S&P Capital IQ

CONTENTS

Aflac Incorporated NYSE:AFL

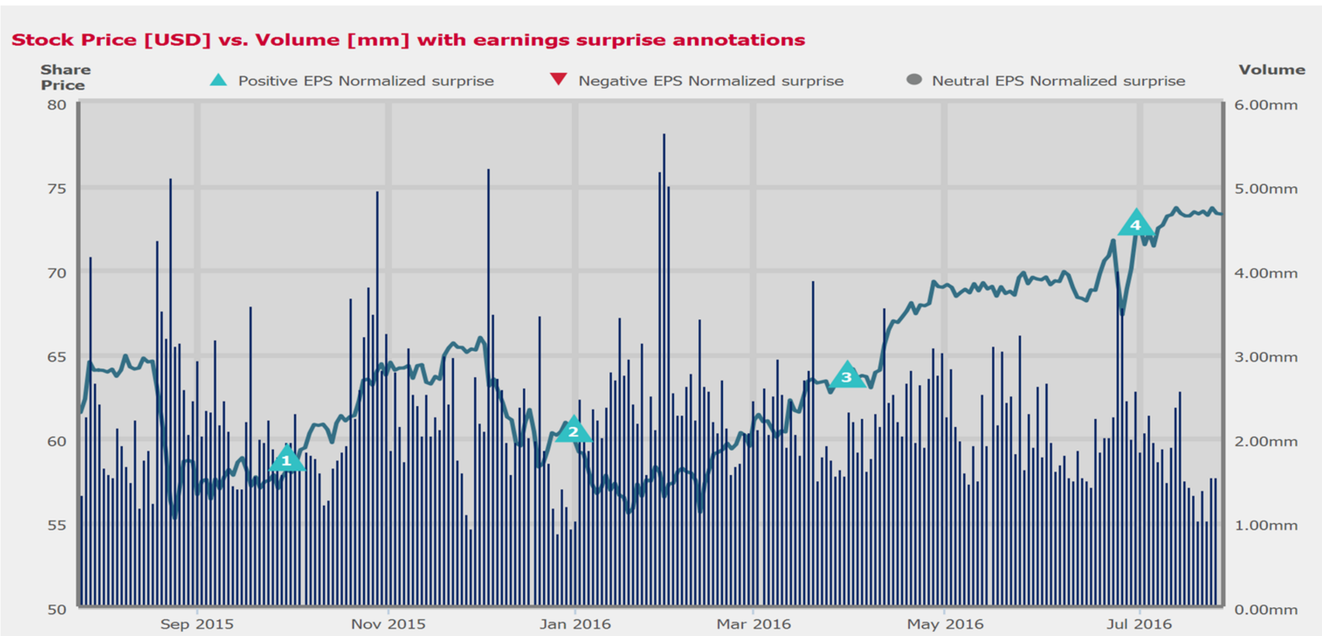
FQ3 2016 Earnings Call Transcripts

Friday, October 28, 2016 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2016-			-FQ4 2016-	-FY 2016-	-FY 2017-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.74	1.82	▲4.60	1.69	6.92	6.91
Revenue (mm)	5768.89	5716.00	▼(0.92 %)	5737.13	22468.30	22850.89

Currency: USD
Consensus as of Oct-28-2016 12:27 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2015	1.48	1.56	▲1 5.41 %
FQ4 2015	1.48	1.56	▲2 5.41 %
FQ1 2016	1.63	1.73	▲3 6.14 %
FQ2 2016	1.68	1.71	▲4 1.79 %

Call Participants

EXECUTIVES

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Chairman & CEO

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Global Chief Investment Officer and Executive VP

Frederick J. Crawford
Executive VP & CFO

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Presentation

Operator

Welcome to the Aflac third quarter 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. Ma'am, you may begin.

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

Thank you, and good morning. And welcome to our third quarter call. Joining me this morning from the U.S. is Dan Amos, Chairman and CEO; Kriss Cloninger, President of Aflac Incorporated; Paul Amos, President of Aflac; Fred Crawford, Executive Vice President and CFO of Aflac Incorporated; Teresa White, President of Aflac U.S.; and Eric Kirsch, Executive Vice President and Global Chief Investment Officer. Joining us from Tokyo is Hiroshi Yamauchi, President and COO of Aflac Japan; and Koji Ariyoshi, Executive Vice President and Director of Sales and Marketing.

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

Now I'm going to turn the program over to Dan, who will begin this morning with some comments about the quarter as well as our operations in Japan and the U.S. Fred will follow brief comments about our financial performance for the quarter and the outlook for the year. Dan?

Daniel P. Amos
Chairman & CEO

Good morning, and thank you for joining us today. Let me begin by saying that I am pleased with the company's overall financial results for both the third quarter and the first 9 months of the year. As you no doubt saw from yesterday's press release, these strong results gave us confidence to upwardly revise our operating EPS outlook for this year to the range of $6.40 to $6.60. Fred will provide more color on earnings and our outlook during his comments.

I'll lead off by providing an update of Aflac Japan, our largest earnings contributor. From a distribution perspective, our traditional agencies, which include individual agencies independent corporate agencies, affiliated corporate agencies, have historically been and remain today vital contributors to our success. Additionally, our alliance partners continued to advance our strong results. I am particularly pleased that just this month, Japan Post, though its 20,000-plus postal outlets began selling our new cancer insurance product designed exclusively for cancer survivors. Our traditional agencies first began selling this product in March of this year. While we anticipate the sale of our cancer insurance for cancer survivors, we'll be slightly additive to our overall sales results. More importantly, it underscores our reputation and commitment to being there for Japanese consumers when they need us most. These various distribution outlets further our goal of having a presence in all the places people want to make their insurance decisions.

