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Aflac Incorporated NYSE:AFL

FQ3 2017 Earnings Call Transcripts

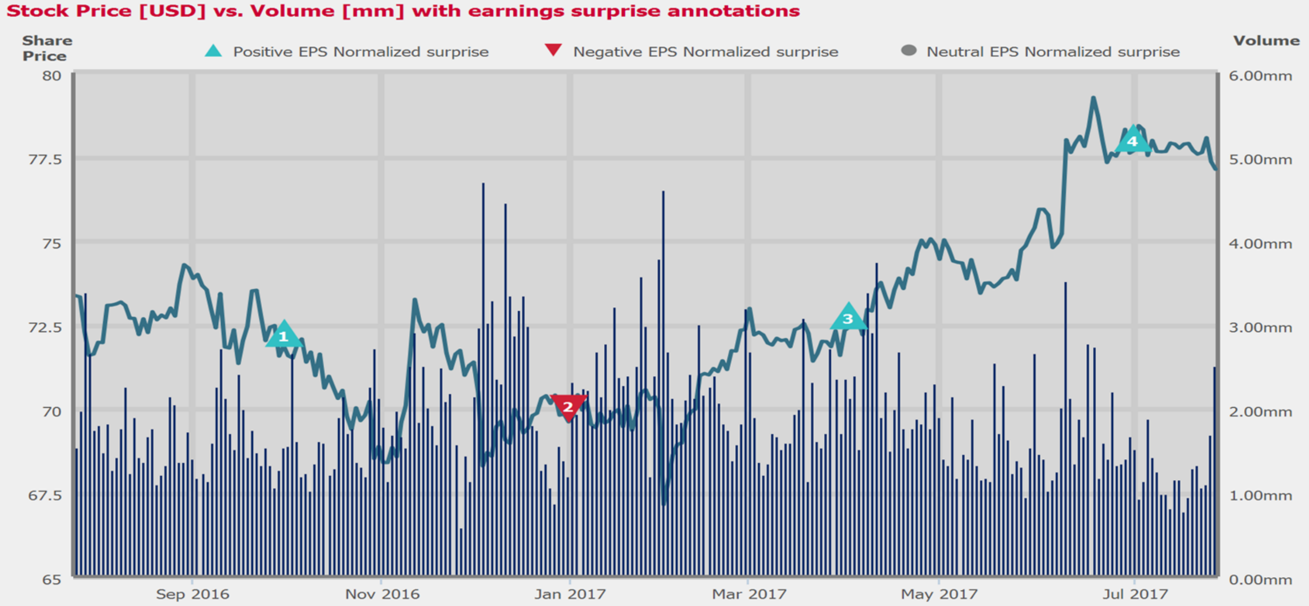
Thursday, October 26, 2017 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2017-			-FQ4 2017-	-FY 2017-	-FY 2018-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.63	1.70	▲4.29	1.54	6.71	6.79
Revenue (mm)	5481.00	5506.00	▲0.46	5459.50	21356.53	21741.93

Currency: USD
Consensus as of Oct-26-2017 11:30 AM GMT

Stock Price [USD] vs. Volume [mm] with earnings surprise annotations



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2016	1.74	1.82	▲1 4.60 %
FQ4 2016	1.63	1.54	▼2 (5.52 %)
FQ1 2017	1.62	1.67	▲3 3.09 %
FQ2 2017	1.63	1.83	▲4 12.27 %

Call Participants

EXECUTIVES

Daniel P. Amos
Chairman & CEO

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Global Chief Investment Officer & Executive VP

Frederick J. Crawford
Executive VP & CFO

Masatoshi Koide
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Presentation

Operator

Welcome to the Aflac Third 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 Mr. David Young, Vice President of Aflac Investor and Rating Agency Relations.

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

Thank you, and good morning. Welcome to our third quarter call. Joining me this morning from the U.S. are Dan Amos, Chairman and CEO of Aflac Incorporated; Kriss Cloninger, President of Aflac Incorporated; Fred Crawford, Executive Vice President and CFO of Aflac Incorporated; Teresa White, President of Aflac U.S.; Eric Kirsch, Executive Vice President and Global Chief Investment Officer; and Todd Daniels, Executive Vice President, Global Chief Risk Officer and Chief Actuary. Joining us from Tokyo are Masatoshi Koide, 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're prospective in nature. Actual results could differ materially from those we discuss today. We encourage you to look at our annual report on Form 10-K for some of the various risk factors that could materially impact our results.

