S&P Capital IQ

CONTENTS

Aflac Incorporated NYSE:AFL

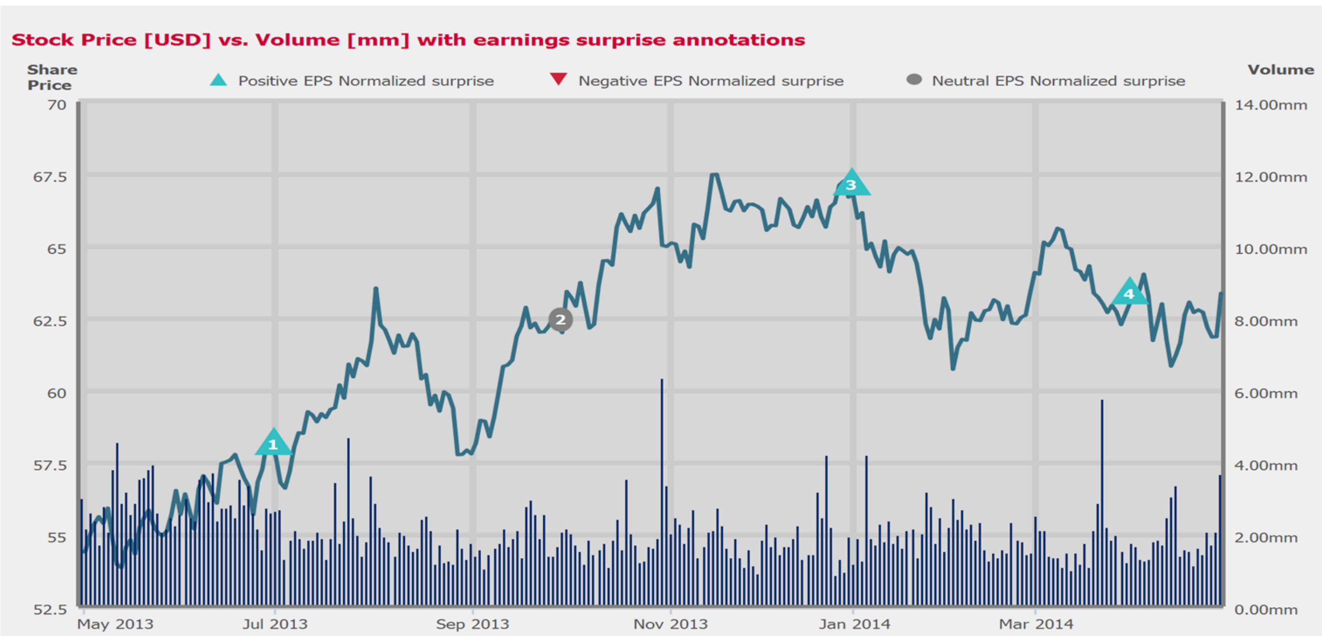
FQ2 2014 Earnings Call Transcripts

Wednesday, July 30, 2014 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2014-			-FQ3 2014-	-FY 2014-	-FY 2015-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.59	1.66	4.40	1.46	6.24	6.51
Revenue (mm)	5817.81	5838.00	0.35	5750.37	22947.86	23338.37

Currency: USD
Consensus as of Jul-30-2014 1:04 PM GMT



	- EPS NORMALIZED -		
	CONSENSUS	ACTUAL	SURPRISE
FQ2 2013	1.51	1.62	7.28 %
FQ3 2013	1.47	1.47	0.00 %
FQ4 2013	1.39	1.40	0.72 %
FQ1 2014	1.59	1.69	6.29 %

Call Participants

EXECUTIVES

Daniel P. Amos
Chairman & CEO

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

Kriss Cloninger
President & Director

Paul Shelby Amos
Former Director

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

Tohru Tonoike
Vice Chairman of Aflac Japan

ANALYSTS

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

Jay H. Gelb
Barclays PLC, Research Division

Randolph Binner
FBR Capital Markets & Co., Research Division

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

Thomas George Gallagher
Crédit Suisse AG, Research Division

Unknown Analyst

Yaron Joseph Kinar
Deutsche Bank AG, Research Division

Presentation

Operator

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

I would now like to turn the call over to Ms. Robin Wilkey, Senior Vice President of Aflac Investor and Rating Agency Relations.

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

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

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

Now I'll turn the program over to Dan, who will begin this morning with some comments about the quarter. Dan?

Daniel P. Amos
Chairman & CEO

Good morning, and thank you for joining us. I am very pleased that we met and, in many cases, exceeded our financial targets for the second quarter. Let me begin today with an update on Aflac Japan, our largest earnings contributor. For the quarter, pretax operating earnings in yen were up 2% on a reported basis and 0.8% on a currency-neutral basis. Our focus remains on growing the sales of the third sector products, which were up 4.5% for the quarter and in line with our annual sales target.

For the 6 months, third sector sales were up 3.2%. Sales of the first sector products declined 20.3% for the second quarter, which was down somewhat more than we had anticipated. Third sector sales grew sequentially over the first quarter, primarily reflecting an increase in cancer insurance sales from Japan Post. The number of postal outlets selling our cancer insurance rose from 1,500 to 2,980 in March 2014, and has remained at that level as of June 30, 2014. We were very pleased that at the end of June, Kampo, which is known as Japan Post Insurance Company, received FSA approval to sell Aflac's cancer insurance. Kampo began selling our cancer product last week through their 79 outlets that employ approximately 1,200 sales agents.

