Aflac Incorporated NYSE:AFL

Earnings Call

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Call Participants

EXECUTIVES

Bradley Dyslin

Daniel Paul Amos
Chairman & CEO

David Young

Frederick John Crawford
President & COO

Koichiro Yoshizumi
EVP of Sales & Mrkt. and Director of Sales, Mrkt., Alliance Strategy - Aflac Life Insurance Japan

Masatoshi Koide
President, CEO & Representative Director

Max Kristian Broden
Executive VP & CFO

Unknown Executive

Virgil R. Miller
President of Aflac U.S.

ANALYSTS

Alexander Scott
Goldman Sachs Group, Inc., Research Division

Erik James Bass
Bernstein Autonomous LLP

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

John Bakewell Barnidge
Piper Sandler & Co., Research Division

Michael Augustus Ward
Citigroup Inc., Research Division

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

Suneet Laxman L. Kamath
Jefferies LLC, Research Division

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Wesley Collin Carmichael
Wells Fargo Securities, LLC, Research Division

Wilma Carter Jackson Burdis
Raymond James & Associates, Inc., Research Division

Presentation

Operator

Good morning, and welcome to the Aflac Incorporated First Quarter 2023 Earnings Conference Call. [Operator Instructions] Please note, this event is being recorded.

I would now like to turn the conference over to David Young, Vice President of Investor and Ratings Agency Relations and ESG. Please go ahead.

David Young

Thank you, Andrea. Good morning, and welcome. This morning, we will be hearing remarks about the quarter related to our operations in Japan and the United States from Dan Amos, Chairman and CEO of Aflac Incorporated. Fred Crawford, President and COO of Aflac Incorporated, is joining us from Japan and will touch briefly on conditions in the quarter and discuss key initiatives. And Brad Dyslin, Global Chief Investment Officer, President of Aflac Global Investments, will discuss the investment portfolio and its positioning given recent market events and volatility.

Yesterday, after the close, we posted our earnings release and financial supplement to investors.aflac.com. Under Financials, in the menu of that site, we also posted several slides of investment details related to our bank, commercial real estate and middle market loan exposure. In addition, Max Broden, Executive Vice President and CFO of Aflac Incorporated, provided his quarterly video update addressing our financial results and current capital and liquidity.

Max will be joining us for the Q&A segment of this call, along with the following members of our executive management in the U.S., the following: Virgil Miller, President of Aflac U.S.; Al Riggieri, Global Chief Risk Officer and Chief Actuary; June Howard, Chief Accounting Officer; and Steve Beaver, CFO of Aflac U.S.

We are also joined by members of our executive management team 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; Koichiro Yoshizumi, Executive Vice President and Director of Sales and Marketing and Alliance Strategy.

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 what 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 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. Good morning. We're glad you joined us.

Reflecting on the first quarter of 2023, our management team, employees and sales distribution have continued to be devoted stewards of our business, being there for the policyholders when they need us most, just as we promised.

The first quarter marked a good start to the year. Aflac delivered another quarter of solid earnings results, especially considering a material weakening of the yen.

Looking at our operations in Japan and as noted last quarter, we are actively focused on numerous initiatives in Japan, involving new and refreshed products and distribution that continues to cover from the

-- as we recover from the pandemic. In addition, we are encouraged by the planned May reclassification of COVID-19 to the same level as influenza as Japan continues to emerge from the pandemic.

I am pleased with the continued sales improvements, which reflect the ongoing rollout of our cancer insurance policy, initially through associates and Daido Life, followed by Dai-ichi Life and the financial institutions.

First quarter sales also reflected the refreshed first sector WAYS and Child Endowment products which we're using as a way of reaching new customers to whom we can also sell third-sector products, including cancer and medical products.

I am also encouraged by the fact that Japan Post Group began selling our new cancer insurance product earlier this month. We expect this close collaboration to produce continued gradual improvement of Aflac cancer insurance sales over the immediate term and to further position the companies for the long term.

In addition to product, another important element of our growth strategy is our intense focus on being where the customer wants to buy insurance. Our broad network of distribution channels, including agencies, alliance partners and banks continually optimize opportunities to help provide financial protection to Japanese consumers, and we are working hard to support each channel.

Turning to the U.S. While the first quarter tends to generate the lowest sales of the year, I'm encouraged by the continued improvement in the productivity of our agents and brokers as well as the contribution from the build-out of our network dental and vision and group life and disability. We are seeing success in our efforts to reengage veteran associates, and, at the same time, we are seeing strong growth through brokers.

I'm very excited that we're in the process of refreshing our cancer protection assurance policy with increased benefits at no additional cost. We believe this will increase persistency, which will benefit our policyholders and lower our expenses.

I believe that the need for the products we offer is strong or stronger than it has ever been before in both Japan and the United States. At the same time, we know consumer habits, buying preferences have been evolving. We also know that our products are sold, not bought. As we communicate the value of our products, we know that a strong brand alone is not enough. We must paint a better picture of how our products help address the gap that people face when they get medical treatment. We continue to reinforce our leading position and build on that momentum. As always, we continue to prudent liquidity and capital management.

We continue to generate strong investment results while remaining in a defensive position as we monitor evolving economic conditions. In addition, we've taken proactive steps in recent years to defend cash flows and deployable capital against the weakening yen.

We treasure our track record of dividend growth highlighted by 2022 marking the 40th consecutive year of dividend increases. We remain committed to extending this track record, supported by the strength of the capital and cash flows. At the same time, we remain in the market repurchasing shares with tactical approach focused on integrating the growth investments we've made in the platform to improve our strength and leadership position.

We also believe in the underlying strength of our business and our potential for continued growth in the United States and Japan, 2 of the largest life insurance markets in the world.

We are well positioned as we work toward achieving long-term growth while also ensuring we deliver on our promise to the policyholders. I'm proud of what we've accomplished in terms of both our social purpose and financial results which have ultimately translated into strong, long-term shareholder return.