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

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

Daniel P. Amos
Chairman & CEO

Thank you, David. Good morning, and thank you for joining us. Let me begin by saying that the third quarter concluded a great first 9 months for Aflac and well positioned us to achieve the goals we set out to achieve for the year. As you likely saw from yesterday's press release, these strong results gave us confidence to upwardly revise our operating earnings per share outlook for the year to the range of $6.75 to $6.95. Fred will provide more context on earnings and our outlook during his comments.

Let me now provide an update on Aflac Japan, our largest earnings contributor. Despite the persistent low-interest rate environment, Aflac Japan generated solid financial results for both the quarter and the first 9 months of the year. In yen terms, the results on an operating basis were ahead of expectations for the year. Aflac Japan's third sector sales increased 2% in the quarter, rounding out a solid increase of 5% for the year. Quarterly sales results continued to benefit from the February launch of our revised medical product EVER. Additionally, as you may be aware, our Income Support Insurance is conceptually a new product, not just for Aflac, but also for Japan. As with any new concept, it takes time to catch on, but I believe our sales force will continue to embrace it. We have high expectations that this product will continue to grow over the long term.

Within the low-interest rate environment, you'll recall that we have de-emphasized first sector savings products like WAYS and child endowment by only selling them in select channels and aggressively repricing these products.

Aflac Japan continued to make significant progress controlling the sale of first sector savings type products down materially in the quarter. Additionally, we are renewing our focus on developing competitive first sector protection products to round out our product lineup.

Regarding distribution, we had meaningful production across all channels, which further establishes our leading position in the third sector market. Our traditional agencies have been and remain vital to our success. Our alliance partners also made significant contributions to our sales results. With such an extensive distribution network that includes Japan Post, 20,000-plus postal outlets selling our cancer insurance, we're solidifying our goal to be where people want to buy insurance.

Looking ahead, Aflac Japan's focus will remain on selling our third sector products, along with first sector protection products, both of which are less interest rate-sensitive and have strong and stable margins. We will continue to develop new third sector products specifically designed to enhance our strong market share, provided they meet the risk management standards we set forth. Our new medical product has done well, and we will continue our pattern of [refreshing] our cancer and medical products to defend and build upon our leading position.

As discussed at the financial analyst briefing, near-term growth rates for the third sector products face challenging comparisons. Which (sic) [while] we expect strong results for the year, we anticipate the fourth quarter will be relatively flat in comparison to 2016.

Strong sales in 2017 were largely due to the launch of our EVER medical product early in the first quarter 2017. In 2018, we've scheduled our product launches to follow Aflac Japan's conversion to a subsidiary to avoid any unnecessary rework or policy disruption post conversions. Taking these factors into account, we expect the first half of 2018 to be down, then recovering in the second half of 2018. We continue to target a long-term growth rate in the range of 4% to 6% through 2019, and we'll update as to our forecast what firms up. Don't lose sight that over the past 4 years, we've taken our third sector new sales from JPY 70 billion to about JPY 85 billion, and that's good business with strong margins. It's also meaningful given our leading market share.

Turning to Aflac U.S. operations, we are pleased with the financial performance and continued strength in the profitability of Aflac U.S. Like Aflac Japan, our financial results for Aflac U.S. on an operating basis were ahead of expectations, which is particularly notable in that they also reflect ongoing investment in our platform. A definite highlight of the third quarter was Aflac U.S. new sales increase of 7.5%, which brings our 9-month sales increase to 3.8%. This outstanding quarterly sales results confirms our focus on the U.S. growth strategy. However, keep in mind that the timing of sales can vary from quarter-to-quarter, but I continue to be encouraged by what I'm seeing with U.S. sales growth. It is exciting to see our platform investment pay off not just in sales, but also in customer satisfaction. It's also energizing to see surveys that indicate that 95% of our policyholders who use One Day Pay are likely to refer other people to Aflac. This demonstrates that One Day Pay is not only a fast claims initiative, it's a way of doing business that helps set our brand apart. Independent research continues to show that there is no doubt American consumers need cash quickly, and paying claims fast and fairly distinguishes us from the competition.

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

Turning to the broker activity. Given the positive results we've seen within our efforts in our Large-case broker space, we continue to expand our broker sales team with new roles designed to focus on the mid-case broker space. I'm pleased with the progress we've made.

The sales accomplishments we've seen in the quarter only further our determination to enhance our sales channel and further sales results. We will continue to make tactical adjustments to meet our long-term growth objectives. We continue to anticipate a long-term sales growth of 3% to 5% in new annualized premium through 2019.

