S&P Capital IQ

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Aflac Incorporated NYSE:AFL

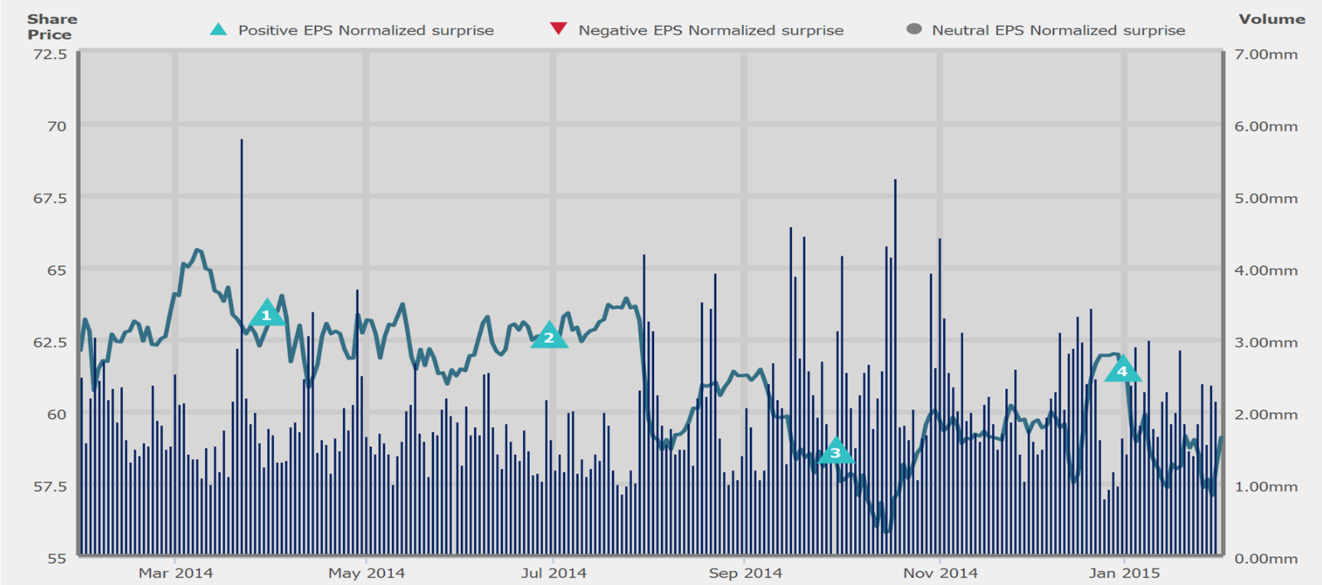
FQ1 2015 Earnings Call Transcripts

Wednesday, April 29, 2015 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2015-			-FQ2 2015-	-FY 2015-	-FY 2016-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.54	1.54	0.00	1.54	6.02	6.42
Revenue (mm)	5289.78	5226.00	(1.21 %)	5322.38	21287.13	21750.24

Currency: USD
Consensus as of Apr-29-2015 1:03 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2014	1.59	1.69	6.29 %
FQ2 2014	1.59	1.66	4.40 %
FQ3 2014	1.43	1.51	5.59 %
FQ4 2014	1.28	1.29	0.78 %

Call Participants

EXECUTIVES

Daniel P. Amos
Chairman & CEO

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

Hiroshi Yamauchi
Vice Chairman of Aflac Japan

Kenneth S. Janke
Former Executive Vice President and Head of Corporate Finance & Development

Kriss Cloninger
President & Director

Paul Shelby Amos
Former Director

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

Teresa Lynne White
President of Aflac US

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BofA Merrill Lynch, Research Division

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

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Thomas George Gallagher
Crédit Suisse AG, Research Division

Presentation

Operator

Welcome to the Aflac first quarter earnings conference call. [Operator Instructions] Please be advised today's conference is being recorded.

I will now like to turn the call over to Ms. Robin Wilkey, Senior Vice President of Aflac Investor and Rating Agency Relations. Ma'am, you may begin.

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

Thank you, and good morning, everyone, and welcome to our first quarter conference call. Joining me this morning in the U.S. is Dan Amos, Chairman and CEO; Kriss Cloninger, President and CFO; Ken Janke, Executive Vice President, Deputy CFO; Teresa White, President of Aflac U.S.; and Eric Kirsch, Executive Vice President, Global Chief Investment Officer. Also joining us from Tokyo are Paul Amos, President of Aflac; and Hiroshi Yamauchi, President and COO of Aflac Japan.

Before we start this morning, let me remind you that some of the statements in this teleconference are forward-looking within the meaning of securities guidelines. Although we believe these statements are reasonable, we can give no assurance that they will prove to be accurate because they're prospective in nature. Actual results could differ materially from those we discuss today. We encourage you to look at our quarterly release for some of the various risk factors that can materially impact our results.

Now I'll turn the program over to Dan, who will begin this morning with some comments on the quarter as well as our operations in Japan and the United States. Dan?