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

Frederick John Crawford
President & COO

Thank you, Dan. Let me first begin with brief comments on our Japan and U.S. operations. As Dan noted, we're off to a promising start. The revised cancer product is doing well and now supported by our [ureso] cancer consultation platform, this providing concierge care to cancer policyholders and connecting them with noninsurance services.

As we look ahead this year, we are focused on the following here in Japan: Continued recovery with our long-standing alliance partners fueled by a refreshed cancer product and joint marketing and training support. Based on our preliminary read of activity levels within Japan Post, the Wings product appears to be off to a promising start and gaining traction.

We are preparing to launch a new medical product in the fourth quarter. We are operating in a highly competitive environment with medical product representing 70% of the third sector marketplace. We are focused on simplifying the product and appealing to both younger policyholders with day needs and older or existing policyholders who desire upgrading to a more comprehensive coverage.

The sale of WAYS is delivering on our strategy of attracting younger policyholders and cross-sell activity. We are primarily selling in our associates channel and are beginning -- are being cautious with respect to selling in the bank channel, with limited volume expected. We understand that over the long term, leveraging the bank channel will require marrying a competitive medical and cancer product with a formal asset formation strategy to drive shelf space.

Finally, our short-term insurance subsidiary SUDACHI launched a line of affordable term medical and cancer product in April. We anticipate a modest level of sales as measured annualized premium. The focus is on introducing young, first-time buyers to the importance of medical and cancer insurance to then upgrade to more comprehensive coverage in the future.

From an operations perspective, we are pleased with our expense ratio coming in below 20% in the face of continued revenue pressure. This is in part a cumulative result of addressing expenses over the past few years.

Turning to the U.S. We have discussed our balanced attack, and this remains the case, with individual dental and vision, group life and disability and consumer markets all contributing to sales growth in the quarter. The underlying signs of momentum remain encouraging, and our agent-driven small business franchise recruiting the number of average weekly producers and agent productivity are all up in the quarter.

Dental and vision sales increased 40% in the quarter with continued strength in cross-sell of core voluntary products. While this is traditionally a slower quarter in the life and disability markets, our platform is off to a strong start for the year.

Finally, we are encouraged by consumer market sales, up 29% in the quarter and with new products gaining traction and alliances coming online.

With expanded business lines and new distribution channels, product development is a key focus in the U.S. We have launched a refreshed approach to cancer, as Dan mentioned. We've advanced coverage for mental health conditions and are adding noninsurance services to our group disability products. We are proactively driving benefit utilization through wellness campaigns and benefit endorsements to in-force policies. We know that utilization drives persistency.

In terms of operations, our expense ratio remains elevated, but as Max commented on in his recorded remarks, roughly 300 basis points are due to the pace of investment in emerging growth businesses all performing in line with our expectations.

So what bends the expense curve in the U.S.? Traditional managing of expenses, along with investment in process automation in our mature individual and career-driven small business franchise; a multiyear technology modernization path, including a new group administrative platform driving process improvement and cost reduction; finally, delivering on revenue build in our acquired and greenfielded properties that requires investment upfront to secure and retain quality business.

Now I'd like to hand over to Brad Dyslin to discuss our investment portfolio and positioning with respect to recent market events and volatility. Brad?

Bradley Dyslin

Thank you, Fred. Given recent events with the global banking system and the uncertain macro-outlook as the Fed continues to raise rates to fight inflation, I would like to provide a brief update on those segments of our portfolio that are most directly impacted by the current environment.

Let me start with our bank exposure. As of the end of the quarter, our total global bank portfolio is $5.6 billion with an average credit rating of A minus. Our holdings are concentrated in large, systemically important banks located in stable countries.

As of today, our U.S. bank exposure is limited to the largest banks. We have virtually no exposure to smaller U.S. regional banks. We do not have holdings or other direct exposure to any of the 3 U.S. banks that failed in early March. While the swift and decisive action of regulators has helped to cull markets, we are watching very closely for signs of further instability in the global banking system and feel good about our holdings.

Like the rest of the industry, we are seeing pressure in the commercial real estate markets. Office properties are the current area of focus given the difficult market for office leasing. Office represents approximately 30% of our total $8.1 billion commercial mortgage loan portfolio, with most of our exposure in our transitional real estate book. We currently expect approximately $500 million of loans to enter into some form of foreclosure, approximately 6% of our total mortgage holdings.

When going into foreclosure, we revalue the property to current market levels. In those cases where we do not yet have an independent third-party appraisal, as an interim step, we established an updated value based on our current -- based on our external managers' current assumptions of the local market and updated cap rates. This process resulted in a small $10 million of additional asset reserves this quarter.

To offer perspective of our potential loss exposure, we have approximately $900 million of TRE loans currently on our watch list. At the time of origination, these loans were 65% loan to value. If you apply a simple stress scenario that assumes we foreclose on the entire amount and each property declines 50% in value, a drop which would exceed what we saw during the financial crisis by about 15 percentage points, we would have to establish approximately $200 million of reserves.

To be clear, this is not our base case, but it highlights that our exposure under such a severe downturn in the office segment is manageable. Although accounting rules may require additional reserves, our strong capital and liquidity position will allow us to hold these properties to maximize our recovery.

Turning to our middle market loan portfolio. Despite the headwinds from rates and inflation, this portfolio continues to perform quite well. Our borrowers' average leverage is stable. They have largely been successful passing through higher costs and sponsors have generally been supportive whenever required.

This quarter, we did take reserves of $20 million related to 2 names that were struggling with issues unique to them and not reflective of broader systemic issues in the asset class.

As the primary outlet for our below investment-grade exposure, we very deliberately built this portfolio with a strong focus on managing through the inevitable downturns in the credit cycle. Our average loan size is a very modest $16 million. We only invest in senior secured first lien positions. We utilize strict limits on position size, diversification and other characteristics. Should conditions worsen, we believe this approach will serve us well.

We expect market volatility to remain elevated as the global economy absorbs the impact of higher interest rates. We will, of course, experience the impact of this volatility across our portfolio, namely in our alternatives holdings.

Relative to many in the industry, our exposure is rather modest, but we expect our $2.4 billion portfolio to experience volatile marks in the near term. We remain committed to our disciplined systemic approach to building this portfolio and fully expect to enjoy the benefits of enhanced returns over time.

