S&P Capital IQ

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Aflac Incorporated NYSE:AFL

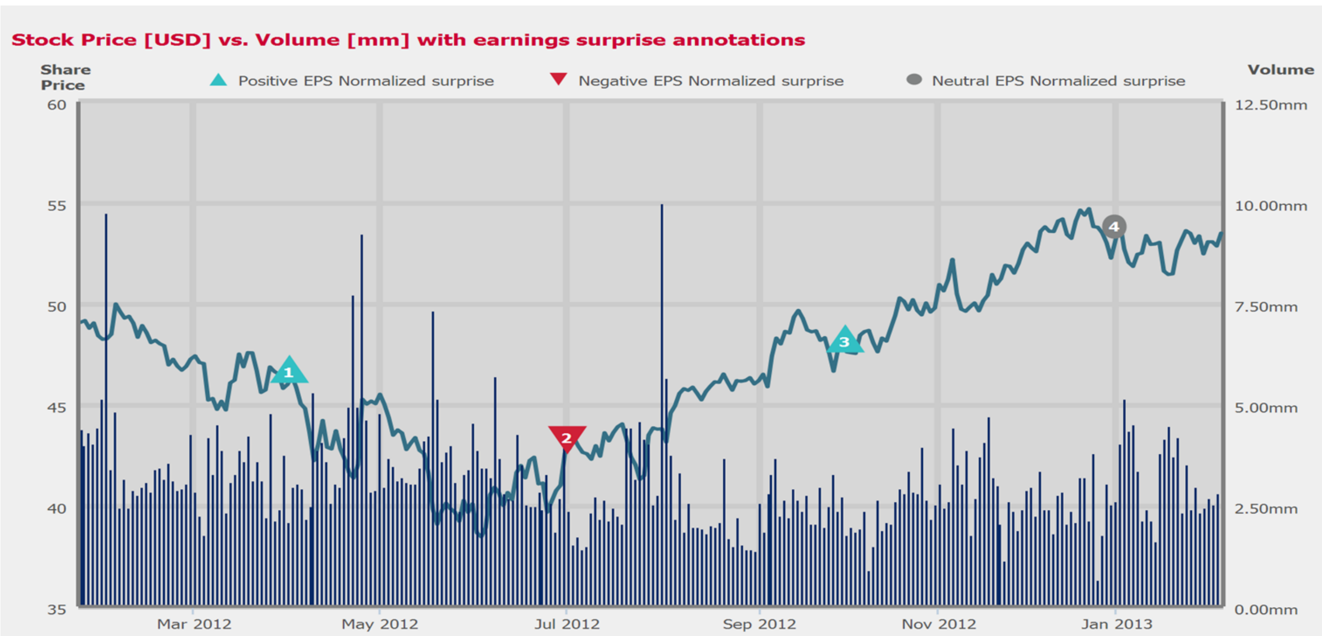
FQ1 2013 Earnings Call Transcripts

Thursday, April 25, 2013 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2013-			-FQ2 2013-	-FY 2013-	-FY 2014-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.62	1.69	4.32	1.53	6.20	6.59
Revenue (mm)	6087.82	6208.00	1.97	5892.53	23940.39	25093.44

Currency: USD
Consensus as of Apr-25-2013 1:29 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2012	1.65	1.74	5.45 %
FQ2 2012	1.62	1.61	(0.62 %)
FQ3 2012	1.66	1.77	6.63 %
FQ4 2012	1.48	1.48	0.00 %

Call Participants

EXECUTIVES

Daniel P. Amos
Chairman & CEO

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

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

Tohru Tonoike
Vice Chairman of Aflac Japan

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Presentation

Operator

Good morning, and welcome to Aflac First Quarter Earnings Conference Call. [Operator Instructions] Please be advised today's conference is being recorded. I would now like to turn the call over to Ms. Robin Wilkey, Senior Vice President of Aflac Investor and Rating Agency Relations. You may begin.

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

Good morning, and welcome to our first quarter call. Joining me this morning is Dan Amos, Chairman and CEO; Kriss Cloninger, President and CFO; Paul Amos, President of Aflac and COO of U.S. operations, Ken Janke, Executive Vice President and Deputy CFO; Eric Kirsch, Executive Vice President, Global Chief Investment Officer; and Toru Tonoike, President and COO of Aflac Japan, who is joining us from Tokyo.

Before we start, let me remind you of some statements in this teleconference that are forward-looking within the meaning of Federal Securities Law. 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 discussed today. We encourage you to look at our quarterly release for some the various risk factors that could materially impact our results.

Now I'll turn the program over to Dan, who will begin this morning with some comments about the quarter and our operations in Japan and the U.S. I'll then follow up with a few financial highlights for the first quarter, and then we'll be glad to take your questions. Dan?

Daniel P. Amos
Chairman & CEO

Thank you, Robin. Good morning, and thank you for joining us. I'm very pleased that we met, and in many cases, exceeded our financial and operational targets for the first quarter. Let me begin again with an update of Aflac Japan, our largest earnings contributor.

New annualized premium sales in the first quarter were up 2.6% to JPY 53.8 billion. Revenues grew 9.7% and pretax earnings were up 10.7% for the quarter. Sales for the first set of products including WAYS and child endowment came in better than expected in the first quarter. This was primarily driven by consumers who wanted to make insurance purchases of per sector products ahead of the rate increase on April 2.

