S&P Capital IQ

CONTENTS

Aflac Incorporated NYSE:AFL

FQ1 2016 Earnings Call Transcripts

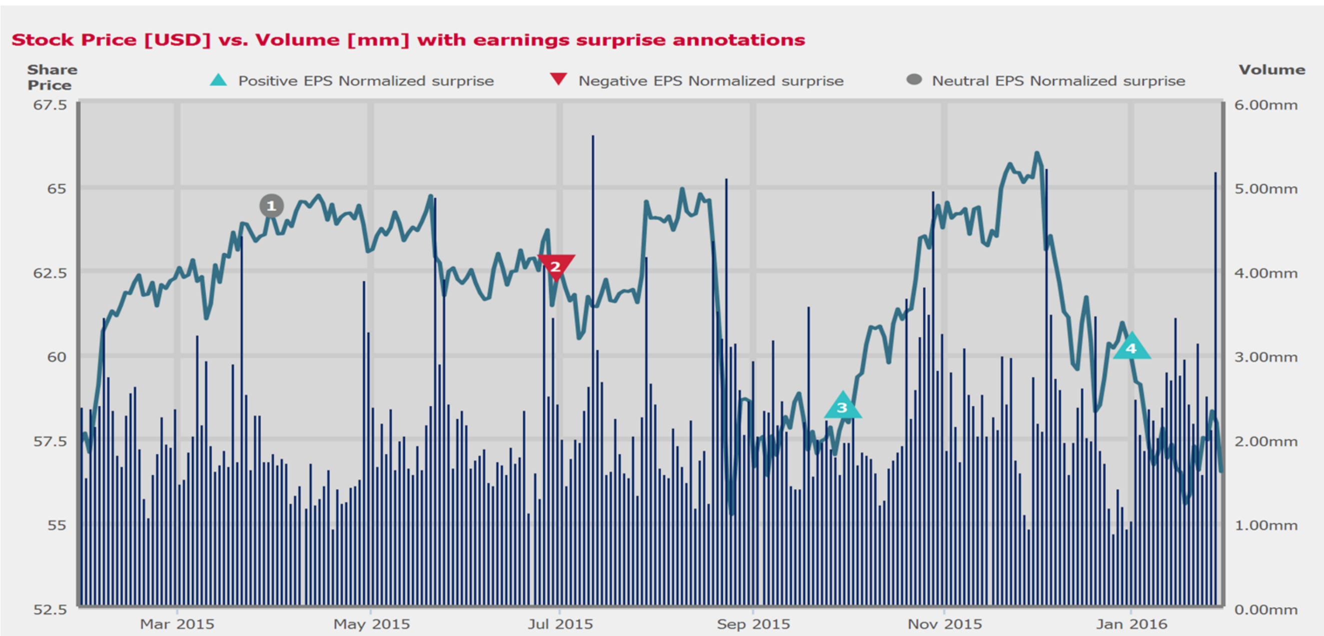
Wednesday, April 27, 2016 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2016-			-FQ2 2016-	-FY 2016-	-FY 2017-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.63	1.73	▲6.14	1.65	6.55	6.91
Revenue (mm)	5287.72	5451.00	▲3.09	5375.10	21553.92	22147.56

Currency: USD

Consensus as of Apr-27-2016 1:04 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ1 2015	1.54	1.54	0.00 %
FQ2 2015	1.52	1.50	(1.32 %)
FQ3 2015	1.48	1.56	5.41 %
FQ4 2015	1.48	1.56	5.41 %

Call Participants

EXECUTIVES

Daniel P. Amos
Chairman & CEO

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

Frederick J. Crawford
Executive VP & CFO

Kriss Cloninger
President & Director

Paul Shelby Amos
Former Director

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

ANALYSTS

Eric Noel Berg
RBC Capital Markets, LLC, Research Division

Erik James Bass
Citigroup Inc, Research Division

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

Nigel Phillip Dally
Morgan Stanley, Research Division

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

Sean Robert Dargan
Macquarie Research

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

Suneet Laxman L. Kamath
UBS Investment Bank, Research Division

Yaron Joseph Kinar
Deutsche Bank AG, Research Division

Presentation

Operator

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

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

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

Good morning, and welcome to our first quarter 2016 call. Joining me this morning in the U.S. is Dan Amos, Chairman and CEO; Kriss Cloninger, President of Aflac Incorporated; Paul Amos, President of Aflac; Fred Crawford, Executive Vice President and CFO of Aflac Incorporated; Teresa White, President of Aflac U.S.; and Eric Kirsch, Executive Vice President and Global Chief Investment Officer. Joining us from Tokyo is Hiroshi Yamauchi, President and COO of Aflac Japan; and Koji Ariyoshi, Executive Vice President and Director of Sales and Marketing.

Before we start, let me remind you that some 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 are prospective in nature. Actual results could differ materially from those we discuss today. We encourage you to look at our quarterly release for some of the various risk factors that can materially impact our results.

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

Daniel P. Amos
Chairman & CEO

Thanks, Robin. Good morning, and thank you for joining us. Let me begin by saying that the first quarter of 2016 was a great start for Aflac.

Let me first provide an update on Aflac Japan, our largest earnings contributor. You will recall that the last quarter that we anticipated sales of third sector products would be down mid-single digits for the full year, following very strong production results in 2015, and that is still the case. However, sales of Aflac Japan's third sector products were up 1% for the quarter, which means we're running ahead of expectations for the third quarter sales.

No one aspect of our business is contributing to the outperformance. It's simply stronger-than-expected productivity across all key distribution channels. We continue to believe the long-term compound annual growth of third sector products will be in the range of 4% to 6%.

