S&P Global
Market Intelligence

Aflac Incorporated NYSE:AFL

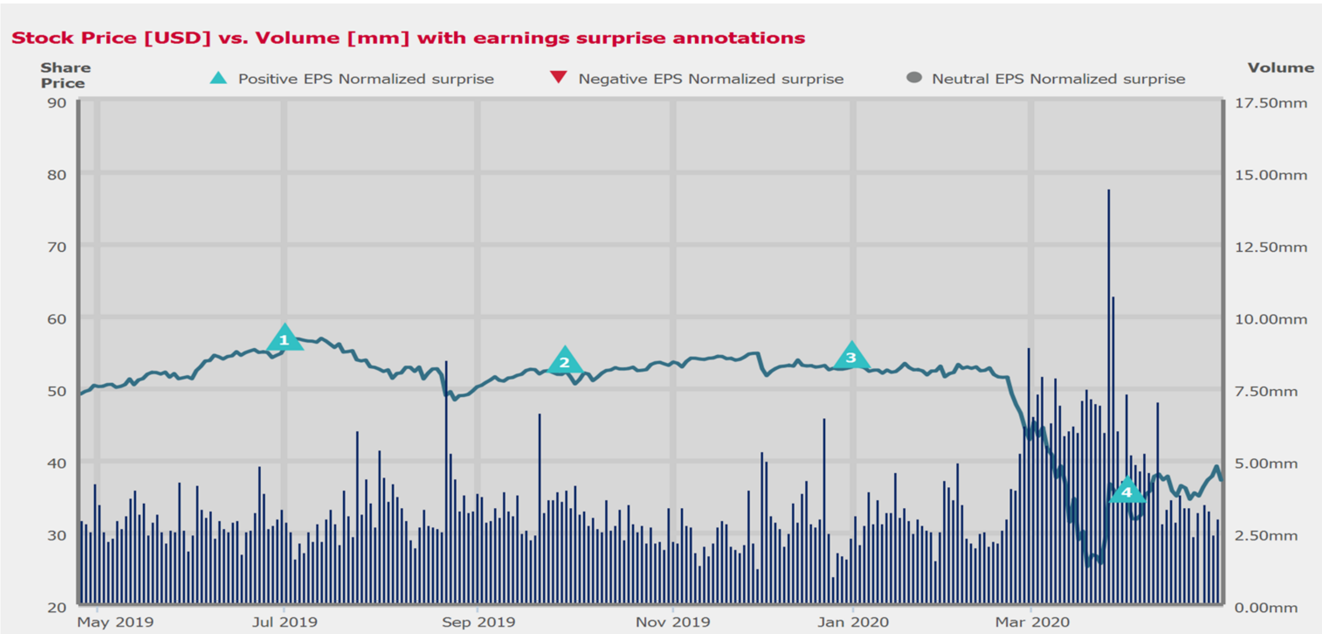
FQ1 2020 Earnings Call Transcripts

Thursday, April 30, 2020 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2020-			-FQ2 2020-	-FY 2020-	-FY 2021-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.10	1.21	▲10.00	1.07	4.36	4.49
Revenue (mm)	5488.40	5162.00	▼(5.95 %)	5336.82	21742.61	21590.09

Currency: USD
Consensus as of Apr-30-2020 11:30 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2019	1.07	1.13	▲1 5.61 %
FQ3 2019	1.07	1.16	▲2 8.41 %
FQ4 2019	1.02	1.03	▲3 0.98 %
FQ1 2020	1.10	1.21	▲4 10.00 %

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Call Participants

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Daniel Paul Amos
Chairman & CEO

David A. Young
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Eric Mark Kirsch
Executive VP, Global Chief Investment Officer & President of Aflac Asset Management LLC

Frederick John Crawford
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Presentation

Operator

Welcome to the Aflac First Quarter 2020 Earnings Conference Call. [Operator Instructions] Please be advised, today's conference is being recorded.

I would now like to turn the call over to Mr. David Young, Vice President of Aflac Investor Relations.

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

Thank you, Brittney. Good morning, and welcome to Aflac Incorporated's first quarter call. As always, we have posted our earnings release and financial supplement to investors.aflac.com. There, you will also find slides relevant to today's remarks.

This morning, we will be hearing remarks about the quarter as well as our operations in Japan and the United States amid the COVID-19 pandemic. Dan Amos, Chairman and CEO of Aflac Incorporated, will begin by discussing the impact of the pandemic and our response. Fred Crawford, President and COO of Aflac Incorporated, will then touch briefly on conditions in the first quarter before providing perspective on future claims exposure to COVID-19 and commenting on our group benefits acquisition. Then, Eric Kirsch, Global Chief Investment Officer and President of Aflac Global Investments, will provide investment highlights from the quarter, including an update on our investment portfolio and related stress tests. Max Broden, Executive Vice President and CFO of Aflac Incorporated, will conclude our prepared remarks with a summary of first quarter financial results and current capital and liquidity.

Joining us this morning during the Q&A portion are members of our executive management team in the United States; Teresa White, President of Aflac U.S.; Rich Williams, Chief Distribution Officer; and Al Riggieri, Global Chief Risk Officer and Chief Actuary.

We are joined by members of our executive management team in Tokyo as well, at Aflac Life Insurance Japan. Charles Lake, Chairman and Representative Director, President of Aflac International; Masatoshi Koide, President and Representative Director; Todd Daniels, Director and CFO; and Koji Ariyoshi, Director and Head of Sales and Marketing.

Before we begin, 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 annual report on Form 10-K for some of the various risk factors that could materially impact our results.

As I mentioned earlier, the earnings release is available on the company's investor site, investors.aflac.com, and includes reconciliations of certain non-U.S. GAAP measures.

I'll now hand the call over to Dan. Dan?

Daniel Paul Amos
Chairman & CEO

Thank you, David, and good morning, everyone. Normally, I begin by providing a high-level view of the quarter and how we performed, but we're in an unusual and unprecedented time. Instead, I want to start by thanking all of those who are on the front lines, fighting the spread of COVID-19 and those who are providing essential services, including our own employees. We truly appreciate all that you do. Our thoughts and prayers are also with those who are among the confirmed cases. This is a challenging time, but we will get through it together.

Let me start by addressing our enterprise-wide COVID-19 response efforts. The guiding focus of our actions has centered around: first, the health and safety of our employees and distribution partners; second, the well-being of our policyholders; third, the business community and maintaining our operations; and fourth, prudent financial and risk management. I will concentrate on how we're protecting our people, operations and brand, and ask Fred, Eric and Max to collectively cover how we've positioned from an operational, financial and risk perspective.