I've said that I would not be surprised if we saw WAYS sales down 40% to 60% following the rate increase. Based on early sales indications for April, that seems like a reasonable estimate. Banks also had a strong sales push in order to end their fiscal year with solid sales results. Additionally, we've seen consumer show interest in a variety of investment-type products, especially with JGB yields at historic low rates and the Nikkei having risen considerably over the past several months. As such, we expect the sales of our first sector products, particularly WAYS, to be down significantly for the remainder of the year.

With respect to total third sector products, combined cancer and medical insurance sales, we're down 7.1% for the quarter, which was in line with our expectations. However, remaining the leading provider of third-sector products is important to us and is the foundation of our product portfolio. We anticipate focusing more on third-sector product development now that deferred sector re-rating has been complete.

We mentioned last year that we are currently underpenetrated in the consumers who are in their 20s to 40s. I'm pleased to tell you that we are working on getting approval of a new medical product with the FSA. As such, we anticipate very strong second half sales. Taking all these factors into account, I believe that 2013 expectation that Aflac Japan third sector, cancer and medical, will be flat to up 5% is still reasonable.

Now let me turn to the U.S. operations. As I mentioned last quarter, I wouldn't be surprised if sales were down slightly in the first quarter, considering our biggest percentage increase last year came in the first quarter. Our results were consistent with that expectation. Aflac U.S. new annualized premium sales were down 5.2% for the quarter.

We know that small employers are still guarded with respect to their business outlook. In addition, some employees have been reluctant to make changes in their benefits in advance of the Healthcare Reform implementation. In terms of relief of small businesses, if there is any recovery of all, it seems to be a jobless recovery. While there are several factors that we can't control, we are driven to improve the factors that we can influence. We continue to expand our marketing activities to maximize our future growth. With brand recognition at 94%, we continue to leverage our popularity to capture the attention of the consumers with the ultimate goal of driving sales.

I hope you've seen our newest commercials that portrays the Aflac Duck as the policy holder and claimant. They have been very popular. We want to continue to educate consumers about our products, while at the same time entertaining them. Additionally, we evaluate and enhance our products to ensure that we are in step with the needs of the consumers, particularly in this economic landscape. We are also planning some aggressive new individual and group product launches. With a strong brand recognition and reputation for paying claims quickly and fairly, we believe consumers will be more receptive to purchasing our products.

As you know, a lot of changes are taking place in the U.S. health care environment and we expect these changes to impact how people choose to purchase insurance going forward. We are spending a great deal of time ensuring that we are prepared to approach this change from a position of strength. Our job is to be multifaceted in our distribution, to make sure we have the presence where the consumer wants to purchase the products.

There are different distribution possibilities we're working on, from creating a private exchange to expanding our reach through insurance brokers, to empowering our individual agents. One thing we know from nearly 4 decades in Japan, is that even with national health care systems, consumers have significant out-of-pocket expenses, and our products continue to be relevant in their needs. Although there will be more competition, we believe the national health care system in the U.S. actually presents Aflac with opportunities as consumers become more aware of financial protection Aflac products help provide.

As I mentioned, first quarter sales comparisons are the most challenging of the year. We expect sales to be weighted more toward the latter half of the year. We believe it's reasonable to expect Aflac U.S. sales to our traditional and broker channels to be flat to up 5% throughout the year.

Having discussed our operations, let me give you an update on the investment function. We made excellent progress in the build out of our investment team and the implementation of our investment strategy. I am pleased we did not have any major investment losses in the first quarter. While we still view Europe as an area of investment risk, I believe our portfolio is better positioned than ever to accommodate market volatility in the future. Also, we're optimistic in the future derisking of our portfolio, including the sale of 25% of our Tunisian bond holdings.

As we have stated for many years, our greatest investment challenge has been to invest Aflac's significant cash flow at reasonable investment yields. The U.S. corporate bond program initiated in July of last year continues to be an effective means for enhancing Aflac Japan's new money yields. In addition to the attractive returns, we are pleased with the positive impact to our overall portfolio of quality and liquidity. For the past 2 quarters, we have invested roughly 2/3 of our investment cash flows in U.S. denominated, publicly traded corporate bonds, and then hedged to currency risk. At March 31, this program represented 8.7% of our total portfolio, which is well below our strategic asset allocation range.

Additionally, as part of our investment strategy, we said we would invest about 1/3 of our cash flow in JGBs. However, with 10-year JGB yields hitting historic lows, we want to be flexible in our asset allocation. We anticipate that the Bank of Japan will keep interest rates low for the immediate future. Our investment team is carefully monitoring Japan's monetary and fiscal policy, as we have seen significant changes impacting financial markets, including Japan interest rates and yen-dollar exchange rates. We are evaluating our investment options and looking for alternatives to lower our planned JGB new money investment allocation. We will consider diversification and liquidity as we approach these investment choices.

As I mentioned, Aflac's consolidated financial performance was extremely strong for the quarter. Excluding the impact from foreign currency, operating earnings per diluted share rose 5.7% for the quarter. I was also very pleased with the increasing strength of capital ratios, which demonstrates our commitment to maintaining financial strength and flexibility on behalf of our policyholders, shareholders and bondholders. While we have not yet completed our statutory financial statements, we estimate our quarterly RBC ratio at March 31 was above our 2012 year-end ratio of 630%. We believe Aflac Japan's solvency margin ratio at March 31 will also improve over the year-end 2012 level of 669%.