With respect to capital deployment, Fred will provide more details shortly, but let me just say that we remain committed to maintaining strong capital ratios on behalf of our stakeholders. We continue to anticipate that we will repurchase in the range of $1.3 billion to $1.5 billion of shares in 2017. As is always the case, this assumes stable capital conditions and a absence of compelling alternatives. I'm very pleased with the Board of Directors' action to increase the quarterly dividend by 4.7%. This marks the 35th consecutive year of increasing our cash dividend and demonstrates our commitment to rewarding our shareholders. Our dividend policy is guided by growth in operating earnings per share along with free cash flow generation and capital quality.

I'll conclude by reiterating how proud I am of the management team, the employees and our sales organization in Japan and the United States as they have worked incredibly hard to generate the results we've shared. Quarters like this only fuel my excitement for Aflac's future and what we can accomplish.

Now I'll turn the program over to Fred. Fred?

Frederick J. Crawford
Executive VP & CFO

Thank you, Dan. Our earnings results for the third quarter came in above our expectations, but consistent with the strong margins we have experienced throughout the year, both in Japan and in the U.S. We reported operating earnings of $1.70 per diluted share. Following a particularly volatile period last year, the yen weakened nearly 8% as compared to the average for last year's quarter, which impacted our comparable performance negatively by $0.07 a share. We concluded as part of our annual actuarial review process that it was appropriate to reduce specific IBNR reserves for our Japan cancer business by JPY 2.4 billion, contributing roughly $0.04 a share to the quarter's EPS. This adjustment is similar to the actions taken in the third quarter last year and reflects continued strong cancer claims experience. We booked approximately $10 million in pretax costs associated with our Japan branch conversion. The conversion remains on track for a mid-2018 closing, with most of the heavy lift and expenses expected over the next 9 months. There is no change to our guidance on total conversion costs of $120 million to $130 million pretax.

In our Japan segment, premium growth continues to be pressured by our first sector savings product, WAYS, and a portion of our block reaching paid-up status. This contributed to a JPY 19 billion decline in first sector earned premium as compared to the previous year. Meanwhile, continued growth in third sector sales drove earned premium up approximately JPY 6 billion in the quarter.

Our Japan segment profitability was strong in the quarter with pretax margins of nearly 20%. Our total benefit ratio in Japan continues to trend favorably in 2017, driven in part by a shift in earned premium mix from first sector towards third sector. The shift in the premium mix has reduced our year-to-date reported benefit ratio by approximately 100 basis points as compared to the previous year. Importantly, our third sector benefit ratio, while favorable, performed consistent with recent experience on a normalized basis.

Our expense ratio in Japan remains stable, but we expect will increase to the midpoint of our range provided at this year's FAB Conference as we move through 2018.

Drivers include first sector premium declines along with the same premium mix dynamic that is positively impacting our benefit ratio, but naturally pressures our reported expense ratio. In addition, we plan to step up our investment in product development, digital and IT initiatives designed to drive future growth and operating efficiencies.

While down year-to-date, Japan's investment income has performed favorable to our original outlook call expectations. Investment income has been pressured by lower reinvestment yields and higher hedge costs versus prior year. We continue to make progress on the buildout of the floating-rate portfolio in Japan and have invested approximately $625 million through September, with a building pipeline of commitments. Our U.S. dollar floating-rate portfolio includes bank loans, middle market loans and transitional real estate, and stands at $2.6 billion or approximately 11% of our U.S. dollar portfolio at quarter end.

In terms of hedge costs, we are on pace to come in below our full-year guidance range. We have benefited from favorable pricing and modestly lower hedge ratio. As a result, we are now forecasting hedge costs in the $230 million to $240 million range for the full year 2017.

Turning to the U.S., Dan commented on our sales results, which together with improved persistency, drove premium growth to just over 2% in the quarter. Benefit ratios show continued strength relative to our 2017 guidance range. Our expense ratio was favorable in the quarter, with year-to-date performance of approximately 34%, more in line with our guidance for the year.

Our expense ratio reflects progress on certain platform investments, including our group administrative platform, enrollment platform and related technology.

Overall, U.S. pretax profit margin at 20% remains strong by historical standards. Our overall capital condition and associated metrics remain healthy at healthy levels. Japan SMR and ESR, U.S. RBC and overall excess capital conditions are consistent with the updates provided at our FAB conference. Overall credit conditions and asset quality remain strong with only a modest level of impairments in the quarter. Of note, this month we issued JPY 60 billion of subordinated debt priced at 2%. I mentioned at our conference a focus on optimizing our capital structure, and the proceeds from the offering will ultimately refinance a callable $500 million subordinated debt security with a 5.5% coupon. We repurchased $219 million of stock in the third quarter and remain comfortably on track to repurchase between $1.3 billion and $1.5 billion worth of our stock for the year. As we discussed at our FAB Conference, we remain tactical in our approach to repurchase.