Let me turn it back to Fred.

Frederick John Crawford
President & COO

Thanks, Brad. Let me just give some additional perspective before we go to Q&A, and that is connecting Brad's comments to capital. Our low asset leverage, which we define as the ratio of assets to statutory capital, particularly when you consider our natural concentration in JGBs places us in a strong position to absorb weak economic conditions.

We watch SMR in Japan as historically it is more volatile during periods of economic stress. However, our SMR, as you can see, remains very strong. We are also comforted by a stable ESR ratio that like our U.S. statutory RBC is robust and more resilient to market volatility.

The punchline is we do not see the events of the last quarter and/or mild to medium recession causing disruption to our capital deployment plans. So with that, let me hand back to David, who will take us to Q&A. David?

David Young
Thank you, Fred. Now we are ready to take your questions. [Operator Instructions] Andrea, we'll now take the first question. And if you want to let people know how to get back in the queue, that would be great.

Question and Answer

Operator

[Operator Instructions] Our first question will come from Wes Carmichael of Wells Fargo.

Wesley Collin Carmichael
Wells Fargo Securities, LLC, Research Division

In Japan Post, you talked about the revised cancer product doing well. But how are you kind of seeing the sales trajectory play out in the second quarter and through the balance of the year? Should we see it kind of accelerate in the near term? Or will that take some time to play out?

Frederick John Crawford
President & COO

Sure. Let me -- this is Fred. Let me do this. Let's go to Koide-san to comment on Japan Post and Yoshizumi-san can follow up with any color from his perspective. Koide?

Masatoshi Koide
President, CEO & Representative Director

[Interpreted] This is Koide of Japan. Regarding the Japan Post Group, our new cancer Wings have been launched in April this year and we believe that the start of the sales has been very successful because we have been preparing to launch this product towards April by doing a lot of preparation as well as training. Yoshizumi-san, if you like to add anything, please do so.

Koichiro Yoshizumi
EVP of Sales & Mrkt. and Director of Sales, Mrkt., Alliance Strategy - Aflac Life Insurance Japan

[Interpreted] Thank you. This Yoshizumi of Aflac Japan. To launch this product in April, we have been thoroughly preparing for the launch. We are seeing the start of the sale of new product is very good and it is gradually growing, and it is meeting our expectation. However, having said that, because this product has just been launched, it would probably be a bit too early to say whether this is truly successful or not, but this is a product that we have launched this year as a cancer new product.

And I do believe that we have been able to get started with a very good new product process because we have been training since January and we have also introduced digital means. So we do believe that this product can be successful. At the same time, this can be a trigger to even more success.

So let me just repeat this again. Our start of the sale of this product has been very successful, and that can be proved by the number of calls that we are receiving at the call center and also the number of illustration estimates that we are providing to customers. And that's all for me. Thank you very much.

Frederick John Crawford
President & COO

Thank you, Yoshizumi. And again, I would say we have been rolling this cancer product out gradually across channels, which is different than we've done in the past. And so it started in our associates channel, but then it's spread on to other affiliate channels, Daido Life, Dai-ichi and the financial institutions. And so we've seen this product roll out or roll out successfully, and we know it's considered one of the ranked products in the country in terms of the attractiveness of the product. So we do come at it with a level of confidence, but as Yoshizumi-san said, it's still early in their system.

Wesley Collin Carmichael
Wells Fargo Securities, LLC, Research Division

That's helpful. And on capital, the capital ratios are pretty strong with RBC north of 600 and SMR 850-plus and holdco capital is strong at $3.3 billion. But how do we think about the outlook for dividends or distributions out of the insurance companies this year? And I think you had proceeds from the reinsurance transaction, but it seems like there may be a lot of capital coming. So any help you can give us there?

Daniel Paul Amos
Chairman & CEO

So I would start by go back to our Investor Day where we announced that on an underlying basis, we expect to generate $2.6 billion to $3 billion of capital each year. And that's a reasonable starting point.

And on top of that, we will periodically generate additional capital through different actions that we take, reinsurance being one of those actions. And we would use that capital pool to then obviously redeploy that capital generated in conjunction with any additional capital that we may be freeing up from having high capital ratios in our operating subsidiaries or at the holding company.

But I do think that over time, as a run rate base, you should think about the $2.6 billion to $3 billion, that's a reasonable annual capital deployment for us, with periodic additional capital deployments from other actions taken. And as you know, that goes through our capital management policy, where we allocate capital, obviously, to the dividend. Currently, that is about $1 billion that we spend on our dividend each year, and we cherish our dividend highly and expect to continue to increase the dividend.

On top of that, we are then allocating capital to buybacks where we see appropriate IRRs and also for opportunistic deployment where we can accelerate our growth long term.

Operator

The next question comes from Suneet Kamath of Jefferies.

Suneet Laxman L. Kamath
Jefferies LLC, Research Division

Just a bigger-picture question for Japan. Obviously, you've had a lot of success there with the cancer block for years, but it sounds like you're losing market share in medical. If you look at the benefits, there's definitely some overlap in terms of hospitalization and surgical benefit. So I guess my question is, is there a risk that people will just start using medical insurance to sort of cover their cancer exposure. And as a consequence, the cancer insurance market will just continually shrink.

Frederick John Crawford
President & COO

We're going to go to Koide-san and Yoshizumi-san to help you out with that, Suneet.

Masatoshi Koide
President, CEO & Representative Director

[Interpreted] So let me start, this is Aflac Japan Koide. Cancer is an illness that is different from other diseases. For example, it would require long-term treatment as well as some mental support or treatment required. Therefore, when you try to prepare for cancer, you would definitely be needing cancer protection type of policy. And the awareness regarding cancer is becoming very high in cancer. The reason is because 1 in 2 in Japan does suffer from cancer in their lifetime.

And looking at the penetration or enrollment of cancer insurance, the cancer insurance penetration is lower than that of medical insurance. Therefore, we do see that there is a bigger potential in cancer insurance sales going forward.