As we have communicated, given the capital structure, our ability to repurchase shares is largely tied to profit repatriation. In contemplating profit repatriation, our first consideration is the safety of the policyholders, as measured by the SMR. Next, we consider the needs of the parent company and consult with Japan's management in making the determination. We currently expect 2013 profit repatriation to be a bit higher than the JPY 50 billion we communicated last quarter. This assumes we have no additional material investment losses between now and mid-June when we file Aflac Japan's FSA-based financial statements.

As we have said for many years, when it comes to deploying capital, we still believe to growing cash dividend and repurchasing our shares are the most attractive means, and those are the avenues we will continue to pursue. Our objective is to grow the dividend at a rate that is in line with earnings per share growth before the impact of the yen. We have a lot of flexibility at the parent company in terms of liquidity. Given the liquidity and the strength of our capital ratios, we plan to purchase $400 million to $600 million of our shares in 2013. We are already off to a great start with our share repurchase plans for the year. In the first quarter, we purchased approximately 3 million shares or about $150 million. I think this shows that we're even more comfortable with this range. Additionally, we expect to accelerate our share repurchase in 2014.

Maintaining strong capital levels remains a priority for us, at the same time generating an industry-leading return on equity, excluding the yen impact, is also extremely important to us and to our owners. Accordingly, the Compensation Committee of the Aflac's Board of Directors made a decision to include operating ROE as a component of the bonus of Aflac's senior management effective this year. On an operating basis, our first quarter ROE was 23.4%. Keep in mind, our ROE is sensitive to currency fluctuations because we have largely hedged equity into dollars, but not all of our earnings. This means when the yen weakens, our ROE declines. Had the yen remained unchanged since the end of the year, our operating ROE would have been 26.1%. So even with the weaker yen, I think it's still reasonable to expect our operating ROE to range between 20% and 25% for 2013.

In yesterday's release, we have reaffirmed our 2013 guidance of 4% to 7% increase in operating earnings per share, excluding the impact of currency. This range reflects the impact of investing significant cash flows at historically low interest rates. I would also remind you that our 2012 earnings were better than expected. Although the yen is significantly weaker to the dollar, the fundamentals of our business and our operations are strong.

Overall, I am pleased with Aflac's position in Japan and the United States, the 2 largest insurance markets in the world. And first and foremost, we are focused on protecting our policyholders and providing value to our investors. We are fortunate that in the process of doing so, we have the privilege of providing financial protection to more than 50 million people worldwide.

Now I'll turn the program over to Robin.

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

Thanks, Dan. Let me go through some first quarter numbers starting with Aflac Japan. Beginning with top line, revenues were up 9.7% for the quarter. Excluding the effect of the weaker yen in the quarter, revenues were up 8.4%. The annualized persistency rate, excluding annuities in the quarter, was strong at 95.0% compared with 94.5% last year. Net investment income increased 7.3%. Excluding the benefit of the weaker yen in the quarter on Aflac Japan's dollar-denominated investment income, net investment income rose 1.2%.

In terms of quarterly operating ratio, the benefit ratio to total premiums increased over last year going from 71.5% a year ago to 72.4% in the first quarter, primarily caused by the growth of the net benefit reserves for our ordinary life line of products, most notably WAYS. The expense ratio for the quarter was 17.1%, down from 18.1% a year ago. The expense ratio was impacted primarily by lower net commissions associated with the sale of the life product lines. As a result of the lower expense ratio, the pretax profit margin rose slightly from 21.3% to 21.5% in the quarter.

Turning to Aflac U.S. Total revenues rose 3.9% in the first quarter. The benefit ratio to total premiums decreased over last year, going from 55.1% a year ago to 54% in the first quarter. This was generally in line with normal seasonality effects during the quarter. The annualized persistency rate for the first 3 months was strong but stable at 74.7%. No change from last year's results. The expense ratio for the quarter was up 32.5%, up from 31.4% a year ago and is in line with normal first quarter activity. The profit margin for the quarter was relatively unchanged at 19.5% compared to 19.6% a year ago.

Turning to some investment activity for the quarter, starting with Aflac Japan. Approximately $1.8 billion of Aflac Japan's new cash flow was invested in the corporate bond program for gross yield of 3.72%, and at annualized hedge cost of 30 basis points. The yield net of hedging cost was 3.42%. This brings the total cash flow invested in the corporate bond program to approximately $8.8 billion, with the total yield on the corporate bond program of 3.41% excluding hedge cost.

Approximately 30% of our new cash flow for the quarter was invested in JGBs with an average yield of 1.53%. The new money yield for the quarter, all in, was 3.03%, an increase of 30 basis points from the fourth quarter and up 100 basis points from a year ago. The yield on the portfolio at the end of March was up 3.01%, up 14 basis points from the fourth quarter, and 17 basis points lower than a year ago.

In terms of U.S. investments, the new money yield for the quarter was 3.69%, an increase of 17 basis points from the fourth quarter and the yield on portfolio at the end of March was 6.19%, down 16 basis points from the fourth quarter and 42 basis points from a year ago.

Turning to some other items in the quarter. Non-insurance interest expense was $48 million compared to $44 million a year ago. On an operating basis, the tax rate decreased from 34.7% a year ago to 34.4%. The weaker yen decreased operating earnings by $0.15 per diluted share for the quarter. Excluding the yen's impact, operating earnings per diluted share increased 5.7% for the quarter. Operating ROE as reported for the quarter was 23.4%. Excluding the impact of the yen, operating ROE for the quarter was 26.1%.