Daniel P. Amos
Chairman & CEO

Yes. Thank you, Robin. Good morning, and thank you for joining us today. Let me begin with an update of Aflac Japan, our largest earnings contributor. Sales of Aflac Japan's third sector products were up 21.3% in the quarter. This result established a strong start toward our expectation that third sector sales would average an increase of 15% for the first 9 months of the year. Sales of cancer insurance continued to be extremely strong, following the introduction at the end of the third quarter, the new Cancer DAYS product, which includes an exclusive policy sole for Japan Post.

Following an outstanding fourth quarter 2014, recession of this product, cancer insurance, sales in the first quarter generated 118% increase through all distribution channels and outlets.

Our distribution side, our strategic alliance with Japan Post continues to be enormously beneficial. This alliance leverages work in Japan, with Aflac Japan status as a leading industry and pioneer of cancer insurance.

Our tremendous progress continues, as more than 10,000 postal outlets offering our cancer insurance to their customers. I believe this allowance -- alliance will continue to benefit both companies as the opportunity to purchase cancer insurance is extended to more and more Japanese consumers. At the same time, our traditional agencies have been and remain key to our success.

Our goal is to have a presence where consumers want to make their insurance decisions, and our various distribution outlets broaden for that reach.

Now let me turn to the U.S. operation. As I mentioned during the fourth quarter conference call, we expected the first quarter sales would be challenging. As we communicated, the expense ratio increased during the quarter, primarily reflecting the expenses related to the changes we made to our sales organization over the last several months. We believe these changes, which were implemented to enhance our sales growth, are better positioning Aflac U.S. for the future.

At the same time, we just started something no one in the industry has ever attempted, no less, done. And that is the One Day Pay. The industry-first initiative means that we process, approve and pay in just one day. We're delivering on our promise to our policyholders in a more meaningful way of getting cash in their hands faster than ever, faster than anyone, in fact.

We estimate that 70% of our policyholders can use One Day Pay for their clients. In 2015, we expect to process nearly 2 million claims within the perimeters of this initiative. One Day Pay has generated a lot of excitement with our distribution channels, our accounts and our policyholders. Along with a strong brand and relevant products, I believe One Day Pay will continue to help Aflac stand out.

As I mentioned last quarter, I'm not willing to say that Aflac U.S. sales had turned the corner until we see the results for the first half of the year. At the same time, I remain encouraged by the progress that we've seen and continue to see. I still believe Aflac U.S. sales will increase 3% to 7% for the year. We'll continue to advance our efforts toward expanding our distribution to access employers of all sizes. Doing so will allow us more opportunities to leverage our brand and attract -- have attractive products in the portfolio in an ever-changing health care environment.

Having covered operations, let me turn to a topic that I know are top of mind with our shareholders, and that is capital deployment. Our commitment to maintaining strong capital ratios on behalf of our policyholders puts us in an excellent position to repatriate about JPY 200 billion to the United States for the calendar year 2015. This reinforces our plan to repurchase 1.3 billion of our common stock in 2015 and puts us in a good position for next year as well.

I want to reiterate that our objective for 2015 remains to increase operating earnings per diluted share 2% to 7% before the effect of currency. Challenging financial markets in a very low interest rate make it difficult to invest cash flows at attractive yields. Therefore, we will continue to be very disciplined in selling first sector products in Japan, which will reduce investable cash flows.

As always, we're working very hard to achieve our earnings-per-share objectives, while also delivering on our promise to our policyholders. I am pleased with Aflac's position in Japan and the United States, the 2 largest insurance markets in the world. Aflac has earned the distinction of being the best-branded company for voluntary supplemental products in each country. We continue to believe Japan and the United States each have characteristics that make them extremely well suited for the products that we offer.

Importantly, both markets offer opportunities for growth. We are fortunate that in the process of growing our business, we have the privilege of providing financial protection to more than 50 million people worldwide.

Now I'll turn the program back over to Robin. Robin?

Robin Y. Wilkey
Former Senior Vice President of Investor & Rating Agency Relations
Thank you, Dan. And now in the interest of time, we are going to start taking calls. Can I have the first question, please?

Question and Answer

Operator

[Operator Instructions] Our first question coming from the line of Randy Binner from FBR Capital Markets.

Randolph Binner
FBR Capital Markets & Co., Research Division

I'd like to try and get some more color on the reinsurance deal, that was announced in the quarter as part of your capital management plan. I guess first, just to kind of understand how this may have differed from the previous 2 deals in regard to kind of the subject matter risk that's covered, if it's with a different reinsurance partner. And you noted that there was a recapture almost immediately. So can we take that last piece to mean that this is less expensive than the previous 2 deals?

Kriss Cloninger
President & Director

This is Kriss Cloninger. I'll handle the -- I'll handle that. The substance of the reinsurance agreement was materially the same as the 2 previous transactions we did. They involved blocks of our in-force medical insurance that had demonstrated financial characteristics and the like. It was done with a different reinsurer. The previous agreements had been done with Swiss Re. This one was done with Munich. We had been talking with several reinsurance partners and we wanted to expand our track record of business relationships and -- so we did that. The retrocession was similar in substance to the previous retrocession we did in the second tranche with Swiss Re, but it was a higher amount. It was 90% of the block instead of 50% that we did in the second deal. Accordingly, it will -- there will be a lower net cost to Aflac on a consolidated basis than there was in the previous transaction.