Consistent with our expectation, sales of first sector products were elevated in the quarter. As discussed on our fourth quarter conference call, steps to control the sale of first sector products are being taken, and we continue to implement various substantial actions later in the second quarter. These include a combination of production caps, commission restructuring, product repricing and, in select cases, product discontinuance.

As a result of these planned actions, we anticipate seeing at least a 50% decline in first sector product sales, namely, WAYS and child endowment, in the second half of 2016 compared to the second half of 2015. Managing through the low interest rate environment is nothing new to Aflac Japan. Paul and the team from Aflac Japan are going to cover this in more details next month at our Financial Analyst Briefing.

From a product perspective, we work hard to remain in step with the wants and needs of the Japanese consumer in our distribution channels. In doing so, we continually enhance our portfolio of products. This quarter, we introduced a cancer insurance product designed for those who have previously been diagnosed with cancer and been cancer-free for 5 years just as we do in the United States as well as an enhanced nonstandard medical insurance product. We will continue to be innovative in our providing options that millions of Japanese consumers are looking for as they struggle to bear the financial burden of higher medical expenses.

From a distribution perspective, our traditional agencies have been and remain valuable contributors to our success, and this was certainly true in the first quarter. Additionally, all of our alliance partners continue to produce strong results, and I am especially pleased with Japan Post and their 20,000-plus postal outlets selling our cancer insurance. Our goal remains to be where the people want to buy, and our various distribution outlets broaden our reach.

Turning to Aflac U.S. You'll recall that 2015 was the year of building out our business through our carrier and broker distribution channels. In doing so, we established the foundation for greater long-term growth opportunities. We see 2016 as the year of stabilization and growth and continue to execute on our strategies.

With Aflac generating new annualized premium sales of 3.7%, we're off to a good start toward our expectation of a 3% to 5% sales growth for the U.S. in 2016. I do want to again emphasize that we anticipate our sales will be increasingly concentrated toward the end of the fourth quarter. But what we achieved prior to that time lays the groundwork for our ultimate success.

As you all well know, success and opportunity breeds competition. That, combined with a clear need for voluntary products, has resulted in a number of other companies entering the voluntary supplemental insurance market. These have included insurance carriers who sell voluntary insurance as well as companies involved in various aspects of the health care management. As a result, we are executing on strategies designed to increase Aflac's importance to the employer and employees in an effort to drive further growth and penetration in our core supplemental voluntary products.

But keep in mind, Aflac's singular focus on supplemental voluntary products has greatly contributed to our dominant position in the worksite insurance industry, and I believe we will continue to drive us in a competitive edge. Teresa will cover this in more detail at the financial analyst briefing.

One Day Pay also remains a key differentiator for Aflac. We will continue to promote One Day Pay to consumers, which we believe will help drive increased brand loyalty and account penetration.

Here is an amazing statistic. In 2015 and continuing through the first quarter, 100% of the eligible One Day Pay claims submitted were paid within 1 day. I think that we will process more than 2 million One Day Pay claims in 2016. Independent research continues to show that there is no doubt that American consumers need cash quickly, and paying clients flat up fast and fairly sets us apart from the competition and, I believe, will really drive our sales.

Turning to capital deployment. Fred will provide more details shortly, but let me just say that we continue to view growing the cash dividend and purchasing our shares as the most attractive means for deploying capital, particularly in the absence of compelling alternatives. Despite recent market volatility, our capital position remains strong and reinforces our plan of repurchasing $1.4 billion of shares, with the majority concentrated in the first half of the year.

I'll conclude by reiterating that I've been in this business now more than 40 years, and I'm more excited today than I've ever been because the future is so bright at Aflac.

Now let me turn it over to Fred for our financial results. Fred?

Frederick J. Crawford
Executive VP & CFO

Thank you, Dan. You've all had a chance to review the details of our earnings release. As Dan noted in his comments, our first quarter results certainly gave us a great start to the year and achieving our 2016 earning guidance.

Our results were driven by strong overall margins in both the U.S. and Japan. The only notable item in the quarter was an unfavorable expense item running through our corporate line of approximately $8 million after tax or $0.02 per share. This item represents an acceleration of stock compensation expense in order to properly reflect our guidelines for retirement-eligible employees. We would not expect this portion of the expense to repeat in future quarters, and the expense itself is largely a timing issue.

Our Japan segment margins were solid in the quarter with continued strength in benefit ratios. Routine adjustments to reserves contributed modestly to the performance in the period and reflect favorable claims trends. Our expense ratio came in as expected and generally in line with our outlook called guidance.

In the U.S., benefit ratios were considerably better than last year's quarter but fairly consistent with our seasonal expectation for a strong first quarter. Benefit ratios tend to be lower early in the year as policyholders manage deductibles and are less likely to experience routine injuries that come with outdoor activity. Lapse rates also tend to be modestly elevated in the first quarter, which has the effect of driving the benefit ratio down and DAC amortization higher. Our overall expense ratio in the U.S. was in line with our expectations as general expenses were down, offset by elevated DAC amortization.

In Japan and the U.S., we would expect both our benefit and expense ratios to trend within our December outlook called guidance ranges as we move into the second quarter and for the remainder of the year.

Turning to investments. New money rates in Japan were influenced by the prebind of our annual budget of JGBs, which served to depress our purchase yields relative to our full year expectation. This tactical strategy was critical in that we purchased the majority of our JGB budget prior to the BOJ's action, allowing us time to fully implement measures intended to curb the sale of certain first sector products while defending profitability.

