hedge of our GAAP equity on our Japanese branch. I told you that in the past it has been our practice to try to hedge a portion of our Aflac Japan equity, either by investing that equity in dollar-denominated securities to achieve a higher yield than we could get if we left it invested in yen-denominated securities, or alternatively to hedge it with yen-denominated corporate debt, which gave us debt at a lower interest expense than we would realize if we borrowed in dollars.

I reminded you that with the relative shutdown of the Samurai market in Japan to foreign financial institutions, in general, that may be softening a bit today, but it continued throughout recent times. We had gone to refresh our debt to the U.S. credit markets, and so we were paying higher interest rates. Basically that allowed us to repay some of the yen-denominated debt and it freed up some funds we could use to hedge the net equity in Aflac Japan.

So we basically substituted dollar investments as a replacement for the reduction in the yen-denominated corporate debt. By achieving higher yields in those dollar investments, we offset the loss of lower interest rates on the yen-denominated corporate debt. So, that's the biggest part of it right now, Tom. It's not a currency play per se, but it's the recognition of the fact that you can get either better yields by investing in dollars, or lower interest by borrowing in yen, and right now that's where we are. We're trying to stay within monitoring our net hedge on our Japan equity right now. Tohru, you want to comment on the desirability or the reasons why WAYS use is attractive, including the optionality that the policyholders realize at their retirement ages?

Tohru Tonoike

We expect that the WAYS to give us the momentum there are a couple of reasons. First of all, we think this is particularly appealing to the bank customers. As we are seeing, the quick growth in the bank channel, the product appealing to the bank channel will grow very quickly. For the bank customers, WAYS is viewed as a kind of investment product.

Now in the environment of the low interest rates, investors are looking for the good ways to invest their money. This product, WAYS, gives them a certain return and also give them some protection in the future, maybe got a benefit or the pension or whatever that the customer like. This is a very unique product and particularly appealing to the women among the bank customers. In addition, the timing is, we think, very good.

So, beginning January next year, the large chunk of the treasury bonds which were issued five years ago are coming due and start getting redeemed. So, the bank customers bought a large amount of this treasury bond five year ago and now they are going to repay it and they have to find a way to reinvest. Now, the interest rate is much lower than five years ago. So we expect that a good part of that money will be shifted to the other products like WAYS. So, yes, we think that WAYS it is appealing particularly to the bank customers and as we expect that the large amount of money becomes available for this type of product in the bank channel, we think the banks will give us the momentum in the future.

Thomas Gallagher
Credit Suisse

Can I ask you what the interest rate guarantee on a product is?

Tohru Tonoike

It's not interest rates guaranteed -.

Kriss Cloninger

I believe the pricing rate Tom, is 1.85% on that and those products, they are hybrid type products. Basically, before the retirement age the policyholder pays a premium. They have a life insurance benefit if they die before their retirement age, but once they reach the retirement age they have a guaranteed cash value they accumulate during the premium period and then they have some options as to whether to continue the life insurance as life insurance or to convert some portion of the cash value to provide a medical insurance during their retirement age or whether they want to convert a portion of the cash value to an annuity benefit. I believe there's another option regarding kind of a long-term care type benefit in there.

So there is some optionality and part of the appeal of this WAYS product relates to the optionality and so we refer to it as a hybrid product. When Tohru says it's an investment product, it's true that it's an asset accumulation product that behaves like a traditional life policy used to behave in 1950s and the 1960s in the U.S. There's no credit, it is a interest account, it is not a universal life type contract, you put your premiums in, we don't credit the excess interest, we don't pay you dividends, we just accumulate to a fixed the cash value at age 65 or 70 or 75, whatever the selective retirement age is.

We find a way to continue the benefits thereafter, either through medical insurance or continuation of life insurance or through just a regular payout of the accumulated cash value. So, we think we are going to have funds quite a while. We're able to invest them in reasonably long-term securities. I think 10 years to 20 years is probably the average duration of these contracts. So, it's not a short investment contract and in a sense that's the imagination is what I'm trying to say.