From a product perspective, I am pleased with the progress we've made in limiting the sale of first sector savings products, which are inter-sensitive. First sector product sales decreased 54% in the quarter, putting us squarely on target to reduce first sector sales by at least 50% in the second half of the year compared to the second half of 2015. We have been aggressively and pulling product from select channels, conservatively repricing our ways in endowment products for the reality of a prolonged low interest rate environment. We are extremely encouraged with the significant progress we made in limiting the sale of the first sector products.

Turning to the third sector sales results, you'll recall that we upwardly revised our annual sales target for these products last month at the Tokyo Analyst Briefing, making this the second positive revision to our sales target this year. At the meeting, we announced a new third sector sales outlook to flat to up 5%. We are pleased that Aflac Japan generated a third sector sales increase of 2.5% for the quarter and 5% year-to-date. These strong sales results in the face of difficult comparisons reflect stronger-than-expected productivity across the majority of the distribution channels. This is even more notable when you consider the sales through the bank channels had been moderated significantly by restrictions on the sale of first sector products. I will remind you that fourth quarter still presents difficult third sector comparisons, particularly following the 2 years of extremely strong cancer and medical sales.

Our third quarter sales results also benefited from the July introduction of a new third sector product called Income Support Insurance, which accounted for JPY 708 million or 3.3% of the third sector sales. This product provides fixed benefit amounts in the event that a policy holder is unable to work due to the significant illness or injury. Additionally, this product was developed as supplement to disability coverage within Japan's Social Security System. Our Income Support Insurance product targets young to middle-aged consumers, ranging in age from 20 through their 40s, a segment of the population in which we believe were underpenetrated and represented. By focusing our efforts on this demographic, we believe that we're building relationships that lay the groundwork for the sale of cancer and medical insurance later in life. While it's still early, we are happy with the reception of the Income Support Insurance as received. We believe this product has the potential to gradually develop into a new Aflac pillar product over the long term.

Turning to Aflac U.S, we are pleased with our earnings are exceeding our expectations for the first 9 months. Profitability in the quarter was driven by improving benefit ratios that we continue to see over the last several years. We have simultaneously pushed resources back into the business, and particularly, we are investing in an end-to-end system for the group platform that will provide the capabilities of all of our group constituents, including brokers who typically sell group products. While we are expanding our presence in the voluntary work site insurance market, we are also being very disciplined in the pricing of the business, especially as it relates to the profitability within the smaller case group space that includes employers 100 to 250 workers.

Although sales in the quarter were lower than expected, I would remind you that, I said many times, that fourth quarter sales and particularly sales in the last 3 weeks of the year largely determine our annual sales results. Our efforts are focused on increasing the productivity of our career agents and brokers. I believe the measures that we rolled out over a 6-month period beginning in the fourth quarter of 2014 are the right approach, and as you'll recall, one major element of the changes we made, included compensation to better align incentives for the career agents with company sales results. We are continuing to fine-tune our compensation package for our top sales management to closely align pay with performance. With this superior incentive program, we're seeing our top sales management being paid extremely well and some of the poor-performing sales managers that decided that they'd rather concentrate on sales instead of management. While we would have liked to have seen the measures have more immediate impact on our sales results, we know that it can take some time. However, I want to point out that we are exceeding our profit target while implementing these changes. Most importantly, we continue to believe the changes that we've made to our sales infrastructure and compensation are in the best interest of the company to produce long-term results.

We also remained encouraged with the broker business. Over the last few years, our sales through the broker channel have grown. Our fourth quarter sales results have become more and more impactful as you saw in 2014 and 2015. This means it becomes more and more challenging to project full year sales, even though sales results for the first 7 -- 9 months we know. Although I am encouraged by the pipeline of business schedules for the fourth quarter, we are still enhancing our forecasting of how much of the pipeline materializes into actual sales results. Therefore, we believe Aflac U.S. will require particularly strong fourth quarter in order to meet the lower end of the 3% to 5% target increase for 2016.

I would remind you that our brand is a key differentiator for Aflac, both in Japan and the United States. As a product innovator and trusted brand in both countries, we've experienced a tremendous amount of success leveraging the strength of our brand to drive sales. In both countries, 9 out of 10 consumers recognize the Aflac brand. But our brand is more than the Aflac Duck or the advertising initiatives, it's also about how we take excellent care of the policyholders. In Japan, it's our powerful brand that has propelled Aflac to ensure 1 out of 4 households. In the United States, we processed, approved and paying nearly $1.3 million One Day Pay claims in the first 9 months of 2016. And most importantly, 96% of the policyholders that use One Day Pay said they are likely to refer other people to Aflac. We believe this will result in more -- new sales going forward.

Our products are well suited in both Japan and the United States markets, and we are well positioned in the 2 largest insurance markets in the world.

Turning to capital deployment. Let me just say that we continue to view growing the cash dividend and repurchasing our shares as the most attractive means for deploying capital, particular in the absence of any compelling alternatives. We are on target to repurchase about $1.4 billion of our shares, with the majority already repurchased during the first 9 months of the year. The Board of Directors action to increase the dividend by 4.9%, demonstrates our commitment to rewarding our shareholders. This marks the 34th consecutive year of increasing our cash dividend. We are proud of the achievement, and our objective is to grow the cash dividend rate in line with the increase in the operating earnings per diluted share before the impact of foreign currency translation.

We continue to manage the business for the long-term benefit of the shareholders, the policyholders and all stakeholders. We believe we will continue to achieve more by building on these strategies and the foundations that have propelled our success. By doing this, I believe we will continue to enhance shareholder value while delivering on our promise to the policyholders.

And now let me turn the program over to Fred, who will cover the financial results and outlook. Fred?

