S&P Capital IQ

CONTENTS

Aflac Incorporated NYSE:AFL

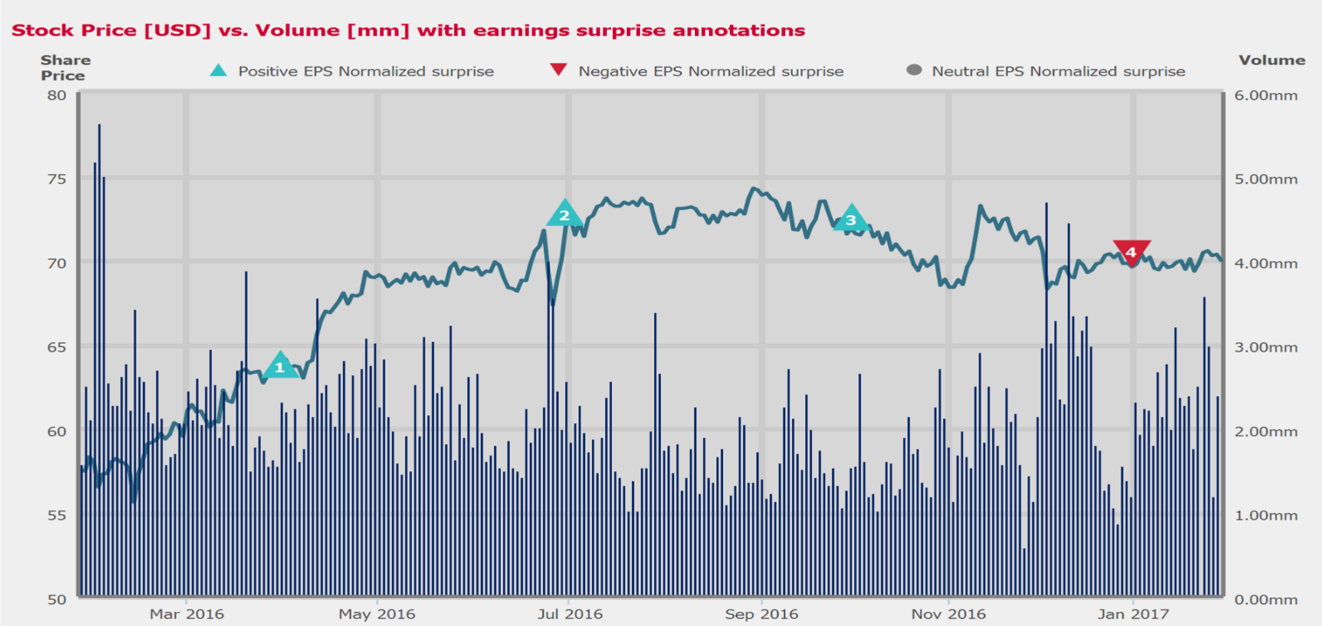
FQ1 2017 Earnings Call Transcripts

Friday, April 28, 2017 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2017-			-FQ2 2017-	-FY 2017-	-FY 2018-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.62	1.67	3.09	1.63	6.45	6.74
Revenue (mm)	5404.25	5309.00	(1.76 %)	5395.00	21685.50	21946.00

Currency: USD
Consensus as of Apr-28-2017 11:47 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ1 2016	1.63	1.73	6.14 %
FQ2 2016	1.68	1.71	1.79 %
FQ3 2016	1.74	1.82	4.60 %
FQ4 2016	1.63	1.54	(5.52 %)

Call Participants

EXECUTIVES

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Chairman & CEO

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

Eric M. Kirsch
Global Chief Investment Officer & Executive VP

Frederick J. Crawford
Executive VP & CFO

Masatoshi Koide
President & COO of Aflac Japan

Paul Shelby Amos
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Presentation

Operator

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

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

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

Thank you. Good morning, and welcome to our first quarter call. Joining me this morning from the U.S. are 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 are Hiroshi Yamauchi, President and COO of Aflac Japan; Masatoshi Koide, Deputy President of Aflac Japan; and Koji Ariyoshi, Executive Vice President and Director of Sales and Marketing.

Before we start, let me remind you that some statements in this teleconference are forward looking within the meaning of the federal securities laws. Although we believe these statements are reasonable, we can give no assurance that they will prove to be accurate because they are prospective in nature. Actual results could differ materially from those we discuss today. We encourage you to look at our annual report on Form 10-K for some of the various risk factors that could materially impact our results.

The earnings release is available on the Investors page of aflac.com and also includes reconciliations of certain non-GAAP measures.

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

Daniel P. Amos
Chairman & CEO

Thank you, David. Good morning, and thank you for joining us. Let me begin by saying that the first quarter of 2017 kicked off a good start to the year for Aflac.

I'll lead off by briefly highlighting 2 changes in the senior management you've probably heard about earlier this month. We welcome Max Broden to Aflac as Senior Vice President and Treasurer. We also announced earlier this week that Koide-san, Deputy President of Aflac Japan, will assume the role of President and Chief Operating Officer of Aflac Japan on July 1 as Yamauchi-san assumes the Vice President -- the Vice Chairman's role. Fred and Paul will comment more on this shortly, and you'll hear from Koide-san as well. We are excited to welcome them both into the new roles, and we look forward to their contributions to Aflac.

Now turning to the results and operations.

We are pleased with the company's overall performance for the first quarter. Our results are consistent with what we communicated on the December outlook call. From a segment perspective, I'll start with Aflac Japan, our largest earnings contributor.

Despite the persistent low interest rate environment, Aflac Japan generated solid financial results. In the interims, results on an operating basis were consistent with our expectations for the quarter. I'm also very pleased with Aflac Japan's better-than-expected third quarter sales increase of 7.6%. Production was solid across all channels, which further affirms our leading position in the third sector market.