Randolph Binner
FBR Capital Markets & Co., Research Division

So just 2 follow-ups. One, so then we can think of I think economically the full JPY 130 billion as being kind of freed up, I just want to clarify that. And also, can you give us color of how many more of these transactions we can expect? Our view has been that there's transactions that free up more of the capital reserve differential between Japan and the U.S. But I would like to understand how many more of these or how systematic these maybe?

Kriss Cloninger
President & Director

Well, let me first say that we do have additional capacity. We're always primarily interested in making sure that our policyholders in Japan are protected at a very high level. Freeing up some of the FSA basis reserves allows us to increase our solvency margin in Japan is the first step that gives us more security that we'll be able to perform with response to our policyholder obligations. We do have a significant capacity remaining, I believe, and we haven't gotten a specific plan. We don't have a specific plan for additional transactions, but I think that we'll talk about that in some more depth in our upcoming Financial Analyst Briefing in May when we talk about sources and uses of capital. I think you can anticipate that there will be more transactions each. We've been taking this one step at a time. The very first transaction we did, we did to increase the SMR to reduce the exposure we have to volatility in interest rates and currency and the like. The second one we did to achieve the same objectives that will reduce cost than it did the first retrocession deal. And this third one has essentially the same objectives in the initial transaction better to further reduce cost through the reinsurance or the retrocession. So I think we'll give you more color at FAB in May.

Operator

Our next question coming from Nigel Dally of Morgan Stanley.

Nigel Phillip Dally

Morgan Stanley, Research Division

Sticking with capital, given the sizable repatriation, seems like you could easily do more buybacks in the current guidance. So first question, what's holding you back from increasing your buyback guidance?

Kriss Cloninger
President & Director

Well, we're doing the additional reinsurance deal, thus increase our financial flexibility going forward. And as I said, we'll talk more about our capital uses plan at FAB meeting. I think it's just fair to say, Nigel, in...

Nigel Phillip Dally
Morgan Stanley, Research Division

Okay. Just to follow up in the reinsurance transaction. You mentioned that it'll be lower net cost given the higher retrocession. Can you quantify what that net cost will be?

Kriss Cloninger
President & Director

Let's see. In terms of cents per share, it has the... Ken?

Kenneth S. Janke
Former Executive Vice President and Head of Corporate Finance & Development

Let me interject a little bit. Nigel, this is Ken. With tranches 1 and 2, we were looking at an annual run rate of about $0.07 per share, that would be reduced by about $0.01 or so from the retrocession of half of tranche 2. Given the size of the retrocession with tranche 3, with the most recent transaction, we don't look at it as materially impacting the net cost of the program in the short run. So when you think about an EPS drag, for instance, for calendar '15, it's still going to be maybe in that $0.05 to $0.06 per share for the first 3 tranches for the full year of this year.

Kriss Cloninger
President & Director

So very little marginal net cost for this transaction.

Operator

Next question comes from Jimmy Bhullar of JPMorgan.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

First, I had a question on your EPS guidance. So I'm a little surprised that you left the guidance unchanged at 2% to 7% since you are going to have the $0.07 reduction in your interest expense. So I'm wondering if that's this year and then obviously next year, that should be around 10%. So I was wondering if that is part of your guidance, and if it isn't, is there anything else that you see as a potential headwind that would offset the benefit of that? And then secondly, on Japan sales, even if sales sustain that sort of the recent level that they've been, it seems like your guidance, at least through the first 3 quarters of the year for the 15% increase, is somewhat conservative. So I'm just wondering why sales wouldn't sustain where they are right now like -- I'd assume that you'd probably get more production from the Japan Post as you keep adding additional branches.

Kriss Cloninger
President & Director

Jimmy, let me start with the EPS guidance and address that and then we'll address the Japan sales guidance. We gave you a pretty wide range. I consider 2% to 7% increase in EPS on a currency-neutral basis to be a fairly wide range. We do wide ranges because we know that some things are going to go well, some things aren't going to go quite as well. And we're always working at activities that will move us up in the range. So clearly, taking advantage of the opportunity to redeem those high interest expense senior notes, the $850 million of senior notes that had a 8.5% coupon will benefit us going forward. That wasn't directly reflected in the original EPS guidance. But again, it's too early in the year to say that we're going narrow the range, at this point, that we initially established. Clearly, that particular transaction will increase our certainty that we'll be able to perform within that range and certainly, it adds to our ability to perform more strongly than we originally anticipated. But that's as far as I'm willing to go at the moment. Now let's turn to...

Daniel P. Amos
Chairman & CEO

I'd [indiscernible]. Let Yamauchi or Paul take that.

Kriss Cloninger
President & Director

On the Japan sales guidance. Okay.