Thomas Gallagher
Credit Suisse

That's very helpful, thanks.

Operator

Our next question comes from Jeff Schuman. Your line is open and please state your company name.

Jeff Schuman
KBW

KBW. Thank you, good morning. I was wondering if Dan or Paul could maybe comment a little bit more about the outlook for some tactical changes in U.S. recruiting. Dan you talked about the secular headwinds, the tough economy, the extension of unemployment benefits and so forth, but you also talked about new programs and a more methodical approach. I'm just wondering is there a lot to kind of hang or hats-on in terms of some tactical changes in the near term or what should we expect?

Dan Amos

I think it's very difficult to weigh out the internal execution issues versus the external market in terms of how much that's going to be affected. You're correct that unemployment being extended is a big factor and that's not just a factor in terms of people who aren't at work.

The other thing that's going on today is, because of how tightened the job market is, we're seeing a lot of people, who we would traditionally hire from a job to come to work and take a commission-only opportunity, are unwilling to leave their job because they feel like the prospect of getting another job should they fail in their sales career are next to nil. That makes it extremely difficult for us because generally people who are employed currently are some of our best prospects in terms of them coming on to work with Aflac, but the unemployment benefit is being extended sours another pool of potential candidates in many ways.

On a relative basis, we did recruit almost 5,500 this quarter. So the numbers continue to be large. You're right. We've changed the bonus structure which focuses long-term on people growth. Do I expect that or would I have expected that to make a significant difference in the first quarter? Just put out, no. I believe that we're making decisions about the long-term liability of the business, really trying not to create short spurts, but trying to create a long-term and consistent or sustained growth. I'm cautiously optimistic about recruiting.

I think that we're going to see things hopefully begin to turn in a positive manner, but again, I cannot predict what's going to happen in the economy and with employment. So, as things continue to struggle today from an economic perspective, it's difficult for me to weigh out the positive things we're doing internally against what's happening in the marketplace.

Paul Amos

The only other comment I would make is, there are checks and balances with it being harder to hire people, to leave their jobs, and the persistency of our business at the work side is higher because there's not as much turnover within the account. So where it hurts recruiting, it helps persistency. So, it balances to some degree on both sides, but saying that, I think I can sense the concentration as I've gone to these 70 state operations on recruiting, and my gut tells me that the focus itself is going to ultimately help us long term.

Jeff Schuman
KBW

So there's room for them to be more focused on recruiting and the incentives over time may move you in that direction. Is that what you're trying to say?

Dan Amos

I just want to be clear, in my 37 years with the company, I've never seen a tougher environment in the United States. That's one reason I went to so many states as to verify all of these things we've been hearing. It truly is difficult for recruiting and it's difficult in the small business environment. Saying that, the morale of our people are amazingly high and we just need to get more of them and that's what we're working on right now.

Jeff Schuman
KBW

Okay, thank you.

Operator

Our next question comes from Suneet Kamath. Your line is open and please state your company name.

Suneet Kamath
Sanford Bernstein

Thank you. Suneet Kamath from Sanford Bernstein. Question for Kriss on the guidance for 2011. When you talk about the low interest rate environment persisting, I guess, through the balance of next year, should we take that to mean a blended new money rate of 2.45% in Japan, which is what I think the number was in the third quarter or does that guidance suggest incremental pressure relative to that 2.45%?

Kriss Cloninger

I will say potentially below 2.45%. I think obviously, as you go down every, say, 25 basis points, it costs you some investment income without any offsetting relief in product pricing or the like, assuming that you've made no pricing activities. Obviously, there is a base beyond which you need to start conserving, doing some re-pricing. Given competitor constraints, but I think the big Japanese companies still have negative spreads, we still have a positive spread, and so we've got more room than they do, but we're not going to let interest rates drive us into the ground so to speak.

We've got the so-called discounted advance premium on some of these products. We only credit 1% on funds we receive under that. Some companies are down at 0.8%. We're watching whether any of the competitors move down below the 1% or decline, say, even below 0.8%. So we're watching the market. We're priced on the high end of assumed interest rates because we've always been able to beat the major competitors with the types of investments we make. Given the strong persistency and long duration of our business, we've been able to be out at the long end of the yield curve.