First, I want to note that we took early actions when the news of the virus broke. We benefited from Japan providing us with an early window into the potential response efforts, as they were about 3 weeks ahead of the U.S. in combating the spread of the virus. We also benefited from the Board expertise, specifically Long Time Director, Dr. Barbara Rimer, who is the Dean and Alumni Distinguished Professor of Gillings School of Public Health at the University of North Carolina at Chapel Hill. She advised us back in early February about the emerging threat of the virus. Early on, we implemented travel restrictions, shifted to working remotely and installed several social distancing measures, both in Japan and the United States.

Japan remains ahead of many countries with respect to COVID-19, with 14,000 confirmed cases and 400 related deaths as of yesterday. We see several possible reasons for this, including existing social norms of wearing masks, not shaking hands. In addition, Japan jumped out early, having to deal with the cruise ship Diamond Princess and prepare for the Olympic Games.

Finally, it's worth noting that Japan has taken a more measured approach to testing, focused on symptomatic cases and localized to where outbreaks have been identified. Despite these factors, cases have been on the rise, resulting in the Prime Minister declaring a national state of emergency through the end of Golden Week holidays on May 6 and possibly extending further.

Along with economic stimulus packages, the state of emergency includes a requirement for business to reduce employees at the work site by 70%. COVID-19 is now classified as an infectious disease, requiring doctors to prescribe hospital care. Further, the Japanese government recognized the potential shortage of hospital beds and is allowing doctors to instruct a patient with symptoms to receive medical treatments outside the hospital, consistent with government policy and industry guidelines and standards.

Aflac Japan and other major domestic life insurance companies announced that hospitalization benefits will be paid for the period, a test by a doctor if a patient receives medical treatment at an alternative accommodation or a temporary facility.

I'm sure most of you are all familiar with the U.S. government's actions and state by state shelter-in-place restrictions. From a state regulatory environment, several states have issued executive orders directing premium grace periods and guidance on treating policyholders with care. In both the United States and Japan, we have taken action in response to COVID-19 to help mitigate risk to our employees, policyholders and communities.

We have ramped up work at home staffing models, with more than 75% of our on-site employees in Japan and more than 90% of our employees in the U.S. working from home. I'm pleased to report that we have had little in the way of disruption in operations. And while not optimal, we have adapted very well. We have adjusted our approach to employee benefits to accommodate the need for extended pay leave and to account for school closing.

In terms of policyholders, we have liberalized how we pay claims to include such things as expanded definition of hospitalization, accepting telemedicine diagnosis from doctors and easing documentation requirements. We have offered premium payment grace periods with no risk of cancellation and following any regulatory guidelines or suggested practices.

Given our strong relationships with the health care industry in both Japan and the United States, we recently announced additional contributions to help provide support to combat the virus in both countries. In the U.S., our contribution of $5 million supports medical device shortages, particularly as it relates to ventilators and protective mask, and humanitarian aid to the 50 state organizations. This aid will be used to provide personal protection equipment and essential medical items for health workers responding to the coronavirus.

Similarly, Aflac Japan is also making a charitable contribution in yen equivalent of approximately $5 million to Japan Medical Association, and identified local municipalities in support of medical professionals on the front lines fighting COVID-19. With this donation, Aflac Japan hopes to help foster improvements and enhance the work environment for medical institutions and health care professionals in Japan.

Turning to the first quarter production and beginning with Japan, total sales were down 25.4% in the first quarter, recognizing last year's quarter was prior to Japan Post running into the challenges. Japan Post made up the majority of the decline and as they remain focused on rebuilding the trust of customers and installing high-quality governance and compliance processes. With respect to what we're seeing in April, total sales are down in the range of 65%, reflecting a full month's impact of reduced activity related to COVID-19 and Japan Post having been a full strength in 2019 period.

We have taken steps to defend our distribution franchise in Japan. We have focused our attention on our exclusive agency relationships and walk-in shops impacted by the virus. Actions in place or under review include extending interest-free loans to the agencies. For walk-in sales shops, we're offering to provide rent assistance. Recognizing the face-to-face sales will be a challenge, we are remaining active in generating business focusing on direct mail and calling campaigns to existing and prospective customers. In addition, we are promoting digital and web-based sales to groups. We are also preparing to introduce a new system that enables smartphone-based insurance applications by allowing the customer and Aflac operator see the same screen through the smartphones.

In the U.S., total sales were down 5.2% in the quarter. Recruiting of career agents was up 2.5% for the first quarter and average weekly producers productivity increased 4.9%. Recognizing our production model in the U.S. relies heavily on face-to-face agent interaction at the work site and is small business oriented, we are being hit hard by temporary closures of businesses and lack of access to the worksite. In April, sales were down in the range of 55%, and we are actively working to adjust.

In the U.S., we have focused on our agency channel, for example, providing 0 interest rate loans to qualified producers, helping agents pivot to digital solutions, which include training and recruiting. It's important to remember that the more successful agents are in fact independent small business owners and are suffering through the same dynamics you're reading about with respect to the U.S. economy.

On a positive note, we continue to build out our digital consumer market platform. Also, our recent definitive agreement to acquire Zurich Group Benefits business allows us to expand our distribution reach and extend our appeal to brokers and large employers. Fred will cover more of this a little later.

Just to wrap things up, let me say, the way a company responds during an unprecedented times like this truly defines the company and its brand. Our people come first, and that includes our employees, our sales force, the policyholders and the communities in which we operate. In doing so, we create value for the shareholders. As I often say, the product we sell is an intangible product. It is nothing more than a promise on a piece of paper that we will be there for the policyholders when they need us most. So for many, that time of need is right now. Our policyholders have put their trust in Aflac to come through, and I am proud to say that we will be there when they need us most. Because that's who we are and what we do.

Finally, I've always said that with change comes opportunities. With all the changes that we're seeing, we think there will be opportunity not just to survive, but to thrive.

So with that, I'll turn the program over to Fred. Fred?

Frederick John Crawford
President & COO

Thank you, Dan. I'm going to touch briefly on conditions in the first quarter and key variables we are tracking, provide some perspective on future claims exposure to COVID-19 and comment on our group benefit acquisition, which we expect to close later this year.

As you can see from our first quarter results, we entered this crisis with strong margins, both in Japan and the U.S. We have the capacity to absorb a period of elevated claims while maintaining important investments in our franchise. In terms of Japan, COVID-19 claims in the quarter amounted to JPY 1.8 million. We also increased our medical product IBNR reserves to include JPY 500 million specific to COVID-19. Taken together, there was very little impact from the claims related to the virus in the quarter. Thus far in the month of April, we have paid out approximately JPY 8 million in COVID-19 claims.

