S&P Global
Market Intelligence

Aflac Incorporated NYSE:AFL

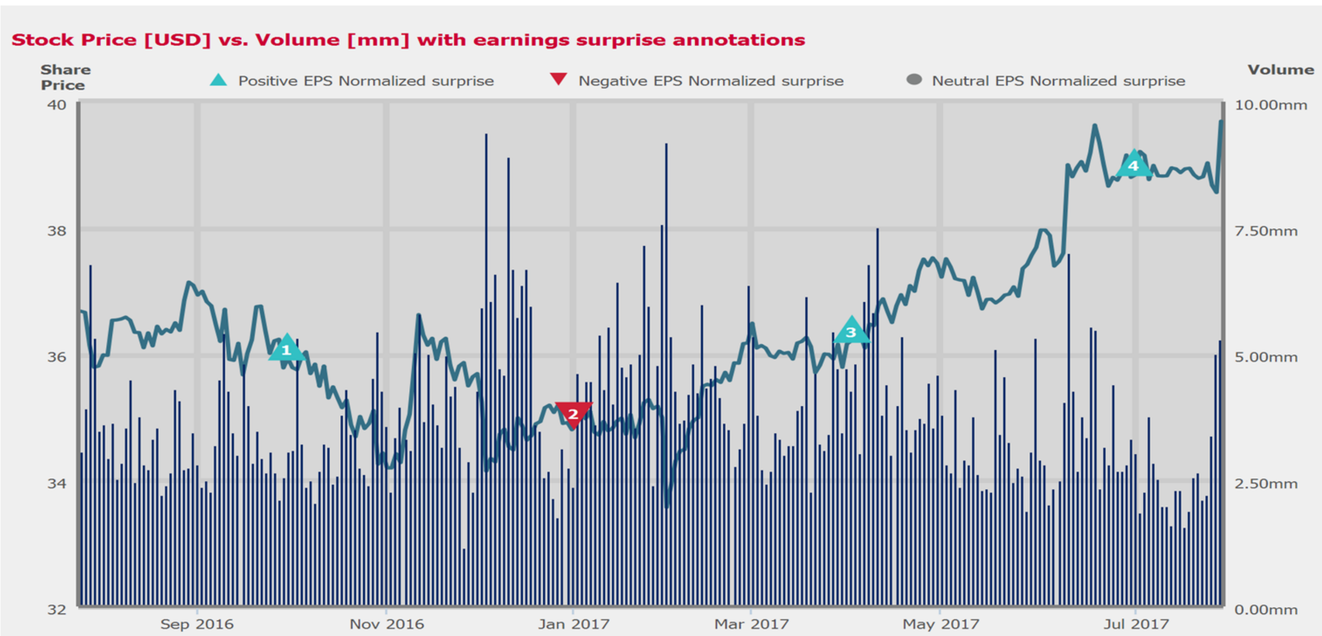
FQ2 2017 Earnings Call Transcripts

Friday, July 28, 2017 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2017-			-FQ3 2017-	-FY 2017-	-FY 2018-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.82	0.92	12.20	0.82	3.27	3.38
Revenue (mm)	5481.00	5428.00	(0.97 %)	5513.50	21791.00	22005.50

Currency: USD
Consensus as of Jul-28-2017 6:46 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ3 2016	0.87	0.91	4.60 %
FQ4 2016	0.81	0.77	(4.94 %)
FQ1 2017	0.81	0.84	3.70 %
FQ2 2017	0.82	0.92	12.20 %

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EXECUTIVES

Daniel Paul Amos
Chairman, President & CEO

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

Eric Mark Kirsch
Executive VP, Global Chief Investment Officer & President of Aflac Global Investments

Frederick John Crawford
Executive VP & CFO

Masatoshi Koide
President, Representative Director & COO of Aflac Japan

Teresa Lynne White
President of Aflac US

Todd Daniels

ANALYSTS

Erik Bass

Humphrey Lee
Dowling & Partners Securities, LLC

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

John Matthew Nadel
Crédit Suisse AG, Research Division

Nigel Phillip Dally
Morgan Stanley, Research Division

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

Sean Robert Dargan
Wells Fargo Securities, LLC, Research Division

Seth M. Weiss
BofA Merrill Lynch, Research Division

Suneet Laxman L. Kamath
Citigroup Inc, Research Division

Suneet Laxman L. Kamath
UBS Investment Bank, Research Division

Presentation

Operator

Welcome to the Aflac Second Quarter Earnings Conference Call. [Operator Instructions] Please be advised today's conference is being recorded. I would now like to turn the call over to Mr. David Young, Vice President of Aflac Investor and Rating Agency Relations. Sir, you may begin.