Another important aspect of our agreement is the sales education and training support that Kampo provides to post offices selling our products. This support, which includes sales practices in compliance, helps expand our reach to agents selling our products.

Looking ahead, we believe this alliance will further strengthen when we roll out the exclusive cancer product for Japan Post. Pending FSA approval, we anticipate introducing this new product later in the year. We remain encouraged with our growing partnership with Japan Post Holding, and we believe this alliance will gradually but steadily benefit our cancer insurance sales.

With respect to third sector sales, we have seen the contribution from traditional agency slowing down, and we've developed partnerships with new channels that help offset that decline. These channels include Japan Post, and we're making gradual but steady progress with advancing our sales through the postal outlets. However, the second half of the year will present us with difficult comparisons due to the medical product we introduced in August last year. Taking these factors into account, we anticipate third sector sales for the full year will trend toward the low end of our expectations of a 2% to 7% increase.

Now let me turn to the U.S. operations. In the second quarter, Aflac U.S. pretax earnings were up 5.7%. As anticipated, our second quarter sales results continued to be challenged, declining 8.2%. For the first half of the year, new sales were down 6.4%. You'll recall at our May analyst meeting, I told you that I was laser focused on a number of initiatives we are implementing to improve sales. We have spent a lot of time evaluating the market and our business model. We determined our sales model is not as effective as it was in the past and needs to be enhanced. As such, we're implementing tactical initiatives centered around better performance management and competitive compensation as it's more closely tied to our corporate goals.

These measures are designed to more effectively link sales management success to Aflac's success. First, we are enhancing compensation through an incentive bonus for our district sales coordinators, the first level of sales management who are primarily responsible for their own personal production and training new sales associates.

On July 1, district sales coordinators began receiving a bonus based on new sales written at small businesses for under 100. If it proves to be effective, which we expect it to be, we will use it again next year. We believe it's vital to ensure all levels of our sales hierarchy had the potential to earn the best compensation in the industry.

Second, we've made a decision to eliminate the commission-based position of the state sales coordinator. To better manage our state operations, we have introduced the new position of market director. Market directors will be salaried with the opportunity to earn sales-related bonuses. We believe this will enhance our performance management and better align their pay with the new business results.

This change will be effective on October 1 of this year. Further, we think this approach will allow us to more effectively and consistently manage the execution of the U.S. sales strategy over all state operations. This is especially critical given our strong brand, the rapidly changing marketplace and the expanding distribution that includes broker and career agents.

From a sales perspective, changes of this magnitude will be disruptive in the short run and take some time to gain traction. These changes are not without cost. We currently estimate that the quarterly cost related to these U.S. sales initiatives will be around $0.02 per diluted share beginning in the fourth quarter of 2014. We will finalize 2015 expense estimates for these initiatives in our budgeting process, and they will be reflected in the 2015 guidance that we will provide in October with the third quarter earnings release. And given these changes in the sales results in the first half of the year, we now expect 2014 sales to be down 4% to 8%.

Now I'll provide you an update on the consolidated financial performance. Operating earnings per diluted share, excluding currency, were strong, rising 4.3% for the quarter and 5.4% for the 6 months. I will remind you that at the second half of the year, we expect to see increased expenses on various initiatives in both the U.S. and Japan. As such, we currently expect that the 2014 operating earnings per diluted share on a currency-neutral basis will be up 3% to 4% for the full year.

On an operating basis, our second quarter annualized ROE was 21.3%. Based on our year-to-date financial results, we expect to meet our annual ROE target of 20% to 25% excluding the impact of currency. We remained committed to generating a strong capital ratios, both on the RBC and the SMR, on behalf of our policyholders and bondholders. Although we have not yet finalized our statutory financial statements, we estimate that our second quarter 2014 RBC ratio will exceed 800%. Additionally, we expect that Aflac Japan's estimated second quarter SMR will be above 800%.

You will recall that at our analyst meeting in May, we raised our proper repatriation estimate from JPY 100 billion to JPY 127 billion. By tomorrow, we will have repatriated JPY 131.4 billion. As such, we have the utmost confidence in this year's plan to repurchase $1 billion of our common stock. For the first half of this year, the company purchased more than 515 million of its shares. For 6 decades, Aflac has been delivering on the promise to be there for the policyholders when they need us most by paying claims fairly and promptly.

While I'm pleased with our financial results, I won't rest until sales are better reflected in Aflac's full potential.

So I'll now turn the program over to Robin. Robin?

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

Thank you, Dan. I'd like to go over some second quarter numbers this morning, starting with Aflac Japan.

Beginning with the currency impact for the quarter, the yen weakened against the dollar, 3.3%. In reference to top line in yen terms, revenue as was reported were up 0.7% for the quarter. Premium income declined 0.4% in the quarter. Reinsurance lowered premium income by 2%. Excluding the impact of currency, revenues were up 0.4%.

Excluding the weaker yen in the quarter on Aflac Japan's dollar-denominated investment income, net investment income rose 5.8%. In terms of quarterly operating ratios, the benefit ratio to total revenues declined over last year, going from 61.5 to 60.6 in the second quarter. Excluding the impact of the weaker yen, the benefit ratio for the quarter would have been 60.8%. Reinsurance had a 50-bps positive impact on the benefit ratio in the quarter.