Paul Shelby Amos
Former Director

This is Paul. I'll start and if Yamauchi wants to add additional comments, I'll let him do so. First of all, you're correct that we've had strong sales in the fourth quarter of last year and the first quarter of this year, and we feel that the market's desire for our new cancer plan has been extremely strong. As we noted in the previous call, we are expecting the first 3 quarters of this year to be strong, with a 15% growth over those 3 quarters. At this point, we're not changing that number. If we see sales continue to go extremely strong through the end of the second quarter, we'll, at that time, talk about any kind of revision. But given the size of the fourth quarter of 2014 and the hurdle that it is to overcome, I'm hesitant yet to talk about any changes in annual sales guidance. But I have to say, overall, I am very pleased with sales, not only through Japan Post, but across the board. All of our channels had been extremely receptive. I do, however, believe that there are many things we're doing to continue to increase our long-term sales. Anytime we announce new product announcements, things of that nature, there can be an adverse impact to short-term sales in a 13-week period. And so as we move further into the year, there are things that may not necessarily cause us to perform at the same optimum level we're performing at today, but we'll still achieve excellent results and so we're very excited about where it's going to forward from here. I think we're good.

Operator

Next question coming from Seth Weiss, Bank of America Merrill Lynch.

Seth M. Weiss
BofA Merrill Lynch, Research Division

If I could ask another question on capital and proceeds reserves released from the reinsurance transaction. So the reinsurance deal releases JPY 130 billion. So call it JPY 80 billion to JPY 90 billion after tax. You increased your repatriation plan by JPY 30 billion to JPY 50 billion. So can you help us think about the plan for that remaining JPY 40 billion that gets released from the reinsurance deal that will supposedly stay in the Japan entity?

Kriss Cloninger
President & Director

I don't know, Ken, you want to add any color on that? We did this additional reinsurance transaction. We increased the anticipated repatriation sum. That's -- it's not really a one-for-one deal. But it's directionally correct in equivalent. We reevaluated the whole scenario as far as repatriation and the like, and the JPY 200 billion is our best estimate and what's provided for in our FSA financials as of March 31, 2015. So that's the color I'm able to provide. And a portion of it said there's provision for potentially future profit transfers and a portion with support the current SMR that we have in Japan. So we've got a lot of flexibility.

Seth M. Weiss
BofA Merrill Lynch, Research Division

Okay. Great. And on the earnings side, I understand there's very little net impact. Just for the case of our models, is there a -- should we think about transferring of earnings from the Japan entity to the U.S. entity? And if you could give us any quantification of that, that would be helpful.

Kriss Cloninger
President & Director

Well, that's what the repatriation is. The JPY 200 billion is a transfer from Aflac Japan to Aflac U.S. Within the insurance entity, then question remains how much of that would be dividend-ed to the parent. But the JPY 200 billion is the transfer from Japan to the U.S.

Seth M. Weiss
BofA Merrill Lynch, Research Division

So I may have been unclear, I mean, on the earnings standpoint, thinking about the retrocession specifically, which I believe goes to the CAIC entity and some of...

Kriss Cloninger
President & Director

Right, right, right. Okay. Well, I earlier commented that there's very little marginal effect on EPS of this transaction because it was 90% retroceded in terms of the cost. We do report the full cost in the Aflac Japan segment and the benefit of the retrocession will come through in our financial reporting identified in the so-called other segment. We didn't include in the AFLAC U.S. segment because it wasn't really an Aflac U.S. transaction but the net cost through corporate will be reflected in a consolidated financials. I'm not sure I'm totally answering your question. But...

Seth M. Weiss
BofA Merrill Lynch, Research Division

Yes. It's just -- it comes to trying it apples-to-apples. So I'm thinking about how much earnings may be lost there in transferring into other, just so we could get a better view of underlying growth in that entity, if we want to strip out earnings, which is essentially being transferred to other.

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

Well, this is Robin. Let me just say, especially for those that may not have reviewed the statistical supplement in detail, we made 2 major changes to the statistical supplement and one of them is on Page 21. We broke out the impact on both premium and on benefits for premiums, gross versus premiums ceded. And we went back from the first tranche, so that you will be able to see trends on this and it should help you model on a go-forward basis. So we did extend the information that we're giving you on that. And so if you'll have a look at that, we'll be glad to talk you through that also following the call, if you'd like to. The second thing I would mention while we're at it. The second change we made in the statistical supplement, and as you all know, we make it in the first quarter of the year, so that we do not have any partial year anomalies occur. We enhance what we think is the reporting of the persistency modeling in the U.S. It now includes CAIC and additionally, it is on a rolling 12-month basis versus taking each quarter to date in annualizing that number. So we found in talking from analysts that, that was a better understood metric and it caused us to eliminate -- be able to eliminate some of those anomalies, especially as you annualize first quarter, which really didn't give you much of an idea of the trend and persistency. I apologize. I want to make it -- [indiscernible] some page. Yes, it was 22 where you can find that breakout of the ceded in spend -- 21 of the ceded in gross premium.

Kriss Cloninger
President & Director

I don't have the net profit impact directly in front of me. But as I recall, and I'm kind of talking to my internal team here. The net effect on Japan P&L was approximately $5 million for the quarter, isn't it? We try to have about $5 million for the 3 transactions combined. And as I said, well, okay, that will show up in the Japan segment as a gross number. And then the retrocession effect will show up in the other segment, but the impact on consolidated P&L ought to be probably less than $1 million for that third transaction -- third tranche.

Operator

Our next question coming from Erik Bass of Citigroup.