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

Good morning, and welcome to our second 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 are prospective in nature. Actual results could differ materially from those we discuss today. We encourage you to look at our annual report on Form 10-K for some of the various risk factors that could materially impact our results.

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 Paul Amos
Chairman, President & CEO

Thank you, David, good morning, and thank you for joining us. Let me begin by saying that the second quarter concluded a strong first half of the year for Aflac.

So now, let me provide an update on Aflac Japan, our largest earnings contributor. Despite the low persistent interest rate environment, Aflac Japan generated solid financial results for both the quarter and the first half of the year. In yen terms, results on an operating basis were ahead of expectations for the quarter. I'm also very pleased with Aflac Japan's robust third quarter sales increase of a 5.8% increase in the quarter, rounding out a strong increase of 6.6% for the year.

Sales in the quarter continued to benefit from the launch of the revised core medical product EVER. Continued strong cancer results fueled by our alliance with Japan Post, and sales of income support insurance, our third sector product offering that we introduced in July 2016.

Turning to first sector savings product, you'll recall, that we've been focused on pulling products from select channel, and have aggressively repriced our WAYS and child endowment products, factoring in the recognition of a prolonged low-interest rate environment. Aflac Japan continues to make significant progress, controlling the sales of the first sector savings type products, which is reflected by a decrease of about 78% of the total per sector sales in the quarter. Regarding distribution channels, we had meaningful production across all channels, which further affirms our leading position in the third sector market. Our traditional agencies had been and remain vital to our success, and our alliance partners have also made contributions to our sales results.

Last week, I had the pleasure traveling to Tokyo to provide my full support of Aflac's new management team. It was an excellent trip, and while I met with key stakeholders, including Aflac Japan Associates, the employees, our alliance partners Dai-ichi Life and Japan Post and others, with respect to Japan Post in 2013, when we first announced our strategic alliance, I noted that the partnership will provide an important source of growth for the company today and to value our customers. I said at the time, that it would be a game changer. Today, I am pleased to say that the second quarter of 2017 exceeded our expectations and was a largest producing quarter [to date] through the Japan Post alliance.

Against that backdrop, during my time in Tokyo, I reaffirmed with Japan Post CEO Nagato-san, the importance of the strategic alliance, and was pleased to hear that he was in agreement to further strengthen our win-win cancer insurance partnership. With such an extensive distribution network that includes Japan Post, 20,000-plus postal outlets selling our cancer insurance, we were furthering 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 stable margins. We will continue to refine our existing product portfolio and introduce innovative new third sector products to maintain our market leading position. As we communicate, we view Aflac Japan's long-term compound annual growth rate in the third sector as being in the range of 46%.

Turning to our U.S. operations, we're pleased with the financial performance continued strength in the profitability of Aflac U.S. Like Japan, our financial results for Aflac U.S. on an operating basis were ahead of our expectations, which is particularly notable and that they reflect ongoing investment in our platform. We're continuing to see our platform investments pay off in the form of improved persistency and customer satisfaction. Customer feedback shows that a whopping 95% of our policyholders who use One Day Pay say they're likely to refer other people to Aflac, which will continue to differentiate and bolster our powerful brand and policyholder trust. 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 the 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 [assess] and therefore succeed with smaller employers. We've also increased our career sales adoption of our Everwell enrollment platform, which in turn, has increased account penetration in the accounts with less than 100 workers.

Turning to broker activity. Great progress has been made via our team of broker sales professionals in strengthening Aflac's relationships with large broker community. Given the positive results we've seen with our efforts with large broker space, we continue to expand our broker sales team with new sales designs to focus on the mid-broker space. I'm pleased with the progress we've made in that space and expect to gain traction in the second half of the year.

With new annualized premium sales increase of 2.4% in the quarter and 2.1% for the first half of the year, it's below our target of our long-term CAGR increase of 3% to 5%. We believe though we're on the right track with a strategy for growth we implemented in both our career and our broker channels. We will continue to make tactical adjustments to meet our long-term sales growth objectives.

Turning to capital deployment. Fred will provide more detail 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 our shares in 2017. As is always the case, this is in stable capital conditions and the absence of any compelling alternatives.

Before I turn the call over to Fred, I'd like to take a moment to reiterate that Aflac's people have always been our greatest asset, and we place high priority on ensuring we have the right people in the right roles at the right time. As you all know, Paul left Aflac during the quarter to become a partner in a private equity firm. As CEO, I want you to know that we have a tremendous management team currently in place, and no matter how strong our team is, we're continually striving to strengthen our bench to ensure that we are prepared for the future. This entails balancing the knowledge and skill sets inside the organization with the expertise and fresh ideas of new people who join our business. I'm excited about our management team, and I look forward to telling you more about their strengths at the FAB Meeting in September.