Frederick J. Crawford
Executive VP & CFO

Thank you, Dan. Our third quarter performance continues the strong financial results recorded in the first half of 2016, and execution on key initiatives designed to drive long-term growth and effective allocation of our capital. Our results were driven by strong overall margins in both Japan and the U.S. Operating EPS increased 16.7% or $0.26 per share with a little over half the growth driven by the strengthening of the yen and the remaining from share repurchase and pure earnings growth. Excluding the impact of the yen, operating earnings increased 7% as compared to the previous year's quarter.

Our Japan segment margins were solid. We concluded as part of our annual actuarial review process that it was appropriate to reduce the IBNR reserves for our cancer insurance block of business by approximately JPY 4.6 billion or $0.07 a share. This amount is very similar to the adjustment we made in the third quarter last year and reflects continued strong cancer claims experience. Expense ratios were generally in line with our guidance.

In the U.S., benefit ratios continued their favorable trends for the year. Our expense ratio was favorable to our expectations for the quarter. Consistent with previous years, we fully expect our expenses to tick up in the fourth quarter as we make progress on certain strategic initiatives and increase our promotional and IT spend. Overall, our U.S. pretax profit margins are set to perform at or above the high end of our 2016 guidance range of 17% to 19% for the year.

Both Japan and the U.S., we will spend some time on our December outlook call discussing revenue trends, benefit ratio drivers and specific to expense ratios where we intend to invest in the platform throughout 2017.

Turning to investments. Results were both the quarter and the year, and we're aligned -- year-to-date, we're aligned with our expectations as we continue to navigate the low-yield environment and further diversify our portfolio. As we discussed during our analyst briefing in Japan, we continue to execute on a comprehensive plan that includes curtailing interest-sensitive premium flows through actions to reduce the sale of first sector savings products; developing alternative high-quality yen investments, including a measured re-entry back into yen private placements; finally, executing on our U.S. dollar investment strategy where we can hedge market value effectively and optimize investment income consistent with risk, ALM and capital objectives.

With respect to our U.S. dollar program and hedge costs, our reported third quarter costs were elevated, recognizing we currently isolate and report the full cost of forwards in the period we purchased. Consistent with the strategy we have outlined at our analyst briefing in Japan, we have successfully executed on covering approximately $3.3 billion of additional U.S. dollar assets under the hedge program and have proactively extended the duration of our forwards to better manage 2017 costs and associated volatility. Both of these actions will serve to exaggerate our reported costs in the period under our current reporting.

Amortizing the cost over the life of the forwards, the non-GAAP reporting convention we plan to adopt in 2017, our hedge cost for the entire book of hedges were $54 million pretax or $0.09 a share this quarter. Assuming no material change in hedging strategy and our current reporting method, our pretax hedge cost guidance remains in the $280 million to $300 million range for 2016.

Moving to an amortized basis for reporting, tactically extending duration, continuing to refine the asset allocation and hedging strategy will serve to reduce the quarterly volatility as we incorporate hedge costs into our definition of operating earnings for 2017. We'll cover this approach and forecast in more detail at our outlook call in December.

Turning to capital. We commented last quarter that hedging additional U.S. dollar asset classes would further strengthen our SMR. We ended the quarter with an estimated SMR above 900%, up significantly from last quarter. RBC is also preliminary at this point, but we expect it to remain Strong in the mid-800% range despite the strengthening of the yen impacting our ratio negatively throughout the year. This is a result of the Japan branch embedded in our U.S. statutory results.

Overall, credit conditions are stable. Impairments in the quarter were modest and preliminary -- and primarily related to our Japan equity portfolios, where depressed market values have triggered impairments in accordance with our internal accounting policies.

We continue to return capital to shareholders. Between dividends and repurchase, we have returned approximately $1.7 billion to our shareholders year-to-date. We continue to spend down excess capital held at the holding company, and expect to achieve our target of $1.4 billion in repurchase for the full year. As Dan highlighted, our board elected to increase the shareholder dividend to $0.43 per share per quarter, a 4.9% increase in marking our 34th consecutive year of dividend increases.

Bolstered by U.S. segment earnings outperformance and solid results in Japan, we are comfortable increasing our 2016 earnings guidance to $6.40 a share to $6.60 per share on a currency neutral basis. We have provided in our press release an EPS range for the fourth quarter, assuming a yen to dollar exchange rate of $100 to $110.

As mentioned last quarter, we are conducting our normal actuarial review of interest-sensitive blocks of business in Japan. There are 2 smaller legacy blocks of interest-sensitive third sector business that may require strengthening as these blocks have been susceptible to strengthening in the past. In addition, from a corporate perspective, postretirement benefit liabilities are sensitive to long-term rate assumptions. And while not finalized, we anticipate an adjustment in fourth quarter and suspect this will be a common theme among many large corporate entities.

Overall, we remain well positioned in terms of core margins and capital strength, and look forward to our December outlook call where we will expand on our strategic plans and 2017 outlook.

I'll now hand the call back to Robin to begin our Q&A session. Robin?

Robin Y. Wilkey
Former Senior Vice President of Investor & Rating Agency Relations
Thank you, Fred. Now we're ready to start taking your questions. First, let me remind you that to be fair to everybody, please limit yourselves to 1 initial question and only one follow-up that relates to your initial question. We're now ready to begin with the first question.

Question and Answer

Operator

[Operator Instructions] We have our first question from Jimmy Bhullar with JPMorgan.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

My question was just on your higher EPS guidance. If you could discuss whether it was more the benefits ratio coming in better that give you the confidence to raise the range or was it just lower discretionary spending. And to what extent are these things that will effect next year, like if it is spending, could that spending go over into next year? Or likewise, if it's the benefits ratio, should that continue to be favorable through next year as well?