As you heard Dan mentioned earlier, we plan to repatriate more than JPY 50 billion in 2013. In anticipation of our profit repatriation this year and considering the current market conditions, we've entered into derivative contracts to hedge the majority of our profit repatriation this year against the potential further weakening of the yen.

Also, as part of a continual refinement in our pricing methodology for our investment portfolio, where we have a large number of privately issued securities, we have elected to move from an internal modeling method for assessment and valuation of these securities to an outside vendor. As a result of this change in market conditions during the quarter, shareholders equity declined by approximately $582 million from December 31.

Lastly, let me comment on our earnings outlook for 2013 and our upcoming Analyst Meeting. You heard us affirm our objective to increase operating EPS, 4% to 7% this year excluding the impact of the yen. If the yen averages 95 to 100 for the full year, we would expect to report operating EPS of $5.99 to $6.37 per diluted share for the full year. For the second quarter, using the same currency assumptions, we would expect operating earnings to be in the range of $1.41 to $1.56 per diluted share.

Now let me take a few moments to remind you that our Annual Analyst Meeting will be held in New York on May 22. We've given careful consideration and thought to our policy of providing earnings guidance at the Analyst Meeting. As we look at our disclosure practices, we've made a modification to the way we will discuss our earnings targets. We conclude that it is in the best interest of our company and our shareholders to provide earnings guidance in the third quarter for the following year, rather than projecting earnings 1.5 years out as we previously done over the past several years.

We do not expect earnings growth to be materially different in what we see for 2013. We simply feel that it's better for us to take the additional 5 months to gather more data that influences our business before we put out an estimate. This will also more closely align our financial modeling with our budgeting process. So at the Analyst Meeting next month, we won't comment on 2014 earnings expectations. However, we will discuss our operations in great detail and update you on opportunities to grow our business in 2014 and beyond.
Please don't forget to register if you'd like to attend. And now we'll get back to this quarter and we'd be happy to take your questions. [Operator Instructions] We may begin.

Question and Answer

Operator

[Operator Instructions] Our first question does come from Chris Giovanni of Goldman Sachs.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

I guess, first question, obviously, with currency and the impact to the yen moving all over the place. Have you guys given consideration to hedging the earnings of the company and just kind of the thought process around that?

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

Chris, this is Ken. Let me start with that. This has been an issue as long as we've been in Japan, as Japan has grown to be a larger portion of our business, it obviously has affected the sensitivity of earnings to currency changes. But the one thing that I would remind you is that there is a distinct difference between foreign currency transactions and foreign currency translation. We are certainly interested, as Robin indicated, in hedging economic events like capital being remitted from Japan to the United States. But we don't think it makes sense to enter into an economic contract to hedge a financial reporting of that. Largely, Japan is a yen-denominated entity that's self-funded. We collect premiums in yen, we pay benefits and expenses in yen, we back our yen liabilities with yen assets. But to a degree that this year's yen rate differs from last year's, influences how those yen get reported in dollars. So again, when we think about hedging, we're really focused on the economics of the business as opposed to financial reporting of the business.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

Okay. And then one question maybe for Paul. I guess the Healthcare Reform opportunity that you guys are pointing to a bit here doesn't take shape by the end of the year, that's 0% to 5% sales growth target. I mean, where would that possibly be shift to?

Paul Shelby Amos
Former Director

Well, there have, obviously, been certain things that had been delayed within the Healthcare Reform package. There are questions about when exchange implementation will occur, whether it will be 2014 or 2015. Obviously, being the preceding fourth quarter open enrollment period, either of those dates, that would have the largest effect. That said, Chris, one of the things that we've been highly focused on is work within the broker market, continuing to have our field force work with brokers, continuing to succeed at the upper end of the broker market and growing that business. One of the reasons that we knew that we would see sales be weaker in the first half of the year was not just the comparisons, but it was also the continued work within that market where we expect to see more fourth quarter enrollments with or without Healthcare Reform. So my overall assessment at this point is that, even given the current environment and not the information that we are knowledgeable about today, that we still believe we will be within that 0% to 5% growth target for 2013. That said, issues and things continue to arise and we cannot predict what those are going to be. We watch HHS and other groups, as well as what's happening at 50 different state governments on a daily and weekly basis, about what they're doing to implement Healthcare Reform. Our sales force continues to be out focused on opening new groups and continuing to try and enroll in the marketplace. But as Dan said, with a somewhat jobless recovery, there had been minor headwinds. So all of those different factors play into everything that we're trying to do while we're simultaneously also implementing our new training system, which in effect had a downturn in our recruiting in Q1, which was planned by us. So in reality, I think that we're headed towards 0% to 5%, but there are a lot of things that we're having to balance at this point.

Operator

Our next question does come from Tom Gallagher of Credit Suisse.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Just one quick follow-up on the hedging and then an earnings question. Ken, just a follow-up on that question, so I think you've hedged, probably using a 3-month currency type of hedge, because you mentioned that June repatriation amount has been hedged, have you guys considered, especially given Dan's comments about accelerating buyback in 2014, has there been consideration to hedging expected repatriation amount for next year as well or beyond?