As Dan noted in his comments, earnings growth, cash flow and capital strength all support our board's decision to increase the quarterly common stock dividend by 4.7%, marking our 35th consecutive year of increase. Bolstered by sustained strong margins in both Japan and the U.S., we are increasing our 2017 earnings guidance to $6.75 to $6.95 per share on a currency-neutral basis.

Our normalized outperformance has been driven by a combination of strong pretax margins in Japan, favorable investment income and hedge costs as compared to our original expectations. Overall stability in U.S. margins and modestly lower effective tax rate for the year also contributed.

Looking ahead, we remain well positioned in terms of our core margins and capital strength, recognizing our desire to invest in the platform for future growth. We'll provide greater detail on our December outlook call.

I'll now hand it over to David to take us to Q&A. David?

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

Thank you, Fred. Now we are ready to take your questions. [Operator Instructions] .
Operator, we'll now take the first question.

Question and Answer

Operator

[Operator Instructions] The first question is coming from the line of Mr. Nigel Dally of Morgan Stanley.

Nigel Phillip Dally
Morgan Stanley, Research Division

So hoping to get some additional data behind the U.S. sales increase. Perhaps some detail on how that increase broke down between the brokerage and agency channels. And also with the brokerage channel, just interested as to how the pipeline is building for the fourth quarter, given that it tends to be back-end loaded?

Frederick J. Crawford
Executive VP & CFO

Nigel, thank you for the question. So as it relates to U.S. sales for the third quarter, I'll give you 3 observations. The first is, we saw positive results in all of the areas of focus that I've been talking about in 2017: career agent, veteran engagement, new associate conversion to producer, middle market broker sales and public sector business. So all of those areas are working well for us in the third quarter. Second thing that I'll mention is, Dan talked about a shift from -- of the sales and how they can vary from quarter to quarter. Well, in the third quarter, we saw higher-than-expected growth in the large broker market, which normally, as you know, skews toward the fourth quarter. However, as we looked at the data, without that large case -- without those large cases our sales team still had strong performance, around 5% for the quarter. The third thing I'll mention is that I'm very encouraged about the growth that we're seeing through the successful execution of our initiatives without changes in the fundamental business practices that we've set forth. So we're building confidence in our strategy, we're building confidence in our sales leadership and we're building confidence in their ability to execute. As to the attribution question, as we look at the broker sales versus the career agent sales, first, the -- Aflac is seeing the same rate of growth from brokers as the market's seeing. So market rate is -- market growth sees an increase on the broker side, while Aflac is experiencing the same thing, and we saw that more pronounced in the third quarter. The second thing I'll say is that, as we're executing on the strategies, both channels are performing. We believe that the bonus programs that we introduced in 2015 allowed the career agents to focus on growing career producers and on sales in the small business markets. We believe that's working. And on the broker side, we're seeing that the broker expansion strategies discussed earlier in the year are coming to fruition, translating into better market growth in that channel. So I hope that answers your question.

Operator

The next question is coming from the line of Humphrey Lee of Dowling & Partners.

Humphrey Lee
Dowling & Partners Securities, LLC

Just a question on the Japan sales. It softened a little bit in the quarter, but at the same time, on a year-to-date basis it seems to be remaining on track. Would you say it's just simply a sign of the product cycle, the products are kind of reaching some level of saturation? And then kind of thinking ahead, would we expect a similar refreshing cycle as you did in 2017?

Masatoshi Koide
President & COO of Aflac Japan

[Foreign Language] This is Koide from Aflac Japan. [Foreign Language] I would like to explain about new product cycle. [Foreign Language] And in terms of medical insurance, competitive environment is becoming much more fierce. [Foreign Language] And so the products that we have seen -- that we're seeing has a coverage where the benefit changes and the premiums are going down. [Foreign Language] So what we need to do is always watch out for what competitors are doing and then perhaps follow up on other company's products or we may want to take a step ahead in the competition. [Foreign Language] So as a result, we have been able to secure -- we have been trying to secure our share by revising our product in a relatively short cycle between a year or 2 in medical insurance. [Foreign Language] And by following the cycle that I have mentioned, we have been able to revise our new medical product in February this year, and as a result, we have had good sales of this product. [Foreign Language] Now let me touch upon the cancer insurance. [Foreign Language] Since we have an overwhelming position in the Japanese cancers insurance market [Foreign Language] and with advancement of treatment technology and also taking into account of the environmental changes of cancer insurance or cancer itself [Foreign Language] and so our policy is to develop products that customer really needs. [Foreign Language] So therefore compared with the medical insurance, the product development cycle is longer, which is 3 to 4 years. [Foreign Language]. And we have been able to maintain our leading position in the cancer insurance under this policy with a new product development, and we have been continuing with this policy. [Foreign Language] And that's all from me.