Frederick J. Crawford
Executive VP & CFO

Sure. Jimmy, thank you for the questions. This is Fred. Really, the revision to our guidance is, as I mentioned in my comments, largely bolstered by outperformance relative to our expectations on the earnings front in the U.S. However, I would add that, year-to-date, both the U.S. and Japan had been traveling at generally favorable ends of our ranges for both benefit ratios and expense ratios. And so I made a point to say also or point out that Japan's solid results are contributing as well. But the true outperformance relative to our expectations was more pronounced in the U.S. earnings side. In terms of as we look forward, we will spend a big deal of time, not surprisingly, during our December outlook call talking about the trends as we look at next year. So I'll spend more time there. I would say, in general, you would expect us in the fourth quarter, for example, to see some expenses pick up. This is not uncommon. If you follow the company over the last few years, you'll see that tick up. It has to do with the timing of promotional spend and the natural progression of initiatives as we go throughout the year. As we go into the next year, we will continue to be investing particularly in our U.S. platform, and we'll speak more about that. I don't know that I would suggest it to be material, but you would see a slightly elevated expense ratio as we invest in that platform. And then in terms of benefit ratios, we have been tracking, particularly in the U.S., at a favorable level. We would expect, to some degree, to see a continuation of that near-term eventually normalizing back towards our range. But we have seen some persistency, if you will, relative to the benefit ratio being favorably throughout the year. And based on what we're seeing right now, that should continue for a bit. But we'll talk more about it during the outlook call.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

And then if I could ask one more. Just on your hedge costs, they're pretty high this quarter. To what extent are the increase relate that you're just increasing duration? And if you could just give us some color on how far you're going out on your purchases and what's the basis points cost is for the hedges that you're putting on.

Frederick J. Crawford
Executive VP & CFO

Yes. There is the really principal drivers of the hedge cost being up given how we reported, and that was really the tactical moves made in the quarter and it was a combination of extending duration as you mentioned. I would say over the past year, for example, we've pushed that duration of our hedge portfolio out from roughly 4 or 5 months to upwards now of 10 months. And that means, by definition, we're buying out into the 1-year 18-month time frame, in some cases, on the forward curve. This is in part not only to manage forward volatility, which we think is important for consistency and stability of our reported earnings and costs, but it's also because we've actually seen a flattening of the forward curve where it's more economic for us to go a little longer and lax some of that in. So we've been quite tactical on that front. The other piece that's contributing, of course, is just simply covering more assets and in particularly, covering assets that we have been building in the U.S. dollar portfolio, things like bank loans, commercial real estate and equities. We're covering those assets are important not only from a pure hedging perspective, but also you get the favorable capital treatment or really protect the favorable capital treatment that you need for SMR. So those have been the 2 areas of contribution. I would say about 35% or so of the cost related to duration extension in the quarter and about 40% of the cost increase or the cost you're seeing related to covering additional assets, just to give you some round numbers. Again, we'll be moving to an amortized basis, which is a more logical way of looking at the costs going forward. I tried to give you some color for what the quarter look like if you were to amortize costs today. We really believe in the tactical moves we're making. And during the outlook call, we'll give you a full rendering of how the year would look and how comparable years would look as we incorporated into our forecast for '17.

Operator

Our next question is from John Nadel with Crédit Suisse.

John Matthew Nadel
Crédit Suisse AG, Research Division

Two questions. One, Fred, just real quick, what's the size of the notional amount of the hedged asset program as of the end of the third quarter? I know it's $14.3 billion or $4 billion last quarter. It sounds like it's probably in the $17.5 billion, but if you have the number, that would be great.

Frederick J. Crawford
Executive VP & CFO

Yes. It's -- and Eric, you can jump in. But I think we're traveling close to the $16 billion, and this would be particular to the forwards that we're covering. So John, realize that we use 2 instruments to hedge. The vast majority of what we use are forwards, and that's where the cost comes in. We also do some collaring on a small portion of the assets, which tends to be a much, much lower cost-type approach of hedging. The vast majority of our hedging is done using forwards, and that notional is traveling around $16 billion, up from around $12.7 billion in the second quarter, to give you an idea. And I think I'm going to anticipate where you may be going with this question from an understanding forward costs. And that is if you were to take our $16 billion in notional and just hold that constant, we're seeing costs traveling between 170 to 180 basis points. Actually, more recently, it's gotten a bit favorable coming off of DOJ and Fed announcements. That's why we've moved to accelerate locking in some of the costs. But we think it's more wise to be thinking in that 180 basis point range, and that gives you a sense of where we're traveling from an amortization perspective.

John Matthew Nadel
Crédit Suisse AG, Research Division

Okay, that's helpful. And would you anticipate that a Fed hike, I guess, in December with all else equal would increase that cost?

Frederick J. Crawford
Executive VP & CFO

It's always hard to say, and the reason for it, John, is while in theory, a Fed moving rate's up and the DOJ staying put or continuing to move rates down. It widens out your hedge costs. Realize that things are priced into the market. And so to what degree a Fed rate hike is already priced into the market is a bit speculation. I don't know, Eric, if you have any view on that.

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

Yes. I would just add to Fred's comments, today, if you look at 1 year hedge costs, they're about 168, but we are anticipating upward pressure for exactly the reason you said. If you look at the forward curve 1 year from now, 1 year hedge costs are about 200 basis points. So to Fred's point, the market is anticipating the Fed hike. One year from now, we would expect hedge cost probably to be higher by 20, 25, 30 bps, anticipating some Fed activity. But even by the Federal Reserve's own public announcements, even if they raise rates, they have been very clear, slow and gradual, nothing sharp because the U.S. economy won't support that.

John Matthew Nadel
Crédit Suisse AG, Research Division

And then that last follow-up on this one is just if you look out a year from now, approximately how much growth would you expect to see in the actual U.S. dollar investment program that would require it to hedge?