Sales in the quarter benefited from the February 20 introduction of our revised EVER and gift products. Results also benefited from sales of our latest third sector product called Income Support Insurance. As you may recall, this product provides fixed benefit amounts should a policyholder be unable to work due to significant illness or injury. It was developed to supplement the disability coverage provided through Japan's social security system. Our Income Support Insurance targets consumers in their 20s through 40s, which is the segment of the population where we're underrepresented. Income Support Insurance has been favorably received, and we believe this product can potentially develop into a new product pillar over the long term.

Turning to the first sector savings product, you'll recall that we proactively pull products from the select channel and aggressively repriced our WAYS to child endowment products, factoring in the reality of a prolonged low interest rate environment. Aflac Japan continued to make notable progress limiting the sales of first sector savings products, reflecting a decrease of 81.3% in the quarter.

Regarding distribution channels, our traditional agencies have been and remain vital to our success. Our alliance partners have also made significant contributions to our sales results.

With such an extensive distribution network that includes Japan's Post 20,000-plus postal outlets selling our cancer insurance, we are furthering our goal to be where people want to buy insurance. As we look ahead, Aflac Japan's focus will remain on selling our third sector products, along with first sector protection products, both of which are less interest rate sensitive and have strong and stable margins.

We will continue to refine our existing product portfolio and introduce innovative, new third sector products to maintain our market leadership. As we've communicated, we view Aflac Japan's long-term compound growth rate in the third sector as being in a range of 4% to 6%.

Turning to our U.S. operations. We're pleased with the financial performance and continued strength in profitability. Our financial results on an operating basis are in line with our expectations, which is particularly notable in that they are reflected in ongoing investment in our platform. We began to see our platform pay off in the form of improved persistency and customer satisfaction. A whopping 95% of our policyholders who use One Day Pay say they are likely to refer people to Aflac, which will encourage us to continue to differentiate and reinforce our strong brand and policyholder trust.

Independent research continues to show there is no doubt American consumers need cash quickly, and paying claims fast and fairly sets us apart from the competition.

With respect to career agent activity, we continue to focus agents on groups with fewer than 100 employees. I believe this market is Aflac's to growth because our career sales agents are best positioned within the industry to reach and, therefore, succeed with these smaller employers.

We're also increased our career sales agents’ adoption of our Everwell employment -- I mean, enrollment platform, which, in turn, has increased our account -- penetration in our accounts with less than 100 workers.

In terms of our broker activity, our team of broker sales professionals has made great progress in successfully expanding Aflac's relationship with the large broker community. Based on the positive results we've seen in the large broker space, we're extending our broker sales team with new roles designed to focus on the mid-broker space.

While our sales increased 1.7% in the quarter, it's below our target of our long-term CAGR increase of 3% to 5%. We believe the strategy for growth we implemented in both career and broker sales is the right one. We also will continue to make tactical adjustments to meet our long-term growth objectives. I want to reiterate that we continue to target to have a long-term compound annual growth of 3% to 5% we provided on our December outlook call.

Turning to our capital deployment. Fred will provide more details shortly, but let me just say that we remain committed to maintaining strong capital ratios on behalf of the stakeholders. We continue to anticipate that we'll repurchase in the range of $1.3 billion to $1.5 billion of our shares in 2017 with the majority taking place in the first half of the year. As is always the case, this assumes that -- the stable capital conditions and the absence of any compelling alternatives.

As we shared last week, last year was the 34th consecutive year in which we increased cash dividends. Our objective remains to grow the dividend at a rate generally in line with the increase in the operating earnings per diluted share before the impact of foreign currency.

You've heard me say that my job is a balance between the interests of all stakeholders. Just as we've done a good job of that in the past, I believe we're going to do it again in 2017 by delivering on our promise to our policyholder and enhancing shareholder value.

I'll conclude by reiterating that I'm more excited today than I've ever been about the future of Aflac. And now I'll turn the program over to Fred. Fred?

Frederick J. Crawford
Executive VP & CFO

Thank you, Dan. Our earnings results for the first quarter were in line with our expectations and consistent with guidance provided on our December outlook call.

Operating EPS came in at $1.67 per diluted share. There were no items worthy of calling out in the quarter. However, there were a couple of items running through net income and outside our definition of operating earnings. We recorded a $14 million pretax charge associated with guarantee fund assessment on Penn Treaty or approximately $0.02 a share after tax, and we booked approximately $6 million in pretax costs associated with our Japan branch conversion. The conversion remains on track, and there is no change to our original guidance on conversion costs of $120 million to $130 million pretax through mid-2018. We anticipate conversion costs picking up pace in the second quarter, and we will continue to disclose them as part of our quarterly reporting.

Our Japan segment margins were solid in the quarter and reflect the inclusion of amortized hedge costs as part of investment income. As we have communicated -- or commented on over the past few years, premium weakness in the period was largely attributed to our first sector 5-pay WAYS product hitting paid-up status, which alone contributed to nearly JPY 10 billion decline in first sector premium in the quarter. As a reminder, while the paid-up product impacts revenue, we have booked a deferred profit liability that amortizes into earnings and serves to largely mitigate any bottom line impact.

Benefit and expense ratios in Japan were in line with our outlook call guidance. The decline in investment income reflects our fourth quarter switch trade, selling higher-yielding bonds and investing proceeds in JGBs as we build out our floating-rate portfolio with 2017 cash flows.

Hedge costs were up, as expected, over the 2016 quarter, and we have locked in over 90% of our anticipated costs in 2017. We are now on track to come in at the low end of our full year guidance range of $250 million to $270 million pretax.