As we look at expenses for the rest of the year, we expect downward pressure related to reduced overall activity, offset by a decision to accelerate a JPY 2 billion investment in our going paperless in our policyholder services operation. This paperless initiative is important for ongoing efficiency, supporting our distribution partners as they move towards digital production and business continuity in the current environment.

Turning to the U.S., we had very little in the way of COVID-19 claims during the first quarter, but did add approximately $3 million to IBNR reserves specific to COVID-19 and based on disclosed infection rates as of the quarter end. Thus far, in the month of April, we have paid a total of $1 million in COVID-19-related claims.

As we look at the U.S. expense dynamics, we would expect expenses to remain stable as we push forward on key growth initiatives and factor in the Zurich Group Benefits acquisition later this year. Key initiatives surrounding improvements to our agent online enrollment tool, the conversion to our new group administrative platform, our efforts on the buildout of network dental and vision and digital direct-to-consumer all remain on track. The initiatives have never been more important when considering the current benefits of diversification in product, distribution and market segmentation.

I would add one final point on expenses. As Dan pointed out in his remarks, we are taking action to defend our franchise in Japan and the U.S. during this period of uncertainty. This includes actions to support our employees, policyholders, distribution partners and the communities we serve. While not material overall, these actions will play into our segment and corporate expenses for 2020 and are essential in being positioned to respond when markets recover.

The first quarter reflects strength in benefit ratios and is consistent with our original outlook for 2020, depicted here on Slide 5. However, that outlook obviously did not contemplate COVID-19 and therefore does not represent reliable guidance as we sit here today.

Let me give you an idea of the variables when considering the remainder of 2020. In Japan, COVID-19 cases are very low relative to the U.S., but trends are up and uncertain. A key variable is Japan's declaration of a state of emergency and the life and health insurance industry's approach to infectious disease treatment and associated hospitalization coverage. In the U.S., along with uncertainty on the trends in COVID-19 rates of infection, we need to carefully track the rate of hospitalization, movement into intensive care and percentage of infected filing for short term disability. Another important variable in the U.S. is persistency and the impact of high unemployment levels. The next few quarters will be significant in terms of providing us a window into the rest of the year and outlook for 2021, which then naturally leads us to a discussion of stress testing.

If you look at Slide 6, our overall approach to stress testing seeks to inform our decision-making, along with ensuring we defend the following during periods of high volatility: keeping our promise to policyholders in the time of need; protecting our strong insurance ratings and access to capital; maintaining our strong regulatory standing and communication; ensuring no disruption to our core franchise and planned investments; and finally, defending our 37-year track record of increasing the common stock dividend.

I'll focus my comments on the stress testing of claims exposure. Eric will cover investments, and Max will tie it together in testing our overall capital position.

Let me start by saying that while we have included stress on mortality, our risk is naturally concentrated in morbidity experience. We are tracking the rate of reported cases, hospitalization and deaths from sources such as the CDC and Johns Hopkins. We are factoring in third-party forecasting models, like the IHME model and any associated revisions. We treat this as a rapid rate of rise in confirmed cases, so we accelerate the impact into 2020 for additional stress. We then build in a significant stress margin. Once bounced up against our in-force policies, we make one last adjustment to build in a range around the point estimate.

In terms of Japan, the focus is on morbidity exposure and our block of medical policies. Our testing in Japan assumes a midpoint estimate of 1.2 million confirmed cases or 1% of the population, and we have assumed a 100% hospitalization rate consistent with infectious disease guidelines and approximately 100,000 deaths. We assume, on average, 20 days in the hospital or related accommodations and run a wide range of outcomes to then build the range. Recognizing Japan has less than 15,000 reported cases and 500 deaths, we believe this to be a very conservative stress test. We estimate the potential stress impact to our Japan third sector benefit ratio in the range of 50 to 100 basis points in 2020.

Turning to the U.S., key products that are subject to elevated claims include hospitalization and short-term disability. We also include ICU benefits that materially increase the daily hospitalization reimbursement rate. There are also wellness benefits that apply across a number of product sets that may see elevated claims. Our testing in the U.S. assumes a midpoint estimate of 6.4 million confirmed COVID-19 cases, 1.5 million hospitalizations and 150,000 deaths. We apply hospitalization rates of 20% beginning around age 20, then increasing to 70% for policyholders reaching age 80. Of those hospitalized, we assume approximately 40% will have time spent in the ICU. We have assumed 20 days in hospital with 10 days in the ICU. We further assume 75% of confirmed cases file for short-term disability coverage for 30 days on average.

Given the current and projected rate of hospitalization in the U.S., we believe this is a very conservative stress test. Furthermore, in the U.S., we are a worksite company with a majority of our policyholders younger and healthier, driving a lower rate of hospitalization. We estimate a potential stress impact to our U.S. benefit ratio in the range of 300 to 500 basis points impact in 2020.

One last sensitivity to touch on. Persistency in the U.S. and -- has historically been tied to unemployment. We have stressed unemployment levels to 20%, and based on historical correlation to persistency, we could see a 3% reduction in 2020 earned premium. Again, we believe this is a conservative view, and we think economic stimulus actions designed to support and stabilize small businesses and employment are helpful.

Finally, our stress testing should not be taken as guidance. The testing applies a significant stress margin and isolates the impact of COVID-19 on our 2020 results, while holding all else equal, such as temporary conditions that may lower claims in this environment. We provide the study to better understand the difficulty in maintaining guidance on benefit ratios at this point and to give investors a sense of our ability to absorb a true pandemic test. We also use this information to guide our decision-making around expense management, capital and liquidity.

Let me switch gears and comment on our March announcement of our planned acquisition of Zurich Group Benefits business. For several years now, we have expressed interest in finding the right true group life and disability property. We have passed on a number of larger businesses that came to the market in favor of a buy-to-build strategy that reduces the capital at risk. This strategy also recognizes that our model in the U.S. is unique in that regardless of the size of the property, we will need to invest in order to properly leverage our voluntary and small to mid-sized business model. This strategic move has broad long-term positive economic benefits to Aflac, including cross-selling, persistency and deeper account penetration with our higher margin voluntary business. It is also not uncommon to bundle true group with dental and vision, so this investment furthers our network dental and vision growth strategy. In the process, we were able to drive more expansive broker relationships and a total benefit solution.