Additionally, the benefit ratio improved in the quarter due to favorable claims experience in our cancer blog, as well as typical seasonality, which usually increases as the year progresses. The expense ratio increased in the quarter to 17.7%, up from 17.0% in the second quarter of 2013. The pretax profit margin increased during the quarter going from 21.5% to 21.7%. Excluding the impact of the yen, the pretax profit margin for the quarter would have been 21.5%. With the expansion in the margin, pretax earnings increased 2% in yen terms. And excluding the yen in the quarter, pretax earnings would have been 0.8%.

Now let me turn to Aflac U.S. Total revenues rose 1.3% in the quarter, and persistency was 76.4%, slightly up compared to 76.3% a year ago. And looking at its operating ratios, benefit ratio for the quarter was 41.1% compared to 49.1% a year ago. The operating expense ratio increased slightly, going from 31.4% to 31.6%. Pretax operating earnings increased 5.7% in the quarter.

Now turning to investment activity for the quarter. Let me start with Japan. Approximately 26% of the new cash flow was invested in JGBs at a weighted average of 1.32%. During the quarter, 74% or $1.5 billion of the new cash flow was invested in U.S. securities for a weighted average yield of 3.02%. As a result, total new money yield in Japan for the quarter was 2.58%, up 59 basis points from March 31 and down 44 basis points from a year ago. The portfolio yield was 2.85% at the end of June, down 1 basis point from March and 16 basis points lower than a year ago.

Turning to a few other items in the quarter. Noninsurance expense was $51 million compared to $48 million a year ago. Parent company and other expenses were $19 million compared to $18 million a year ago. On an operating basis, the corporate tax rate was 34.5% compared to 34.4% last year. As reported, operating earnings per diluted share were $1.66 compared to $1.62 a year ago. The weaker yen decreased the operating earnings by $0.03 per diluted share for the quarter. Excluding the yen's impact, operating earnings per diluted share would have increased 4.3%.

Lastly, let me comment on and reiterate some of the statements Dan has already made. We've tied our range for our 2014 objective and now expect a range of 3% to 4% increase in operating earnings per diluted share. For the third quarter, if the yen averages between 100 to 105, we would expect operating earnings to be in the range of $1.38 to $1.47 per diluted share. Using the same currency assumptions for the remainder of the year, we would expect to report operating EPS of $6.16 to $6.30 per diluted share for 2014.
Now we're ready to take your questions. [Operator Instructions] We'll now start with the first question. Carol?

Question and Answer

Operator

Randy Binner, FBR Capital Markets.

Randolph Binner
FBR Capital Markets & Co., Research Division

I wanted to ask a question kind of higher level about U.S. sales. I appreciate all the commentary on the various initiatives regarding mostly incentives for managers but other structural changes. But I guess my question is, you're not the only one who has seen maybe bumpy sales kind of in your segment of the supplemental health market in the U.S. And so is there something going on from a macro perspective from your perspective, meaning, the economy, how things are changing in certain regions you have? Or is it ObamaCare? What is it, from a macro perspective, that may be causing some of this headwind?

Daniel P. Amos
Chairman & CEO

Well, we spend a lot of time trying to analyze this, and I believe that it's our -- we've been doing business basically the same way for 50 years. Our structure is paid absolutely the same way. And what we've always said, the founders, if we're going back to my dad and others, was if the agent does well, everybody else up the structure does well. And it's gotten out of proportion to some degree. And we needed our districts to make more money, and we needed to make sure that everyone was aligned to where the company did well, the others. And I think that's our problem, and I think we've addressed that. I'm not so much worried at this particular time. I will say that there still is uncertainty with people trying to figure out, and there is no one just tearing the numbers up in terms of sales growth in our particular sector no matter what. But I think we can do much better, and I think focusing them on that will allow that. I'll just give you an idea. At our state level, one of the problems we had is when a person comes in and was taking over a state, they -- because it was an independent contractor status, they would take on such high expenses that it was hard for some people to ever take that position. Now we're going to pay everything, and our state sales coordinators will be the highest paid, or we're going to call them market directors now, will be the highest paid in the industry. And we don't have to worry anymore about anyone being able to take on the expenses. We're going to cover that. And over a 3-year period, it should break even for us, but that will make a big difference. It means not only can we hire internally, which is the way we want to do it, but we can hire externally. If there is someone else we want to talk to, we can talk to them. Whereas before, we couldn't talk to them because there was no way they could take on those expenses. They were in the hundreds of thousands of dollars. So I think it's positioned us correctly in the new environment we're in, and I'm very pleased with the attitude of our state people and their willingness to adapt. They get it, they understand that the company has to do well, and they have to do well. And I just believe long-term, this is going to be very effective for us. And I still believe that the market is huge and has great potential. But until everything goes into effect, there still is uncertainty in the marketplace as people look for it to happen.

Randolph Binner
FBR Capital Markets & Co., Research Division

Yes, and just, I guess, a follow-up there. So your answer is you think it's tactics, and that's very clear. But then does that mean that whatever this ObamaCare distraction has been, do you feel like you're -- are you through the worst of that, kind of are people getting more organized in how they approach that and maybe getting closer to make buying decisions?