So the conclusion here is that it is not that there is no need for cancer insurance just because you have medical insurance.

Frederick John Crawford
President & COO

One of the things I would also add is that I had mentioned in my comments, our uresocancer care consulting practice, which is really wrapping noninsurance services around our cancer policies for our policyholders, and that's gotten off to a good start and is building.

And I mentioned that only because one of the things we do have to do, Suneet, is continue to differentiate and protect our leadership position. And we differentiate the overall value proposition of a cancer product not just from the enhanced coverage advanced treatments, advanced types of care, but we also wrap that policy with noninsurance services, and that really differentiates it from a traditional and often basic medical product sold to individuals.

Suneet Laxman L. Kamath
Jefferies LLC, Research Division

Got it. And then I guess one on transitional real estate and middle-market loans. If I just look at the book yields that you're disclosing and compare them to what we saw at FAB, I mean, I think they're up 175 to 200 basis points in 6 months. So I'm just curious, how have these borrowers essentially been able to pay what is a pretty sizable increase in interest payments? And kind of what's the outlook there?

Bradley Dyslin

Yes. Thank you. This is Brad. It's a very good question. A couple of things I'd say in response to that. On the transitional real estate book, most of those loans contain rate caps. So the sponsors are protected from the large increase in rates. In fact, our average rate cap is about 200 basis points below where SOFR is today. Now that benefits the borrower, we still get the benefit of the higher rate. They just get the offset through the rate cap and the hedging that they've put in place.

On the middle market loan portfolio, there's a couple of things at play here. First, these are largely service-oriented companies, which means they generate a fair amount of free cash flow. Now that's less free cash when you have a higher cost structure. But these companies have also been part of a growth strategy for the underlying sponsors who own these. So they've continued to perform well. They're continuing to grow. Margins have been relatively stable. And while cash flow may be reduced, they are taking actions to mitigate that. And the overall thesis for most of these companies remains intact.

Daniel Paul Amos
Chairman & CEO

This is Dan. I want to go back to one -- the question about the cancer insurance. Sorry took me a second to get my connection here. But we've got an aging society in Japan, cancer is a disease of age. I've been around since we got licensed in Japan, and I think there's more need and more emphasis on buying cancer insurance today than ever in Japan, and it only makes sense that, that should be the case because of it being a disease of age.

And so not only do I disagree with that question, I feel very strong about that it's the opposite. People are wanting cancer insurance more. We've done a good job in buying it. But as you can imagine, it's the middle-aged people more than the younger ones. And our challenge there is how to get younger people involved because they're not as frightened of cancer. And that's no different than it was in 1974. It's just a matter of being able to do that, and we've come up with some things to do that as well. But I think, if anything, I want to leave you with confidence that we feel like the market is more important now than it was in 1974.

Operator

The next question comes from Jimmy Bhullar of JPMorgan Securities.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

So first, just a question for Brad. On the real estate portfolio, commercial real estate, you mentioned a loan-to-value at origination of 60%. What would you guess that is now given that rates are higher since you've originated most of these loans? And then obviously, demand for office space has dropped over the past couple of years because the COVID is gone and work from home.

Bradley Dyslin

Yes. Thank you, Jimmy. Actually, the average is 65% when we originated these. And when you look at the office portfolio, it really does depend on the specific asset, and it's driven in part by the overall occupancy as well as other investment needed to boost the occupancy to get the asset relatively full.

I will tell you that for those loans that are in the process of being revalued, we generally saw a decline based on input from our managers and the updated cap rates of 30% to 35%. Now those are -- I would caution those are unique to the assets that we are in the process of foreclosing. I'm not sure you can apply that across the universe of all office space, but that's what we saw in the specific loans that went through the revaluation process.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

Okay. And then fair to assume that the numbers are smaller, but there's a similar decline across the rest of the portfolio in terms of value as well?

Bradley Dyslin

Again, it depends on the specific asset. We -- not all office in the portfolio is bad. We have some that are performing very, very strongly. They have good occupancy. The business plans are at or above plan. And we don't expect those have seen nearly the price decline is those that are -- have less occupancy and are resulting in us taking the keys.

Operator

The next question comes from Alex Scott of Goldman Sachs.

Alexander Scott
Goldman Sachs Group, Inc., Research Division

First one I had is just on the potential impact if the yen rates or JGB yields, I should say, were to go up in a more significant way. I know you guys have provided the financial analyst brief meeting and so forth some sensitivities to your capital ratios. But could you maybe unpack how something like that would affect your business maybe across sales, like maybe the product mix. What are the ways that would impact your business?

Frederick John Crawford
President & COO

This is Fred. From a business perspective, and I'll let Max comment on capital sensitivity, and I would invite in either Koide or Yoshizumi-san to comment on. But as you start to see rates recover, then you start to bring in some of the first sector savings products, particularly the yen-based products as potentially being able to price to offer up a more valuable value proposition, a better value proposition to the consumer. So you can see some of that, but it takes quite a while because the way that reserve discounting works in Japan, you have to go for quite a while of rate recovery before you are able to price more appealing and make the product more appealing broadly. So you need to have consecutive years, if you will, of recovery. But it does add some added tailwind to those products.

I don't think you see much of any impact to the other aspects of our business that are far less rate sensitive and are really more of a morbidity play, as you can imagine.

Max, I'll let you comment on the SMR dynamics, ESR dynamics.

Max Kristian Broden
Executive VP & CFO

Well, Alex, you obviously know the sensitivities to SMR, ESR, RBC, et cetera. But I would make one comment, and that is that as we get closer to ESR adoption in Japan, that is going to make our business slightly less interest rate sensitive. And the reason I say that is that our yen interest rates are now going to be much more aligned between the assets and liabilities, which means that movements in interest rates are going to follow more the economics of it, i.e., the economic impact on our business is going to flow through and have an economic impact on our capital base as well. So that means that our sensitivity is somewhat less, which obviously then means that currently I can tell you that we do hold volatility capital associated with interest rate volatility.