The Zurich business fits well with our strategy as a startup platform 4 years in the making, with modern technology, best-in-class product and leave management capabilities, and a very experienced staff who understands this business. The current business is designed for the large case market, where we intend on being a competitive alternative to the current market leaders in the space. We are taking a phased approach to integration, with the first few years continuing the momentum that currently exists in the platform and exploring opportunities as part of the Zurich network of international group carriers. Our second phase will combine with core Aflac voluntary solutions that fully exploits the breadth and depth of our products as we look to accelerate our current position in the mid-case market. This phase will include network dental and vision.

Our final phase will be bringing the capabilities down market into the smaller employers and via our unique agency driven small business distribution model.

The teams on both sides of the transaction are excited about what the possibilities can be, armed with the Aflac brand, our voluntary capabilities and an expanded client list. The total consideration is less than $200 million, including capital in support of the business. However, we plan to invest a similar amount in the coming years to build the business to scale. In that regard, we expect $0.05 to $0.06 of dilution on an annualized run rate for the next 3 years as we build the business.

I'll now pass on to Eric to discuss our investment portfolio. Eric?

Eric Mark Kirsch
Executive VP, Global Chief Investment Officer & President of Aflac Asset Management LLC

Thank you, Fred. We ended the first quarter in a strong asset quality position, which I will comment further on in a moment. Impairments experienced in the quarter were partly due to the adoption of a new accounting treatment for loan losses, which many of you know as CECL. This accounted for approximately half of our loss reserves. In addition, we impaired 2 energy names, both of which are below investment grade.

Net investment income was modestly positive to our plan, a result of stable rates in Japan and, in the case of U.S. dollar loan portfolios, because we locked in the majority of our floating rate income and our associated hedge costs prior to the large drop in LIBOR.

As we look forward, the low rate environment will be a headwind to net investment income. In addition, our full year 2020 plan resumed certain deployment objectives for our middle market loan portfolio, which includes our recent strategic alliance with Varagon. We have seen that market slow and do not currently expect to invest as much money in 2020, which will negatively impact income.

As an offset to these challenges, we also expect a slowdown in prepayments in our loan portfolio. Many of these higher-yielding loans have LIBOR floors that protect our income against low rates, so we expect to retain much of this protection in the current environment. We also expect outperformance from our floating rate income hedges due to more loans hitting LIBOR floors given the significant LIBOR decline.

In terms of our alternative investment portfolio, namely private equity and real estate equity, we, like the rest of the industry, are likely to experience lower returns in the second quarter as these results typically lag by a quarter and track public equity valuations. Fortunately, since we have a relatively young portfolio, we entered this crisis with a relatively low allocation of approximately $600 million.

With respect to our U.S. dollar hedging, we have not seen any meaningful impacts to the program since we locked in the majority of our FX forward costs for the year. In order to protect the SMR impact of unhedged dollar investments, we use costless collars with caps for extra protection against negative settlements in the event of an extreme yen weakening. With current market volatility, we have been tactical in our approach to the use of collars and caps, balancing capital protection with the potential for negative settlements. We currently have $9 billion of collars and associated caps in place, and, while not material to overall investment income, we could see additional costs associated with maintaining this program throughout the year. Max will add his comments to this later in the call.

We have executed on about $8.5 billion in derisking activity across our fixed income and public equity portfolio since 2015. Our activity includes: reducing our energy exposure by about 1/3; lowering our overall BBB exposure, including a 47% decline in BBB- position; reducing about $1.4 billion of fallen angels; and a continued reduction in concentrated and low-rated private placements. We have tactically reduced our public equity portfolio by $888 million over this time as well. Our strategy had been to reduce credit and equity risk that might underperform during the slowdown and shift in the credit cycle.

Additionally, proceeds from derisking activity allowed us to accelerate our alignment with our strategic asset allocation plan. As a reminder, the SAA modeling provides a guidepost for optimal portfolio allocation among asset classes, considering risk tolerances and asset liability management. The reinvestment of derisking proceeds is reflected in our new money asset allocations, which align with greater diversification and capital efficiency, serving to reduce overall risk and improve returns.

While of course we did not envision COVID-19, we did have a view of the credit cycle emerging in 2020. And over the past few years, we have moved our portfolio into a relatively defensive position. Our portfolio is well diversified by asset class, has a high average quality rating of single A and is highly diversified by sectors.

As you can see in the sector allocation chart, we have limited exposure to those sectors that we expect to be most impacted from COVID-19 and the economic slowdown.

Continuing with our approach to stress testing, we have conducted a bottoms-up loss analysis focused on risk assets in the most vulnerable sectors as defined by the nature of this crisis and where we are most likely to experience potential defaults. The analysis pictured here focuses on a universe of approximately $3.2 billion of our most concerning fixed maturity exposures given the nature of the COVID-19 economic crisis. Asset categories include BBB and lower-rated energy exposure, travel and leisure sectors, the airline industry, and casino gaming.

In addition, we have identified approximately $1.4 billion of middle market loans most exposed in the current environment and have stress tested $1.3 billion of transitional real estate. While this economic crisis is unprecedented and predicting the trajectory of the economy and recovery is difficult, we have taken a pretty bearish view in our credit stress test. For instance, we have assumed an extremely severe second quarter drop in economic activity of 30% to 50%, with just a modest pickup through year-end; revenue declines of 30% to 80%, depending on the specific sector and company; losses on our most sensitive below investment-grade and middle market loans of up to 20%; oil prices staying below $20 for most of the year as demand slowly recovers.

Let me emphasize that the impacts to the global and U.S. economy are going to be highly volatile and very difficult to predict. We will continue to evaluate as more economic information becomes available, along with the impacts to the sectors and companies in our portfolio. Our loss analysis estimates approximately $680 million in pretax potential losses. This equates to approximately 100 basis points of potential losses on our total fixed maturity and loan portfolios, of which fixed maturity corporates are 72 basis points.

This compares to about 94 basis points using the Moody's market loss rate experience from the 2008 to 2010 financial crisis. We estimate about a 16% default rate on our middle market loan portfolio, which is higher than the 12% experienced during the last crisis. This reflects what we believe is the severity of our stress test, given the unprecedented economic impacts we know will occur to small and medium-sized businesses across the country.

For our transitional real estate portfolio, we estimate about 90 basis points of potential losses, mostly reflecting exposure to the hotel industry. I'll go into more detail on our loan portfolios in a moment. This stress test is a pure economic loss approach, and, unlike a capital stress test, does not take into account accounting-driven losses such as impairments and associated bright-line tests or downgrade risk. Let me stress, these estimates are subject to change as we all learn more about economic consequences during this unprecedented shutdown of economies around the world.