Daniel P. Amos
Chairman & CEO

I'd like to make one other comment about it. When Koide mentioned aggressive competitive environment, that really hasn't changed. It's been aggressive for years. And we're constantly on top of it, but the pattern that I have seen in sales is no real change. The only change that I really see, and we basically told you that the second half were tough comparisons, so the third quarter and the fourth quarter should be no shock to anybody what we've said. We are ending up in the range we told you. And then for next year, it's simply because of the shift of that product that will be one of the reasons. But let's be clear, the hardest part is not the competition, it's the comparables of growing from JPY 70 billion of new sales to JPY 85 billion of new sales and just the law of numbers becoming tougher. But all in all, I'm very pleased with the results of what's going on in our sales department.

Humphrey Lee
Dowling & Partners Securities, LLC

So in terms of the current product suite, do you think there is still some lag underneath it for another year or so? Or do you feel like you may have to refresh it a little bit in 2018?

Daniel P. Amos
Chairman & CEO

I think you'll -- you're going to see a new -- a revised product in 2018 in the second half.

Humphrey Lee
Dowling & Partners Securities, LLC

Got it. And then just a quick follow-up on U.S. sales -- and I believe there is some hurricane-related impact in the quarter, but still delivered very strong sales results. We think -- how should we think about these hurricane-related impact in the third quarter? And do you anticipate any kind of further impact in the fourth quarter as you go through the beef of the renewal cycle?

Daniel P. Amos
Chairman & CEO

So thank you for the question. Three things as it relates to hurricane impact. From a sales perspective, we anticipate the impact of hurricanes to be about 1% of U.S. 2017 sales, and so that includes the third and fourth quarter. From a persistency perspective, the figures in the FAB supp are slightly elevated due to the emergency orders that we're following, the hurricanes in September. So those orders, as you know, mandate that the affected counties -- we don't lapse policies in those affected counties for about 60 days. Now -- so we estimate the impact of that to be about 20 basis points from a persistency perspective. While we don't see any material increase in the loss ratios due to claims, we are monitoring the benefit ratio due to the impact of lapsed accounts -- the potential impact of lapsed accounts. And Fred, is there anything else you want to add?

Frederick J. Crawford
Executive VP & CFO

Yes, I think it might be informative just how do you deal with these types of natural disasters from the standpoint of our financial statements and benefit ratios. Look, the punchline is that you should not expect and we do not anticipate any material financial movement in our core margins as a bottom-line impact. So I would not worry about that. We're not worried about that, but it is interesting. You obviously have the Virgin Islands, Puerto Rico, really the entire state of Florida and then sections of Texas that were affected. And what we do is, because there is a -- basically a blackout, if you will, of paid premium and submitted claims as people are dislocated from their homes and away from work, and so forth, we have a way in which we can estimate what we would have expected the premium levels to be and the submitted claims level to be, and we adjust our due premium assumptions as well as our IBNR to take that into account. And that's done through an estimation process. When it comes time to -- as you may know, the states actually put what amounts to a stay in place, that requires keeping policies in force while people are dislocated. And so we have to make these estimates as to how the business would have performed had that stay not been in place. When it comes off of that dynamic, which is typically about a year long, it can be shorter at times depending on the nature of the disaster, there'll be some movement in policies, such as policy lapsation, which is what Teresa talked about. And in that case, what you will have under a lapsation dynamic is, you'll have a natural release of reserves on the product, which could actually benefit your benefit ratio, but that's offset by DAC amortization, accelerated DAC amortization, which weighs on your expense ratio. From a bottom line perspective, you're not impacted, but you will see those moving parts. In any particular quarter, it may be noticeable, and we'll point that out if it takes place. But I would tell you over a year's time frame, it's a rounding error and does not adjust our outlook.

Operator

The next question is coming from the line of Mr. Jimmy Bhullar of JPMorgan.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

The first question I had was just on buybacks. I think you mentioned you're still committed to your $1.2 billion to $1.4 billion range for -- or $1.3 billion to $1.5 billion range for 2017. That implies a significant pickup in buybacks from what you've been doing in the last few quarters, and I think roughly $300 million to $500 million in the fourth quarter based on your range. So what's going to -- like how do we think about where you're going to come out in that range? And what's really going to be the deciding factor from your standpoint? Is it the stock price? Or is it something else you're watching to see whether you are higher end or lower end of that range?