Frederick J. Crawford
Executive VP & CFO

Yes. I think we will provide some back up to that, John, on the outlook call. I don't want to steal some of the analysis from that. So I would suggest you will go into more detail. I will point this out, however. It's not simply a matter of growth in the U.S. dollar program, which I would anticipate to be gradual, it's also the mix of where we're investing. And what you've seen us do through bank loans for example, middle-market lending and then more recently, exploring transitional real estate lending, which is just a form of bridge loans on commercial real estate, these are all characterized as being floating-rate U.S. dollar investments. That's particularly advantageous for us because, one, you will tend to hedge that using short-dated forwards where it's relatively less expensive forwards. But also from a duration matching perspective, you end up at the same pressure that's applied to hedge costs tend to result in increased LIBOR rates and returns or yields on the floating-rate securities. So one of the things that we're working on is not just the notion of asset allocation and where the U.S. dollar program goes, but also refining our asset allocation in that portfolio to be more effective, as I mentioned in my comments, more efficient and effective in hedging, and in the process, further managing volatility.

Operator

Our next question is from Michael Kovac with Goldman Sachs.

Michael Edward Kovac
Goldman Sachs Group Inc., Research Division

I wanted to focus a little bit on the U.S. sales slowdown this quarter kind of relative to your longer-term expectations. I'm wondering if we could dig in a little bit more to what was really driving it this quarter. It seems like a slowdown across some of the accident and core cancer products, but any additional color you could provide would be helpful.

Teresa Lynne White
President of Aflac US

This is Teresa. So thank you for the question, Michael. The weak sales this quarter really, I think, attribute to the changes that we've made that are settling in. The markets that are succeeding has 3 fundamentals: One is timing of broker collaboration; the second is, as Dan talked about, productivity per producer, increased and improved productivity per producer; and then the third thing is an increase in conversion rates, their recruits to producers. So what we're really focused on is making sure that we manage the performance of all of the markets from that perspective. We are seeing some positives. We're seeing positive growth in new account AP. We're seeing positive growth in producer productivity, but we don't have all markets flicking on all cylinders. And so that's really the focus from a U.S. perspective.

Daniel P. Amos
Chairman & CEO

And I'll make one other comment. The new contract that we put in 18 months ago or so, what you saw is, if you remember, we had an enormous fourth quarter that year and a lot of people stayed around, continue to produce. But now that half the organization is doing great in making more money, the other half is making less money. These ones that are making less money were making more money under the old contract. So they're having to perform to get paid, which is the way we wanted. But a lot of them are reevaluating how hard do I want to work for that money. And if they want to work hard, they can make a lot more. And some of them are saying, I've done well, I'm going to take my money and I'm going to move more towards just sales and not have to worry with sales management. And how much more complicated it's gotten. I mean, everwell, One Day Pay, all these other aspects have changed them from just being a sales manager to the managing or -- change it from just managing sales to being a real sales manager, which includes looking at profitability, making sure we're disciplined in our approach to offering group products at certain prices. And so we're going through a little change with that, that we hoped wouldn't happen, but I'm certainly not surprised. And so that's the other aspect.

Michael Edward Kovac
Goldman Sachs Group Inc., Research Division

Great. And then I guess now that it's been sort of 18 months since you mentioned since the initial rollout, do you feel like most of that is sort of through the system? Or should you expect kind of a continued drag from sort of the transition through the next couple of quarters?

Daniel P. Amos
Chairman & CEO

I think that it's hard to call. I can't tell you how much the market's changed. And I've been around here a long time, and it's always been more the same for first 25 years I was doing it. Now it's not. It's a -- our great sales organization, which I'm so happy with, and -- but in addition to that, it's the brokers. It's the change when we never had the skew of business to the fourth quarter. But because of the way they enroll the accounts, the way it's working now wears me out. It's like a football game where you got to pull it out in the fourth quarter, but that numbers becoming larger and larger. And we're trying to shift it more to the third quarter, and it didn't work. They still want to turn it in, in the fourth quarter, and we had more control over the associates because they listen more. But when you deal with this broad-based broker, you just take it when -- so -- but we got this big pipeline. So I think things are moving in the right direction, but I still believe next year the fourth quarter is still going to be big because of the way it happens, correct if I'm wrong.

Teresa Lynne White
President of Aflac US

Yes, yes. And I'll say from a pipeline perspective, when you look at re-enrollment, you look at new business in the pipeline, the pipeline looks good. So we feel good about the pipeline, but to Dan's point, you've got to pull it out in the fourth quarter, which is very, very different from what we've been accustomed to in the past.

Michael Edward Kovac
Goldman Sachs Group Inc., Research Division

Great, that's helpful. And one last follow-up on that. As we think about the promotional expenses, I know Fred and others mentioned that those tend to be higher in the fourth quarter. Should we expect them to be sort of above prior year's levels as a result of sort of trying to pick up some of the potential sales growth in the U.S.?

Frederick J. Crawford
Executive VP & CFO

Not particularly. Actually, our overall budget year-over-year is relatively stable from an overall promotional and marketing spend. There may be modest differences quarter-over-quarter from a timing perspective and particularly, timing of ad spend and so forth. But the notion of it being bunched around enrollment season and in the fourth quarter is not unusual, and there's not really a large step-up delta, if you will, to the promotional spend.

Daniel P. Amos
Chairman & CEO

I'll make one final comment, and that is I don't like the sales quite where they are. I'd like it better, but I like what's happening in our operations. I like the idea that we're doing the One Day Pay. I like what's happening with everwell. I like how the brokers are coming on. I like what I'm seeing and writing large accounts, but we're being disciplined and not just writing every account. Some that couldn't be profitable were passing by. I like what Teresa's doing in merging the brokers and the associates together, but with that are growing pains. But all in all, I'm pleased with what's taking place from that regard. I just want stronger sales.

Operator

Our next question is from Seth Weiss with Bank of America.

Seth M. Weiss
BofA Merrill Lynch, Research Division

Fred, I wanted to follow-up on your comments that, in the U.S., you expect the beneficial underwriting trends to persist in the near term, but normalize back in the long term. Could you just comment in what gives you the visibility in both the near term and long term?