Daniel P. Amos
Chairman & CEO

Well, every day, it's in the press about is this going to pass, or is that going to pass, or can they -- I've said all along that once it got put in, it was never going away that if there were -- you can argue any way you want, but the idea that it'll ever go away, I just don't think will happen because you've got to get a Republican President or you've got to get -- if you've got a Democratic President, you've got to get 60 people on the Senate side. And I just -- that is not something that can -- is likely to happen. So we'll just have to wait and see, but there is still uncertainty. As long as that's going on, we'll have to wait. But I think it is beginning to -- I think the worst is probably over, but there are still a lot of people that are waiting and seeing. Saying that is, I'm not going to use any of that as an excuse to why we shouldn't be up, and I expect us to be up.

Operator

Don Siegel [ph] from Sterne Agee.

Unknown Analyst

Maybe a couple of quick questions. One on Japan. And I guess, I'll phrase it this way. Dan, perhaps I'm reading too much into the commentary in the press release, and you talked about gradual this morning. But not long ago, you talked about the post-relationship in Kampo as a game changer and now it seems you're really tempering expectations there. Now we're looking at the full year third sector sales being maybe at the lower end of your outlook, but you already knew the back half of the year was going to be a tough comparison. So I guess, if you could help us understand what's changed there, that would be helpful.

Paul Shelby Amos
Former Director

This is Paul. I'll start, and then I'll let Toru chime in. Ultimately, we had hoped that the first half of the year would be slightly better than where it is today. And I'll let Toru talk about some of the reasons for that. When we gave you an update at FAB, we had data as late as the month of April that gave us better indications of some things that would have happened in the second quarter that we thought would produce overall better results. We do see Post is improving. The Post in the first quarter did not meet expectations, but in the second quarter, we saw them moving in the right direction, and we believe that will continue. But as Dan stated earlier, the headwinds that we face due to the launch of the medical plan in August last year will make the second half of the year substantially more difficult to overcome than the first half of the year.

Toru, do you want to chime in on the specifics around the corporate affiliated agencies?

Tohru Tonoike
Vice Chairman of Aflac Japan

Yes. For the -- I think on the quarter, our largest disappointment was observed by our large corporate affiliate agencies. And particularly, they are -- the sales of Post that employees to the -- our customer companies. So in April, typically, that they had that fully stationed to the new employees of our customer companies, which are very good. So that was -- the results of that kind of sales was in line with our expectations, more or less. But in May and in June, when our corporate affiliate agencies tried to solicit existing employees, the sales are less than we had -- or they had expected. That's where the largest disappointment came. In addition to that, we had some disappointment with the sales of the independent -- individual agents, and that impact is largely offset by the growth of our sales to that large non-exclusive agencies. So that's a reason why we have a lower -- our expectations for the year is somewhat changed. And Dan is quite right that Japan Post sales can be a game changer. But Japan Post is a huge organization, so it takes time to realize the entire potential of the channel. So the sales of the Japan Post is improving month-to-month or quarter-to-quarter, but still, it has not quite reached the full potential of the channel. So I think that's the overall situation on the Japan sales.

Daniel P. Amos
Chairman & CEO

But John [ph], I want to make one more comment about the game changer. It is a game changer. It is a game changer, and it was the only outlet that was left that could possibly be major and go against us in cancer insurance. When we nail that outlet down, that new distribution channel, and took it over and now control it, that was a major game changer for us. From a -- or a compensation or really, a production basis, it is going to be its game changer. I believe that, I still believe that, and I think the numbers will reflect that as we move forward. These numbers could be larger. Our job is not to predict what we hope it will be, but to be conservative. So I could have given a high -- we could have given a higher number, but I don't like to ever disappoint. I've said this before, and I'll say it again, we're not very good at predicting sales. Everybody else predicts revenues, but we would like to predict sales. It's 13 weeks and it's the best we know. But there is enormous variance in how they do that. And so I'll continue to monitor that, but I feel Japan Post is exactly where we want it to be right now. We were -- I didn't like the first quarter as much, but I do like second quarter, and I do like what July is looking like in going forward so I'm very pleased with that. So let me be clear on the phone if nothing else, Japan Post is a winner, and I'm thrilled with it. And Kampo and the rollout of the product is the unknown what will happen there, but they are committed and we are committed and I feel good. Now the individual or agencies and the corporate agencies are our challenge. We've seen consumers move away from writing business at the work site or buying at the work site. That's why we've done the shops. That's why we're doing other things. That's why we're adding these new channels because we do see consumers moving that direction. That's our challenge and what we have to find ways. It's not so many of the new employees, it's the old employees who have had the mail-outs for many times, and that's been going on for many years now. And we will continue to monitor that and work towards that.

Unknown Analyst

Okay. And I appreciate all those comments. And my follow-up question is sort of unrelated. I'm just curious, after you take this JPY 131 billion back to the U.S., or the remainder of it, I suppose, how do we think about the impact on a pro forma basis for your SMR ratio in Japan? How much did that come down? And then related to that is just the question, back half of the year expenses being higher, is that simply a matter of timing you are slower to spend in the first half? Or is there something truly incremental about those expense levels?

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

John, this is Ken. Let me start off, and Kriss may want to add something to this. First, on the SMR, the profit repatriation estimate or the number of JPY 131.4 billion is fully reflected in the SMR estimate of around 800% that we've announced.

Already reflected in there. As far as the expenses go, for Aflac Japan, we had expected to see their earnings more front-loaded this year in terms of our internal forecasting and modeling, and part of that is just related to the expected infrastructure expenses that we talked about last year with our third quarter release and our guidance. It's one of the headwinds, for instance. And then clearly, the restructuring of the state position from a mission-based position to a salary position, which starts in October, is something new, but also would result in higher expenses in the fourth quarter.