In summary, while it's natural to anticipate a higher level of defaults and losses, we are very well positioned to address weakness on the asset side from an economic loss perspective. We have been building our middle market and transitional real estate loan portfolios, favoring loan structures for shorter duration and favorable underwriting protection. Our middle-market loans remain well diversified, are entirely first lien senior secured, have low leverage and come with natural protections, including loan covenants and collaterals. Recognizing most of our middle market loans are sourced via equity sponsors, there is the potential added protection that they will be a source of capital to bridge the short-term liquidity strains brought on by a steep drop in business activity.

Our investment philosophy in this asset class has always been focused on disciplined underwriting and diversification.

In addition, we take a regular CECL reserve of 203 basis points, reflecting that over time we expect loan losses to occur. We are well positioned entering into this credit cycle brought on by COVID-19.

Our commercial real estate portfolio, about $7.3 billion in size, is 76% allocated to transitional real estate and 24% to commercial mortgage loans. The portfolios are highly diversified by property type, geography, and conservatively underwritten to average loan-to-values of 60%. We only hold loans secured by first lien on quality assets. We do not have any B notes, mezzanine or other subordinated exposure, and we do not utilize leverage against our loans. Because of these strong attributes, we anticipate the potential for only a small economic loss stemming from our transitional real estate debt holdings.

Transitional real estate is unique in that the quality of properties only improves from the moment we make our loan, as the asset owner is transitioning the property to a more valuable state. This typically requires the owner injects their capital before any loan capital is drawn, providing an important protection for our debt. TRE underwriting incorporates the property value at the time of purchase as well as the value upon completion of the business plan. The risk to the business plan includes cost to execute and prospects for success given the local market conditions and the strength of the sponsor, including their experience with the type of asset transition and their financial resources to ensure completion.

We do expect to see many amendments to our loans, primarily offering short-term relief from monthly cash interest payment in exchange for other protection. This is especially true for the $1.1 billion of hotel loans in our TRE portfolio. We believe the modest LTVs on solid assets, supported by strong owners, will cause our loss rate to be very low.

Our commercial mortgage loan portfolio is of very high quality, with an average rating equivalent of A plus. This portfolio is well diversified, with an average loan size of $21 million, and our average LTV is right at a very low 50%. As such, we do not anticipate any losses from this segment of our commercial real estate debt portfolio.

I will now turn the call over to Max.

Max Kristian Broden
Executive VP & CFO

Thank you, Eric. Let me start my comments with a review of our first quarter performance with a focus on how our core capital and earnings drivers are positioned heading into the COVID-19 crisis.

For the first quarter, adjusted earnings per share increased 8% to $1.21. The strengthening yen benefited earnings in the quarter by $0.01. As a result, adjusted earnings per share on a currency-neutral basis rose 7.1% to $1.20 per share. Adjusted book value per share, including foreign currency translation gains and losses, grew 8.9%, and the adjusted ROE excluding foreign currency impact was a strong 15.8%, a significant spread over our cost of capital. There were no onetime items to call out for normalizing purposes in the quarter.

Turning to our Japan segment. Total net premiums for the quarter declined 2.1%, reflecting third sector policies paid up impacts and to-pay medical policies sold in 2018 reaching paid up status, while net premiums for our first sector protection and third sector products was flat year-over-year.

Japan's total benefit ratio came in at 69.4% for the quarter with third sector benefit ratio coming in at 59%. We did not experience any increased incidence rates in our cancer block this quarter as we did during the back end of last year. Our expense ratio in Japan was 20%, down 20 basis points year-over-year. In the current environment, we experienced lower promotional spend, which we view as primarily timing related, and lower surrenders brought down our DAC amortization. Both factors contributing about the same to the decrease in the expense ratio, which was driven by strong expense discipline as revenues are under pressure.

Net investment income increased 4% in yen terms despite variable investment income coming in at the lower end of plan, driven primarily by higher allocation to U.S. dollar floating rate assets. The pretax profit margin for Japan in the quarter was 22.5%.

Turning to our U.S. segment. Total net premiums increased 1.5%. Despite weaker sales results and a 100 basis points decrease in persistency, similar to our experience in Q4 2019. Our total benefit ratio came in at a strong 48.1%, 120 basis points lower than Q1 2019, driven by similar claims trends and mix of business with a continued shift toward our group and accident products. Our expense ratio in the U.S. was 38.4%, up 210 basis points year-over-year, primarily driven by our continued increased spending on digital capabilities and the inclusion of Argus and build-out of Aflac Network Dental and vision, which structurally has increased the expense ratio by 140 basis points.

Net investment income in the U.S. was flat. Profitability in the U.S. segment was impacted by the previously discussed elevated expense ratio, leading to a pretax profit margin of 19.3% in Q1, down 40 basis points year-over-year.

In our corporate segment, the main driver of improved results is higher levels of amortized hedge income driven by our enterprise corporate hedging program. Amortized hedge income contributed $29 million on a pretax basis to the quarter's earnings, with an ending notional proposition of $5 billion. For 2020, we expect the Corporate and Other segment to record a pretax loss for the full year in a range of $100 million to $120 million. This incorporates increased interest expense from our recent global yen and U.S. dollar debt issuances of approximately $1.54 billion and increased philanthropic donations to support those individuals who are at the frontline and fight against COVID-19.

Our capital position remains strong, and we ended the quarter with a headline SMR of approximately 881%, and 837% excluding unrealized gains in Japan. The estimated RBC was 550% for Aflac Columbus. Holding Company liquidity stood at $4.8 billion, pro forma, including our recent USD 1 billion debt issuance.

The low interest rate environment clearly adds earnings pressure. But our products generally have low interest rate sensitivity, and our asset leverage is low, driving continued strong gross profit testing margins as we cash flow test products and blocks of our in-force.

In short, while the first quarter is materially different than what we may face in the coming 9 months, we enter this period of uncertainty with strong capital, liquidity, earnings, and as Eric highlighted, strong asset quality. As Fred noted, we have been monitoring current conditions and making refinements to our stress testing. Fred discussed claims stress testing and Eric addressed our asset loss analysis and estimates. In both cases, we have taken a practical approach with respect to current models on the spread of the virus and current economic views.

When considering capital and liquidity stress testing, we take a more severe approach, more in alignment with what we share with regulators and rating agencies. Our approach to capital stress testing assumes a greater and more prolonged spread of the virus, which is roughly 6x as severe as the stress Fred walked you through. On the asset side, we combine Eric's economic loss analysis with changes in market value of bonds, impairments and downgrades, recognizing our core ratios can be impacted by these factors. We have assumed the market crisis that [blends] both the global financial crisis of 2008 and the 2016 oil shock. Then we have further refined the shock to various sectors in our portfolio, by moderating the impact to the financial sector, which has much improved liquidity since 2008. But increasing the assumed severity of the impact to COVID vulnerable sectors, mainly travel, energy and middle market loans. This is arguably a very stressed scenario and certainly not our base case. But we do find it instructive to stress our balance sheet and capital plan with these kind of scenarios, as it can inform us of how to utilize capital tools, enhance optionality and plan for capital deployment.