Frederick J. Crawford
Executive VP & CFO

Yes. The -- what we're seeing right now is, first of all, realized, of course. Benefit ratios will fluctuate each quarter, and so there'll be quarters where we're in our range and quarters where we move within the range or a little favorable. But what we've seen year-to-date, even somewhat last year, in the latter stages of last year, is a consistently favorable benefit ratio. And what we see going on there, we believe, relates to, somewhat to mix of business. And 2 particular types of business that are driving this, we believe, are: One, group business, where our group business naturally is priced to and expected to travel at a lower benefit ratio than you would find, say, on individual products in the way it's priced, and that's just a function of how it's priced and structured as a product. And as group business grows and becomes more of our in-force and plays more of an influence on our benefit ratios, you'll see a little bit of that. The other dynamic though is really more guaranteed issue business where the actual building reserves tends to be slower and more moderate in the early years. And so as you start to sell more of that guaranteed issued business as a proportion of other business, you'll see just a slower ramp-up in reserves and a generally more favorable near-term benefit ratio. So that's what I mean when I say we would expect to see, as those types of business age, that they will age back into our expected long-term range of benefit ratio. But for a period here, it looks as if we're traveling at a, again, a persistently low benefit ratio relative to our expectations. And again, it's all on the margin. We're traveling, I think maybe 50 or so basis points better than our guidance in general, but we'll provide more of an update on this and some trends as we get to the outlook call.

Seth M. Weiss
BofA Merrill Lynch, Research Division

Great. And one quick follow-up just on the hedge cost. You commented or reiterated that $280 million to $300 million range for the full year. I believe you're already at the low end of that range. So could we assume that you'd effectively done most to your purchases for the year on the U.S. dollar denominated program?

Frederick J. Crawford
Executive VP & CFO

That's right. Unless we take a different tactical approach. For example, deciding to aggressively lock in more long-term hedges, then we would expect to stick with that guidance. And what that really means is you can see we've covered effectively all of our needs. We are, right now, about 98% covered, if you will, on our hedge activity in 2016. And furthermore, we've gone into '17, and we've covered or locked in, if you will, about 40% of our costs in '17. And that's what we want to try to do. We're going to try rolling, if you will, as we go forward so that can create a level of consistency in our hedge cost.

Operator

Our next question is from Humphrey Lee with Dowling & Partners.

Humphrey Lee
Dowling & Partners Securities, LLC

Just another follow-up on these hedging costs, given a lot of the Japanese insurance companies are talking about expanding their foreign investment program backed by a hedging program behind it. So from a hedging insurance perspective, given the higher demand, do you see any potential impact on the hedging cost from a capacity perspective from your common parties?

Frederick J. Crawford
Executive VP & CFO

From my conversations with the team, I'll ask Eric to weigh in, though. The forward market, particularly the forward market involving 2 of the largest and most stable currencies on the planet, dollar and yen, they're such a deep and strong market that you tend not to see the ebb and flows of purchasing and selling having a tremendous impact on it. There will be times where supply and demand do play in, in fact, into the forward costs. That's natural. And by the way, by locking in a little bit longer, we have the ability to sort of step out on the margin where necessary and step back in tactically, and that's part of what we try to do on the margin. So there's no doubt. There is some possible influence, but I'm not sure. And given the depth of this market, that it would be significant. But Eric, maybe you have some comments?

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

Yes. I would just add. Fred is absolutely right. There's not an issue of the availability of forwards. There's plenty of capacity with the markets from counterparties. However, it does drive into the price of the forwards. We tend to mostly talk about the difference between Central Bank policies. Between the Fed and Japan, that is the largest driver and historically, the largest driver. But there's also something called the basis. And basis is basically a reflection of supply and demand for dollars. But to your point, a lot of the Japanese insurance and other investors outside of Japan are buying a lot of dollar assets, and therefore, in the currency market. And that will drive up the price of the forwards, but will not reduce the supply. There is more than ample supply for most liquid market in the world [ph].

Humphrey Lee
Dowling & Partners Securities, LLC

So to that point, even if longer term, maybe the interest rate environment to become more normalized, but if -- as long as there is the demand from the Japanese insurance companies, that could create an upward pressure on the basis?

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

That's right. It's investors from around the world, not just Japanese insurance companies.

Humphrey Lee
Dowling & Partners Securities, LLC

Okay. And then just a follow-up on the U.S. dollar investment. So talk to the point that there are definitely greater demand from kind of foreign buyers of U.S. assets. So for your tactical shift in terms of your asset allocation to your bank loans and middle market that are lending, have those asset class being tapped in by the other foreign buyers as well? And if so can you talk about the competitive landscape in terms of sourcing of these assets?

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

Sure, happy to. It's a very, very large market, and it is attractive to insurance companies like ourselves. However, there's a trend of a shift that's capital available to the loan, middle market, loan market, even transitional real estate. And what I mean by that is there's hundreds, if not thousands of lenders, across the United States, lending to thousands of small middle market companies and in the real estate market.

Historically, banks have been the capital providers to those loan markets, to the lenders, if you will, as well as re-syndicating some of those loans. Because of Dodd-Frank, the banks have removed themselves from that market. It's no longer capital-friendly for them. For an insurance company like us, we like to focus on credit risk and underwriting where we can negotiate very tight covenant of a high predictability of securement of loans, if you will, and our money. So it's an attractive asset class. So yes, it's true. There is a trend of insurance companies and other investors substituting for the banks. So in a way it's a zero-sum gain, I couldn't give you the exact specifics, but insurance companies are coming in where banks are leaving, providing that capital to the market. Now naturally, it's supply and demand, so there may be more demand than there's been in the past and that might tighten spreads a bit, but you are getting paid with -- for taking the credit risk in those types of particular loans, companies, but you're also getting senior secured status, very tight negotiations to your favor to protect yourself in case there's any credit challenges with the company.