Unknown Analyst

Okay. So it's -- but aside from that $0.02 in 4Q, the rest of it's really just timing?

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

Yes. And I'd also point out, too, that we have benefited in the first half of the year from lower benefit ratios than we had in prior periods. If you look back historically, you'll see that generally, the second half benefit ratios for both Japan and the U.S. are higher than they are in the first half of the year. So we'd expect them to increase.

Operator

Yaron Kinar, Deutsche Bank.

Yaron Joseph Kinar

Deutsche Bank AG, Research Division

Ken, going back to your last comments on the immediate expense ramp-up in Japan. If I remember correctly, the CVEP program was supposed to be about $0.12 of a headwind this year. I think looking at the G&A in Japan today, we see about $0.01 maybe. So just wanted to get a better understanding of the ramp-up process, are you still expecting those $0.12 to fully materialize this year? And how much of a success that would end up being for this year's ability to maybe come out with products at a faster pace? I guess, I have 2 questions in here. One being the expense load and the ramp-up of the CVEP, and two, being has that impact on the ability to come out with products at a faster clip, which, I think, was also built into the sales expectation number for this year originally and that has since come down slightly?

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

Well, I'll let Paul address the second part because clearly, a shorter speed to -- a shorter time to market or a faster speed is something that we want to accomplish in Japan. That speaks to the kind of the nature of the long-term corporate value enhancement project, but we don't -- there's really no expected change in the emergence of those expenses related to our spending in Japan.

Paul Shelby Amos
Former Director

In terms of the ability to launch products quicker, that is one of the primary goals of CVEP. Currently, we are working on multiple different initiatives. One of those is the new business process. The new business process is the single largest element that we must work on in order to bring products to market faster. And so I feel like we prioritized correctly what we're doing there. It is going to take a period of time in order for that to come together, but I feel confident that we're trying to move things in the right direction. That said, as we continue to expand our channels and we continue to work with groups, like Toru mentioned, with the non-exclusive agencies, it's essential that we be able to simultaneously fix whatever we need to in order to compete in the marketplace today, while also focusing on what the long-term solutions will be for what Japan is as a market in the long-term, including cost efficiency to make sure we are maximizing our profit levels on our products.

Yaron Joseph Kinar
Deutsche Bank AG, Research Division

So I think, a little while back you talked about maybe coming out with another medical product in Japan this year. Is that still a possibility?

Paul Shelby Amos
Former Director

We've talked about an additional third sector product this year, that being the revision of our cancer plan, and we are currently working through the final details around that with the Japanese government and internally.

Operator

Steven Schwartz, Raymond James & Associates.

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

Just some follow-ups. Dan, the corporate affiliate agencies, that's been a problem forever and ever and ever, maybe there's nothing to be done there, but what can you do with the individual agencies?

Daniel P. Amos
Chairman & CEO

Well, I think that we continue to look at different aspects of the way they're operating and try to run more ads for them that we've done. We've done better training, but there is some -- we eat away a little bit by adding distribution channels to the situation. Like with the banks, it does impact individual sales to some degree when we do that. So it's been the new channels to me that would offset it more than anything else. But Toru, would you like to comment or make any -- have any comments, I should say?

Tohru Tonoike
Vice Chairman of Aflac Japan

Sure. Dan, you're right. So individual agents will continue to be the important part of our distribution channel. There is no question about that. However, there are some other channels which are growing faster than the individual agents. The biggest one of such growing channel is the large and nonexclusive agencies. So like Dan said, we are focusing more on our business with those large nonexclusive agencies, as well as other types of distributors, such as the Japan Post. So on a comparative basis, individual agents, we are now shifting away from the individual agents, but they will continue to be producing as much as they are doing now, I think.

Daniel P. Amos
Chairman & CEO

I think what I would say about it is it's a stable block, and we'll continue to grow it, but we're going to where the consumers are going. And the consumers are moving more toward other places, and we're trying to make sure that we're there for them to fill those needs. And that's very important and what we'll continue to do, but we do care about our individual agents. We do constantly focus on that. We have contest. We want to grow it, but that is not where we see the real growth channel going forward.

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

Okay. And I'll cede a little move to the U.S. as a follow-up. I get the market director to move from state sales coordinator to market director. I get that. I'm not getting the compensation to the DSCs. I mean, I get trying to incentivize them to go to the right accounts and what-have-you, but are you implying that these people don't make enough money? People who aren't out there selling?

Daniel P. Amos
Chairman & CEO

Well, what I believe is that we have more district sales coordinators than a lot of our competitors, and we need to focus on making sure that they are making the money we want with them to make. And I'd like to see them -- I'd like to have strong districts that are making good livings, and we promoted a lot of people. If they've got renewals, they make very high numbers. But when they're coming on, they need more front money, and so we're trying to concentrate on that and making sure that they are able to grow their business. What we've done over a period of time is we've made some adjustments by -- an example would be we might cut in a new level of management. And that would mean that we have cut the commissions back a little bit to take that into account. Now at that time, the districts were for it, we were for it, but you take a little bit away and take a little bit away here, it begins to hurt their income. So by adding this back, we're now getting them up to the level that they were in 2008 and, I think, ultimately, will benefit us. We've always said that the district levels are the key to our organization, that and the associates. And so trying to make sure they are high paid is very important to us, and we want to make sure that happen -- continues to happen going forward. And we think this submits that and allows us to really grow the business because they are the ones training the new people, and we've got to hire more new people. And that requires a lot of time and effort on their part, and they're going to be working harder, and so we want to pay them more for working hard.