So all I'll say, Suneet, is that we were running about 2.45% year-to-date on the investment yield. If we get pressured down much below that, that's where I'm saying, I think in our analyst materials we got backed up the projections in the guidance we put forth in May, I think we said 2.5% to 2.75% or 3% on the Japan new money yields. So, if rates continue to decline and we end up in the 2% to 2.5% range, we're going to have to just see how that affects guidance. Right now all we want to do is remind you that if rates stay low, it's going to push historical low end of that range. Clearly, up to 12 million shares a year was a part of that guidance too.

Some of you have asked, do we have capacity beyond that? It depends on how the investment market behaves between now and the next 15 months as to how much we actually repurchased. We probably had some more capacity than we put in the estimates. We're going to still react cautiously and powerfully over the next 15 months. We're pleased we've been able to build RBC ratio up to the high end of where we wanted to be. So we don't feel much pressure to retain additional cash to cushion against further investment problems, but we're just taking a look at everything. I probably got saying more than I needed to, but that's how I feel about it.

Suneet Kamath
Sanford Bernstein

That's great. More is always better than less. So, just to be clear in terms of the 8%, assuming new money rates fall a little bit less, embedded in that 8% growth number would be buybacks at the higher end of the 6 million to 12 million share range?

Kriss Cloninger

Yes, I'd say so.

Suneet Kamath
Sanford Bernstein

Perfect. Thank you very much.

Operator

Our next question comes from Ed Spehar. Your line is open and please state your company name.

Ed Spehar
Bank of America Merrill Lynch

Thank you. Good morning. Bank of America Merrill Lynch. I had a question on the low interest rate issue. I'm wondering, is there any guidance that you're giving us here on the impact of lower rates relate at all to potential exchange offers or anything else related to the hybrid portfolio and the idea that there might be some investment income give up to maybe lower some of the concentration risk in some of these areas?

Kriss Cloninger

I would say, no, right now. I'll ask Jerry if he's got anything to add to that.

Jerry Jeffery

I don't think our strategy has changed any. We have been and we remain opportunistic and when it comes to exchange offerings and where it benefits us, we will take them on, but we don't have a contemplated strategy where we are aggressively going to seek out exchange offers. Today we haven't had to. Basel III is in effect encouraging banks to approach us with proposals. We haven't seen many recently, but I still think we're going through the digestion phase with Basel III.

Ken Janke

Thinking through the impact of rates, we do assume that what is scheduled to get redeemed will be redeemed next year. So, there's some natural de-risking that will be go on in the perpetual portfolio. If I remember correctly, there's about $388 million at par with 11 economic maturity dates and that's been factored into the new money yield outlook for next year.

Ed Spehar
Bank of America Merrill Lynch

Okay, thank you.

Operator

Our next question comes from Darin Arita. Your line is open and please state your company name.

Darin Arita
Deutsche Bank

It's Deutsche Bank. I was wondering if we could go back to the U.S. business and talk about Aflac Group. I was wondering if you could comment, how you're feeling about this business relative to the start of the year. If you could also provide numbers around your payroll accounts as we enter the fourth quarter versus a year ago?

Dan Amos

Darin, obviously we've had a lot of things that we've been going through since the transition to purchase back in October 1, of last year, and then really transitioning over to Aflac in January. As I have said many times, group business is a new business for us. The ability for us to forecast how things are going to go and what's going to happen, continues to be something that we're learning and getting better width.

In terms of the third quarter, we told you we did $17 million in sales, I was very happy with third quarter performance. I continue to see that things are moving in the right direction. We did discontinue several major product lines in 2010. In fact, we discontinued the number one product line they sold the previous year. We did that because of healthcare reform, because of strategic decisions, aligning our product portfolios. As a result, we're having to overcome some of those numbers, but we still continue to write very strong level of business. So, I'm very happy. On a relative basis, it was only $17 million in sales in the previous quarter. So it still continues to be very small, but there is high demand for the group platform.