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

Yes, Tom, we have. Again, we've entered into a series of contracts. Our anticipated profit transfer for 2013 will really be toward the latter part of July, right around the time we release second quarter earnings. We should be able to give you a better idea of what that number is in a few weeks when we conduct the Analyst Meeting. But again, we've undertaken a series of transactions to hedge a significant portion of this year's anticipated repatriation. And we are looking at what is available to our disposal and what makes economic sense for us for '14. And we're fine tuning those estimates and we'd hope to give you a range of estimates at the Analyst Meeting about what repatriation in '14 would look like as well.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Okay. That's helpful. And then, Dan, just a question about the decision to push out 2014 earnings guidance. Should we be reading into that partly driven by the uncertainty with a very large decline in WAYS sales? I guess my main question is, does the change in what you expect from WAYS, do you think that's going to have a potential impact on what I think you've been saying previously leading up to this point, you would expect a slow steady earnings growth recovery trajectory over the next several years?

Daniel P. Amos
Chairman & CEO

Okay. Kriss, just told me and he said he wants to answer, but let me say one thing. One of the reasons that I want to do it next year is because I don't think it's going to be significant. I want to do something in a year when it's uneventful. And I think what we've given you guidance for hasn't changed that dramatically.

Kriss Cloninger
President & Director

Yes. Tom, let me just follow up on that. It's not that we're not going to give you guidance. We're going to give you guidance relative to the key components of the models you guys independently developed to estimate our EPS. That is, we're going to give you long-term outlooks, 2 to 3 year outlooks for Japan ratios, Japan margins, U.S. ratios, U.S. margins and that will give you a good basis for populating your models for the operating results. What we're trying to avoid is some of the noise, the favorable or unfavorable tax settlements that might impact the change in EPS and things like that, that we have a hard time seeing 18 to 20 months in advance. So we're partly -- we've been talking about this for several years on the advice of SEC counsel and what you do in terms of going on the line for long-term projections. And so what we've decided is to focus more on giving you solid guidance on what we can best predict and let you reach your own conclusions about some of the things that are not quite as predictable. So I'm going to show you what I told you last year at FAB relative to Japan operating ratios and reconcile them to our actual results and update them for another year or so. And so you'll get that kind of guidance, but you're just not going to get the specific EPS prediction.

Daniel P. Amos
Chairman & CEO

And Tom, to be specific, last year at this time, we didn't know we're going to have those additional profits that would come in. All of a sudden they came in, we did better than what we thought in 2012. We had also given you guidance for '13, which ramped up the pressure on us in 2013. So we like to be able to see it, so that -- it was the positive things that happened last year that really drove this to want us to wait a little bit longer in doing it and then the SEC attorneys as well.

Operator

Our next question does come from Mark Finkelstein of Evercore Partners.

A. Mark Finkelstein
Evercore ISI, Research Division

I got a couple of questions. I guess just firstly, can you just talk a little bit about the philosophy of repatriation going forward? I mean, obviously, historically, you've looked at FSA earnings maybe 80 percentage of those. Now you're in a situation where the yen has weakened considerably that has capital impacts. How should we think about the interplay of FSA earnings kind of capital levels at some of our ratios and repatriation?

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

Mark, this is Ken. Let me start with this and I think Dan and Kriss, and maybe even Toru might want to jump in and add something. But the basic thought process is this, clearly, we're in the business of making commitments to customers and foremost on our mind is that we can fulfill those obligations to our policyholders, we have to protect their interests. So in that regard, their protection really is measured by Japan's capital requirements. In other words, the solvency margin ratio is critical. So we do a lot of work around the solvency margin ratio itself, projecting the ratio, stress testing the ratio in both relatively mild scenarios, as well as very extreme scenarios, to understand what risks there are to those ratios. And as we've discussed in the past, unlike the RBC ratio, that we also have interest rate risk to the SMR in Japan because a portion of the portfolio is mark-to-market for FSA reporting, whereas RBC does not do that. And in both ratios, SMR as well, there is currency risk because we have a fairly significant unhedged dollar position in the dollar portfolio that we've had for more than 20 years. So the -- really, the analysis around making sure that our SMR is helping up to protect our customers and accommodate risks. Once we have comfort with that, we do look at our FSA-based earnings as a guide. And as you point out, generally, we have looked at the rule of thumb of pulling out 80% of FSA earnings, and that would be FSA net income to include operating results as well as realized investment gains or losses. And then we'll simply look at what the parent company's needs are, liquidity needs, and we will deliberate internally as well with our management in Japan and come up with the recommendation and agreement on what we'll repatriate. And that's basically how we've done it for some time. And again, we'll give you more insight into the exact numbers in just a few weeks. But that's really the process.

A. Mark Finkelstein
Evercore ISI, Research Division

Okay. And then just on the Japan margin, which was I think stronger than most people had expected. How should we think about that going forward and how would you characterize what we saw in the quarter, particularly in the expense side?