Frederick J. Crawford
Executive VP & CFO

Yes, it's -- when I made the comment, Jimmy, in my script comments, if you will, that we're being tactical, but quite honestly, it's substantially similar to the tone and discussion we had at our conference, and that is, we've got to start weighing alternatives for our excess capital, including reinvesting back into our business and that it's not just going to be automatically repurchased, particularly as we trade up towards our view of intrinsic value. And so we're going to be more tactical. Having said that, I'm comfortable that we'll be within the range, but I think when looking at the fourth quarter and just a practical approach to repurchase, it's likely the case that we'll be at the midpoint or lower than the midpoint of that range as we are tracking. And again, that really has more to do with paying careful attention to the expected returns on our excess capital. So we continue to repurchase, we'll continue to -- that pace, but I think from a practical perspective I would not anticipate the mid- to high end of that range all in the fourth quarter.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

Okay. That's helpful. And I had a follow-up on the question on Japan sales. Specifically, on the income support product, your sales were down from last year. They've been flat the last few quarters. So what's your expectation of the ramp-up in sales of that product over time? And has -- have the results over the past few quarters affected your view of the potential for that product? Do you think it's more limited than you might have thought initially?

Daniel P. Amos
Chairman & CEO

I still -- I'm going to go ahead and answer that. I still believe it's a strong product. Sales agents take the path of least resistance. And when the medical product came out, they jumped back on it and moved away from this other product. As we've experienced, if you go back years to introduction of accident or other things, it took a while to get the sales force into it. You need to pay some claims. You need to be able to use those as examples. It's just going to take time. It isn't going as fast as I would like, but I still am very encouraged. And I was -- I've been in Japan twice since August and I had a lot of discussions with this, and we've got some contests that are small that are coming up that we'll do in the first quarter and continue to try to push it. But it's -- anytime you're doing something brand new, especially when it's never been out there at all to the industry, the good news is it has enormous potential. The bad news is that it's new and people don't know exactly what to do with it yet. But time will tell, but I'm convinced it's going to be a winner. It's just going to take a little while.

Operator

The next question is coming from the line of Mr. Tom Gallagher of Evercore.

Thomas George Gallagher
Evercore ISI, Research Division

Dan, just a question on the comments you made about the first half '18 sales in Japan, that you expected them to be down based on -- was that the delay of new products because of the subsidiary conversion? Or can you elaborate a bit on that?

Daniel P. Amos
Chairman & CEO

Yes. Well, first of all, it's a tough comparison in the first quarter. Let me be clear, our strongest quarter was the first quarter, so -- in terms of percentage increase. So that's the first thing I'll tell you. And the first quarter will be much harder than the second quarter. But in addition to that, it's because the first quarter we won't have a new product. We believe that with all we've got going on with the conversion and we expect it to be on time, we don't want to have anything going on with the systems that will separate us from any issues that might occur. So we've just decided to delay the product introduction until the second half of the year or certainly in late second quarter after the conversion is done. So it's just the delay time on it. So I look for a stronger second half versus a stronger first half, which we saw this year.

Thomas George Gallagher
Evercore ISI, Research Division

Got you. And then Fred, I just wanted to make sure I understood the comments that you made about Japan. Did you say that you thought margins heading into 2018 would be more midpoint of guide versus sort of the high end of the guide that they've been running at more recently? Was that where you saw things going into 2018?

Frederick J. Crawford
Executive VP & CFO

No, that comment was specific to the expense ratio in Japan. And so what I'm referring to there is at our conference, we talked about the expense ratio in Japan for a 3-year period being in the range of 19% to 21%, and so my comment was, when looking at that long-term range, as we proceed through 2018, we would expect to be in the midpoint of that range. As you can see, we are traveling just a touch above a 19% expense ratio in Japan. And note that, that expense ratio is really not an expense issue as much as it is a revenue issue, and that we are fighting both the combination of paid-up policies driving premium down in the first sector space as well as the natural decline in net investment income year-over-year based on the rate environment. So that's what we've been fighting. It's really been a revenue fight, not an expense issue. That continues to be with us as we go into 2018. The difference being, though, we are in fact stepping up some of our investment on digital and technology really with the idea of driving long-term efficiencies and driving growth. So my comments, Tom, were really more specific to the expense ratio. Meanwhile, our benefit ratio is doing much better in Japan, and it's doing much better mainly because of the mix-related issues. So as we do pull back on first sector and continue to grow our third sector business, we're seeing a shift in earned premium towards third sector, which naturally carries a more favorable benefit ratio. As I've mentioned, year-over-year that's contributed 100 basis points to our benefit ratio. And as a result, we actually lowered our long-term guidance for benefit ratio range over the next 3 years. So bottom line, i.e., pretax profit margin, we would expect to continue at a relatively stable level with what we've experienced in 2017.