And to some extent, if you have a lower interest rate sensitivity going forward, that means that you obviously need slightly lower in terms of a volatility buffer. All of this is going to be optimized as we get closer to ESR adoption, so I'm not going to put a number on what that is, but I am encouraged by what I see in terms of the sensitivity to interest rates.

Alexander Scott
Goldman Sachs Group, Inc., Research Division

Got it. That's helpful. And then for a follow-up, I wanted to ask about the additional benefits you were talking about for the U.S., some of the things you're doing to improve persistency. I mean, could you help us think through what some of those things may be. And I mean when I hear higher benefits and no additional costs, I would think maybe that would put pressure on the benefit ratio itself. But maybe I'm not thinking about that right.

Virgil R. Miller
President of Aflac U.S.

First, this is Virgil from the U.S. Let me give you a perspective first on what are we doing to help improve our persistency. The first thing I'll say though is you saw the numbers, and given that the numbers reflect a 12-month rolling period, I will first start by saying that we did see improvement in our lapses during Q1. If you compare Q1 of this year to Q1 of last year, our lapses were down about 20% when it comes to related premium.

What we've done though to ensure we continue to see a term with this though is we stood up an office of persistency. The intent there is to get a team of data-driven experts to look at the analytics behind what are some of the key drivers to help improve persistency, but also put together a framework and a governance framework to ensure there are actions going forward.

Some things we've already done this year would be to drive utilization of benefits. You heard Fred allude to this in his comments, but we launched a wellness campaign in Q1. What we're really trying to do is, a, really push preventive maintenance when it comes to helping our consumer base. But more importantly though, it is to drive utilization of the benefit. When people utilize the benefits, we generally see a higher persistency, generating more loyalty to the product and have them keep them longer.

So during a 5-week period, during the campaign, for the wellness benefit alone on the individual products, we saw a 27% increase in wellness utilization on that particular product line. You will see us continue to do things like that, but the premise would be driving utilization. Another key foundational effort would be, remember, our products are portable with a lot of movement in the job market, if you see someone leave one organization to go into another or perhaps no longer working with their current employer, you can keep your coverage with Aflac. We're making sure there's ease of portability, making sure we've improved our ways to collect money through billing mechanisms and making sure we have digital needs for people to go online to keep the available coverage.

So those are some of the things I'll share right now, but overall, I am pleased to say that there is progress, and we have a definitive focus on that going forward for the remainder of the year.

Operator

The next question comes from John Barnidge of Piper Sandler.

John Bakewell Barnidge

Piper Sandler & Co., Research Division

I know there's a traditional seasonal 4Q increase in the expense ratio but there's also expense increases around product launches. So with the new cancer product being rolled out in Japan Post in the second quarter and then in the first effort really through that channel dated back before the pandemic, can you maybe talk about one-off efforts to train agents or any market partnership that we should be thinking about?

Frederick John Crawford
President & COO

John, I want to make sure I heard that last part of your -- you're on the track of expense ratio quarter-to-quarter related to product launches. But what's your last part of your question?

John Bakewell Barnidge
Piper Sandler & Co., Research Division

Yes. Yes, so with the new cancer product being rolled out in Japan Post in the second quarter, are there any efforts to like retrain the agents or remarket the partnership and expenses associated with that because big launch since before the pandemic [indiscernible].

Frederick John Crawford
President & COO

Understood. Why don't we do this? Let's go to Yoshizumi to talk about the training and rollout of training for Japan Post agents. And then Todd Daniels is with us and can comment on any implications for expense ratio. So why don't you go ahead, Yoshizumi-san?

Koichiro Yoshizumi
EVP of Sales & Mrkt. and Director of Sales, Mrkt., Alliance Strategy - Aflac Life Insurance Japan

[Interpreted] So regarding the Japan Post training, what we are doing is that the management layer or the management of both companies are very involved at each layer of the training. So what we are doing is going through the cycle plan, do check and action to make sure that things are going successfully. And through this planned do check and action cycle, we are trying to identify weaknesses and try to resolve those weaknesses and overcome them. And those are being monitored and also being taken action by both companies.

And as one of the examples of having the checking process is this once in every 3 months or on a quarterly basis, we do have this strategic alliance committee where the top management of each company is involved to talk about these issues.

And furthermore, in the associate channel, we are strengthening our training method.

Masatoshi Koide
President, CEO & Representative Director

[Interpreted] Now this is Aflac Japan Koide once again. Regarding expenses, normally, when we launch a new cancer product, we will be doing training or renewing our solicitation materials, et cetera. And this is sort of like a normal course of action that we normally take when launching a new product. So that's what we did for this new cancer product as well.

Frederick John Crawford
President & COO

And Todd, I don't know if you have any color on timing of expenses. John, the premise of your question, that was correct. And that is, for example, this quarter, we had a pretty low expense ratio in Japan, but that oftentimes can move around with the timing of product launch and training and promotion costs. Todd, if you have any comments on that?

Unknown Executive

Yes. I agree, Fred. I think the first quarter is traditionally lower with expense ratio, and you see a higher expense ratio later in the year with IP and marketing spend. But we have been paying for the training and the marketing of the product all throughout the quarter, so a lot of that is [some] cost. And now you have the sales of the product and most of the acquisition expenses will be amortized into DAC. So you should see a slightly higher expense ratio as expected in the second quarter, but not really materially a result of Japan Post.

Daniel Paul Amos
Chairman & CEO

John, for the full year, we would expect to have an expense ratio in the 20% to 22% range.

Operator

The next question comes from Erik Bass of Autonomous Research.

Erik James Bass
Bernstein Autonomous LLP

I had a couple of questions for Brad on the CRE portfolio. And I was hoping you could talk more about the common factors among the loans that are entering foreclosure. And then also maybe talk about what's driving the $900 million of CRE loans [indiscernible] in your watch list currently. Maybe how that watch list has changed in the past few months and what's the risk of that growing over time.

Bradley Dyslin

Sure. Thanks, Erik. On the common factors, it's really a combination of the leasing velocity not being quick enough relative to the original business plan and the sponsors being unwilling to continue to support the asset. In many cases, we have an upcoming maturity. And when that happens, we have a couple of choices.