Kriss Cloninger
President & Director

I'll handle that. I'll say our margins have been typically a bit higher in the first quarter than the latter part of the year, partly because on the Japan side and to the U.S. side, to some extent, later in the year we have some benefit true-ups, and stuff like that, accounting adjustments that we're committed to because of our SOX process. And the first quarter is usually both a favorable and more better day quarter and a lack of extraneous adjustments. So over the last several years, our Japan margin has been higher in the first quarter than it has been throughout the year. The other thing is, we tend to be heavily oriented toward the expenses being incurred in the latter part of the year. We usually start the year somewhat cautiously on expenses. And as we gain confidence that we're achieving the plans, we've loosened the reins on expenses to the extent we can, so expense ratios tend to be a bit lower in the first quarter than the latter part of the year. And so I'm just saying, overall, our margins tend to be a little bit higher in the first part of the year than the latter part of the year. But part of that is management oriented. I'd say my take on this quarter was there was a favorable quarter, meaning that it was in line with expectations. As I mentioned in an earlier response, I'm going to give you a reconciliation at FAB on the guidance we gave you on ratios as far as benefits and expenses and the like last May and tell you how that came out in 2012. And then in the first quarter of 2013, I'll say, on Japan, our benefit ratio was maybe on the high end of the forecast because we produced more WAYS relative to third-sector health in the latter part of 2012 than 2013. So the benefit ratios were a bit higher than my forecast, but the expense margins were a bit lower and the profit margin came in right in the middle of the range. So I consider that to be a favorable outcome.

Operator

Our next question does come from Jay Gelb of Barclays.

Jay H. Gelb
Barclays PLC, Research Division

First, I just want to follow up on the 2014 outlook. If I -- I want to clarify Robin's comment. It seems as if you said that the pace of earnings growth in 2014 could be similar to that of 2013. So I'm assuming that it's 4% to 7% excluding the impact of the yen?

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

This is Ken. Jay, we're not going to go that far. I know you see this in your model. The vast majority of our revenues are known at January 1 of each year, given the significant persistency of Japan's in-force block, the stable and recently improving persistency of the U.S. block, the investment income combined with the predictability of our expenses and benefits. It's not a catalyst type of story. You see fairly consistent results emerge over the long periods of time. And I think that's really what Robin was referring to. Again, we don't want to get into a specific range, but I think her comment is really suggest that we don't expect a material change either upward or downward in earnings trajectory for next year. We're just going to give ourselves a bit more time to fine tune those estimates for '14.

Jay H. Gelb
Barclays PLC, Research Division

I see. Okay. And then on the Japan sales, if WAYS sales starting in 2Q could be down 40% to 60%, I just have a little trouble getting to flat to up 5%.

Daniel P. Amos
Chairman & CEO

Flat to up was only dealing with third sector. And remember, the down 40% to 60% is just for April, but I think that trend may improve a little bit because, always, April is going to be your -- with that rate increase going in into effect, but the flat to up 5% was only for third sector.

Jay H. Gelb
Barclays PLC, Research Division

Okay. And the down 40% to 60% is just...

Daniel P. Amos
Chairman & CEO

Toru, do you want to make a comment?

Tohru Tonoike
Vice Chairman of Aflac Japan

Not really, but we have done this right. We are trying to achieve the delta of 5% increase in the sales of the subsector that cancer and the medical combined. And we, at this point, we expect a significant decline in the sales of the WAYS and the going forward, not as much as the decrease in April, because April is a month right after that rate increase. So many people came to us trying to buy this product before the rate increase in March. So as a reflection, the action to that, we will see a very quiet April. But later in the year, that situation will be improved a little bit. But still, we expect a difficult year of income to the sales of the WAYS product.

Daniel P. Amos
Chairman & CEO

Paul and I heard the presentation on a new advertising campaign we're holding toward the end of the third quarter and fourth quarter. And I think you're going to see sales results more in line with '09 where we came on very strong in the fourth quarter. And so I'm very excited about what Aflac Japan showed both of us. So that's very encouraging.

Kriss Cloninger
President & Director

I want to further add that just because the sale of WAYS is soft doesn't necessarily translate into profits, actually it could result into some profit improvement. I'll talked a little bit on the last couple of calls about the impact of selling a higher volume of business at the lower margin. The converse is true, too, if you sell a lower volume a high margin business, it tends to offset and then you got the impact of higher level of nondeferrable costs, both on our U.S. GAAP basis, as well as the regulatory basis and that improves our regulatory financial results profit-wise. So lower volumes of WAYS is not necessarily negative for profit expectations.

Daniel P. Amos
Chairman & CEO

Proper repatriation.

Kriss Cloninger
President & Director

Right.

Operator

Our next question does come from Jeff Schuman of KBW.

Jeffrey R. Schuman
Keefe, Bruyette, & Woods, Inc., Research Division

I just wanted to kind of come back to the issue of, I guess, capital build and repatriation and see if we could get a little bit of perspective from a different angle. Granted you had to be sensitive to SMR and the FSA earnings, but it's sort of fascinating to look at the statutory capital, I mean your statutory operating earnings I think $2.9 billion in '11, $3.3 billion in '12. And then I have to assume, in '13, given that the business is bigger and you may have less capital strain on some new business that, that number just continues to go up. I think, you need to properly retain about $0.5 billion a year to fund growth. It just seems like you're destined to have this enormous statutory capital build, and I'm wondering if that's inevitable and you continue to be governed by the FSA constraints for the next few years or how we think about what appears to be this destiny for enormous statutory capital build?

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

Well, it's -- Jeff, it's is Ken again, it's long been the case that the real source of our free cash flow is profit repatriation from Japan. And as we discussed last year at the Analyst Meeting, the U.S. has been settled from a cash standpoint with additional tax payments to the U.S. Treasury because of the significant derisking that occurred in the Japanese portfolio, which simply shifts the U.S. tax burden as you have tax filed Aflac U.S. as well. The U.S. is responsible for all of the interest expense on the debt at the parent company level. So when you're thinking about, at least until we see more normalcy, and I think we're getting to that point because the losses have really been diminished recently. And to the extent that we don't have realized investment losses in Japan, you don't see that tax burden hurting the U.S. segment as much. So we're starting to see more normalcy there, but it is fair that the constraint for cash flow largely is the SMR and Japan's ability to repatriate capital.