Turning to U.S. segment. Dan noted improved persistency, up nearly 1% over the previous year's quarter and supporting a premium growth rate of 1.7%. Benefit ratios were solid, recognizing last year's performance was particularly favorable. Our expense ratio was at the high end of our guidance range and reflects progress on certain platform investments, including our group administrative platform and enrollment platform and related technology. Overall, our U.S. pretax profit margin of 19.7% is strong by historical standards and in line with our guidance.

Before commenting on capital, the first quarter was an active period of successful execution on our tactical investment strategy to build back net investment income after our 2016 switch trade and stabilizing near-term hedge costs. We announced an alliance with NXT Capital to build out our middle-market private debt portfolio. These assets have attractive yields and the floating-rate structure is an attractive asset to hold in our Japan dollar portfolio as they are efficient to hedge. Along with allocating NXT an initial $500 million portfolio, we invested $50 million in the equity of NXT Capital and look forward to developing a strategic partnership as we build this important asset class.

In addition, we lengthened the duration of our hedge program through purchasing $1.5 billion of long-dated, 5-year forwards and have now locked in nearly 50% of hedge costs for 2018. While hedge costs have risen over the past couple of years, a flattening of the cost curve and favorable market conditions offered us an opportunity to lock in future costs without pressuring 2017 net investment income.

These strategies are all steps in building out a 3-bucket portfolio approach to managing the U.S. dollar program in Japan. Those buckets include: First, unhedged dollar investments where capacity is guided by our view of the risk-adjusted economic value of our Japan branch and capital volatility; second, a disciplined approach to building out a short-duration, floating-rate loan portfolio, where LIBOR-based yields are correlated to hedge costs and are primarily hedged with short-dated forwards; finally, a diversified debt portfolio where we are actively extending the duration of our hedge instruments, reducing near-term exposure to rising hedge costs. Early execution on this strategy has reduced investment income in the short run but, once fully developed, will build back income with less volatility.

Our capital ratios remain very strong. SMR is estimated to be in the mid-900% range and RBC estimated in the 875% range at quarter-end. We ended the quarter with $1.7 billion of excess liquidity at the holding company, which includes $500 million of contingency capital.

Leverage remains at the low end of our policy range of 20% to 25%, consistent with securing our strong ratings. Overall credit conditions and asset quality remained strong with only a modest level of impairments in the quarter,

Including dividends and share repurchase, we returned approximately $773 million to our shareholders in the first quarter. We repurchased $600 million of stock in the first quarter and are on track to repurchase between $1.3 billion to $1.5 billion for the year. This again assumes repurchase as the optimal use of excess and deployable capital. Including our common dividend, we are reaffirming our guidance of deploying $2 billion to $2.2 billion to shareholders in 2017.

We announced a few weeks ago the launch of Aflac Corporate Ventures. We expect to invest approximately $100 million over the next few years in early-stage companies with focus across the insurance value chain, insurance and benefits digital innovation and customer experience. While a modest commitment of capital, we are already actively investing in select properties in the U.S. and Japan and expect our investments will generate solid returns and contribute to Aflac's future growth.

Finally, I want to reiterate our 2017 earnings guidance of $6.40 to $6.65 per share on a currency neutral basis. Looking ahead, we remain well-positioned in terms of core margins and capital strength, consistent with our December outlook call comments.

Before we hand the call back to David for Q&A, Paul and I want to comment briefly on 2 notable senior management announcements that Dan referenced earlier.

First, I want to welcome Max Broden to the team here at Aflac as our new Senior Vice President and Treasurer. Max is known to many of you in his previous position as Global Insurance Portfolio Manager for Norges Bank. Max brings great experience and perspective to Aflac in optimizing our capital allocation and deployment strategies to drive long-term value. Max is responsible for treasury, corporate finance, investor and rating agency relationships and partnering with Teresa and her team on U.S. corporate development opportunities.

I'll now hand off to Paul on our Japan leadership announcement. Paul?

Paul Shelby Amos
Former Director

Thank you, Fred, and good morning. As you're probably aware with my release earlier this week, we announced that Hiroshi Yamauchi, who currently serves Aflac Japan's President and Chief Operating Officer, will be assuming the role of Vice Chairman of Aflac Japan in July as he passes the torch of President and Chief Operating Officer of Aflac Japan to Masatoshi Koide. When someone has impacted the company as much as Yamauchi-san has impacted Aflac Japan starting in the first recruited class of college graduates 41 years ago when our Aflac Japan operation was in its infancy, it is astounding to consider the changes he has seen and the initiatives he's been a vital part of implementing. We will certainly continue to benefit from his support of Aflac Japan from a broader perspective as he assumes the role of Vice Chairman of Aflac Japan. This transition also highlights one of the many major strengths. And that is Yamauchi-san's leadership and his vision for succession planning. When he assumed the role as President of Aflac Japan 2 years ago, his main goal was to identify and prepare a successor. And that's exactly what he has done by identifying and preparing Koide-san to be President and Chief Operating Officer of Aflac Japan effective July 1.

Now let me turn the call over to Koide-san to make a few comments.

Masatoshi Koide
President & COO of Aflac Japan

Thank you, Paul.

I'm Masatoshi Koide. Effective July 1, I will assume the role of Aflac Japan's President and Chief Operating Officer. I would like to take a moment to introduce myself and talk a bit about how I plan to approach my role as Aflac Japan's President.

I started my professional career in the Japanese banking sector in 1984 and joined Aflac Japan in 1998. I first worked in investments and moved to legal and compliance. Since then, I have been working in various areas.

In recent years as Executive Vice President, I have been overseeing corporate planning and have worked with Dan, Paul, Charles and Yamauchi-san to design and develop Aflac Japan's business strategy. In addition, I support Paul as the Japan owner of the overall project to convert Aflac Japan to a subsidiary.