Under this scenario and assuming that we shut down share repurchase and retain capital in the insurance subsidiaries, we expect SMR to hold at or above 700% and RBC to hold at or above 400%. In addition, we expect holding company available cash and liquidity of over $3 billion through 2021. This scenario assumes no change in our franchise investment plans and defending our 37-year dividend growth track record.

In light of our stress testing work, we have taken certain defensive steps to ensure stability on our core capital ratios and liquidity position. These include raising $1.54 billion in the global yen and U.S. dollar senior debt markets. In both cases, we enjoyed favorable pricing and strong subscription levels. This move provides ample contingent capital and liquidity with a very modest cost to EPS and leverage. Retaining capital in our Japan subsidiary by JPY 75 billion in 2020, adding additional buffer to our SMR ratio given the potential for continued market volatility. This move provided an additional 40 points of SMR.

In the U.S., while we have not experienced deterioration in RBC levels, we are reducing our second quarter U.S. dividend by $75 million and injecting $150 million of capital into our smaller group legal entity, CAIC. Our group business continues to grow, and we are investing heavily in this part of the business, for the capital both protects and sustains strategic investments in this legal entity. All told, we enter the critical second quarter in a very strong position. And these moves do not materially impact our capital planning as we carefully monitor conditions. We also have no debt maturities until 2023 due to liability management actions taken in 2019, setting us up well for the future.

Before turning the call back to David, let me comment briefly on our approach to guidance. As you can see from our press release issued last night, recognizing likely volatility and a need to be tactical in our approach to excess capital, we have elected to withdraw adjusted EPS and share repurchase guidance for 2020. While this withdrawal of guidance is not necessarily a view that our ranges are not achievable, we are off to a strong start to the year but must recognize that the current spread of COVID-19, its impact on the communities that we serve and the volatile markets simply make it very difficult to accurately project benefit ratios and other earnings drivers. It is fair to say we face a number of obvious EPS headwinds in terms of benefit ratios, investment income and overall revenue, but it's still very uncertain as to the timing and the magnitude of the COVID-19 impact on 2020 earnings. We also need to be flexible in the actions we take to defend our franchise and making sure we do all we can to support policyholders.

In terms of repurchase, we remain in the market but are buying at roughly a 50% level in dollar terms versus the first quarter. We are taking a tactical approach depending on how we see the crisis develop in the second quarter. By tactical, we mean we may be in a position to maintain, cancel or even accelerate as we see conditions evolve.

And let me now hand off to David to take us through Q&A.

David A. Young
Vice President of Investor & Rating Agency Relations
Thank you, Max. Before we begin, I just want to ask that you please limit yourself to one question and a related follow-up, to allow participants an opportunity to ask a question. Brittney, we'll now take the first question.

Question and Answer

Operator

[Operator Instructions] And our first question comes from Humphrey Lee from Dowling Partners.

Humphrey Lee
Dowling & Partners Securities, LLC

In terms of the capital and liquidity stress test, I'm just wondering, like when you look at the potential kind of downgrades and rating migrations, can you share like some of the -- what your findings were related to that? Kind of how does that impact your RBC or your capital position?

Max Kristian Broden
Executive VP & CFO

Humphrey, we're not disclosing in detail the underlying assumptions for specifically for rating migration. But at a high level, I can comment that rating migration is predominantly an issue when it comes to risk-based capital and less so when it comes to our solvency margin ratio in Japan. It's obviously a factor in Japan as well, but it's really the RBC formula that is more sensitive to rating migration.

Our asset leverage in the U.S. is fairly low. And even when we look at rating migration, it has a fairly limited impact on our capital conditions in the operating subsidiaries.

Humphrey Lee
Dowling & Partners Securities, LLC

Got it. And then my second question is related to sales in U.S. and Japan. I clearly understand that there's going to be a very fluid situation. There's a lot of unknowns. But looking at the decline in April, is there any kind of difference between the beginning of the crisis versus kind of more towards the late April? Do you see a change in productivity or sales decline, maybe in the sense that maybe how your agents are adapting to the new situation?

Frederick John Crawford
President & COO

Humphrey, let's do this -- this is Fred. Let's split this up and have our colleagues speak directly to their markets. And so perhaps we'll start with Koide and Koji to address how they're adapting in Japan to the new environment, and then we'll switch to Teresa and Rich Williams. Koide?

Masatoshi Koide
President & Representative Director

[interpreted] This is Koide. Let me talk about agency first. So the state of emergency has been declared effective April 7 to 7 prefectures, major prefectures in Japan. And this state of emergency expanded to all prefectures in Japan on April 16. So as a result, the activities of the agencies turned to be refraining from -- voluntary refraining from face-to-face activities. And we have also decided to suspend or close down our shops. And in Japan, there has been some impact from coronavirus from mid-February. So as a result, the number of people coming to our shops or going to face-to-face solicitation have been declining. And then as regarding to April, because of the state of emergency, face-to-face solicitation was refrained as well as our -- we had to stop or close down our shops as well. So as a result, the agencies are not doing face-to-face solicitation anymore, instead, a combination of phone calls and mail outs are being done by agencies. However, because more and more customers are staying home, there's a better chance of being able to communicate with customers. Although the policies may not be purchased right away, it is good to maintain relationship with customers and enhance relationships with customers and also to develop new prospective customers as well.

And in May, we are trying to send out direct mails nationwide, and there will be a follow-up calls made after direct mails. So we do believe that this will be successful and see some results in May. And during this time, we are also conducting trainings to the sales agents of large exclusive agencies using the web. So there are some advantages that we are able to conduct the training in a very efficient manner, rather than visiting them or have them visit us. And at the same time, our agencies are starting to feel the benefit or the convenience of using digital tools.

So as a result, we do believe that there will be some improvement in efficiencies as well as productivity by leveraging digital tools. That's all from sales perspective.

Daniel Paul Amos
Chairman & CEO

Let me -- this is Dan. Let me say one other thing. I want to make sure it's clear. The closing of shops is only temporary. We're still going to be using the shops. It very much plays an important role in Japanese culture. They actually like to bring the families in, sit down and discuss their overall products that they own and what they have. And we -- what this has done for us, talking about with change brings opportunity, it's forced our sales associates to use technology more and ultimately will enhance us long-term. So I wanted to be sure we said that.