As we move forward, navigating the rate environment in Japan will involve allocations to long-dated JGBs, which, while low yielding, provide certain ALM and capital benefits. We will continue our work to develop alternative yen investments and support our hedged dollar program.

U.S. new money rates were influenced by the continued buildout of our strategic asset allocation and were modestly elevated relative to our full year expectations due to a concentration of purchases in higher-yielding middle-market loans. We continue our efforts to build a position in diversified asset classes, helping to support higher long-term returns.

Let me comment for a moment on hedge costs and know that I'll go into some more detail on strategy at our Financial Analyst Briefing in May. We have experienced an increase in hedge costs as compared to last year. This is not only market-driven but somewhat the result of our tactical efforts to extend the average duration of the forwards backing the dollar program. As you know from our previous comments, the rise in hedge costs was fully expected as recent years have experienced abnormally low costs relative to historic norms.

As indicated in our press release, we recorded $29 million after tax or $0.07 a share in hedge costs for the quarter. We record the full cost of forwards upfront in the quarter purchased. Thus, the timing of what is rolling on and off the program can make a difference in any 1 quarter. We have approximately $13 billion of dollar bond program hedged with forwards at an estimated full year average pretax cost of roughly 110 basis points.

While early in the year and recognizing the accounting treatment, the 110 basis point range is a practical pretax estimate for our full year cost expectations on our existing portfolio, this assuming no material change in our hedging strategy or market movements.

Our capital and liquidity position remain strong. We have only estimates on SMR and RBC at this time but expect both to remain strong and generally consistent with recent periods despite a return to volatility in the quarter. Impairments in the quarter were modest, and prices in our energy portfolio have recovered somewhat after a volatile January and February.

Between dividends and repurchase, we returned $773 million to our shareholders in the quarter. Depending on overall capital conditions, we expect to repatriate 80% to 100% of FSA earnings in 2016 or roughly JPY 120 billion to JPY 150 billion. We continue to spend down excess capital held at the holding company, in part driven by repatriation of 2015 reinsurance proceeds, and are on pace to achieve our $1 billion share repurchase target for the first half of 2016 and $1.4 billion in repurchase for the full year.

Our business model is resilient to market volatility, and our overall cost of capital continues to decline in contrast to industry players with more exposed business models. We have made no adjustments to our earnings guidance of $6.17 to $6.41 per share assuming the same average exchange rate as last year, which was roughly JPY 121 million to the dollar. Given strength in the yen during the quarter, we have provided in our press release an EPS range for the second quarter assuming a yen to dollar of JPY 105 to JPY 115. While important to recognize exchange rates with respect to cash flows and capital ratios, we focus on EPS progress on a currency-neutral basis.

We believe our performance in the quarter certainly bodes well for 2016.

Thank you. And I'll now turn the call back to Robin to begin our Q&A session. Robin?

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

Thank you, Fred. Before we begin Q&A, I wanted to remind everyone of our upcoming Financial Analyst Briefing meeting to be held in New York on May 25. Additionally, we'll have our mini FAB meeting in Tokyo, September 12. We all hope to see you there.
Now we're ready to start taking questions. [Operator Instructions] We're now ready to begin.

Question and Answer

Operator

[Operator Instructions] Speakers, we have a question coming from the line of Erik Bass of Citigroup.

Erik James Bass
Citigroup Inc, Research Division

I guess how does the year-to-date strength in the yen, coupled with the BOJ's focus on weakening the currency, influence your thinking around repatriating capital from Japan or hedging future repatriation?

Frederick J. Crawford
Executive VP & CFO

Sure, Erik. Thanks. It's Fred. There's a couple of components to be mindful of in a strengthening yen. One is because we, of course, have a dollar program where we're generating dollar-based income from an investment perspective, on a cash basis, you're needing to convert that dollar back into yen, and as it converts, it will actually be a headwind to FSA earnings. And so when it comes to looking at repatriation, for example, just FSA earnings themselves will typically see some modest headwind related to yen strengthening. Now you couple that also, however, with looking at the overall condition in your SMR ratio and what's happening in capital conditions. And as I mentioned in my comments, we continue to have stability in our SMR ratio, meaning that exchange rates aside, the spread gap -- gap in spreads and lower interest rates have actually provided a little bit of a modest lift to SMR ratio. So when you combine those 2, the capital conditions by SMR and looking at any pressure to FSA earnings, I would expect to hold steady on our repatriation efforts. Now the other end of your question is a good one, and that is, well, don't you have an opportunity to then convert that yen back into more dollars in the U.S. through your hedging of repatriation activity? And the answer is yes, but there's a lagging effect. And the reason there's a lagging effect is because our strategy on hedging repatriated yen is to really roll forward, if you will, our dollar cost, average our way into hedging typically about 5 to maybe as much as 6 quarters out in advance. So eventually, we start locking future cash flows into more attractive exchange rates on a yen to dollar basis, but for a while, it lags. So for example, in 2016, we've hedged effectively all of our repatriated -- repatriation plans at least on an FSA earnings basis, and the average hedged exchange rate that we've converted dollars into is about JPY 117 -- of about JPY 117 to the dollar. So that gives you an idea. So we're on the negative side, if you will, compared to current exchange rates, but realize, over time, that will all flow together in dollar cost averaging. There will no doubt be a time where we're actually on the attractive end of converting yen to dollars as exchange rates move around.

Erik James Bass
Citigroup Inc, Research Division

Got it. And what do you think about -- I guess for next year, Dan, you're potentially repatriating more given that you'd be locking in a more favorable exchange rate?