As Deputy President, I currently oversee all Aflac Japan divisions and serve as Yamauchi-san's deputy. In this context, I also have had the honor of leading the team that drafted Aflac Japan's long-term strategy, VISION 2024, which I presented at the Financial Analyst Meeting in Tokyo last September. VISION 2024 lays out the mid- to long-term direction for Aflac Japan by the end of 2024, which will mark its 50th anniversary. Against the backdrop of business environment change driven by a rapidly aging society and information technology innovation, Aflac Japan is committed to continuing to create new value and growth by adapting to and embracing change.

Aflac Japan is currently implementing its 3-year medium-term business plan and the VISION 2024. And from this July, it will be my responsibility as President to ensure these efforts produce sound results.

As Aflac Japan's President, I am determined to ensure that Aflac Japan continues to be the leading company that supports creating, leading in your own way. Thank you.

I will now turn the call back over to Paul.

Paul Shelby Amos
Former Director

Thank you, Koide-san.

I know Koide-san will continue to do an exceptional job in his new role as President and Chief Operating Officer. Koide-san shares Yamauchi-san's same dedication and work ethic. He's been a driving force in guiding our Japan branch conversion.

Now I'll turn the call back over to David, who will bring us to Q&A.

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

Thank you, Paul.
Now we are ready to take your questions.[Operator Instructions]

Question and Answer

Operator

[Operator Instructions] Our first question is coming from Nigel Dally with Morgan Stanley.

[Audio Gap]

Nigel Phillip Dally
Morgan Stanley, Research Division

Penn sales. Typically, in the past when you've introduced new product, sales of that product benefit, but it comes at the expense of lower sales of other products. That didn't seem to be the case this quarter. Medical sales benefited, but cancer [sort of] remained strong. So hoping to get a little color as to what was different this quarter.

Paul Shelby Amos
Former Director

Yes, this is Paul. I'll be more than happy to answer that, Nigel. The reality is, as we've talked to you about, 13 weeks of sales are sometimes difficult to predict. In this particular case, we felt like sales had the potential to be down for multiple reasons that we mentioned on the previous call, and one of those was that our key alliance partners, who primarily focus or solely focus on selling our cancer plan, we felt were going to focus on their own internal products more than they were focusing on selling Aflac products. For our benefit, that didn't solely turn out to be the case. We saw that many of our alliance partners continued to sell well, and our cancer line of business for that primary reason was propped up by those sales. In terms of our other products, as you may have seen, the income support product was down slightly sequentially from quarter-to-quarter. Part of that had to do with the increased focus in our agency channel and traditional channel on selling our new EVER plan. So we believe that the quarter results from a sales perspective exceeded our expectations. Sales of EVER launched more quickly than we anticipated. This was in part due to the launch of not only the traditional product but also an additional 2-pay and 5-pay version of the product, which has similar profit characteristics. But to the overall, that only added about an additional 2% of sales, up 5% versus up 7%. But overall, we felt that sales for the quarter did an exceptional job. Koji and his team performed across all channels, and we were very happy to see our alliance partners perform in the cancer line of business.

Operator

Our next question is coming from Jimmy Bhullar with JPMorgan.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

First, I just had a follow-up on just Japan sales. Has the growth in sales in 1Q affected your view for the rest of the year? And specifically, if you think about the new EVER product or the [revised] EVER that you launched in February, to what extent has it fully ramped up? Or do you expect that to happen in the second quarter and provide a lift of sales in the near term?

Paul Shelby Amos
Former Director

Jimmy, thanks so much for the question. The reality is that we are not ready to make any change to our sales thoughts in future so far. First quarter did, however, exceed our expectations, but it's difficult for us to tell over the remaining 3 quarters of the year how that will fare out. We are happy with where we stand in terms of the launch of EVER at this time, and we do believe that will be a boost to our second quarter. However, we had already been planning for it to be a strong boost for our second quarter. We didn't, however, expect it to sell so well in March. So the reality is as it's ramped up, we expect to do well. But I want to be cautious just because I believe that we have tough comparisons coming later in the year, and I don't -- I'm not yet ready to commit to any change in our guidance.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

Okay. And then on -- you had a fairly large derivative loss, I think around $90 million -- $92 million this quarter. Could you discuss what the drivers of that were?

Frederick J. Crawford
Executive VP & CFO

Yes, Jimmy, this is Fred. So there's a few things running through that number that really are somewhat noneconomic in nature. And that is, we have treasury swaps on our books, which do nothing more than swap dollar to yen. And those swaps are mark-to-market. There's a portion of the swap that's actually recorded through investment -- or, sorry, interest expense, as you would expect, but then there's a mark-to-market portion. And so as there's movements in the yen, you will sometimes have wide marks on those swaps. The second component is that we've been ramping up a commercial mortgage loan and middle-market loan portfolio in Japan, and we hedge those portfolios. But in the way the accounting works under GAAP, as you don't have the mark-to-market dynamic on those loans on our books, but you do mark the hedge instruments, and that separation in the treatment between the loan approach and the derivatives will create some noise. And so we had some losses related to that. Again, not economic as that's meant to be part of a long-term strategy. And then we also have some remeasurement that takes place. This is nothing more than U.S. dollar cash and related liquidity that's in Japan that gets remeasured, if you will, as U.S. dollar assets held in Japan. So that's really the noise running through that number. It will fluctuate from period to period. Sometimes, it will add to net income, sometimes take away. But largely, uneconomic in nature.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

And shouldn't really affect your free cash flow or dividend?