Erik James Bass
Citigroup Inc, Research Division

Can you talk about the trends in U.S. recruiting and the incentives you've put in place to try to increase the agent force. I guess, given the changes you've made in the middle of last year, and the increased commission payments, I'm a little surprised that recruiting hasn't accelerated in recent quarters?

Teresa Lynne White
President of Aflac US

This is Teresa. So I'll answer that. First, let me explain the recruited agent metric. The metric includes both career agent recruits as well as broker recruits. So as I mentioned in the fourth quarter, we did expect disruption in the number as we started consolidation of that global organization, and we redirected a lot of their efforts, at least in the short term, to focus on existing broker relationships. So we had done a really good job at recruiting brokers, but we wanted to do was enhance the relationships and obviously, help to increase penetration with regard to Aflac business. So even with this results are not acceptable. We know that we have to have a marked improvement in the long term. But it's important to note that the changes that we've made are really driving the operation to -- one side of the operation to look at, career recruiting and the other side of the operation to focus on broker recruiting and developing of those relationships.

Erik James Bass
Citigroup Inc, Research Division

Got it. And I guess, how do you think about the sales growth pattern for the U.S. And given the, I guess, relatively flat producing agent levels on kind of the traditional channels, do you expect to see material growth from that over the next quarter? Or most of kind of the year-over-year growth come in the fourth quarter when you see the higher group sales?

Teresa Lynne White
President of Aflac US

So as we start increasing the volume of group product, we do anticipate that more of the sales was skewed towards the fourth quarter. And that's just how a natural progression as you increase your sales in -- with brokers in the group market. So we do see a skew towards the fourth quarter with sales growth.

Operator

Our next question coming from Steven Schwartz, Raymond James & Associates.

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

A couple of questions. Teresa, just to follow up on that. Anything that you can say with regards to progress with the Alpha Brokerages would be appreciated.

Teresa Lynne White
President of Aflac US

Certainly. We are seeing progress with many of the large brokerage houses. As a matter of fact, we're -- they're moving in our top -- they're in our top 5 now. And before, as far as production, sales production. And before, we couldn't say that. We were seeing marginal improvements but now, they've moved in our top 5 as far as sales growth. So we are seeing tremendous improvements there. Obviously, we continue to work with each of those brokers houses and we've now created an organization, I think, that will help us to further enhance relationships in those brokerage houses as well as other relationships with regard to regional and large case brokers.

Daniel P. Amos
Chairman & CEO

And let me say one thing, because the number is so big, our general associates or agents that work for us on writing accounts of 100 or less, we must maintain continued stability there. We do have growth there. And so this has been an evolution as we're going through this process of trying to add on brokers while protecting and building our existing field force. And that's been a real challenge for us but it's -- under Teresa's leadership, it's doing very well and I'm very encouraged about that. And I think long term, these decisions that we've made have been the right ones. I will make one comment about recruiting and that is that we've made so many changes from a production perspective that there's a lot going on. And so all of its time together, I like the One Day Pay, I like that we're -- that we've set it up in a way that these people -- our important market directors will do very well, that the company does very well and they won't if we don't. So I think it's all working nicely together. And as I said in my comments, I'm not willing to declare victory. But it's certainly going the direction. I'd like it to go faster as Teresa would, but it's still moving in the right direction of what we ultimately want to accomplish. I do find it interesting with all the changes we made that we did not lose any market directors. And so there's probably a few that will change out, but if they don't do as well, they won't make as much and they may retire or whatever. So there's still some changes probably to take place. But all in all, I think we're going down the path that is going to prove that it's working the right way. It's just a question of how fast it's working.

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

Dan, as a follow up, part of what I think I heard you say, at least at the beginning when you started talking, you didn't say it in so many words, but that trying to keep the career agents in a sense where they belong at smaller accounts under 100 people is continuing and is working.

Daniel P. Amos
Chairman & CEO

Yes. We're paying them more right there. So it's been an enhancement of moving them in that direction by paying because that's where they're the most effective. And it's also the least area of competition.

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

Okay. And then just an accounting question. I don't know, Chris, if you know this answer or not. But given the retrocession back to the U.S, is there any increase in the deferred profit liability?

Kriss Cloninger
President & Director

On -- you're talking GAAP, not statutory, right?

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

Yes, I'm talking about GAAP.

Kriss Cloninger
President & Director

Okay.

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

Was it -- I mean, 10%, I guess. There's a difference.

Kriss Cloninger
President & Director

Well, the retrocession would be proportion of the direct transaction. And we do use -- well, see, on a GAAP basis, it's -- we use deferred profit liability to minimize any profit recognition effect. So...

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

So there would be, right in Japan, I guess?

Kriss Cloninger
President & Director

Yes, yes, in Japan.

Operator

Our next question coming from Tom Gallagher of Crédit Suisse.

Thomas George Gallagher
Crédit Suisse AG, Research Division

I wanted to ask Eric a question in terms of the new money yield in Japan. It was only 1.1% this quarter. I think the plan for the year is 2%. Can you comment on why -- it looks like you pretty much just invested in JGBs this quarter. Was that just a timing issue? And then second question related to that for Chris. And I appreciate that first sector sales felt lot, but they're still north of 20% of your Japan sales for the quarter at terms of WAYS and endowment. Are you actually making a profit for those products, earning 1.1%?