Thomas George Gallagher
Evercore ISI, Research Division

Got it. So Fred, did the 2 of those things largely offset each other, would you say, the elevated expense ratio and then the move down in benefit ratio?

Frederick J. Crawford
Executive VP & CFO

Yes, in general. In general, Tom. Obviously, there is a lot of moving parts as you can imagine. But in general, when it comes to pretax profit margin, we end up holding to a stable margin with those 2 elements offsetting.

Operator

The next question is coming from Alex Scott of Goldman Sachs.

Taylor Alexander Scott
Goldman Sachs Group Inc., Research Division

Could you just provide an update on the, I guess, the switch trade? And what portion is still left to reinvest in U.S.-denominated assets in Japan?

Eric M. Kirsch
Global Chief Investment Officer & Executive VP

Sure. As Fred -- this is Eric, Alex. As Fred mentioned, year-to-date about $625 million, $626 million in new floating-rate assets, primarily focused on transitional real estate and middle market loans. When you look at the total floating-rate portfolio, about $2.6 billion currently. We're continuing to focus on private debt, transitional real estate, middle market loans, and we would expect that by the end of next year, we will fully replenish that switch trade of $2.5 billion. The exact timing is a little hard to give you. It could probably be in the first half of the year, but remember, these are private loans. So they have to be negotiated, they have to be sourced, and then funded. So we would expect the switch trade of that $2.5 billion to ultimately be closed sometime next year, and then we'll continue to allocate more to the floating-rate bucket within the dollar strategy. And back at the FAB analysts' meeting, I put up a number of charts with some estimates in terms of percentages.

Taylor Alexander Scott
Goldman Sachs Group Inc., Research Division

And one other quick one. When you guys talk about the economic solvency ratio in Japan, is that impacted at all just by the branch conversion? Or is that sort of isolated? What will be the Japan piece following the separation?

Frederick J. Crawford
Executive VP & CFO

It doesn't. The ESR comments that we've made at the FAB meeting, and kind of where we're falling, are not impacted by the branch conversion. It's really a uniquely ESR calculation, and whether a branch or a subsidiary, it doesn't adjust our calculations.

Operator

The next question is coming from the line of Mr. John Barnidge of Sandler O'Neill.

John Bakewell Barnidge
Sandler O'Neill + Partners, L.P., Research Division

About first sector sales in Japan, I know there has been an extraordinary amount of reduction. What do you believe is the minimum level of first sector sales required to maintain distribution relationships? And how quickly do you think you'll be able to get there?

Daniel P. Amos
Chairman & CEO

Koide?

Masatoshi Koide
President & COO of Aflac Japan

[Foreign Language] Well, first of all, in terms of the first sector products, I think we need to divide the first sector products into 2 types. [Foreign Language] One is savings-type first sector products and the other is protection-type first sector products. [Foreign Language] And what we think is needed as a first sector product to maintain our relationship with our agencies is the protection-type first sector products. [Foreign Language] And we will continue to strategically sell this product going forward as well. [Foreign Language] And we revised our product gift in February this year, and even after the rate change, this product is selling very well.

Daniel P. Amos
Chairman & CEO

Is that it Koide?

Masatoshi Koide
President & COO of Aflac Japan

Yes.

Daniel P. Amos
Chairman & CEO

But what -- the question that he is really asking is at what level do we need to hold? And the answer is, we're getting very close to that level. So I would say somewhere in this range, within 20% kind of gives you a range to note. But we are very close now.

Frederick J. Crawford
Executive VP & CFO

I think a helpful comment is that obviously, Aflac is not unique in its strategy as it relates to the rate environment in Japan, and we've seen all the peer companies really start pulling back on yen-based first sector savings products. And so where we're really in the pack, if you will, in terms of our approach to doing that, what makes us different is that we've got such a robust and wide-ranging third sector product dynamic, but this is what makes things like the income product so important and a renewed focus on first sector protection product where you'll see more product development coming out on that front. Those are going to be important products for us to build for the very purpose of your question, and that is making sure that our agencies can make a living and generate income.

Operator

The next question is coming from the line of Mr. Suneet Kamath of Citi.

Suneet Laxman L. Kamath
Citigroup Inc, Research Division

Just turning to Aflac Japan, if we look at the annualized premiums in force, down, I guess, 3.7% in the quarter. I think it's still down if I adjust for the -- that paid-up phenomenon. So my first question is, is that right? Or are you still down adjusting for that? And then second, when do you think we can start to see some growth in that in-force premium number?