Frederick J. Crawford
Executive VP & CFO

That's right. That's right. That's essentially what I mean by economic. It's not having implications on free cash flow.

Operator

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

Humphrey Lee
Dowling & Partners Securities, LLC

Just to follow up on the hedging costs. So you mentioned that right now, you're looking at towards the low end of your guidance of $250 million for the full year of '17. So comparing these, the $52 million in the quarter, that seems to be still kind of below what the quarterly run rates would imply based on the low end. How should we think about the trajectory of the hedging costs in the -- for the balance of the year?

Frederick J. Crawford
Executive VP & CFO

Yes. So the -- you're right to point this out. We -- if you recall in the fourth quarter of last year, we recorded a little north of $60 million. Now in the first quarter, you're seeing that amortized level step back to $52 million. That's nothing more than really 2 basic components. One is, recall the switch trade that we executed on in roughly the November time period last year. That resulted in a move out of bonds, which were hedged, and into JGBs. And as a result of that, we brought the notional down pretty considerably. That was a USD 2.5 billion switch trade. So that brought the notional down. And so somewhat of what you're seeing in the first quarter is a natural ramping up then of the floating-rate portfolio, which is starting the process ramping up but won't pick up steam until we move into the second half of the year. So you're going to see a natural rise in the hedge costs throughout the year as we build out that portfolio.

Now realize, while that is taking place, you're also seeing a rise in net investment income as we put to work the money in the floating-rate investments. But that's how it will move forward. The other element of it that's worth noting is that we did actually proactively bring the hedge ratio down a bit. We currently run around the $22 billion market value U.S. dollar portfolio currently. And we have, as you know from our disclosures, not quite $11 billion of that hedged with forwards, about $10.7 billion. We brought that hedge ratio down a little bit, and we used the economics of bringing that down to execute on the $1.5 billion 5-year forwards that we purchased. So think of it this way. On the money we saved by bringing some of the hedge ratio down, we spent that economics to extend the duration of the hedge program. And it made sense from a risk management and market perspective. However, when we did buy those long-dated hedges, we got them at pretty good prices. Better than we thought because the market had cooperated on the long side. So we took advantage of it. So those things are actually favoring our hedge costs and allowing us to be comfortable with the low end of the range. But the buildup is more naturally going to take place as we build the portfolio.

Humphrey Lee
Dowling & Partners Securities, LLC

Okay. And then switching gears just a little bit. So there's some discussion about the change in mortality table in Japan. Can you talk about how that would in fact -- how that you would affect your in-force business and new product pricing and -- especially given my understanding that the change in the mortality table would suggest a higher pricing for the third sector products?

Frederick J. Crawford
Executive VP & CFO

Yes, I'll ask Todd to comment on developments on that front.

Todd Daniels

Yes, thanks, Fred. For the in-force business, the changed mortality table would not have an impact. But when you start selling new products, obviously that table would have to be reflected in your reserve assumptions. We would review the table relative to where we are with our current assumptions with pricing, but we don't have to reflect that table with the new premiums. But we will investigate it, and I think that's coming out April of 2018. So we have a little bit of time.

Humphrey Lee
Dowling & Partners Securities, LLC

Based on my conversations with some of other Japanese insurers, they talked about -- because of the competition in the marketplace, it will be difficult for them to pass through some of the required price increases to the marketplace. Do you get a sense that, that is kind of similar to what you're seeing over there?

Todd Daniels

I think we're still going to have to review the assumption relative to where we are with premiums and capital strain with those products. So hopefully, later in the year, we would be able to comment further on it.

Operator

Our next question is coming from Yaron Kinar with Deutsche Bank.

Yaron Joseph Kinar
Deutsche Bank AG, Research Division

I just want to go back a second to third sector sales in Japan. So the pressure from partnership sales did not really manifest itself as you had expected. Do you think it's something that could still pop up later in the year?

Paul Shelby Amos

Former Director

Well, as you may recall, Japan's fiscal year runs April through March. And so what we believed was that our partners were going to primarily focus on finishing the Japanese fiscal year with that transition. And they have obviously not finished -- they finished the year in a different way. I mean, they sold their internal product but also sold ours. We do believe that the sales of our 2-pay product helped add some benefit to the quarter and can -- could continue to do so going into the next quarter. But the reality is that as we go into the next Japan fiscal year, we've renegotiated, as we always do, with all of our partners, and we're hopeful and continue to believe that our alliance partnerships will continue to yield good results going into the next Japanese fiscal year, which began April 1.

Yaron Joseph Kinar
Deutsche Bank AG, Research Division

Got it. And then my follow-up question. I realize this framework is still a work in progress, but I think industry ESR levels actually came in quite a bit given the low rate environment in Japan. Can you maybe give us an update on where Aflac stands now?

Frederick J. Crawford
Executive VP & CFO

Yes, yes. Actually, what we've seen -- the last we commented on -- again, the economic solvency ratio -- is -- but we -- it goes by different names in Japan. But effectively, that ratio -- I was at our FAB meeting in Tokyo, and you might remember at that time -- I'm going to guess here, quite honestly. I don't have it in front of me, but 30-year JGBs were very low at that time. They had actually recovered a bit by the time we got to our conference, but they were still, I would say, certainly, I think, sub-50 basis points, if I recall right. Today, the 30-year JGB is upwards of north of 80 basis points. I mentioned the 30-year JGB because that has an awful lot of directional impact, if you will, on how to think about these economic ratios. At that time, I had mentioned being in the 160% range as a ratio which is quite strong. Today, given the rates having recovered a bit in Japan, we are pretty consistently recording a ratio in and around 200%, which is quite strong. I would note that the mix of our business tends to make us have a -- tends to yield a much better ratio than many that are more concentrated in first sector business. The other very important thing to remember, if you'll recall our comments at the conference, is that don't lose sight of the fact that that's also assuming an ultimate forward rate recovery that is put into -- it's really a long-dated recovery rate that's assumed in the formula, which contributes to it, but is believed to be the type of practice that would be eventually adopted. Now again, remember this is in testing phase. There are still -- it's still a bit unclear as to the preciseness of the calculation once adopted, if adopted, and the pattern or method of adoption. But we've been tracking it and we continue to be very healthy.