Jeffrey R. Schuman
Keefe, Bruyette, & Woods, Inc., Research Division

I mean, that's certainly the case I think during the periods of extraordinary growth that you've just had. But I mean, at some point, don't all the accounting systems sort of converge and does that difference sort of...

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

Normalcy. They do, but it takes time. If you close the block, it would happen more quickly.

Daniel P. Amos
Chairman & CEO

I had that problem when I first became CEO. We had that issue -- we couldn't get money out of Japan, they thought. But it was because of the conservatism and the way they viewed it on an SMR basis. But once it hit the maximum, it then took off. And the normalcy here is coming back. And I think over the next few years, you're going to see it go back, assuming we don't have any more major losses. And we don't foresee them in the future, although we continue to be cautiously optimistic.

Operator

Our next question does come from Erik Bass of Citigroup.

Erik James Bass
Citigroup Inc, Research Division

Just hoping, can you provide an update on expected margins on new sales by different products following the repricing, kind of given where you're investing new money today?

Kriss Cloninger
President & Director

Yes. It jumps the gun a little bit on our FAB presentation, but I anticipated that someone would ask a question about the margin on the reprice business. For the business we're currently selling, after the April 2nd effective date on the repricing and with the discounted advance premium rate at 1% on business written with that, we anticipate that with a lifetime of the product, net investment yield rate of 2%, our profit margin as a percent of premium would be in the 15% to 20% range. Our ROE would be about 16%. If you say, okay, the net investment yield is going to be 2.5 life of the product kind of thing, you get up into the mid-20s. The range I'm going to show you is probably close from 22% to 30% and ROE close to 22%. So I'll let you reach some conclusions about where the appropriate number for net investment yield over the life of the product is going to be. But those are the ranges I'm going to show you at the FAB meeting in May.

Erik James Bass
Citigroup Inc, Research Division

Okay. That's helpful. And then just maybe one follow-up on the new money yield. You did see it increase in Japan pretty dramatically from kind of the fourth quarter to the first. And just wondering since you're investing sort of same mix between JGBs and U.S. corporates, kind of what it was on the U.S. corporate side that allowed you to get higher new money yields and if you changed anything either in the duration of securities you're buying or the credit level?

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

It's Eric Kirsch. Nothing really has changed about the guidelines of the program. It's a longer duration corporate bond portfolio, about 10 to 12 years typically or about 11 years on average. I think if you look at the fourth quarter to the first quarter within the U.S. corporate bond market, by and large, yields have come down -- or yields had gone up during the first quarter, excuse me, though there was some spread compression. But there was a steepness to the credit curve particularly in the fourth quarter. So we did pick up some additional spread because we are focused on the longer end. But by and large, the yields we've invested in have been kind of in the area that we expected, plus or minus 10-or-so basis points. So we did get a little bit of pickup in the first quarter just from the shape of the credit curve in general.

Operator

Our next question does come from Steven Schwartz of Raymond James & Associates.

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

I want, before I ask my question, I do want to follow-up on one thing. Ken, at the beginning when Tom asked this question, I was unclear, are you looking at hedging 2014 profit repatriation very early in the year?

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

We're looking at our options to do so right now.

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

Okay. Then if I may, Kriss, looking at margins, could you give us a sense of maybe what the margin was on the first sector product that was sold in the first quarter, given that there was -- you've got a higher rate to the corporate debt program, but you didn't have the rate increases in yet?

Kriss Cloninger
President & Director

That's correct. It'd probably be more in that 15% to 20% zone than in the higher numbers I quoted. But keep in mind, for the WAYS business, with the discounted advance premium, we did still have the 50 basis point rate in effect for that business up through the April 1 switch date. So the initiatives we took to improve profitability on new business that we took during 2012 carried over into the first quarter of 2013. And I think pretty conservative life of the block assumptions for net investment yield rate should get at least 15% to 20% on the first sector business you wrote.

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

A good point about the tap. And then for Paul, 2 things here. Paul, you talked about kind of alternative distribution maybe participate in private exchanges, what have you. I didn't hear anything about going over the Internet, maybe going over portals like eHealth, things like that, that may be connecting to the exchanges. And I'm also interested, you have, through your sales force, probably an unparalleled look into the spending plans, the health spending plans of small employers. Are you hearing anything from your sales force to suggest that significant amounts of employers will be dumping their major medical plans? And maybe in association with that, dumping the supplemental health plans as well?

Paul Shelby Amos
Former Director

All right. It's a whole bunch in that. Let me get started. First of all, we view the exchanges as an opportunity not to be necessarily an online enrollment tool where we're selling directly over the Internet but instead, we view it as a direct tool to enhance our sales force to go to market and allow them to further their strength in the small business market. We're building our own private proprietary exchange where we'll be partnering with certain companies, of which we believe it's going to allow our sales force to really strengthen their hold on the accounts that they have, as well as continue to grow their accounts in the small business market. So I believe the exchange is a win for our sales team as opposed to being an online sale. In terms of participating in online-only enrollments, there are aspects that we may tests. But today, there continues to be large adverse selection around that type of sale, as well as with increased competition in that marketplace, we know that there's going to be a drive toward limited profitability, and we want to do everything we can to maintain the margins on our profits. And by selling through our own private exchange, we believe we maximize the ability to sell with higher margins and maintain those ratios. And at the same time, obviously help our sales force. On the latter half of your question around health care cost increases, what I would tell you...