Operator

Our next question is from the line of Ryan Krueger with KBW.

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

Fred, first, I'd like to follow up on your comments about the fourth quarter actuarial and postretirement benefit review. Are those -- are anticipated impacts from those included in your fourth quarter EPS guidance? Or would that be viewed as separate impacts?

Frederick J. Crawford
Executive VP & CFO

Yes, it's -- here's how to think about it. In terms of our fourth quarter estimates, the postretirement benefit adjustment, we have allocated or set aside in our forecast, in our estimate, an amount of money. It is preliminary, and we don't have the final because it ends up being a result of a final posting, if you will, of the pension interest expense or basis points from a composite. And so what the pension world waits for is the production of that composite. But we fully anticipate it to be down. It's hard to envision they're being a recovery in it. And as a result, we have a greater level of confidence. There'll be something, and so we have set aside some money for that. In the case of our review of these blocks, legacy blocks of business I mentioned, that is not in the numbers because we really are too early in the process to know what might be the practical ranges or if there will be a reserve strengthening at all on those products. And so we do not have anything in the numbers for that.

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

Okay. And then another follow-up on U.S. sales. Is the comment that it will be more challenging to meet the 3% to 5% full year target, should we view that as more reflective of somewhat lower sales in the first few quarters of the year relative to what you would have expected? Or does it have more to do with your actual outlook for the fourth quarter and broker production?

Teresa Lynne White
President of Aflac US

I think the broker production, as far as the pipeline, looks pretty good. So within the range. I had hoped that we would be a lot further along after the third quarter. And so I would view it more so as my disappointment in where we are as of the end of the third quarter. However, I will say this, as Dan said, we -- there's plenty of opportunity for us to really bring in new business. We also are looking at the profile of the business that we're trying to bring in, and we are turning down some of the cases. And so when we talk about it's going to be a little bit more difficult. It's really going to require a great fourth quarter for us. Now we said that the last couple of years, and our sales teams delivered. So that's really just kind of how I'm looking at it at this point. Do have anything else, Dan?

Daniel P. Amos

Chairman & CEO

No, that's all.

Operator

Our next question is from Yaron Kinar with Deutsche Bank.

Yaron Joseph Kinar
Deutsche Bank AG, Research Division

I also have a question on U.S. sales. So in talking about your forecast and the environment you're seeing right now. You talked a lot about the distribution force and the dynamics that you're seeing there. Can you also talk a little bit about what you're seeing think in terms of the competitive landscape from a manufacturing perspective?

Teresa Lynne White
President of Aflac US

Well, from a competitive and did I hear manufacturing perspective?

Yaron Joseph Kinar
Deutsche Bank AG, Research Division

You did.

Teresa Lynne White
President of Aflac US

Okay. So from a competitive perspective, we are seeing a lot more competitors in the voluntary space. Some of the employer paid benefits are now becoming voluntary benefits. So again, additional voluntary benefits in the space. At this point, we're also seeing competitive bids, specifically on the broker business. Some of the bids, as I've said earlier, we really are passing on because of the profile of the business and we want a really stable product profile. And some we're choosing to partner to get like the long-term care type products. So we're trying to go to best-in-breed to get those. So really from a competitive set, we are seeing a lot more competitors in the market, but we still feel good about what we're doing in the market as well.

Daniel P. Amos
Chairman & CEO

I want to say one other thing about this. This is not unusual and that I can go back 20 years ago and remember when our competitors got in the market and they were going to give unlimited cobalt and chemotherapy benefits. We kept telling ourselves we couldn't need that. They ended up 50% rate increases 2 or 3x in a row to offset that. The good news is, we've got all these statistics of what we've been doing in the cancer insurance business and in this area for so many years. We kind of know how to price it. And some that want to make low balls, it generally bites them later on. And yes, it gives us a little problem short term with sales. Go back 20 years ago, we were losing sales to some of the competitors. A couple of those companies aren't even do -- in business anymore and a few that were had to change the way they approach things. So this is not unusual that we're having people lowball on products. We've seen it in Japan even. But the fact is we know what we're doing, and we're pricing it right and we're giving the customer a good value. And in return, we're making a good profit.

Yaron Joseph Kinar
Deutsche Bank AG, Research Division

I appreciate the color. And then another question regarding the revised guidance. If I back then -- out of the numbers, correctly, I think I get to roughly flat constant currency earnings in the fourth quarter in the midpoint of that guidance range. And if I heard Fred's comments earlier, I think that those numbers don't include the potential adjustments to reserves or on the pension front or, at this point, with the retirement front, sorry, at this point. So what other drivers are there with now that are serving as a headwind relative to last year? Or is just that last year was a very strong quarter?

Frederick J. Crawford
Executive VP & CFO

No. I would say, in general, it's really a couple of things. One is what I mentioned, we believe there will be a bit of an acceleration in expenses in the fourth quarter. That's what we're forecasting. Sometimes that plays out, sometimes the timing of that doesn't play out. But at the moment, that's our forecast. And then again recall that I did, in fact, include some level of expense related to what we believe is an inevitable postretirement benefit adjustment related to interest rates. Now again, that's not finalized. And you need to understand the final before you can book anything, but we know enough to know that there's probably a range found -- amount in there. So that's a little bit of what's traveling through the number, and obviously, we'll continue to do our best to meet or exceed the forecast to the best we can.

Yaron Joseph Kinar
Deutsche Bank AG, Research Division

But I thought that fourth quarter usually you're seeing acceleration of expenses, so when that have -- how true, last year as well?

Frederick J. Crawford
Executive VP & CFO

Yes, it's all relative. It's a matter of how big the acceleration was last year and how big this year. So I would say, those are really the issues.

Operator

Our next question is from Tom Gallagher with Evercore ISI.