Operator

Our next question is coming from Ryan Krueger with KBW.

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

Fred, on the 50% of the hedge costs locked in for 2018, could you disclose at what level of cost in basis points that is in and then where forward hedge costs are running at this point?

Frederick J. Crawford
Executive VP & CFO

I'll thrust to Eric on the forward hedge costs. And I don't know, Eric, if you've got anything on the costs going out in '18. I would suspect it's approaching 190-ish basis points, in that range, maybe a bit north of that, but...

Eric M. Kirsch
Global Chief Investment Officer & Executive VP

Yes, it's a bit north of that because in '18, as Fred mentioned earlier, we executed on 5-year forwards. So when you think about the forward curve for hedge costs, those are higher going out 5 years than, say, 1-year hedge costs or 2-year hedge costs. But what I can share with you is based on that 50% locked-in, and so looking at forward markets for the other 50% estimates of our cash flow, we'd be running at about 224 basis points for next year. Again, that reflects no lengthening of duration, locking in a 5-year forward on those hedge costs.

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

Got it, okay. And then just a quick follow-up on the excess capital. I guess the $1.7 billion of excess liquidity at the holding company, how much of the U.S. excess capital has been up-streamed at this point?

Frederick J. Crawford
Executive VP & CFO

So we have not -- if what you're referring to is the excess capital that we would expect to unlock as part of our Japan branch conversion, we have not moved any significant portion of excess capital up to the holding company at this point. It would be a little premature to do that. We are, however, though, proactively moving what I would call excess cash flow or free cash flow generated on our U.S. property up to the holding company. But we have not necessarily started into the movement of the excess capital that we expect to create mid-2018 upon conversion. One other thing I would say about 2018 hedge costs that's worthy of note, too, is recall that we are ramping up a floating-rate portfolio as part of our strategy. And remember, that floating-rate portfolio will be largely hedged and largely hedged with very short-dated forwards, which, depending on the nature of the curve, should be less expensive. And so ultimately, we'll have a blended cost structure as we go into '18. But our forecast is for rising hedge costs, and until that changes, it's good to be certainly prudent on the estimate.

Operator

Our next question is coming from Erik Bass from Autonomous Research.

Erik Bass

I guess a question for Teresa. On the fourth quarter call, you outlined a number of initiatives to boost sales and address the areas of weakness from 2016. So I was just hoping you could provide an update on those. I mean, which are already starting to have an impact versus which ones will kick in later in the year?

Teresa Lynne White
President of Aflac US

Certainly. Thank you, Eric. In the fourth quarter, I talk a little bit about 4 areas. And those areas were: Career agent sales and specifically veteran engagement. We talked about the middle market, broker sales, sales leadership and then public sector. And so I'll just kind of go through each of those. From a career agent standpoint, we're seeing better-than-expected new associate conversion to producer, which is a positive underlying metric. We're also seeing better veteran engagement, and a lot of that, we believe, is due to some of the compensation strategies that we have at play. So we do see -- and actually, a large part of our increase for the first quarter was the veteran engagement piece of that. So we do see that working for us. Then we talked about, again, the broker sales side, and we specifically talked about the mid-market. We are hiring a 25% increase in our broker sales professionals. And as we do that, we've already hired about 50% of that number. And we've onboarded those folks and we're continuing our hiring up through the second quarter. And we really don't expect a positive result of that until the second half of the year. And so that -- but that's going well for us. And then on the public-sector side, we, I believe, talked about additional competition that we were seeing in the public-sector market. And we've also hired a department head over the public-sector arm of the business, and we have a large book of business, public sector. And so we're making sure that we protect that book of business, but we're also building out strategies that are tools and services for the public-sector market. And so that is well on its way as well and we expect to see results with that in the second half of the year as well.

Operator

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

Seth M. Weiss
BofA Merrill Lynch, Research Division

Just to follow up on Eric's question. It sounds like there'll be a lot of expense initiatives on the effort to turn around the U.S. sales channels that may yield sales in the back half of the year into 2018. How should we think about the expense ratio for the U.S. with regard to your guidance within this context here?

Frederick J. Crawford
Executive VP & CFO

Yes, I would say -- this is Fred. There will be, quarter-to-quarter, some ebb and flow in the pace of expense because these are projects that will naturally move around a bit. But our guidance remains the outlook call range on expense ratio of 34% to 35%. So we're running a bit high, as I mentioned in my comments, in the first quarter, but we would expect that to moderate as we go through the year. It's the first quarter. And so as we move through the year, we see some difference in that, we'll, of course, communicate that to all of you. But as it stands right now, our plans are for -- to be running in the -- essentially in the middle of that 34% to 35% range.

Operator

Our next question is coming from Suneet Kamath with Citi.

Suneet Laxman L. Kamath
Citigroup Inc, Research Division

I just wanted to circle back to the U.S. again. When you first entered the broker market in the large case side of the business, you ran into this channel complex with the career agents. So as you expand the broker market into the middle market, what are you doing differently to avoid any future channel conflict in that area of the business?