We can enter into negotiations to extend and renew the loan. But in those examples, we always require additional protections. It usually involves a pay down of the loan to reflect the current market and current progress of the plan. It can include personal guarantees, cash sweeps, a variety of other things. Then we usually get paid a little more as well. And if the sponsor is unable to meet those, that's when we enter into a more intense workout process, which will usually lead to foreclosure. And that's been the bulk of the issue with the $500 million of current NRO.

I do want to mention though that of that $500 million, we do have occupancy. These are running on average about 60%, which obviously is lower than we would like, and the sponsors would like. But these are not sitting there as empty buildings, they are functional, they do have tenants, it's just a matter of continuing to grow the tenant base and that has slowed in this current environment.

As to the $900 million, that's just our forward look on loans where we do have maturities coming up. We do have some issues with the underlying business plan. We are in negotiations with the sponsor and we're still unclear on exactly how those situations will resolve. But if we thought they were imminent, they would have been included in that $500 million. So we're watching that $900 million very closely, but those are largely issues that are coming down later in the year.

Erik James Bass
Bernstein Autonomous LLP

Got it. And then just to clarify, when you talked about the $200 million of reserves that could be needed in your stress scenario, is that the full capital impact? Or could there be any additional pressure from capital charge changes when you bring a property on to your balance sheet?

Max Kristian Broden
Executive VP & CFO

So the additional capital that you would also have on top of that would be, let's call it, rating migration. As you take ownership of a property, you obviously move from the capital charge of that being a loan to being an owned real estate equity and operated property.

If you -- just to give you a sense for it, if we were to add $500 million of real estate-owned equity versus that being a mortgage loan, that would impact our SMR negatively by 5 points, a relatively modest number.

If we were to add $100 million on our U.S. balance sheet going from a loan to real estate-owned equity, that would decrease our combined RBC ratio by 8 points.

Keep in mind, these numbers are not going to be exactly linear, but it's going to -- that gives you a good flavor for our sensitivity.

Operator

The next question comes from Tom Gallagher of Evercore ISI.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Just a few follow-ups on the real estate foreclosures. The $500 million that you're, I guess, in the process of foreclosing on, did you not take any reserves or losses on those? And is that -- and if not, is that just because of the value of the land still exceeds the value of the loans? That's my first question.

Bradley Dyslin

Yes. We did -- that is where the $10 million of additional reserves came from. It was on that $500 million in process of foreclosure. And the reason it wasn't larger is because looking at the decline in the asset, both the physical property as well as land or any other peripheral value, the declines were not severe enough to dip into our 65% loan to value.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Got you. That makes sense. The -- what about lost NII? You were getting presumably 8% or 9% yields on these loans. Now as you -- as they become owned real estate assets, would you expect there to be a meaningful change in the yield on those assets? Sorry, go ahead.

Bradley Dyslin

Sorry, Tom. Yes, it's a really good question. It's one we spend a lot of time on. These properties, by and large, are generating some income. There is an NOI coming off of them. It is going to be lower than the yield we're getting on the underlying loan, and that is baked into all of our projections and planning.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Got you. And Brad, any indication on the $500 million, are we talking about 8 or 9 going to 4, 6, 2? Like some range would be helpful.

Bradley Dyslin

Yes. Well, right now, it's currently 9 properties. We think that is -- that reflects our current best estimate of the number. There are different levels of discussions going on in the workout process with the sponsors. We may have a couple of those break positively where they end up coming out of this bucket. But at this point, we think that's unlikely, and we believe it was prudent to assume that this full $500 million are going to be foreclosed and become real estate-owned.

Operator

Next question comes from Wilma Burdis of Raymond James.

Wilma Carter Jackson Burdis
Raymond James & Associates, Inc., Research Division

Could you give an update on any plans to refresh the Japan medical product? I think it's about 18 months old, and you tend to refresh the product every 2 years or so.

Frederick John Crawford
President & COO

Yes. As I mentioned in my comments, we're coming out and ready to be prepared to have that -- our new product in the market in the fourth quarter. And as I made comments in my script, the idea there is to have a simplified product that attracts younger and new policyholders as well as a more comprehensive version of the product that's attractive for existing policyholders as well as older policyholders that seek more comprehensive coverage. That's the basic game plan.

I'll go to Yoshizumi-san to comment on the rollout of the medical product and any thoughts he has on how we're going to market with that product.

Koichiro Yoshizumi
EVP of Sales & Mrkt. and Director of Sales, Mrkt., Alliance Strategy - Aflac Life Insurance Japan

[Interpreted] Okay, this is Yoshizumi once again. Thank you for the question. Well, regarding the Japanese medical market, what I can say is that it is very competitive. And especially the competition is in trying to acquire young to middle-aged customers, and that's where all the companies are aiming for. As a result, what is being asked by the market is to come up with something with reasonable premiums and simple benefit structure. And we are hoping to launch a new product that are focused on those points and will have competitive advantage.

And especially by using this new product, the channel that where the competition is the most severe is a large, enormous collusive agencies channel, and that's where we would like to regain our share. Right now, we are collaborating between Japan and the U.S. to come up with a good product and we are in a full preparation mode. And that's all for me. Thank you very much.

Wilma Carter Jackson Burdis
Raymond James & Associates, Inc., Research Division

And then just give a little bit of color on the WAYS and Child Endowment products. I know these products have been a little bit pressured in the past by fluctuations in interest rates. So maybe talk a little bit about why you feel like this is the right product for now and how it's different than earlier versions of the product.

Frederick John Crawford
President & COO

Yes, I'll make just a couple of comments, and then I'll ask Koide-san and Yoshizumi-san to comment. But first, remember back when we were selling WAYS a number of years ago, 10 years ago, much of the volume of that sale -- those sales were through banks and particularly what we would call mega banks or the large banks and regional banks. And much of it is sold with discount advanced premium features. So products structured more for deposit like mining, meaning single premium-type short pay products, which can be much more attractive particularly in the banking channel.