Frederick J. Crawford
Executive VP & CFO

I think the important thing to note on that, Erik, is that my first stop in terms of thinking about repatriation strategy is really on capital quality, capital conditions and what types of risk and issues and performance is taking place in the business. Only then do I think about exchange rate strategy. And that's really -- exchange rate strategy, in my view, is the tail that wags the dog. It's not the major dynamic. So if you were to, for example, assume stability in capital conditions, which currently, we think conditions are relatively stable, then what we may do on the margin is go out a little further and lock in more of that yen coming back home into dollars. We may also toggle between that 80% and 100% of FSA earnings based on -- somewhat on the value of the dollars or the yen to dollar that we're bringing back. But that is a very, very minor component to the overall decision, which is, hey, what's going on with the capital conditions in Japan.

Erik James Bass
Citigroup Inc, Research Division

Got it. And if I could just sneak in one last one that's related, you mentioned that you were spending down some current excess capital. Can you just help us think about how you would quantify current excess capital?

Frederick J. Crawford
Executive VP & CFO

Yes. The -- what my comment is referring to is, in 2015, as you know, in March of 2015, right, prior to my arrival, Aflac executed on a reinsurance transaction that generated after tax about JPY 90 billion, if you will, in FSA earnings. And as you recall from last year, over the course of the year but most predominantly in the fourth quarter, we effectively brought the majority of that JPY 90 billion, if you will, back to the U.S. or let's call it $750 million. That served to really kick up the level of excess capital that we had at the holding company at year-end, and we have been essentially spending that down through the combination of accelerated repurchase into the first quarter, but also, we will gradually feather down that excess capital over the course of 2016 and also 2017. So the important point to note that is there's the true free cash flow of the company, and then there's the cash flow or excess capital that's been generated through reinsurance. And last year's exercise is a good example of that. So as we spend that down over the course of 2016 and '17, that's what's supporting some of our deployment -- deployable capital estimates that you've seen historically in previous FAB discussion.

Operator

Your next question comes from the line of Nigel Dally of Morgan Stanley.

Nigel Phillip Dally
Morgan Stanley, Research Division

With first sector sales, I had 2 questions. First, can you discuss the margins you're generating on those products given the current interest rate environment? And second, you talked about managing down sales. Is there anything to stop you from just discontinuing those sales?

Frederick J. Crawford
Executive VP & CFO

So let me talk a little bit about -- let me hit your margin first, and then I'm going to toss to Paul to clarify also or expand on some of the actions we're taking. But just on the margins, first of all, these products have been priced to exceed our cost of capital and obviously drive economic value for the company, realizing that, in many cases, we're selling the product in combination with third sector distribution relationships, and so we think in terms of sort of a blended economic value driven off the distribution. Where there are distribution partners that are more dominant in the first sector in much more, say, lump sum dumping or interest-sensitive type sales, that's where you particularly want to take more decisive action. Now I mentioned that early in the year, we bought -- prebought JGBs. We bought JGBs at around a little north of 1% at an average duration of around 20, 22 years, and obviously, pricing these days, you're talking about yields more down around 30 to 40 basis points. That has gone a long way to defending our returns in the product over the course of this year. It doesn't completely immunize the returns, but it gives you a great start to defending and allows you or buys you time to take not only actions on the distribution front but also actions on the investment front as flows come in over time. And so right now, keep in mind that we tend to price these products out with an expectation for yields in the roughly 1.25% to 1.4% range. And just to give you an idea, in the first quarter alone, even with the heightened allocation to JGBs, we, after hedge costs, generated around a 2% or so yield, net of hedge costs. And so we've got some room in our pricing to suffer the natural low interest rate environment over time and still defend yields. But we've got to be diligent in shutting down the flows because over time, clearly, these are much less attractive, and we need time to reprice and recalibrate. Paul, maybe I'll toss to you then on some of the actions we're taking.

Paul Shelby Amos

Former Director

Sure. Nigel, first and foremost, I want to go back and revisit the fourth quarter outlook call for this year when we basically differentiated between first sector savings products and first sector products that are level premium products. And so I'm going to differentiate a little bit here because we're obviously making significantly higher profit margins on the level premium than we are on savings products. So to get into the specific measures that we're taking, we are suspending sales of our lump sum WAYS product while we are restricting sales on our level premium WAYS product. We're also going to move up the repricing of our WAYS product into this year. Additionally, for all of first sector, we're going to reprice our products effective April of 2017, and so we believe that, that would put the portfolio back in a much better place. In terms of channel and distribution partners, because, as Fred said, this is a critical component to the decision of a lot of stake in the market, from a bank channel perspective, effective May 2, we've suspended all WAYS and lump sum child endowment from a nonexclusive agency perspective, which are some of the largest growing agencies throughout Japan. April 1, we put in caps for WAYS and child endowment. And finally, for the traditional agencies, we are lowering commission. Now again, as what I've said in the past, when we have these exclusive agencies who sign a contract to basically offer only Aflac product, they do so with a belief that we're going to provide them not only third sector products but also first sector products. And as a result, we make sure that we offer those products, and that prevents us from discontinuing them altogether. Now that said, I know you want us focused on third sector, and as Dan mentioned in his opening remarks, we're heavily focused on the 2 new products given they're smaller products that we've just put out our cancer for cancer survivors and our revised nonstandard medical. And even though it was only the last couple of weeks of the quarter that those were out, we're very happy with how those are starting. Finally, we're going to be launching a new product this summer, and we can't go into all the details yet. Hopefully, by FAB, we'll be able to cover some of the details about that new third sector product line that we've never been in before. But we are refocusing the attention of our distribution partners on third sectors to the extent we can. We did anticipate the spike in first sector as a result of these discontinuances and sales restrictions that we're putting in place. And we believe the second half of the year, we will be having some substantial reduction in first sector because of the changes that we're making, and we've accounted for all of this.