Frederick John Crawford
President & COO

And Rich Williams, why don't you comment on the U.S. and our activities to pivot.

Richard L. Williams
Executive VP & Chief Distribution Officer

Okay. Very good. So Humphrey, thanks for the question. I'll just speak maybe near-term about what we see the preparation for worksite and then really what the future holds. Really through the first 11 weeks, we were seeing a very favorable quarter play out. And then as everyone knows, we had a 42 state stay at home or shelter in place, and that basically just stopped the progress of worksite sales. So near term, until businesses get back in business, I think we'll see about this level. From a preparation perspective, for the worksite, we've always had multiple enrollment options, face-to-face enrollment call center, self-enroll, using digital means. And what you're seeing right now is really the ingenuity of our sales force and leveraging those latter 2 tools, enrollment call center and co-browsing and self-enrollment, to be able to sell in this sort of impaired environment. I think thirdly and more broadly -- I know both Dan and Fred made these comments -- is the plan for the future. We're expanding our value proposition to increase access and distribution diversification with our consumer markets, building of that business as well as our Aflac Dental and Vision and now our Aflac Group benefits. I think that's the perspective of the U.S.

Frederick John Crawford
President & COO

So Humphrey, hopefully, that covers it for you and others in terms of what we're seeing out there production-wise and this attempt to pivot. I think one general theme we're seeing, both in Japan and the U.S., is that digital communication, non-face-to-face communication, has always been the secondary approach, the primary being face-to-face. Now you have agents and distribution partners having to pivot to making digital the primary and face-to-face a secondary. That takes a little bit of time to make that switch. And so we'll just have to be patient and work to support those efforts. We can go to the next question.

Operator

And our next question comes from Nigel Dally from Morgan Stanley.

Nigel Phillip Dally
Morgan Stanley, Research Division

So I wanted to question -- I had a question on the U.S. operations. Small businesses clearly being hit very hard. And in addition to lower sales, you mentioned pressure on persistency. How much higher should we expect lapses to go? Is that going to be a major headwind? I think you mentioned a 3% potential premium decline, but I don't think you mentioned the sales and persistency assumptions on which you base that. So any color there would be helpful.

Frederick John Crawford
President & COO

Yes. The -- I think as it pertains specifically to persistency, it's a very tricky dynamic. We have historically seen our persistency, for example, during the last financial crisis, track unemployment levels, and that is that we see greater lapsation or weakness in persistency during periods of high unemployment. And so it stands to reason we would have that as a sensitivity test or a stress test as part of looking at the U.S., and that's why we provided that number. Obviously, it's quite severe in its approach, particularly any sort of prolonged level of unemployment at the levels I discussed, 20%. But nevertheless, it's a worthwhile stress to apply. I would say that one other aspect to be aware of is that we're providing right now guarantees, if you will, waivers of premium payment while guaranteeing the policy remains in place. And it differs by state, but generally speaking, it tends to be upwards of 90 days or so, 60 to 90 days, depending on the dynamics. Similarly, we're doing that in Japan. When you do that in the United States, what happens is you see actually persistency remain high until such time those efforts are released and then you'll find a level of shock lapse typically, particularly if there's unemployment associated with the crisis.

We know this. We have some experience in this because this is very commonly done in states where there's been natural disasters, hurricanes, even recently tornadoes in Tennessee, for example. And so this is not an unusual event. What is unusual is that it's nationwide. And so what we're trying to do is understand what that sensitivity might be like. It has very little bottom line implications, because you're releasing reserves, you're writing off DAC. And so this is not necessarily a profitability or margin issue. It's really more related to your earned premium. And that's why we provided that forecast.

I think, Nigel, that's a very severe stress. We certainly hope we wouldn't get there. We're -- we find it beneficial that the stimulus packages that are being announced are directed towards small businesses and are wired to payroll and maintaining employment, which is how we collect our premium and how we sell our product. So there are some offsetting or mitigating factors, but we have to take a conservative approach when we're applying a stress test.

Operator

And our next question comes from Jimmy Bhullar from JPMorgan.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

I just had a question on the Japan Post, and if you could just give us an update on what's going on there. And how you see your business sort of trending through the Post over the next -- especially in the near term?

Daniel Paul Amos
Chairman & CEO

Well, I think Koide should start with that, and then I might say something afterward. Koide?

Masatoshi Koide
President & Representative Director

[interpreted] Japan Post group is currently doing additional research or investigation into their policyholder base. And they are also trying to gain confidence of the policyholders at the same time. And although the administrative order for suspending their sales was until the end of March, Japan Post is voluntarily refraining from sales at this moment still from April and after as well. So from Aflac perspective, we are trying -- we are supporting Japan Post Group's activities to recover or reinstate the confidence of the customers. We do respect and we would like to support their activities. So what we are trying to do right now is to help them conduct -- to take in the customers' needs and then try to sell, and trying to train them to do solicitation from that perspective. And then at the same time, conducting these kind of trainings, we are also enhancing solicitation management activities as well. And what we are expecting is that whenever Japan Post sales resume, they are able to sell our cancer insurance based on customer needs and have appropriate solicitation management in doing their sales. And the situation continues that since Japan Post group is refraining sales of Japan Post insurance products, which means that cancer -- our cancer product is not selling that much as well. So we are in that situation. And that's all for me.

Daniel Paul Amos
Chairman & CEO

I'll make a couple of comments. I don't believe our Japan Post relationship has ever been any stronger. I believe, and no one knows in these uncertain times, but this is just my personal belief and gut feeling from being a CEO for 30 years, is that when the COVID issues pass to some degree, and we go back to whatever the new normal is, we'll see a pickup in Japan Post and things will start back again. And so I'm encouraged about that. As you know, they're our largest shareholder, and we are confident that that relationship was made even stronger with that acquisition. And it's in their best interest and our best interest to see cancer insurance grow with them. And I think we'll see that moving forward.

Operator

And our next question comes from John Barnidge from Piper Sandler.

John Bakewell Barnidge
Piper Sandler & Co., Research Division

This question is on the investment portfolio. Can you talk about rental forbearance experience? And then maybe based on communications, what your expectations for May 1 are?

Eric Mark Kirsch
Executive VP, Global Chief Investment Officer & President of Aflac Asset Management LLC

Sure. Thank you, John. To date, or at least through the end of March, we didn't have any. We certainly expect going forward there to be some. We don't necessarily think a huge amount, just because of the nature of our properties. But where we do have them, as I mentioned in the speech, we'll be making more amendments to loans, getting other protections in return and just really adjusting cash flows. So we do expect those, but we don't expect financial difficulty at the end of the day for those sponsors that may need it.