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

Thanks, Tom. Let me -- this is Eric. I'll go first, and thanks for asking that question because I know it sticks out a little bit. But the short answer and the simple answer is our cash flows for the first quarter were insignificant. And that was primarily and all planned for because as you know, we've increased the frequency of repatriation. We had tax payments. So the amount of money we had to invest was inconsequential and not reflective of all, at all, of our strategic asset allocation. We do expect in the second quarter, cash flows to be relatively low as well, but in the second half of the year, they will pick up. And our new money yield at that point will reflect the types of investments you're used to us making, whether those be in dollars or other products. But for the first quarter, it was just simply an inconsequential amount of new money.

Thomas George Gallagher
Crédit Suisse AG, Research Division

And Eric, when you say inconsequential, would that be less than 10% of the money you expect to invest in the year? Is there a way you could quantify?

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

Yes, yes. Actually, it was about 4.5%, 5% of the total new money for the whole year. So it really is back ended in the second half of the year.

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

Got you.

Kriss Cloninger
President & Director

And Tom, on your question about the profitability of first sector business, which show endowment and WAYS we're still writing. Those are profitable at the anticipated annual investment yield of about 2%. Recall that reserving was reduced to 1% FSA interest assumption. And we repriced the products with an interest assumption of 1.25%. So we still -- we'd have a positive spread at our anticipated yield for the year. If we look at first quarter only, at 1.1%, it'd be pretty marginal. There are sources of profits, so as an interest spread, but for the quarter itself it'd be closer to breakeven than profitable on that first sector business. But keep in mind, we're writing the first sector business, primarily as an accommodation to keep distribution alive and maintain relationships primarily with the banks. So to some extent, first sector business today is an accommodation and we do have caps on total production to try to mitigate the lower anticipated profit opportunity at these low interest rates.

Daniel P. Amos
Chairman & CEO

Yes. Paul or Yamauchi, do you all want to make any comment about that?

Paul Shelby Amos
Former Director

I'll be glad to. Our exclusive agencies have continued to be, obviously, dedicated to Aflac and all of its products. As a result, we continue to allow those exclusive agencies to offer, not only our third sector products, but in order to be competitive in the marketplace, they do still offer certain levels of our first sector products. In terms of the other channels, as Chris mentioned, we are holding back and putting in caps for certain areas and certain channels in terms of the total sales. I believe this meets our objectives. We obviously talk about those caps on an annual basis. And so we continue to look at them and how that will be effective throughout the remainder of this year as the sales reach those caps.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Got you. And then -- that's all helpful guys. Just one final question, if I could. The --

Kriss Cloninger
President & Director

Yamauchi went in very quickly here.

Hiroshi Yamauchi
Vice Chairman of Aflac Japan

[Foreign Language] So basically what Paul has said is absolutely correct. And for our agencies to be selling the first sector product, they -- correction, in order for our agencies to sell third sector products, they need to sell first.

Paul Shelby Amos
Former Director

We can't hear you.

Kriss Cloninger
President & Director

It's not clear.

Paul Shelby Amos
Former Director

It's not clear. Do it the way you were just talking.

Hiroshi Yamauchi
Vice Chairman of Aflac Japan

Let me repeat. As Paul has just mentioned, the first [ph] sector [indiscernible] by our agencies, and in order for them to do so, the first sector [indiscernible] customers. And for some channels such as that channel, we are capping the first sector. We are capping the first sector. And for our customers, that is needed in order for -- to retain the customers to be selling -- to be purchasing the third sector products.

Daniel P. Amos
Chairman & CEO

But all of that are in our numbers that we -- with the earnings per share guidance that we've given, all of that's taken into account and there's nothing there that we're shocked about going forward.

Operator

Our next question coming from Eric Berg of RBC Capital Markets.

Eric Noel Berg
RBC Capital Markets, LLC, Research Division

My question -- my first question is for Dan and for Chris. While I certainly understand value appreciate what you're doing on the capital accounts side of things, with the reinsurance, repatriation and so forth and the related share repurchase, I can't help noticing that your business in Japan, on a constant-currency basis, is reporting lower earnings. Your profits are down this year on a constant-currency basis and it's -- right, so it's not the yen. My question is when do you expect to start seeing the earnings, not the earnings per share but the earnings of your business in Japan growing and relatedly, what would you view at this point, in the history of the company, as the sustainable growth rate of your -- sort of the long-term sustainable growth rate of your Japan business.