Operator

The next question comes from the line of Yaron Kinar of Deutsche Bank.

Yaron Joseph Kinar
Deutsche Bank AG, Research Division

I want to start with U.S. benefit ratios or the claims experience there. I think you noted that it was pretty much in line with what you would have expected in a strong quarter. But going back several years, I don't remember seeing such a strong quarter, and I was hopeful that you maybe could give a little more color as to what exactly drove these very strong results.

Frederick J. Crawford
Executive VP & CFO

Sure. Yes, in my comments, I do want to be clear that what definitely is expected when we play out the seasonal dynamics of our business is that we would experience stronger than normal, and in fact, typically, the strongest quarter of the year is the first quarter for the reasons I mentioned on my calls. Natural seasonality, some of the natural lapsation that comes off of a strong 4Q sales into 1Q sales and the enrollment periods and everything that plays into the natural rolling of our business, that all plays into a better benefit ratio in the first quarter. However, I would tell you that this benefit ratio is certainly a bit lower than we would have naturally planned for. This is still doing a little better than what we would expect. And I think as we go through the numbers obviously and dive into the actuarial performance in the business, we're seeing a few things. One is obviously some of the continued positive trends we've been experiencing in recent years in terms of just overall claim activity. When you couple that with the natural adjustments or, in some cases, lack of adjustments in IBNR, as your actual to expected continues to perform well, you can essentially hike -- enhance, if you will, the impact on your benefit ratio in any period. In other words, couple just good old-fashioned positive claims activity with positive IBNR adjustments once you've studied the business long enough to make the adjustments. In past few years, I would tell you that even though we have experienced strong first quarters, there were at times where we made certain IBNR adjustments on select lines of business where we felt as if there was modest efficiencies, for example, when looking at actual to expected. And now having caught up with those reserve strengthenings, we are not seeing as much of that anymore. And so you tend to highlight the first quarter, but I want to remind you that we also had actually quite a positive fourth quarter relative to our expectations. So we will develop perhaps a little more dialogue around this at our FAB meeting in May. And what I would tell you is that our practice here, as it takes quite a bit of time, of research and looking at the trends before we would declare victory, if you will, on resetting our expectations for benefit ratios, we fully expect second quarter benefit ratios to rebound back, if you will, towards our outlook guidance that we gave in December, and you should anticipate that as you think about modeling our results.

Yaron Joseph Kinar
Deutsche Bank AG, Research Division

Got it. That's very helpful. And then my follow-up question actually goes back to the series of questions you got earlier about first sector sales. As you discontinue the -- some of the WAYS product and curtail some of the other first sector product, is that factoring into your expectations that third sector products would come under pressure this year as well? Or is that purely a factor of the strong sales growth that you had last year?

Paul Shelby Amos
Former Director

It is -- this is Paul. It is factoring into our third sector thought process. The reality is, first quarter, third sector sales were better than we anticipated, but the additional reduction that we're taking and the measures we're taking to pull back on first sector are accounting for Dan's continued comment that we expect to be within the range in terms of third sector sales. So I'm very positive about the first quarter, but I recognize these additional measures may have an impact in the latter part of the year. Therefore, we want to reverberate our range of sales as what it was in the December outlook call.

Operator

Next question comes from the line of Ryan Krueger of KBW.

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

I had a question on profit repatriation. Fred, you talked about you're benefiting from some of the reinsurance that's already been done. Can you talk about what your expectation would be on a more normalized basis for profit repatriation just from ongoing earnings that the Japanese business generates on an FSA basis?

Frederick J. Crawford
Executive VP & CFO

Yes. It's really implied in some of my outlook comments. And that is, as we sit here today, based on our planning, we've suggested FSA earnings and associated repatriation in the range of JPY 120 billion to JPY 150 billion. Let me also clarify something just to make sure we're all on the same page, and that is I'm talking about a 2016, just realize that we print our FSA earnings on an annual basis at 03/31 year-end. You don't need to necessarily concern yourself with that, but we really trap things in terms of year-end to year-end 03/31. But when focusing on repatriation, that's -- effectively, our estimate right now is JPY 120 billion to JPY 150 billion, and that is essentially 80% to 100% of our FSA -- our annualized FSA earnings estimate for the year. And we'll have to see how things play out. What would cause you to go from 80% to 100% is entirely on the overall dynamics of the capital development, key ratios that we look at, of course, investments and investment risk and performance. It's all the things you would expect. Again, conditions seem to be moving forward nicely, but we have to be careful. There were some yellow lights flashing, if you will, in the first quarter with market volatility, energy prices, et cetera. And so we had to pay very careful attention. Things have stabilized a bit, but I don't think anybody would declare a victory. We could still see periods of market volatility and need to be careful.

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

Got it. But just on a more ongoing basis, longer term, I should basically take the profit repatriation guidance for this year and exclude the benefit from the reinsurance, and that would be more of an ongoing normalized expectation?