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

So pay these guys more on their sales on like the same level of sales they can live and then go out and use the extra time to train?

Daniel P. Amos

Chairman & CEO

Well, they -- then let's be clear, almost every time they're selling, they're not selling by themselves; they're taking somebody with them. So they're splitting the commissions on what they're doing when they're out training a new person. So we're trying to make sure that they're better positioned, and frankly, this, I think, will put us in a position where we'll be able to hire more people at the district level and really grow the business long-term. But shifting some money to them is exactly what we need to do.

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

Okay. And then one more if I may, very quickly. California, I don't know if you all looked at this, but California, AB 1962, with regards to MLRs for dental, have you guys looked at that?

Daniel P. Amos
Chairman & CEO

I don't know anything about that now, but I'll find out and get back with you.

Operator

Jimmy Bhullar, JPMorgan.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

First on the changes that you're making in the U.S. You mentioned in the release, it's about a $0.02 expense per quarter in the fourth quarter. Should that actually stay about the same next year? Or would it, like, go up or go down? And then how long would it take for you to get a return on this? I'm assuming it's like a 1% to 2% headwind on earnings growth next year, but you could let me know if that's right or not. And then on the share buybacks, you -- obviously, your capital position is fairly strong. So just wondering, and you stayed with the $1 billion guidance, but just wondering why you did less in the second quarter than that would have -- than we would have expected given your billion-dollar guidance.

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

This is Ken. Regarding the expenses related to the change to the salaried position, we'll know a lot more in the next couple of months as we budget. Because of that amount, about half is related to the state operating expenses that Aflac will now be responsible for. In addition, it also includes the overhead that it will take to manage, in effect, 66 teleworkers around the country plus their whatever administrative staff. They have a secretary or admin that we also pull in on. And so we'll have to tighten down those expenses, but that's the best estimate right now. So we're layering on fixed costs. There's an expected offset with the reduction in variable costs because we'll now -- you should see total commission expense as a percentage of revenues decline going forward because we're not going to be paying out renewals for that level of the hierarchy any longer. So the more that we sell, the shorter the payback period in terms of that reduction in variable expense offsetting the fixed expense that we'll be putting on the income statement.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

But the true sense is sort of like the net of the higher fixed minus the variables. So it's more like an ongoing expense, at least, initially as opposed to a onetime-type expense?

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

Right. It is more. You'll see in year 2, meaning, the second 12 months, you see a larger offset because the state sales coordinator position will still be there. In effect, they're still earning commissions on business that they had written all the way up to September or will write all the way up to September 30 this year. So their drag is really greater in the first year than it would be in the second.

On your follow-up question on share repurchase, when we buy, we want to make sure that we're buying in a manner that we're acting as a responsible investor. We try and buy below the V [ph] web, which we did in the second quarter, and we've generally been able to do. We want to stay on track for the full year amount of $1 billion and try and be as opportunistic as we can. So really, it was just some judgment on our part based on market conditions, volumes, the way the stock was trading, so on and so forth. But we still, again, expect to be at the $1 billion mark for the full year. We'll have to see how that plays out between third and fourth quarter.

Operator

Jay Gelb, Barclays.

Jay H. Gelb
Barclays PLC, Research Division

I want to circle back on something that was mentioned earlier in the prepared remarks with regard to Japan Post. I believe it discussed rolling out the new Japan Post-specific policy. My sense was that was going to be done earlier. So can you give us some perspective on what's the delay there?

Daniel P. Amos
Chairman & CEO

[indiscernible] Toru?

Tohru Tonoike
Vice Chairman of Aflac Japan

The concept product designed specifically for the Japan Post -- our plan was -- I don't know if we had slowed the market that we were going to introduce that product earlier. So we are working on that. We are working exactly as we have been planning. So I don't seem to understand exactly what your question is?

Jay H. Gelb
Barclays PLC, Research Division

Sure. Well, my question is -- my understanding is it's a pretty simplified product. So I'm not sure what the delay is in terms of launching it, specifically within the Japan Post system.

Kriss Cloninger
President & Director

So this is Kriss. I'll just kick in. It -- so we have to get it approved by the FSA. We had a target date that pretty much the anniversary of the new agreement, which would be around October 1. We didn't anticipate implementing it prior to that time. So if you had the impression we were doing it earlier, it was somewhat inaccurate. But we are more or less on track with our original plan to get the JP-specific product in their hands, hopefully around the beginning of the fourth quarter.

Jay H. Gelb
Barclays PLC, Research Division

Okay. And then my follow-up question is on -- is also on Japan for the third sector growth outlook for 2015, 2016. At FAB, you discussed the range of 2% to 8%. And given that's been narrowed for 2014, I'd like to kind of see if you can update your confidence level on achieving that target for 2015, 2016.

Daniel P. Amos
Chairman & CEO

I think it's too early. What we don't know is the uncertainty of Japan Post, and specifically, how Kampo will do with the new product. At the end of the third quarter, we can probably shed a lot better light on that.