Operator

[Operator Instructions] And our next question comes from Erik Bass from Autonomous Research.

Erik James Bass
Autonomous Research LLP

Can you provide a bit more color on how you're thinking about the NII outlook over the near term? And also beyond 2020, when some of the current hedges roll off and I think you have some more reinvestment risk?

Eric Mark Kirsch
Executive VP, Global Chief Investment Officer & President of Aflac Asset Management LLC

Sure. As reported, the first quarter was slightly better than we had expected; we did get most of our deployment in middle-market loans done by the end of February for the quarter. So that was fortunate just because, as I reported, it will be slower the rest of the year. As we think of the rest of the year, I'll put it in 2 buckets, the stable and the variable, the alternatives, just because it's 2 different stories. On the stable, we actually expect it to be a fairly decent year despite some of the headwinds of lower rates on our floating rate book. As I've reported, we locked in our hedges and our income. So despite the low drop in LIBOR, we're protected by the hedges we did and the LIBOR floors. And in fact, because of the precipitous decline in LIBOR, our hedges actually ended up performing better than we expected because more loans hit the floor, that was so extreme.

So actually, we were able to book some of that extra income, if you will, which will help offset some of the headwinds naturally from lower rates. The other thing to mention through the year, part of our allocation actually does go to yen assets. And in a surprise that we haven't seen in a number of years, yen yields have actually been stable to going up a little bit. So relative to our plan, that put us in a good position. And when we are buying yen, we continue to see actually attractive opportunities in the yen public credit as well as some yen private placements, where we can find good credits and earn a spread.

So on that part of the allocation, doing relatively well. Obviously, for alternatives, we're expecting lower variable income versus our plan. Now that'll depend on what happens with equity markets. Now they're up. There's still a lag effect on valuations. But our base case right now is lower than we had planned. But if you put that all together between the stable and the variable, we're feeling like we're going to come right in the strike zone, maybe a bit better versus planned for the year.

Looking forward, I obviously can't really comment holistically in the sense of being specific to 2021. But to your question, Erik, around the floating rate assets, as I've mentioned in many FABs and answering other questions around this, the way we think of those floating rates is as a natural hedge between hedge costs and the income. And right now, we're in an environment where, if you were to just say today was January 1, and I don't have the specific days of the rolls of our group 1 hedges, but they're around -- in the fourth quarter, maybe beginning January and February -- but if you just said we roll them right now, well, for this year we locked in hedge costs in the area of 210, 220 basis points because we locked them in in December and January. Well, right now, 3-month hedge costs are, I think, last night, 69 basis points.

So if the notional of our floating rate book is the same, our hedge costs will go extremely down. The same token, those loans, which are based off of LIBOR, those are resetting down. Now they have LIBOR floors, so there is a natural protection. But the point of me saying it that way is, at the end for net investment income, I'm looking at the net result. The net result of the income on the assets, less the hedge costs.

So all things being equal, we actually see that net result being fairly manageable going into next year, if you take out any onetime gains like from hedges that I described earlier for this year. So as time goes on, we'll see, but that's how I would think of group 1. And then the rest of the book, obviously if reinvestment rates continue to stay at this low level, again, as you know, we have high level -- high coupon private placements from years ago maturing, so that would be a headwind going forward into income. Hope that helps.

Operator

And our next question comes from Tom Gallagher from Evercore.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Fred, just a follow-up on your question about the premium waivers that you had mentioned, 60 to 90 days in the U.S. Can you comment on what percentage of your in-force in the U.S. is currently paying versus what percent is on this premium waiver? And is that a decent way to gauge some proportion of that might end up lapsing? Is that the way you're approaching it?

Frederick John Crawford
President & COO

It's a good question, and we're studying all those metrics, Tom, for that reason, but it's a bit early to give you anything with any sort of concise nature. It's just been rolled out state by state. We're just getting into it. What I would tell you is we're collecting our received premium. We're calculating our received premium. And actually, I just saw a report on that yesterday, and it was into the month of April, which is really where things are kicking in. And so far, we haven't seen much movement in terms of collected premium. I think it's down a little bit from last year at this timeâ€¦

Teresa Lynne White
President of Aflac US

Yes. Fred, this is Teresa. I think we have 86.2% of premium collected versus 87.6%. So we're still doing pretty well on premium collection, and that's collecting through invoices to the worksite. It's a little bit less on the -- I'm sorry, it's a little bit more on the group side, 89% collected. But we're doing relatively well.

Frederick John Crawford
President & COO

Thank you. So we're tracking that, Tom, and we'll have to continue to watch it. But we've been here before. As I mentioned earlier, we've had to do this in various states. Florida, Texas, et cetera, with hurricanes, California fires and so forth. So we understand how this works and typically operates. And so we've got a good handle on it.

Operator

And our next question comes from Alex Scott from Goldman Sachs.

Taylor Alexander Scott
Goldman Sachs Group Inc., Research Division

My first one is just a quick follow-up on the last question, actually. And I'd just be interested, is there anything going on in Japan around premium relief? And way to think about an impact there as well?

Frederick John Crawford
President & COO

We can have Koide add any comments he wants. But the answer is yes. There is a somewhat industry-adopted conventional practice of allowing premium waiver for an extended period of time. I think the big difference in Japan is that you tend not to see necessarily implications for persistency, because these policies are age priced there. As you know, the Japanese consumer values the policy and has very specific intentions around the policy protecting savings and their livelihood. And so while the waivers do matter from an economic perspective, we tend not to see dramatic movements in persistency related to what I mentioned earlier in the U.S. but if I'm off on that, either Todd or Koide, if you want to add any color.

Masatoshi Koide
President & Representative Director

Todd, could you answer that question?

James Todd Daniels
Executive VP, Director & CFO of Aflac Life Insurance Japan

Sure. Thank you, Koide. Yes, Fred is correct. Just to be clear, this is a premium grace period, not necessarily a premium waiver that's being put in place. So we're not forgiving premium in any of these cases. Japan does have special circumstances, and as Fred said, has been adopted by industry. Each company that operates in Japan is looking at the situation in the states of emergency and adopting their practices during that time period.

Frederick John Crawford
President & COO

Yes. And thanks for making that point, Todd, that both in the U.S. and in Japan, these are grace periods, not waivers in the sense of outright waving the collection of premium.

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

Brittney, I think that concludes our call.

Operator

Thank you for your participation in today's conference. All parties may disconnect at this time. Speakers, please stand by for your post-conference.
[Portions of this transcript that are marked [Interpreted] were spoken by an interpreter present on the live call.]