Frederick J. Crawford
Executive VP & CFO

That would be more the run rate, and you have to recall that, I think in total, we've done roughly JPY 300 billion, from a reserve perspective, reinsurance transactions, over 3 transactions, that has resulted in approximately JPY 200 billion in FSA profits. And we've retained about 40% of those proceeds and repatriated the rest, so give or take JPY 120 billion. And so when we go out, reinsurance, we have a blended approach of retention to support our capital ratios and defend our capital ratios and repatriation where it makes sense to repatriate and deploy. And so over the last few years, supporting our deployable capital measures has certainly been the rolling-through reinsurance transactions. If you were to subtract out those benefits and move to more of a true cash flow, it's typically more essentially the repatriation estimates in any given year plus what I would call free cash flow in the U.S. and/or the movement of excess capital in the U.S. up to the holding company. We'll give you a little bit more color around this for sure as part of our comments at the Financial Analyst Briefing in May.

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

Okay. And then just to follow up, your debt-to-cap ratio is 21.5. Obviously, debt costs are very low in Japan right now, and I think your target is up to 25%. Do you see any opportunity to add some additional leverage at this point?

Frederick J. Crawford
Executive VP & CFO

At this time, no specific plans and certainly nothing in our outlook, if you will. So the guidance we've given relative to EPS and the like, we don't have any levering up, if you will, in our plans. We have some refinancing and prefunding, if you will. We tend to go out early. And over the course of the end of this year and into the early part of next year, we have in a range of $800 million to maybe as much as $1 billion of refinancing-related activity or prefunding activity. So we do have those in our plans, but we don't have an outright levering up in our plans. I think it's true that there's a certain amount of what I would call debt capacity or leverage capacity at the holding company at Aflac. But again, I want you to be careful about any potential market volatility and also want to defend our strong ratings. Part of the reason we have a very low cost of capital -- and in fact, in recent periods, our cost of capital has been drifting actually below 8%, which is tremendous. Part of that reason is we maintain extremely strong ratings and can access the capital markets at very aggressive rates, both yen and U.S. dollar. And so we want to make sure we protect that. Our coverage ratio is essential. In fact, actually, there's only a 2-notch separation between our financial strength ratings and our holding company ratings, and part of that is because of the very strong interest coverage ratios we have. So we pay attention to that, Ryan. But I would argue, yes, we have some level of debt capacity but no immediate plans to leverage up.

Operator

Your next question comes from the line of Eric Berg of RBC Capital.

Eric Noel Berg
RBC Capital Markets, LLC, Research Division

Fred, you mentioned in your -- I think it was in your prepared remarks or maybe an answer to a question, pardon me, that the FSA earnings would face headwinds due to yen strengthening as dollar investments get converted back to yen? I would understand that in the absence of hedging, but given that you have such a large and well-developed hedging program, why is there this earnings -- FSA earnings headwind in the face of -- in the presence of a hedge program?

Frederick J. Crawford
Executive VP & CFO

Well, I mean, some of it is that we have a meaningful unhedged portion of the dollar program. And so be mindful of that. We run, for example, about a $22 billion-or-so U.S. dollar program in Japan, and we tend to maintain a hedge ratio of about 65% of that. So you have an unhedged portion that's tossing off dollars to be hedged back into yen. So it's that dynamic. And Eric, I don't know if you have anything to add.

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

No. I'll just add, a number of our private placements or what we call the emergence of currency bonds where, well, the principal is in yen, the coupon actually comes in dollars. So that also would contribute similarly to the unhedged portion that Fred mentioned.

Eric Noel Berg
RBC Capital Markets, LLC, Research Division

Okay. The other question I had relates to the first sector programs. And I just want to place a sharper point than we have on the problem here. Of course, we're all aware of the extremely low interest rates indeed on the short end of the yield curve, negative interest rates in Japan. But if you are able, with your dollar investment program and associated hedging, paired with long-dated JGBs, to produce target rates of return, if you can earn north of 2% at present in the multiplicity of ways or approaches that you're using and you're able to earn target rates of return, as you would say you did in the March quarter on the new products, why do you nonetheless feel you must cut back?

Frederick J. Crawford
Executive VP & CFO

I mean, I will give you my financial perspective and then certainly welcome any comments from Paul strategically. But this is a product set in general that even though we can achieve and cover, for example, our cost of capital and arguably add economic value, this is not just a lower return of capital relative to third sector, but it can also be a potentially more volatile return on capital, meaning think of it as the spray of potential return outcomes on the product can be quite a bit wider and less predictable, if you will, less manageable, if you will, than third sector. This relates to things like lapse rates, buyer behavior. As you know, the WAYS product, for example, converts into several different options of products, so who converts and who converts into what can play into it. So you have a lot of dynamics at play that really, in my mind, raise the stakes on the return expectations. In other words, if you were to describe a broader spray of potential returns to me, I would have a higher expectation of returns in general. And that's not the case given the rate environment, so what I would say is, remember, we're remaining in the game. It's just at a greatly reduced level. And we're remaining in the game for the very reason you point out, Eric, and that is we can certainly reprice and cover our cost of capital in such a way that we remain offering the product and support our distribution partnerships in Japan, which is critical to third sector. It's just that from a relative use of capital, we'll want to grow and support and build third sector all day long and would rather pull back a little bit on first sector, which should, by the way, over time, now over a long period of time, should, by the way, bring gradual lift to FSA earnings and cash flow and allow us to repatriate and redeploy capital in other higher-returning opportunities.

Daniel P. Amos
Chairman & CEO

But Eric, you've been around a long time as I have, and the fundamental things of what's built our business is right in third sector. The life insurance was always a door opener to help put our agents in a position when they went to the table to meet with people and go over things, if they wanted life insurance, it was there. But we still want our focus on third sector, and that's really the driver.

Operator

Next question comes from the line of Steven Schwartz of Raymond James.