Kriss Cloninger
President & Director

This is Kriss. I'll take a first shot at that and if Dan wants to supplement, he can. First, regarding first quarter Japan operating results, we were down a little bit on a currency-neutral basis. We had better -- well, lower benefit ratios last year in the first quarter than we had -- or magnitude of plain reserve adjustments. Last year, we had some release of claim reserves to get us down to the high end of the range that our auditors like to see. And last year, we had a larger release than we have this year. We did have some release this year but, again, we're -- we maintain conservative claim reserves, I believe. And we'd rather be within the range that the auditors independently recalculate. And so we just to have -- it was really a more difficult comparison, so to speak, of earnings, first quarter '15 versus '14. Overall, I would say that we had the headwinds, primarily of low interest rates slows and the like impacting our operating earnings in Japan, and keep in mind, our margins in Japan are the highest in the industry. And we really don't anticipate that they'll increase significantly. We've got a bit of a mix shift going on still between first and third sector and even though first sector sales are down relative to where they had been as was previously pointed out, they're still significant and we're still having a larger proportion of our overall premium income be associated with first sector products as the business continues to earn out on the premium thing basis. Long-term growth rates, Eric, the way I look at it is that at least related to the third sector business, the medical and cancer. I'll relate our fundamental business to the level of health care expenditures in the country. And in Japan, we anticipate the level of health care expenditures will continue to increase. Independent statistics have numbers in the 5% range, and our fundamental business in the third sector is to help our policyholders meet their share of the health care cost that they have to bear in Japan. Right now, under the national healthcare program, the copayments are 30%. We think those will either remain stable or increase going forward. And that might increase our opportunity to further our medical sales. Regarding first sector sales, it's going to depend on the trend in interest rates. Right now, we -- the profit margins were lower than what we want to have in our portfolios. So we're deemphasizing the production of first sector business. So...

Daniel P. Amos
Chairman & CEO

In fact, we -- what we try to make sure of is if they sell a first sector, they have to sell a third sector as well. And pretty much what I would have said, Chris covered, especially when it comes to third sector. Because that's really the way I view our business. The first sector is nothing but an introduction of selling ultimately third sector products. And I would like to see a growth rate of 5% in new sales. It gets tougher as the number gets bigger. But that's a goal that's certainly worthy of us continuing to strive for. And no one's got the distribution systems we have, and so we're always looking for new products and ways to do that. And if we are right now working on another new product, which we can't talk about but that we're doing, we will constantly be revamping. And then the wild card, as Kriss said, is whether or not the co-pays and deductibles go up. I don't have any reason to think they are tomorrow other than if you look at the issues they're having regarding their budgets, they're continuing to have problems and they've got to find a way to bring down their deficits. And with an aging population, there's a much higher likelihood that it's going to continue to go up, not down. So I would think they'll be more pressure on reviewing and seeing if they want to increase the co-pays and deductibles, and if they do that, that's a game changer for us.

Kriss Cloninger
President & Director

Let me add one thing, Eric, and a little advertisement for the FAB meeting. I do talk about anticipated margins between first and third sector during FAB speeches. As you can refer back to our FAB booklet for what I forecast for 2014 to '16 as far as benefit ratios, expense ratios and profit margin, separately for our first and third sector business, and I'll update those in May. So I can just tell you right now, there's no major change in our margins that we anticipate. So that's a bit of a preview. But it says that a lot of our future growth will be related to revenue growth not margin expansion.

Eric Noel Berg
RBC Capital Markets, LLC, Research Division

One quick follow-up and I'll end it there. I have a question, too, about the reinsurance. I tend to think of the, so to speak, the cost of reinsurance in a coinsurance deal like this one as the amount of premium and the amount of assets that you have to cede -- invested assets that you have to cede to the reinsurer in order to be relieved of a certain amount of risk. So I guess, my question is in order to -- are you really reducing the cost of the reinsurance? Or more accurately, are you just ensuring significantly less than would be the case if you weren't retroceding the business?

Kriss Cloninger
President & Director

Well, that's the way to look at it. The retrocession reduces the direct cession, obviously. And so instead of reinsuring 100% of a block of business, you reinsure 10% of it. And accordingly, you have 10% of the cost. It is a risk-sharing transaction between Aflac Japan and the reinsurer and then it's a reassuring transaction between the reinsurer back to the U.S. subsidiary, CAIC. That's a legal entity that picks up the retrocession. So clearly, there are cost transfers but net to the overall company, you're correct. So let me just tell you that we didn't -- we haven't had to do asset transfers in this coinsurance. The prospective cash flows on the block of business is such that no asset transfer was done in any of the tranches, and we just ceded the liability for future claims and exchange for our share of the gross premium. And there is a net cost associated with it. Just to review the very first tranche that we did for capital raising purposes in Japan, basically, we did it because that was the lowest cost of capital of any alternative we had. And we've reduced the cost or reduced the size of the future tranches through the retrocession. So we are achieving some reserve relief on an FSA basis, enhancing our solvency margin, continuing to protect policyholders and the like. But continuing to free up some of, what I sometimes refer to as 0 [ph] capital. So that's an overview.

Operator

Our next question coming from Humphrey Lee of Dowling & Partners.

Humphrey Lee
Dowling & Partners Securities, LLC

Just a quick follow on the reinsurance. So you -- Kriss mentioned that there will be additional capacity for the reinsurance. But can you tell me on the appetite like -- in other words, what factors that will push you to do more this year as opposed to doing less this year?