Paul Shelby Amos
Former Director

And I don't believe those were actually our sales projections. I believe those were data that was placed into Kriss' financial projections that he shared with you and clearly articulated at the time that they really aren't meant to be projections but meant to be ranges of assumptions that we would articulate. When we get to the end of this year, we will do as we typically do and give out our sales guidance for the coming year. And I feel like at that time, we'll be better able to give you forward-looking guidance.

Operator

Tom Gallagher, Crédit Suisse.

Thomas George Gallagher
Crédit Suisse AG, Research Division

I just wanted to ask a question about the change in the seasonality, the earnings pattern here. If I go back 3 or 4 years ago, you saw what was an emerging pattern of 4Q earnings would be lower based on what you guys have flagged as timing of higher expenditures in 4Q. And now you've definitely seen that's still into 3Q with -- it started happening last year, and it seems to be more pronounced now. So you're getting a very big delta between what you're earning in the first half of the year versus second half of the year. And you flagged some of the higher back half expenses so, and I get that, when you gave out guidance. But the order of magnitude here is a lot bigger than I would have guessed, looking at a 15% earnings drop sequentially that you've guided to. Can you peel back the onion a little bit and talk about how much of that is expenses, how much of that is benefit ratio change that we've seen on some of these newer products? And anything else you could elaborate on?

Kriss Cloninger
President & Director

Tom, Kriss. I'll try to address that. Yes, we have had lower earnings in the second half of the year than the first half and part of it's due to the reasons you identified. Sometimes we're cautious on our expense initiatives in the first half of the year. And as we move through the year and gained more certainty that we're going to be able to achieve our annual EPS guidance, then we kind of loosen the purse strings a bit and particularly in the marketing promotion area may have larger expenses. That's been true, gosh, for years now, not just last 3 or 4 years, maybe more recently in Japan. The other thing that has gone on traditionally, Tom, is that we -- now that we've had all the sock stuff in place for years and years, we've had to define the process of evaluating our claim reserve estimates and the like with the auditors, and we've got a particular process in place where we evaluate certain reserves in the third quarter and certain other reserves in the fourth quarter. And so the historic patterns reflected some reserve strengthening, for example, in closed blocks, like dementia, due to lower interest rates than anticipated in the reserve and the like. And we've had some reserve strengthening over time for that, that tends to occur to some extent in the third quarter, to some extent, in the fourth quarter. So that's been more a financial reporting seasonality than an actual benefit reserve seasonality. This past year, yes, we did reinsurance agreement in the fourth quarter. That actually improved benefit ratios in the fourth quarter relative to the third. We'll have the reporting of that reinsurance fully integrated into our benefit ratios by the end of the third quarter, and we'll get some improvement in the third quarter benefit ratio in 2014 compared to the third quarter 2013. Robin identified there was about 0.5 improvement in the benefit ratio in the second quarter this year and will be again in the third quarter. In the fourth quarter, that will be in the system. We'll have direct comparability so that improvement will go away. We do have some seasonality claim patterns that we reflect in the financial statement more today than we used to. We used to be able to smooth them out a little bit. And these days, the accountants are more sensitive to smoothing anything out. So we have to go more with the actual seasonality of things, and claims tend to be lower in the first part of the year as people, they tend to backload the business to the doctor in the actual claim processing, partly due to deductibles and the like, but partly just due to the holiday is another seasonal pattern. So that's a long answer to a pretty short question, but I focus more on the accuracy of the annual estimates. And we did because we exceeded our 6-month EPS increased x GN [ph] and exceeded our annual high end of the range, 5.4%. It was greater than our annual range of 2% to 5%. And because of some of the anticipated expense, as we've talked about earlier, we decided to tighten the range within the 2% to 5% going to 3% to 4%. So that's some of the rationale behind it.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Got it. That's helpful, Kriss. And so if I'm interpreting your answer correctly, this is a pattern that we will continue to see each year directionally much greater order of magnitude in terms of first half earnings and second half earnings, in part, normal higher expenditures, but also, the benefit ratio change being more directly reflective of claim payment patterns. Is that a fair way to put it?

Kriss Cloninger
President & Director

Yes, that's a fair way to put it. I do want to just say that I specifically mentioned dimension reserves. And we've had a couple of increases over the last couple of years, but right now, we don't anticipate doing that in the third and fourth quarter. We'll have to look at the interest assumptions behind the reserves, but with the stabilization of investment yields in the total portfolio and the like, we don't think we've got that kind of interest rate exposure we had in the past which led us some reserve increases. So that's a favorable thing.

Operator

Christopher Giovanni, Goldman Sachs.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

I guess, first one, just on in terms of medical sales. You clearly alluded to the tough comp in the back half of this year, but I wanted to think about the sustainability of the quarterly sales we've seen so far year-to-date.

Paul Shelby Amos
Former Director

Sustainability of quarterly sales?

Kriss Cloninger
President & Director

In medical.