Thomas George Gallagher
Evercore ISI, Research Division

Another question on the hedging program. So Fred, if you factor in the cost of hedges currently and then you consider the impact on your first sector business like WAYS, are those products still going to be profitable when you factor in the cost of rolling these hedges here? And is that the way you're thinking about it at a discrete product level in terms of profits? Or you're thinking about the hedge in a different way? Is that sort of corporate expense, it's discreet and not being factored in at the product level?

Frederick J. Crawford
Executive VP & CFO

No, it's not discrete. In a sense of when we look at our putting new money to work, if you will, premium, and what new money assumptions, let's call it the new money curve, we need to achieve to achieve certain profitability levels. We not only factor in what I would call the gross yields we would expect on investing our money. But when it comes to the U.S. dollar program, we also are projecting a hedge cost environment into the net yields that we expect to support the product. So when we are pricing a product like WAYS, we're looking not only at the interest rate environment and mix of investments and associated credit spread, if you will, but we also, in our case, have to be factoring in hedge costs. So it's a very real part of how we think about the product. And so as a result, all of the repricing that we're doing is really having to take into account the low interest rate environment, our asset allocation, hedge costs. And then most notably in Japan, there's also a recognition that the standard rate, if you will, or the discount rate assumption used for reserving practices, is going to come down materially in Japan at the end of March of next year. All of those things have been factored in to pricing out our savings or intersensitive-related first sector products, namely WAYS and child endowment, in making sure that we can adhere to a decent profitability.

Thomas George Gallagher
Evercore ISI, Research Division

Okay. So we shouldn't be thinking about -- worrying about DAC or reserve adequacy for your first sector business in a broader sense when you consider what's going on with these hedge costs?

Frederick J. Crawford
Executive VP & CFO

Right. We do that actuarial work. I pointed to a couple legacy blocks of business as it relates to being particularly closer to the edge, and we have to watch and carefully watch that. And these tend to be blocks of business that you're familiar with: dementia, Super Care. These are products that we've been watching for a number of years. But we do the testing work on all of our products, both third sector and first sector in the fourth quarter. Not surprisingly, we will see the reserve margin squeeze on first sector savings products as it relates to the current environment, including hedge costs. But we have solid margins in those areas. And so at the moment, we don't see that as a risk. It's more this acute, what we are calling legacy smaller blocks that are actually third sector business to be technically correct.

Thomas George Gallagher
Evercore ISI, Research Division

Okay. And then just a follow-up for Eric. Can you comment on what's the breakeven of where hedge costs would have to go to, to the point where you would say, this has been a negative decision from an economic standpoint in terms of building out this U.S. dollar portfolio? Clearly, running at 180 basis points, I know it's high. Is that still -- is that a net positive, like when you factor that in and look at the yield and the risk related to building out this program?

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

Yes, absolutely. The approximate number is 2%, meaning our earnings are about 3.6%. If you look at the stock hedge costs, call it 160, 180. We got about a 2% margin built-in. But we just like to follow up a little bit on Fred's comments before to put this in context, because your focus appropriately so is on the large increase this quarter. When we went into this program, we presume the long-term average of hedge cost is somewhere between 2 and 3/4 of 3. So we were very clear when we got into the program, hedge costs were historically low, and that was about 60 bps back in '12. They kept traveling down to 20. So what we're seeing now is more of a normalization. We could never know exactly when or where this exact macro dynamics that would make hedge cost go up, but we always knew they would go up. So even though they're at 168 to 180 basis points today, that's about 50%, 60% of the way towards the long-term average. But then if you think about that long-term average, it would take quite a huge amount of growth in the United States for the federal reserve to raise interest rates so substantially to get to those numbers. It could happen someday, but we've got about a 2% margin to be precise on your question before we'd be saying, Jesus, it's a breakeven trade.

Thomas George Gallagher
Evercore ISI, Research Division

Got it. So really, this would have to cost you 350 to 400 basis points before it became breakeven?

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

That's right. And finally, I'll just, again, reiterate what Fred said earlier, that assumes were passive, and we do nothing. But again, we continue to look at asset allocation and changing the mix of the assets to set or match off against those hedge costs like the floating rate assets. We also look at the current composition of the portfolio, we may decide to lighten up on certain asset classes. And then, of course, there's the how do we look at the hedge strategy itself, which we continue to look at, and, as Fred has mentioned, continue to lend in duration. So if we just, we're passive. That's the answer. But we would expect to continue to manage that with a fine-toothed comb to preserve as much of that margin, whether it's through higher income or better hedge cost management. So that would be dynamic over time, certainly.

Thomas George Gallagher
Evercore ISI, Research Division

And Eric, when you compare that cost, is that the JGB yields? Is that the benchmark?

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

That's correct. That's the ultimate benchmark. So that's another great point. 3 or 4 years ago, 20 or 30 years in JGBs, were 2% when I got here. They traveled at 10 basis points a few months ago. Now they're at about 40 or 50. So it's all in relativity. And once again, the dollar program has limits, and we're actually pretty close to those limits. We have some capacity. And as Fred said, we'll talk more in the December outlook call about future purchases. But in context of a large global portfolio, we like the diversification because if all we were buying were yen assets and we've got quite a large amount every year maturing, private placements, old assets of 2% and 3%, our reinvestment -- net investment income would go down pretty rapidly as well. So it's a diversifier and it's a balancing act, but that's why we have limits on each part of our program.

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

Thank you very much. We're at the top of the hour right now. So before we end today, I want to take the opportunity to remind everybody, as Fred said -- mentioned earlier that we're going to have our 2017 outlook call that will be held later this year on December 2. So we want to make sure you mark your calendars for that event, on December 2. And for further details on the call, please feel free to call our Investor Rating Agency Relations department, and we look forward to speaking to all of you. And thank you for joining us today.

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