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

Paul, it wasn't health care cost increases. It was the idea that employers may take advantage of the existence of the exchanges to basically tell employees, "Look, instead of me providing this, here's some money, you go get it."

Paul Shelby Amos
Former Director

I understand. I'm sorry about that. There is a technology that is going to allow us, within our exchange, called iFrame, whether the employer chooses to or not to push their employees out to the exchange will be able to actually enroll at the work site, whether they do that or not. So we can actually pull up the state or federal exchange through our enrollment technology, through this technology called iFrame. Therefore, we can -- we believe we can persuade the business to allow even if they want to go push their people out in order to qualify for the subsidy, we can help them do that. At the same time, we believe that the implementation of subsidies is going to go at a very slow manner. We believe that it's going to happen on a state-by-state basis, depending upon their current fiscal environment. And we believe that there is going to be a very inconsistent roll out of exchanges. That's not the political view, it's a straight financial view on what's going to happen. And so we're monitoring this with the knowledge that it is going to be a highly complex environment, that what's happening in California versus Iowa versus Alabama may be drastically different. And therefore, will have an impact on how those local businesses decide what percentage of their people to push out to the market. We do know that the only place in the United States where we have a test market about that is the State of Massachusetts. Today, only 6% of businesses actually pushed their employees out to the open exchange as opposed to McKinsey, who's gone out and said it could be as much as 40%. We believe it's going to be on the lower end. In America, there continues to be a war on talent, where we know that small businesses, more than ever, value their employees, and not only recruiting them but retaining them. And in order to retain them, we believe that health benefits is something they're going to continue to want to offer, i.e. so to the extent that we could help partner with America's small businesses to both leverage the exchange, but also to bring Aflac products and other companies' products to the table. We believe we can continue to do extremely well.

Operator

Our next question does come from Yaron Kinar of Deutsche Bank.

Yaron Joseph Kinar
Deutsche Bank AG, Research Division

Can we talk a little bit about the individual and independent agencies in Japan. It seems like the number of those agencies is coming down and productivity is going up. I was curious, is the productivity increase simply due to a weeding out of the low -- the underperformers or is there more going on there?

Daniel P. Amos

Chairman & CEO

Toru?

Tohru Tonoike
Vice Chairman of Aflac Japan

Yes. I'll take that question. The growing in the recruiting number of the individual agencies and independent agencies is, I'll say, is in accordance with our plan. As I told in the past conference call, we have been shifting focus from recruiting large numbers of independent -- those individual agents told us that putting more resources to the training of the existing recruited agents, that's part of -- and also, particularly in that free large metropolitan areas namely Tokyo, Osaka, Nagoya, we have created a network of our Aflac consultants, the group of visiting sales force employed by Aflac. So instead of hiring a large number of individuals in that area, we are hiring a selected number of Aflac consultants, more professionally trained people, so that they can make sales more efficiently than the average, the newly recruited individual. So yes, the numbers of recruits has been decreased substantially. But again, this is, I'll say, in line with what we have planned.

Yaron Joseph Kinar
Deutsche Bank AG, Research Division

Okay. And then on the investment side, as you're exploring alternatives of the JGBs, could you maybe walk us through some of the alternatives you're thinking about or maybe the framework that you're using in order to look at these alternatives?

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

Sure. I'll be happy to. First, I think it's important to put it in perspective. The JGB allocation for us is 25% to 30% or so of our new money. And while certainly on April 4 or 5, after the new BOJ policy came out, yields fell precipitously. They have also come back up very strongly as well. So they're certainly lower than they were at the beginning of the year. But even if we followed our JGB allocation for the rest of the year, if you do the math, relative to our new money yield objectives, it would impact it by about 5 basis points. So it's a huge differential. Nevertheless, we do consider, do we want to lock up 20 year or 30 year money at these low yields given their historic lows? And our viewpoint is that there's a good chance there will be success in Japan. So some time in the future, whether it's a year out or 2, interest rates will eventually rise. So keep that framework in mind. So our objective is within that 25% or so, is there some alternatives that we could be comfortable with, we'll outperform those yields, but not necessarily lock us up for 20 years or 30 years. So as an example, we could take a look at a short-term corporate bond program hedged back to yen, where we could take advantage of good quality, corporate bonds in the U.S., shorter durations and maturities, or probably pick up 40 or 50 basis points over those JGB yields. And because the duration of those corporates would be shorter, they will be subject to less price sensitivity than, say, our long corporate bonds. So over a year or 2 from now, JGB yield should go up. And we think we need to just the asset allocation at that time, we'll have some flexibility as well. So we haven't reached any conclusions. We think it's critical, we follow what's happening on the monetary and fiscal side in Japan and always reflect on that, but it's not going to be a huge difference ultimately through our yields for this year when you do the math and settle that down. So everything will be thought of in perspective.

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

Thank you very much. We've reached the top of the hour. And if you have any further questions, please give us a call. Tom and myself will be in office. And if not, please make sure that you sign up for our FAB Meeting, and we look forward to seeing you there. Thank you.

Operator
Thank you. Today's conference has ended. All participants may disconnect at this time.