Teresa Lynne White
President of Aflac US

I think the primary -- and thanks for the question, Suneet. This is Teresa. The primary driver or the primary success measure for us is ensuring that in that market, if we have employers that have brokers, that we honor that and we work with the broker side. We have sales leadership -- our sales leadership, quite frankly, just I've been very impressed with because that leadership is working -- from the career side and the broker leadership side are working together to tackle this mid-market space. So the strategy that was put together, it's really put together by those leaders. And certainly, there are going to be -- still be conflicts, but those leaders are working to manage through that conflict. And a lot of the -- what we're really trying to do is we're trying to put compensation where we want each of those channels to play. And I think we're -- we've seen some success in doing that. And so we hope to see that same success in the middle market as well.

Suneet Laxman L. Kamath
Citigroup Inc, Research Division

Okay. And then, I guess, maybe a bigger-picture question for the U.S. I mean, you continue to target this 3% to 5% long-term sales growth. If you look over the past 5 years or so, I think you've only been there in that range once. So I guess at what point, do you think, you'll be able to get into that range on a sustainable basis?

Teresa Lynne White
President of Aflac US

Well, again, we actually are looking at this for the long term. We're continuing to progress toward that long-term 3% to 5%. And at this point, what we're doing is we're rebooting some of our strategies, we're assessing the underlying metric. And I do believe that we're actually seeing progress toward our longer-term goal. So we expect to continue to progress forward that long-term CAGR.

Daniel P. Amos
Chairman & CEO

I'd like to make a comment on that. I believe that the foundations that we're setting right now give us an opportunity, and we should be able to do that. Whether it's going to be -- when exactly, I'm not sure, but I know the new systems we're putting in is going to give us a big competitive advantage on the group insurance. And frankly, we've been evolving into that, as you know, over the years, and we're getting better at it. The broker strategy is beginning to work. Well, the challenge has been much like it was in Aflac Japan. As we have shifted from just being corporate agency driven in Japan to adding the alternative distribution system, is the corporate agency is what kept us afloat for many years. Well, our field force is still key to keeping it growing or at least flat while these new areas, specifically broker, are growing our business. And So that's been the challenge, but it's -- it gets closer uphill every year. And once it does, I think we'll see it take back off and do very well, and I'm encouraged with the things we're doing.

Operator

Our next question is coming from Tom Gallagher with Evercore.

Thomas George Gallagher
Evercore ISI, Research Division

Fred or Eric, I just wanted to make sure I understood what you guys said about the hedging costs and what that would imply, at least as an initial run rate of overall hedge costs for 2018, the 224 basis points. I'm just not sure what notional amount to compare that with because I know that's moved around a bit. Would that be -- can you give us a ballpark range? Is that going to be meaningfully above the $250 million to $275 million '17 run-rate hedge costs?

Frederick J. Crawford
Executive VP & CFO

A couple things I would say, Tom. One is, this sort of creeping into 2018 outlook comments around earnings and earnings' drivers is a bit premature. And so I would suggest to you that we would hold to refine those types of comments and guidance more specifically as we approach FAB in September and are able to outline it together with a strategy and, of course, the outlook call. So I don't want to front-run our traditional pattern of guidance. What we do plan to do, though, is build that U.S. dollar portfolio throughout the year. As I mentioned, we're running at about $22 billion now. That will build to approximately $25 billion at the end of the year. We're currently running at about a 50% hedge ratio using forwards only. Remember, we do use collars on the unhedged portion but just forwards, which drives the costs. We run around a 50% hedge ratio, so you would expect the notional decline throughout the year to approaching between $12 billion and $13 billion, and then you start applying your cost. But it's a little easy to move in -- it's a little early rather to move into forecasting hedge cost ranges next year. Also remember, we're disclosing this as part of our net investment income for a reason. And that is, don't just isolate hedge costs. Remember, in part they're building because we are proactively building out a floating-rate portfolio that has very attractive yields. So while we see some rising hedge costs, we're also building net investment income in the process, and you need to be mindful of that. But we'll provide greater detail as we start to move into really 2018 comments more broadly.

Thomas George Gallagher
Evercore ISI, Research Division

That's helpful perspective, Fred, because -- yes, so it sounds like it's going to be against this more notional amount. So it wouldn't -- if you just took the nominal increase in basis points, it would imply like a spike in hedge cost, but it sounds like there'll be some offset. I just wanted to understand directionally that point.

Frederick J. Crawford
Executive VP & CFO

Yes. It's really -- really the best answer is just it takes a holistic understanding of where you're going with the U.S. dollar portfolio and its mix, what is your hedge ratio philosophy and why. This is the 3 buckets we're talking about. And then, of course, execution, which includes the pricing and market pricing. And that's the type of color and backdrop that we'll provide when really, we start into the planning process around 2018 and can give more refinement, namely an outlook call and some strategic color at our FAB.

Thomas George Gallagher
Evercore ISI, Research Division

Okay. And then just a follow-up on the -- there were higher incurred claims in Japan during the quarter. If you look at the mix of how the benefit ratio played out, you had lower future policy benefit reserves being put up and you had higher incurred claims. Could -- was there a mix shift? Something going on there that you could explain?

Frederick J. Crawford
Executive VP & CFO

Let me just pause -- one thing before we answer that. Eric, did you -- you wanted to add something?

Eric M. Kirsch
Global Chief Investment Officer & Executive VP

Yes. I just wanted to emphasize as Fred has mentioned the 3 buckets and the build-out of the floating-rate portfolio. Keep in mind the strategic reason besides liking the asset class from a credit perspective: Floating-rate assets or short duration; their coupons float with LIBOR, which has a high correlation, not a perfect one, to hedge costs. So as this floating-rate portfolio grows, you guys will be able to see that the net margin -- so the net income, gross income from the floaters less the hedge costs, becomes much more stable in our net investment income. It won't be a perfect match quarter-to-quarter because the floaters may reset on different dates than the hedge costs, but that's the concept. So that's just important to note. So while notional could [jump] as a floating-rate builds, net investment income will go up. That was the exchange for the switch trade, build that back up, but it becomes much more stable in the future.