Kriss Cloninger
President & Director

Well, I think I mentioned on the last conference call, I don't want to do reinsurance just for the sake of doing reinsurance. I want there to be an appropriate use of capital in order to incur the cost regardless of how small the cost maybe. If there's still a capital cost associated with doing the deal, and unless we've got an appropriate use for the reinsurance, we're not going to have the appetite. I've covered the uses of capital from the reinsurance we've done so far. We've certainly got additional capacity in terms of the blocks of third sector business in Japan. We've certainly got to continue to have an excess of FSA reserves over U.S. statutory reserves on the same block, and I'm confident that the U.S. statutory reserves are adequate. So we believe we've got some opportunity to relieve ourselves of some of the excess reserves we're holding on an FSA basis. But there's no point in doing a risk-sharing reinsurance arrangement unless you have an appropriate use of capital. And again, I'll give you some more color on that in May. I don't want to do it on this call. But we do have significantly more financial flexibility today after having done the reinsurance and particularly at a lower net cost than we had 18 months ago. So I think we're in a much stronger and more flexible financial position, having done each of these 3 transactions and proven we could do it, we'd continue to have reinsurance capacity, both from the 2 companies we've done business with so far. And we've got other parties that continue to knock on our door and ask for opportunities. So we're happy with where we are.

Humphrey Lee
Dowling & Partners Securities, LLC

Thank you for the color. Another question on the U.S. side of the business. So the expenses were a little bit elevated. I think that's in part because the compensation structure changes and also some other kind of ongoing initiatives going on in the U.S. Like how should I think about the kind of expense ratio? Or the expenses for the quarter that will be considered more of a recurring expenses due to the compensation structure change as opposed to these initiatives going on.

Kenneth S. Janke
Former Executive Vice President and Head of Corporate Finance & Development

This is Ken. Let me comment on that. I talked a little bit about that in the fourth quarter when we kind of released our guidance and talked about what went into it. In the first quarter of this year, the added expense from the changes we made to our field force structure was approximately $19.5 million net of capitalization. And we expect it to run kind of in the $20 million, $22 million or so. So we expected it to run around $20 million, $22 million as a run rate for the 4 quarters of this year. So we're little bit lower than in the first quarter than what we'd anticipate but it was, again, about $19.5 million of additional fixed expense coming from those changes.

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

We're coming up to the top of the hour now, so we have time for one more question, please.

Operator

Our last question coming from the line of Suneeth Kamath of UBS.

Suneet Laxman L. Kamath
UBS Investment Bank, Research Division

So a question on these reinsurance deals. Can you just remind us -- does the FSA or the U.S. regulators need to approve these transactions?

Kriss Cloninger
President & Director

We've reviewed the reinsurance transaction with both the FSA and the U.S. regulators. We've reviewed both the direct reinsurance agreement and the retrocession agreement with the FSA. Certainly, we covered the first tranche with them. With the FSA, we approached of them to -- we approached the FSA with an opportunity to discuss the retrocession arrangement. They appropriately observed that Aflac Japan was not a party to the retrocession agreement then and wondered why we had brought it to their attention. So we apologized and thanked them for their interest. We just wanted to make them aware of the transaction. But yes, we've covered both aspects of the agreement with the FSA, and of course, we have covered them with the state of Nebraska, both on all 3 tranches, and South Carolina, with respect to the retrocession. So we're in good shape on regulatory relationships and approvals with respect to these transactions.

Daniel P. Amos
Chairman & CEO

Yes. We just want to make sure that we are not only taking care of the shareholders, but also making sure that we have strong capital position on behalf of the policyholders for Japan. So that's important to us, too. And everyone seems happy at this point.

Suneet Laxman L. Kamath
UBS Investment Bank, Research Division

Okay. And my second question is on Japan sales. And you've talked about on this call and earlier calls, sort of the benefit of staying in the first sector area in terms of your ability to sell third sector products. But have you quantified that? In other words, if you decided to significantly scale down, even incremental to what you're doing now, per sector sales, how big of an impact do you think that would have on your ability to sell third sector products?

Daniel P. Amos
Chairman & CEO

Well, I'll just answer that for the time running out. I think we're safe for this year. We feel very comfortable with the quotas we've set and what will take place as the year goes on and according to what interest rates do, we'll have to review it. But we're not going to be selling products at losses. So we'll take it on and figure accordingly. But that's a problem for the industry, not just for us. If it's affecting us, it's affecting everyone else in the industry. So what we've seen in the past is as the interest rates stay down we did [ph] lower assumptions, which is ultimately mean the rate increase on the premiums. So I would expect if rates continue to stay down, then we probably have rate increases on policies going forward and that would help solve part of our problem.

Kriss Cloninger
President & Director

Let me add one thing and it's not earth-shattering. But I think what will happen is that if the low-interest rate environment continues, you'll see a migration away from the asset accumulation element of life insurance contracts or first sector contracts more to the protection -- for protection in the first sector products. And I think that, that'll become a larger part of the first sector products that we sell, the pure insurance elements that are still required by policyholders. And we may move more to a protection product in first sector. But I think we'll still do first sector. And keep in mind, that we sell the first sector products for a long time and we really started to see in spikes in first sector sales, probably around 2010, when interest rates started moving the way they did and, of course, we had to respond to the truly low interest rate environment in 2013. But if you kind of lopped off the spike in our sales, you'll see that we're about where we were.

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

Appreciate you listening this morning, and be sure to give us a call if we can follow up with anything. Thank you very much. Bye bye.

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