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

Question for Eric. I just want to follow up on kind of what you did in the quarter with JGBs, kind of what percentage of JGB buying that you expected to do, and your plan was done in the first quarter. And given that, presumably a lot more would be done in the dollar program where we could see new money yields throughout the rest of the year.

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

Sure. That's a good point. About 70% of our full year expectations for JGBs were purchased in the first quarter. And that was a tactical move on the investment group's part partly because one, we were aware of the cash flows related to WAYS and had an expectation of them being more overweighted in the first half of the year; and second, we obviously always talk about macro factors like the DOJ. We were pretty strong in understanding that the likelihood was -- JGB as we continue to go down. So we made that tactical move, which turned out to be a good one. But you're right, as we go through the rest of the year, dollar assets, growth assets will be 17% probably of our allocation, with JGBs being about 25% or so or JGB-like investments as part of our plan. So when you look at it in that regard, in the first quarter, and this is gross hedge cost and other numbers, 214 net of hedge costs, as Fred mentioned, about 201. For the rest of the year, we would expect that new money yield based on that allocation differences to be about 320, take off about 5 or 6 for a hedge cost depending on the exact makeup of the asset. So for the full year, our expectation now, based on market conditions, cash flows that we know, would be about 270 before hedge cost and, again, knock off about 5 for average weighted hedge cost in that new money yield with respect to the rest of the year. Now for us, as you know, the markets are dynamic, things are moving quickly, so we certainly reserve the right, based on where markets are, asset classes are, to change those allocations. But based on plan, that's our expectation.

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

Okay. And then a follow-up for Fred. On the hedge cost, I was trying to do some quick math while you were talking. Given you mentioned 110 basis points on the existing $13 billion that's being hedged and the costs that were incurred in the first quarter, I'm coming out to about $0.23 for this year. Would that be in the ballpark?

Frederick J. Crawford
Executive VP & CFO

Your math is good. So for example, you take 110 basis points on $13 billion, that's $143 million pretax, for example. Tax affected, divide by our 420 million shares outstanding, and you're in that $0.22, $0.23 a share. Now a couple of things. If you noticed and remember my comments, I said, hey, timing is everything as you move quarter-to-quarter because of the way in which we account for that. We had $44 million pretax, $29 million after tax, $0.07 a share in the first quarter. If you look at a run rate basis, you're thinking about more in terms of $0.05, maybe a little north of $0.05 of share. And so I made the comment that, hey, I would expect, for the year as we roll the whole year together and look at it, that it's something in the 110 basis point range but realizing the first quarter, that was ticked up a little bit because of the simple buying pattern. Now one other thing to be careful about, right, is I'm holding essentially all else equal. I'm holding the size of our portfolio equal, I'm holding our hedge strategy effectively equal, and I'm holding the markets in and around where they're at today. Markets have stabilized a little bit. No one is getting excited or anything, but after a March rise in hedge costs over the last year, there's been a little bit of stabilization as we see markets calm down. But I think we're about, what, 12 hours away from a Bank of Japan meeting or so, if not short of them to add. And so things can change. We'll have to watch it carefully and carefully manage it.

Operator

Next question comes from the line of Suneet Kamath of UBS.

Suneet Laxman L. Kamath
UBS Investment Bank, Research Division

Appreciate the comment about the first sector products being above your low cost of capital, but can you just remind us what the expected returns are on the first sector and how those compare to the third sector products you're selling?

Frederick J. Crawford
Executive VP & CFO

Yes. We -- it's very, very assumption-dependent, which is why you tend to see us back away a little bit from giving you precise point estimates. I mean, it has an awful lot to do with the nature of the product child endowment versus WAYS, the nature of the WAYS product and, very importantly, how that WAYS product plays out. So that's my point about the spray of returns. Returns -- and remember, in Japan, you have an even lower cost of capital technically in Japan than you do on a consolidated basis for obvious reasons. But these products, based on the runs I've seen and on various interest rate assumptions, they can range from the high single digits to as much as low 10-plus percent range, but we can build this out a little bit more for you and talk a bit more at FAB. I want to just caution that it has everything to do with what the verdicts passed are for these products along with sensitivity in interest rates.

Suneet Laxman L. Kamath
UBS Investment Bank, Research Division

Okay, got it. And then my follow-up question that's related is, can you give us an update in terms of your Aflac Japan pretax earning in terms of the mix between first sector and third sector?

Frederick J. Crawford
Executive VP & CFO

I don't have that particular mix handy. As we talk about it, we talk about the difference in benefit ratio and expense ratios between the products, as you know. The benefit ratio on first sector products, you'll tend to have a much higher benefit ratio and much lower expense ratio than you do on third sector. And so we would need to give you a little bit of commentary around the relative premium between the 2 so that you could do the math. Kriss, I don't know if you...

Kriss Cloninger
President & Director

This is Kriss. We'll update that at FAB. As I recall from last year's numbers, first sector profits comprised roughly 20% of our total [indiscernible] Japan. Profits in the third sector were the balance. I don't know if I'm remembering that exactly right, but it's short of that order of magnitude. The premium income was skewing up toward first sector products, but the profit margins, being lower, diluted overall profit as a percent of the aggregate total. But we showed you that in a chart last year, and we'll update it again in May.

Suneet Laxman L. Kamath
UBS Investment Bank, Research Division

And is your expectation that, that portion from the first sector will now start to decline maybe starting from that 20%?