Frederick J. Crawford
Executive VP & CFO

And then, Tom, I'm going to turn to Todd. I know the interaction you're talking about there in the way of paid claims and an FBR on the P&L this quarter. So Todd, any color you are able to provide?

Todd Daniels

Yes, I'll give you a little bit of color on that. There's normal seasonality that happens in the first quarter in the benefits in Japan with extra lapses that happen around what I'll call retirement or leaving your employer that happens in -- at the end of March. So you have -- incurred claims are going to include your cash surrender value. And when we pay that cash surrender value, we typically release the reserve associated with that policy. So you would have a lower change in FPB for the quarter.

Thomas George Gallagher
Evercore ISI, Research Division

So really, it's just related to lapsation and releasing the reserve due to that?

Todd Daniels

That's correct.

Operator

We have one more in queue, and it is coming from John Nadel with Credit Suisse.

John Matthew Nadel
Crédit Suisse AG, Research Division

Maybe a question for Teresa. Just a little bit more follow-up on the U.S. I think you sort of hinted that veteran agents having a bit more of a -- a bit better production this quarter. Can you give us a sense when you break down the 1.5-or-so percent year-over-year growth in sales, where the real drivers were? I mean -- and we know it from a product perspective. It looks like the short-term disability product was the key driver. But can you help us understand which of the pieces of the distribution mix drove it?

Teresa Lynne White
President of Aflac US

Certainly. So the -- you're right, we benefited from higher-than-expected, short-term disability sales in Q1. But the other piece of this is Everwell adoption. We also benefited from higher Everwell adoption. And if you remember or recall, Everwell is our sole business solution, and we get higher policyholder participation rates with Everwell versus our SNG unit. So many of our [stayed-up] organizations have adjusted their training. They've engaged the veterans in training of the Everwell unit. And so we see a lot more of our adoption of Everwell. I think we had about -- around a 28% adoption of Everwell this quarter, and that was well above what we had anticipated that we would have. So the increased productivity of those veterans. We also had a couple of initiatives to specifically -- and these were compensation initiatives where we were driving veterans to go back into some of our existing accounts to offer additional product and services. And so we saw success with that initiative as well. So again, if I sum them up, it'd be veteran engagement and it'd be technology with our Everwell unit that increased our productivity.

John Matthew Nadel
Crédit Suisse AG, Research Division

And can you -- and maybe can you just touch on what you saw from the broker channel as well?

Teresa Lynne White
President of Aflac US

From the broker channel, we were relatively flat when you look at the mid-case market and the large case market, and we expected that. And we expected that. We expect to see a lot more from our broker side in the second half of the year.

John Matthew Nadel
Crédit Suisse AG, Research Division

And then, Fred, one last one just on the ratio of hedge-to-unhedged U.S. dollar investments out of the Japanese arm. How should we think about your risk limits there? And how -- I know you're not really leaving the other 50% unhedged, but how do we think about risk limits there?

Frederick J. Crawford
Executive VP & CFO

Yes, I think the way to think about it is for quite a long time, Aflac has always had a level of unhedged U.S. dollar portfolio, a long time. And it tended to be married up to the GAAP equity, if you will, that we have allocated to the Japan branch. And I want to recall that, that traveled, say, in the $7 billion to $8 billion territory, for example, perhaps a little less than that. But nevertheless, it was always in that category. So the idea of an unhedged portion, if you will, of the portfolio is frankly nothing new. Really what we're introducing is more what you're seeing from a number of companies that operate in Japan and go down this type of a portfolio strategy, which is becoming more common. And that is, particularly U.S. companies that have Japanese branches or subsidiaries, what is the economic value that's driven in that branch, the theory being that, that value over time comes back in dollar form. And so as a result, what really is an amount of unhedged that you can make an economic case for and a risk case for? And as is always the case with a company that's performing very well and are -- as we are in Japan, your economic value tends to be quite a bit north of what you may be holding in the way of GAAP book equity. And so it allows you to think more about a higher dollar amount that you can hold unhedged. Now, however, there are risk limitations to that, and the risks tend to be revolving around SMR volatility, potential FSA volatility. And you do, to some degree, depending on the collar structure, need to be thinking about carrying more capital against that type of a strategy. And so you have to think about a capital-adjusted value proposition of going more unhedged. So that's the way in which we think about it. There are some fairly good science and stress testing about what you can tolerate, but it's allowing us to drift up, if you will, in an amount unhedged but protecting the outer limits of movement through collars. Hopefully, that helps. But it's -- that's what I mean by an economic value-driven approach. But again, very importantly, it's a stressed economic value. Don't confuse it with what you might post or calculate. It's also got to be under stress conditions.

John Matthew Nadel
Crédit Suisse AG, Research Division

Understood. And then one last one. Since I'm last, I'll sneak one housekeeping item in. How much was repatriated during the quarter?

Frederick J. Crawford
Executive VP & CFO

I think we repatriated a bit north of JPY 30 billion, if I recall right. Let me see if I can get that number. I think I have it handy, but let me -- actually, I should be able to gather it if you give me a minute. I got it right here. JPY 31 billion year-to-date.

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

And operator, are there any other calls in queue?

Operator

I see no questions in queue at this time, sir.

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

Thank you. Well, for those of you that have questions after this call, please feel free to contact our Investor and Rating Agency Relations Department. We'll be happy to answer your questions and look forward to speaking with you then. Thank you.

Operator
That concludes today's conference. Thank you for your participation. You may disconnect at this time.