As Dan mentioned now that we're providing choice for the market, not only as the group platform continue to be positive for us, but it's actually also driving individual sales, now that we're offering choice and people are open to individual sales as a whole, and that's why you heard the strong numbers on the broker market than were listed earlier.

So, in terms of payroll accounts, we have not given out any information. We were trying to bring those levels together based on different things that we're looking at, but hopefully by year-end we'll be pulling some of those numbers together and talking about what accounts look like on an Aflac Group side like we do on the Aflac U.S. side.

Dan Amos

I'd like to comment on it, I would say that the acquisition of this particular company is one of the most important things we've done in the U.S., because I saw for the first time going to field a crack in the die in terms of an opportunity. If you took company A and company B was out there and I was a competitor to Aflac, and I knew that company A had our insurance and company B did not, private group insurance, I would have always called on company B. The reason I would have called on is because they didn't have our insurance. With group insurance, if I was a competitor, I would call on company A, because I already know they see a need for the product, all I have got to do is sell them the group insurances better than individual insurance.

So one of our message is that we've gone out to this field force within the last year has been, you have got to go back and at least say to them, we offer both and you may recommend it, you may not recommend it. There are pros and cons to both. As an individual I'd rather own an individual policy. As an employer in multi-states, I might rather have a group product. Again, this only applies to accounts of 100 and over and remember, a 100 less accounts are 90% of our groups. So it's prestigious groups and big groups that we're talking about and what it's done is, it stopped the issues that we were having because now they have choice.

So whether they buy or don't buy it, the impact is much more sort of in the numbers themselves. I use this example, when I was going out to the field, I said, I went and looked at a TV set and I looked at a Sony place and they said to me this is the best TV. I said, of course, it is, that's all you offer. When I went to Best Buy, they offered a Sony and a Panasonic, and they said we recommend Sony. So I bought it because I had choice. So offering this choice has really put us in a position of being leader again and countering any punch that we might get from a competitor.

Unidentified Speaker

We're almost at the top of the hour so we have time for just one more quick question please.

Operator

Thank you. And our final question today comes from Steven Schwartz. Your line is open and please state your company name.

Steven Schwartz
Raymond James

Hey, it's glad to be to be lucky than good. Raymond James. Good morning, everybody. This may not be quick. Here's my question. It seems to me in Japan, if I were you, I would rather have the dollar of sales of medical than dollar of sales of ordinary life insurance because of the margin. I'd rather sell maybe, if I were you, an ordinary life policy because it's so much bigger. Is that an accurate statement?

Kriss Cloninger

Yes, I think it's reasonably accurate, Steven. If you like high products, then you want to sell more of the health. The point I was trying to make was both products are more than covering the cost of capital to acquire those products, and therefore, they are adding value to the company. Really, what you want is the most volume you can get on both types of products. That way you increase your company's value by the maximum amount you can and really that's what we're trying to do, increase the value of this company.

Steven Schwartz
Raymond James

I understand that. Where I want to go with this is, prior to March 2009, you can see U.S. was lower than expected, Japan was higher than expected. If the total dollar value of sales came out, you were actually ahead because a dollar of Japanese sales was worth more than a dollar of U.S. sales because of the persistency.

Kriss Cloninger

Yes, that's right.

Steven Schwartz
Raymond James

Is that still accurate today?

Kriss Cloninger

I would speculate that it is, because the profit stream has a longer annuity factor associated with it, if you will. So if you present value each year's profit, I think per dollar of sales you're going to get a bigger value from the Japanese dollar of sales than you're going to get from the U.S. dollar of sales.

Steven Schwartz
Raymond James

That's even with this increased emphasis on WAYS and child endowment?

Kriss Cloninger

I believe so, Steven.

Robin Wilkey

I want to remind everybody that we're at an offsite location, as Ken indicated earlier. So we will be flying back this afternoon. We'll be glad to take your calls tomorrow or shoot an email to Ken and myself and we'll be glad to answer when we get back.

Operator

Thank you. That does conclude today's presentation. Thank you all for joining. You may disconnect at this time.