Paul Shelby Amos
Former Director

We have seen, beginning last year, a very strong sales in our medical product. We anticipated that the medical sales would sustain slightly better growth in the first half of this year than we originally saw. That said, we still believe that the product continues to go in a strong manner. We're focused on the standard medical plan, not our Gentle EVER plan at this time, but we believe those products will continue to sell well in the coming quarters. That said, there -- it is a reality that competition continues to put out more and more new products all the time. And one of the things that we have to continue to do, one of the key reasons I mentioned earlier, our desire to be able to launch products in a quicker manner is the sustainability of the length of time that a product lasts in terms of the boost in new sales. So we are constantly monitoring that. We do believe we still have continued tailwinds with our medical plan for some period of time, but we continue to notice that amount of time that the new product is lasting is slightly less than it used to be.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

Okay. And then for Dan, sort of a silly question. But given your recognition that you won't be growing kind of at the pace you have in the past, the increased focus you have on capital generation, returning capital to shareholders, I guess, why have -- continue to have such an emphasis or heavy emphasis on publicly stated goals around sales targets?

Daniel P. Amos
Chairman & CEO

Because we are a sales company, and I expect sales to grow. And there, I believe it sets a trend for us to what ultimately earnings are going to be and persistencies in that number and other elements. But I want to -- I believe that, ultimately, when the agent does well, everybody else will do well, and that's what we've got to see happen here. And I am committed to fixing this in the U.S. and believe we'll be able to do it. I put my reputation on the line of trying to fix this, and that's what I get paid the big bucks to do is to fix things. And I understand that's the way it works. And I'm willing to go out on a limb and tell you, and I expect third quarter sales to be down, but I want to see an upward movement in that fourth quarter. And I know that's quick and knowing how hard it is to make changes sometimes, but that's where I'm focused, and that's what I'm going to continue to do.

Kriss Cloninger
President & Director

This is Kriss. I pushed Dan a bit, saying, look, we got to have the revenues to build a house, the house of earnings, and we've done well at building earnings over the period. And sales are an important part of the earnings for Aflac U.S. The premium income for Aflac U.S. is probably at least 25% first year and about 75% renewal. In Japan, it's not as big. It's a little less than 10% first year premium, 90% to 92% renewal. But I need that growth in first year premium to help grow the revenues overall if we're going to get earnings growth. So that's why it's important to keep getting new sales and to keep pushing on new sales estimates and the like to achieve our overall financial objectives, which include growth in earnings per share.

Operator

Blan [ph] Smith, Doshi [ph] Capital.

Unknown Analyst

So if my recollection is correct, my understanding of the state sales coordinators has been that they are the ones that have the largest historical enforce book and that they're earning most of their money on the commissions that they're getting from that, and those aren't going away. However, if those state sales coordinators do not choose to take on the new position of market director, what is the outlook for those books of business? And is there the potential for them to move those to some other carrier if, in fact, they move to a different company as a rep?

Daniel P. Amos
Chairman & CEO

First of all, it is not -- their book of business is based on the people that work for our company. I was a state sales coordinator for 10 years, so I understand it totally, and no, you can't move it that easily. So that won't happen. The other thing is we have not had a single state sales coordinator not go for this new program. It's going to be the highest paid in the industry. They like it. There is a wonderful retirement, where for your salary, we put up equal amount for retirement. So they like it very much. But they will become more of a manager than just a sales manager. They'll look at profits. They'll look at all aspects. So I am very pleased with -- we had them signed confidentiality agreements and we introduced it a week ago. And to just them in 6 locations, we had them at the exact same time, took away all cell phones, everything, and we are very pleased because we're pleased of what we offer them. This is a great deal for them. It is a great deal for the company because we now can be a united front. We don't have 50 independent people running state organizations or, in this case, 65 going different directions. We will unite with the strongest brand that's out there in the insurance industry and be able to push forward with what I believe will ultimately drive our sales. Now again, I warn you the third quarter, but the fourth quarter and going forward, I am -- been in sales, it's in my blood, and I just think we can do this. So we'll wait and see, but that's the way I will look at it now.

Unknown Analyst

Okay, okay. Dan, just as a follow-up real quick. So the fourth quarter, you're looking for an uptick. Is this something that you think is -- I mean, this is not like a major change that would be disruptive for an extended period of time. Is that what you're suggesting that people are on board, that now they're going to be directed towards what the overall objective of the company is, which is to bring in the sales of the core small business employer for some of these agents that are not going after the large cases, et cetera? So you think that this is something that can get implemented and it could be back to business as usual by fourth quarter and we should start to see some improvement then?

Daniel P. Amos
Chairman & CEO

Well, one reason I'm optimistic about an uptick in the fourth quarter was that it was such a rotten fourth quarter last year. So I didn't like our sales last year. So that's the reason that I'm encouraged about that. I don't want to be too optimistic in terms of it not being somewhat disruptive. Remember, all these people are used to being independent contractors. So it's a change of the way they've operated, but we think that we can mold the way we're going to do it in a way that they're going to like it, and it will be less disruptive for them. But anytime you change jobs, and this is a change in job, there is some disruption. But I think the districts making higher money in between is going to help offset the disruption because here, these districts are, as we're announcing this, making more money, so they need to be out there selling because we've only guaranteed it through the end of the year, although I hope we'll possibly continue it if it works. So while we've got this disruption at the state level, we've got this enormous positive thing happen at the district level, which I think will help drive sales. So that's why I'm encouraged. But look, I'm an eternal optimist when it comes to sales. I don't want to overstep it. But as I've said, I will be very disappointed if I don't see an uptick in the fourth quarter. And then going forward, I expect to see improvements.

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

Carol, I think we're out of time. If anybody wants to follow up with more questions, I and my colleagues will be available in Investor Relations, and thank you for joining us today. Goodbye.

Operator
It does conclude our conference for today. All participants may disconnect at this time. Thank you.