During our investor conference, we talked a bit about the approach we're taking here which is more of a level pay process product. And that level pay product is less appealing in the bank channel which is why we have rather muted expectations for volume. But it is -- it can be a useful tool and sell in our associate channel and more of a financial planning environment and attracts a younger policyholder in the process. And so that's where we came back in.

From an engineering perspective, I'd also add that in the last 10 years, we've quite advanced our investment strategies and structures quite a bit under the leadership of Aflac Global Investments. And that is a nice weapon to have when looking at first sector savings products and dialing in investment strategy to back product and product pricing. And then as Max Broden has covered with you, we now have a reinsurance unit, and reinsurance is actively used to help manage capital returns over time of that product. So we have some engineering benefits that make it more attractive to come in at this time.

Koide-san or Yoshizumi, maybe on the [indiscernible].

Daniel Paul Amos
Chairman & CEO

Yes, this is Dan. I want to make one comment about it is that one of the ways or the most important way we're judging WAYS and Child Endowment is our ability to add on our third sector product with that. So we're not just looking at sales. If you gave us nothing but sales, although it's profitable and hit some of the targets we want, it's the ability to do that.

It also is very helpful because of the premium that's involved for our agents to make commissions and getting them reengaged, which they had been off a little bit. So that's been very helpful, too.

So it is a product we're watching carefully. But I think Fred's comments were good ones in that it's really the bank channel that we do not see as being the market for us because of the single premium and the older ages. We want these younger people with lower premiums to get them engaged, and it has been working so far.

Frederick John Crawford
President & COO

Yes, that -- I think we've covered it here. I would say we're -- I believe roughly half of our sales are to individuals younger than -- even more than that, younger than 50 years old, that may be even north of that. And then I think we're achieving upwards of 40% cross-sell results to new and younger policyholders, to Dan's point.

So those are critical metrics. We want to see it attracting young and we want to see the cross-sell activity because that's fundamental to the strategy of coming back in the market.

Masatoshi Koide
President, CEO & Representative Director

[Interpreted] This is Koide from Aflac Japan. Well, let me just add a little bit information here. Last year, in October, we did change rates of Child Endowment and WAYS product. And the purpose of that time was to acquire new customers as well as young customers using these products. And for that purpose, we have focused on selling level premium type of product. And as Fred mentioned, this level premium-focused product is very important for associates to sell. However, it is not so popular among the bank channels. And as a result, associates sales were our focus. And as Dan mentioned earlier, these products also go well in terms of doing cross-sell with third sector products. So we are using a lot of leverage where -- we are using these products as leverage to sell third sector. And the proportion of WAYS product being sold through banks is still maintained very low, and it will be very limited again this year. That's all for me.

Koichiro Yoshizumi
EVP of Sales & Mrkt. and Director of Sales, Mrkt., Alliance Strategy - Aflac Life Insurance Japan

[Interpreted] So let me just add a word as well, this is Yoshizumi speaking. So what I would like to say is that those customers that have actually purchased WAYS and Child Endowment are basically 40s and below. So those customers in their 30s and 40s account for 83% of all customers. And on top of that, as was mentioned, we are planning to sell third sector product using WAYS and Child Endowment by using this level premium product. That was our strategy. And right now, our sell rate is 47%.

And so what I'd like to do going forward is to really expand and really sell more in third sector products by using Child Endowment and WAYS as a trigger and catalyst. That's it for me.

Operator

The next question comes from Ryan Krueger of KBW.

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

Get back to this transitional real estate. A couple of questions. One is, can you -- what is the total people reserve specifically against the transitional real estate that you're holding at this point? And then I also just wanted to confirm that the $900 million on the watch list, is that in addition to the $500 million potentially foreclosed or is the $500 million the subset of the $900 million?

Bradley Dyslin

Yes. Thanks, Ryan. Let me start with the second question first. The $900 million does include the $500 million, so an incremental $400 million that we're watching.

On the CECL reserves, essentially all of those reserves are related to the loan book. The split between middle market loan and TRE -- or real estate, generally, most of which is in TRE, it's about 35%, 40% of the total CECL reserve is related to mortgage loans.

Max Kristian Broden
Executive VP & CFO

And Ryan, our total CECL reserve was $250 million.

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

And then I guess for Max, you have the 400% RBC target in the U.S. When you think about Japan, how would you frame kind of your targeted capital ratios there at this point? Because it's a bit more challenging from the outside to think about the cushion you have.

Max Kristian Broden
Executive VP & CFO

Yes. So we obviously operate with strong levels of capital, and you know our sensitivities to different kind of macro factors. We're also in this now transition over time from SMR into the new ESR world. As we do that transition, we obviously are going to find our way to, over time, optimize our capital base somewhat.

But also every time you go through a transition, you actually want to do that with some additional level of capital in order to make sure that you have the flexibility to then down the road optimize your capital structure.

So right now, we feel comfortable where we operate, both from a standpoint of it gives us flexibility to be opportunistic where we can, but also then obviously absorb any kind of losses that may come our way. And also it gives opportunities for us to also deploy capital organically into opportunities that we might see as well.

Operator

The next question comes from Michael Ward of Citi.

Michael Augustus Ward
Citigroup Inc., Research Division

And thank you for all the color on the loan books. Extremely helpful. So Brad, on the commercial mortgage loans, I think you mentioned the process of making office buildings more attractive for tenants and leases. I guess my understanding on office is that they sort of have to be super new and exciting to attract new leases. We've heard that the cost of that can be super expensive at times. So just curious if you have any thoughts on that and if the $10 million reserve math incorporates that.

Bradley Dyslin

Yes. Thanks, Michael. You're right. In this environment, the leasing that is occurring is migrating towards newer properties with nicer amenities. About 80% plus of our total TRE book is in Class A properties. But keep in mind, too, the nature of transitional real estate is that transitional piece. These loans are providing that funding to reposition the asset. A lot of them are lease-up transitions. So our capital is going to refresh the asset. So through this process, we're getting, in most cases, the newest, most refreshed with the current amenities asset in the local submarkets. So that is one very good thing we have going for us. But in some cases, the business plans just need a little bit further work, and that's what's resulting in some of the foreclosures.