Frederick J. Crawford
Executive VP & CFO

Yes, I think the answer is, yes. Although accelerated by the paid-up policies, you're naturally seeing a little bit of additional runoff. Although it's predominantly the paid-up dynamic. I say that because earned premium on the third sector side has been growing at a decent rate, low single-digit type growth rates of third single -- third sector premium. So I would say it's predominantly the paid-up premium dynamic and that will start to slow. As I mentioned, I think, at FAB, we're running at around JPY 55 billion, JPY 60 billion estimate of paid-up premium in 2017. That will be cut effectively in half in 2018, and then again cut in half in 2019. So that pressure, if you will, starts to taper. And as a result, we'll start to see more of an offset between third sector premium growth and first sector premium decline. But realize, in addition to the paid-up policies, we have in fact, obviously, pulled back substantially from just the outright sale of first sector savings, and that certainly doesn't -- weighs on your growth rate. Lapse rates are very low on first sector savings products. They tend to hover around 1%, sometimes a bit above 1%. This is excluding paid-up policy dynamics. It's just pure lapse. So you have a very, very slow runoff. But when you're not selling any savings-related products of any magnitude, that will catch up to your premium. But remember, this is an economic decision that we made. You need to sort of wrap your head around the idea of what is the economic value of the relative premium between third sector and first sector. So while it is affecting negatively our GAAP results, we are seeing FSA earnings -- or said differently, cash flow pickup because we're allocating much less in the way of capital towards that product and it's a product that is very capital-heavy, and we think the relative economic value of third sector, we don't think we know, is substantially better than first sector savings products and some of the tail risk and interest rate risk that comes with it. So even though it's a headwind on GAAP-type results, it's a tailwind on economic value development.

Daniel P. Amos
Chairman & CEO

I'd like to add too, if you adjust for the year-to-date paid-up products on an in-force premium basis, we're about flat with where we were third quarter last year.

Suneet Laxman L. Kamath
Citigroup Inc, Research Division

Got it. That's helpful. And then separately, just on the tax rate, it was low in the quarter. I know some of that was due to stock compensation, and then I think there was also, I guess, a moratorium on a tax-related item related to ACA. So as we think about kind of going forward, do you think you get back to the 3%, 4.5%, which is about where you have been tracking? Or are we going to be below that because of that ACA dynamic?

Daniel P. Amos
Chairman & CEO

Yes. I would tell you that there may -- there would be perhaps some benefit, although I believe that ACA benefit starts to fade a bit here as we move forward. I will tell you from a financial planning perspective, and we're in the midst of our financial planning work right now, of which we will then talk more about that, obviously, on our outlook call first week of December. We're not going to necessarily assume this type of effective tax rate going forward. The main driver of the low effective tax rate, as you mentioned, is really specifically the treatment of option-related -- stock option-related compensation. And really what it is, is that the -- essentially the expensing of it for tax purposes is dealt with using the fair market value of the options as they're exercised. And so when your stock price has been doing as well as it has throughout the year, and you see naturally a level of stock option exercising, you then will see this benefit run through your effective tax rate. This actually has always been part of the accounting. It's just that it previously to January, when the new accounting came into place, it was run through equity and not through your earnings. And so companies now are seeing this affect their tax rate. And so that's a very difficult thing to project and predict. In general one could say, if your stock price is traveling at these high levels, and you expect there to be a natural level of continued option exercising, you should see a natural benefit. But internally, I would tell you, we're not planning for that because it can be quite variable.

Operator

The next question is coming from the line of Mr. Sean Dargan of Wells Fargo.

Sean Robert Dargan
Wells Fargo Securities, LLC, Research Division

Since the FAB, there has been an election in Japan. Just was wondering if we could hear your thoughts on if that played out the way you thought it would? And if there are going to be any changes in policy that would affect your business?

Daniel P. Amos
Chairman & CEO

Koide? Somebody over there? Is Charles on the line or you want to take it? How are you going to do it?

Masatoshi Koide
President & COO of Aflac Japan

[Foreign Language] This is Koide again from Aflac Japan. [Foreign Language] The fact that the LDP that Abe -- Prime Minster Abe is leading, we were expecting that his party will win. [Foreign Language] So as a result, since Abe administration will continue and his economic policy is not likely to change significantly, as a result, we are not seeing any material impact to our business. [Foreign Language] That's it from me.

Daniel P. Amos
Chairman & CEO

We're very happy with the results.

Operator

At this time, we don't have any questions on queue. I will turn the call over back to Mr. David Young.

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

Thank you. And before we end the call today, I'd like to remind everyone of our upcoming outlook call at 9:00 a.m. on December 1. Until then, please feel free to contact our Investor and Rating Agency Relations Department with any questions. And we look forward to speaking with you soon. Thank you, all.

Operator
Thank you. This concludes today's conference call. Thank you all for joining. You may disconnect at this time.