Frederick J. Crawford
Executive VP & CFO

It's going to be glacial in terms of its impact. And I would say that because you're talking about a product that tends to have maybe a little better than a 1% lapse rate, particularly first sector products like WAYS, child endowment, et cetera. So over time, as you throttle back on the new sales, you would expect to see it become less and less of the percentage of your earnings simply because we would fully anticipate to continue to grow our third sector business at a more significant compounded annual growth rate. So that will happen, but in terms of, say, near-term modeling-related issues over the next few years and so forth, you're not talking about a material impact or swing in that dynamic.

Operator

Next question comes from the line of Jimmy Bhullar of JPMorgan.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

I was wondering if Dan or maybe Paul could just talk about competitive trends in the Japanese third sector market and your confidence in your ability to improve third sector sales to your 4% to 6% growth guidance longer term over time. And the reason I'm asking is, a lot of companies who have JGB yields being depressed have been talking about pulling back from life insurance, selling more third sector products. So are you seeing that now? Is that affecting your view on what the expected pace of growth in your sales will be longer term as a result?

Paul Shelby Amos
Former Director

Well, let me start by saying historically, if you went all the way back to deregulation in 2001, which Dan can comment on, everyone has always said they're going to come after our business and our profit margins. And this has been happening for 1.5 decades. In reality, we've been able to fend those off and continue to grow our business. And I think there's no better evidence of that than the sales we saw from our cancer plan, which many people thought could be a saturated market, but in reality, we see it as a growth market as it continues. We think that our resurgence is up above 70% market share at one point as we launched the product and now staying above 50%. It's very positive for us. In terms of medical, there is no doubt that the markets -- there are a high volume of competitors, that it is a highly competitive situation and that we continue to focus on making better and better product. I think the factor that we have to place on this is quicker product launches. We are more likely going to see a more periodic launch of a new product with new benefits based on health care changes as well as competition in the marketplace, but we have not seen substantially lower margins put on by other companies. And so we feel like we can still, with the brand that we have, with the products that we've put in place and the distribution outlets that we have that are pretty much comprehensive as compared to most of our competitors who will focus on 1 or 2 distribution channels, we feel like we're in the right places to grow this business. Additionally, I mentioned that we're going to launch a new third sector product and category later this year. And we believe that's one more benefit to our overall third sector portfolio. I'll let Dan make some comments.

Daniel P. Amos
Chairman & CEO

Well, the only thing I would say is, in all the years with Japan, certainly now is not the time I've been the most worried about competition. I was much more worried in 2001 and other times probably. But it's never going to be one person or one company that comes after us. It's just a lot of little ones, and again, I think most of them spike, and then it goes back down. And so I believe, because it is our major product and that's what we do all of our concentration on, that we've got a distinct advantage. And although these life insurers that talk about getting into third sector, if that's all they've got to look forward to, they're in big trouble. So they've got to solve their life insurance issues one way or another and have got to find other ways. We can -- they could get in third sector for a little bit, but it's not going to solve their problems. And so I feel pretty comfortable with the way we're doing it. And at the same time, I don't want to be cocky because anything can happen. But I think we're better prepared with new products, new ideas, and continue to pretend like we're #2 instead of #1 where we're always fighting to stay on top. And that's going to be our mode as it has been in the past.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

And as you think about your sales progression through the rest of the year, would you expect the decline in sales or weaker sales in anticipation of the new product that you're launching? Or should that not have an impact on the rest of the business since it's a new type of product?

Daniel P. Amos
Chairman & CEO

I think our overall sales is a result of such a strong year last year. Double-digit -- above the double-digit growth makes this year much harder for us. So it's that more than anything else.

Operator

The next question comes from the line of Sean Dargan of Macquarie.

Sean Robert Dargan
Macquarie Research

I have a question about the trajectory of book value per share for investors who think of the world in that way. The jump between fourth quarter of last year and the first quarter you've been on an ex FAS 115 basis was pretty meaningful. I'm wondering if there's some FX remeasurement impact perhaps tied to the hedge that is affecting that number. And is there a way we should think about it excluding that?

Frederick J. Crawford
Executive VP & CFO

Yes. What you -- it's a decent question because it goes to book value. It also goes to ROE implications in terms of the way we report it, even a little bit related to leverage in terms of how you define shareholders' equity. But just note that in the way in which we calculate it, while we removed unrealized gains and losses on funds from traditional pricing issues or traditionally what most insurance companies do, in our calculation remains an unrealized gain and loss on foreign exchange, on FX. And what you saw here with the strengthening of the yen is that line item in our shareholders' equity, which has, in recent years, been a large negative number, has become less of a negative number, with yen strengthening, i.e., adding to shareholders' equity. And so it has served to, both year-over-year and on a sequential basis in particular even if you just look at fourth quarter to the first quarter, actually kick up your shareholders' equity and therefore pops up your book value per share a little bit more than usual. Obviously, we bought back a good amount of stock as well. But then also, it weighs down mechanically, if you will, on the ROE reported sequentially and year-over-year but also can also play into your leverage calculation as well. So as we go forward and as investors pay more attention to that book value, book value growth, ROE and the like, we'll want to take some more time in understanding the mechanics of the calculation and make sure you understand what's being done to move ROE forward. Obviously, coming off the earnings in the first quarter, our buyback of stock, we certainly pushed ROE forward, but you do have some FX-related denominator impacts in those ROE calculations.

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

Thank you very much for joining us today. If you have more follow-up with any questions later on, Investor Relations will be in the office, and we look forward to taking your call. Thank you again, and hope to see you at our Financial Analyst Briefing in New York in May. Bye-bye.

Operator
Thank you so much. And that concludes today's conference call. Thank you all for participating. You may now disconnect.