Michael Augustus Ward
Citigroup Inc., Research Division

Awesome. And then on the rate caps. I was wondering if you can help us understand maybe the percentage of rate caps on the portfolio that have reset with the jump in rates over the last 12 months.

Bradley Dyslin

The rate caps exist for the life of the loan. So only those that have reached maturity and are in some process of workout would have -- they would lose that protection. So the bulk of the portfolio prior to maturity is still protected by those rate caps. And for transitional real estate, it is essentially the entire book. And as I said, for middle-market loans, it's a very small percent.

Operator

The next question is a follow-up from Wes Carmichael of Wells Fargo.

Wesley Collin Carmichael
Wells Fargo Securities, LLC, Research Division

I actually had a question for Dan, and it relates to succession. And I know you've had a couple of leaders transition, but I'm really thinking about your CEO role, how -- I know you've laid out some '25, '26 sales targets. But what are you thinking for your role in the timing on that and how we should think about transition.

Daniel Paul Amos
Chairman & CEO

Well, I'm not going to be that good a retiree and I'm not in that big a hurry. I just had a physical at Emory and got a good report. So I plan on staying around a few more years. But I still think my #1 responsibility is to make sure I have it prepared. We never know what can happen in life, and we've got to have a company ready to go and go uninterrupted. And so that's one of the things that I'm doing.

I will say, for example, with Virgil and the changeover to Teresa, that's been smooth. I will say that Eric's changeover to Brad has been smooth. You go back to Koide. We've gone on interrupted on the -- as things take place. And to me, that's one of the things I have to make sure happens. And I promise you, I'm working toward that with the Board of Directors who ultimately make the call. But we have very structured and very intense meetings about what goes on in regard to personnel and human resources at our August meeting. And so I'll be constantly updating on what's going on there.

But I would say I'll be around a few more years. So unless the Board gets tired of me, look for me to be here.

Operator

The next question is a follow-up from Tom Gallagher of Evercore ISI.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Just a few CRE follow-ups. Brad, the $900 million watch list, are those all '23 maturities? And can you comment on total maturities for both '23 and '24?

Bradley Dyslin

Yes. Thanks, Tom. The $900 million on the watch list is predominantly near-term maturities. I will have to double check, but I don't believe we have anything out into 2024 on that watch list. But it is predominantly near-term maturities that we have to address. No, I'm sorry, what was your second question?

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Just what are the total maturities of your total.

Bradley Dyslin

Sorry. Yes, these are very short-term loans. The -- at origination, they're generally 3 years in term with options for 1-year extensions based on certain thresholds being met. So these do turn over pretty quick. We do have -- it's less than 1/3 of the total portfolio rolling over this year. But a big portion of those are what's on this watch list.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Got you. And then just one on, you mentioned your [alt] portfolio, you expected near-term returns to be volatile. Should we -- is the interpretation that 2Q [alts] return should be negative? Or just any perspective on that?

Bradley Dyslin

It's really way too early to try to give any insight on second quarter. I think you're familiar with the lag we have in our marks. For first quarter, we're really reflecting broad market activity from third and fourth quarter just given the lag in the reporting to our managers and then the reporting to us and it gets extended a little bit longer in fourth quarter.

So second quarter should correlate more closely with the general market activity we saw in fourth quarter and a little bit of first quarter, but it's just way too early to give you any direction on that.

Operator

The next question is a follow-up from Jimmy Bhullar of JPMorgan Securities.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

Just a question for Fred on the implications of the May reclassification of COVID equivalent to influenza. What do you think the financial implications are? Because your margins in Japan have already been pretty good actually.

Frederick John Crawford
President & COO

Well, really, the reclassification to 5, the Class 5 influenza, is really more related to overall business activity, in other words. And you're starting to see it here in Japan. I would just tell you from a personal perspective, when I first got here, people inside office buildings, outside office buildings, in meetings, out of meetings, at restaurants, doing daily activities, you were talking about 3% to 5% of people not wearing a mask. That now has clearly freed up. And in fact, the Japanese government has been encouraging companies and hotel operators and office building managers to adjust their policies in accordance to guidelines from the Ministry of Health here in Japan, and companies are taking that to heart. And so you're starting to see less and less mask wearing, although still a considerable level of mask wearing. And so I wouldn't call it back to normal but clearly has improved. And we think with that, there's improved face-to-face activity and improved economic activity overall.

So we are seeing that, and that's really what we would point to. It's not anything related to, for example, benefit ratios and margins from that perspective. The whole deemed hospitalization issue is behind us.

We've seen claims come back to their normal levels. Our operating platforms here in Japan are back to normal response times and volumes in the claims departments and call centers. And so we're through that episode. Maybe that answers your question.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

Yes. So obviously, more of an implication for potential sales activity than...

Frederick John Crawford
President & COO

That's right. Gradual, but we certainly hope that's the case. Yes.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

And then for Max, the stress that you're seeing in your investment portfolio, specifically in CRE, is that causing you to reevaluate your capital plans because you did buy back a decent amount of stock, and your overall capital levels, both in Japan and the U.S. are pretty healthy.

Max Kristian Broden
Executive VP & CFO

So obviously, we factor that into our capital plan. And obviously, the way we sort of think about buybacks, dividends, et cetera, it's all a combination of our current capital levels, our cash flow generation, any stresses that we see on the asset side of the balance sheet and the overall economy and the outlook for our business. And that all then boils down into the actions that we take. And we bought back $700 million of our own stock in the first quarter. And I do believe that, that is the most that the company has ever done in the history of the company. And I hope you should see that as a reflection of our view of both our business cash flow generation capital levels and any thoughts that we have around sort of future stress on the asset side of the balance sheet.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to David Young for any closing remarks.

David Young

Thank you, Andrea, and thank you all for joining us this morning for our call. Please reach out to the Investor and Rating Agency Relations team if you have any questions. And we look forward to speaking with you soon, and wish you all continued good health. Have a good one.

Operator
The conference has now concluded. Thank you for attending today's presentation, and you may now disconnect.