And now, I'll turn the program over to Fred, to cover the financial results. Fred?

Frederick John Crawford
Executive VP & CFO

Thank you, Dan. Our earnings results for the second quarter came in above our expectations, driven primarily by strong insurance margins both in Japan and the U.S. We reported operating EPS of $1.83 per diluted share, which included a favorable tax item in the quarter that contributed approximately $0.05 per share. The tax item represents the release of certain tax reserves associated with prior tax years that closed in the second quarter. Offsetting this somewhat, was a weaker yen, impacting the quarter's results negatively by $0.02 a share when compared to last year's quarter. Even after adjusting for that taxed item, our earnings per share were up over 9% on a currency neutral basis.

We booked approximately $8 million in pretax costs associated with our Japan branch conversion, coming in below our estimates but largely timing related. The conversion remains on track for a mid-2018 closing, and there is no change to our original guidance on conversion costs of $120 million to $130 million, pretax. Conversion costs will pick up in the second half of the year and into the first half of 2018 as we approach closing.

In our Japan segment, premium weakness in the period was largely attributed to our first sector savings product, WAYS, and a portion of our block reaching paid-up status. This alone contributed to a JPY 14.5 billion decline in first sector premium in the quarter. We are in the peak year of savings policies reaching paid-up status, and our estimate -- and we estimate for 2017 the premium impact will be approximately JPY 55 billion to JPY 60 billion. Third sector earned premium continues to grow, up approximately 2% or JPY 5.5 billion in the quarter.

Our Japan segment profitability was strong in the second quarter, with pretax margins approaching 21%. Benefit ratios in Japan were favorable and partially the result of a premium mix and the shift from first sector towards third sector, which carries a lower benefit ratio. There's an opposite impact on the expense ratio, modestly increasing in the quarter and pressured by an overall decline in revenue. As a reminder, while the paid-up product impacts revenue, we had booked the deferred profit liability that amortizes into earnings and serves to largely mitigate any bottom line impact. Setting aside the paid-up policy dynamic, we continue to experience favorable loss ratios and are focused on managing expenses in the face of revenue weakness.

Japan's investment income decreased consistent with our guidance, reflecting lower reinvestment yields in Japan, increased hedge cost versus prior year, and the fourth quarter 2016 switch trade, selling higher-yielding bonds and investing proceeds in JGBs as we build out our floating-rate portfolio during 2017.

We continue to make progress on the build out of the floating-rate portfolio and have invested approximately $450 million through June, with a building pipeline of commitments through year-end.

We have locked in over 90% of our anticipated hedge cost in 2017, and are on pace to come in at or modestly below our full year guidance range of $250 million to $270 million. While we have benefited modestly from favorable pricing we are building out a fully hedged, floating-rate portfolio throughout the year, and reserve the flexibility in our forecast to lock in more of our 2018 cost as the year proceeds. We, therefore, are forecasting run rate hedge cost to increase in the second half of the year.

Executing on our refreshed hedging strategy is beginning to yield results in a way of less volatile, net investment income. Eric will expand on our investment strategy, optimizing our U.S. dollar portfolio in Japan and related hedging strategy at this year's Financial Analyst Briefing in September.

Turning to the U.S. Dan commented on our sales results, which together with persistency, up nearly 1% over the prior year drove premium growth of approximately 2%. Benefit ratios were strong, both in the quarter and year-to-date. We are currently running favorable to our outlook called guidance range of 52% to 53%. Our expense ratio calmed down from the first quarter levels, with year-to-date performance within our guidance range of 34% to 35%. Our expense ratio reflects progress on certain platform investments including our group administrative platform, enrollment platform and related technology.

Overall, our U.S. pretax profit margin of 21% is very strong by historical standards and sets us up for solid results in 2017.

Our capital ratios remain strong. SMR in the 985% range, and RBC estimated in the mid-800% range at quarter end. We ended the quarter with $1.8 billion of excess liquidity at the holding company, which includes $500 million of contingent capital. Leverage remains at the low end of our policy range of 20% to 25%, consistent with securing our strong ratings. Overall credit conditions and asset quality remain strong with only a modest level of impairments in the quarter. We repurchased $200 million of stock in the second quarter and remain comfortably on track to repurchase $1.3 billion to $1.5 billion for the year. Our repurchase slowed in the second quarter, a result of stepping out of the market pending certain executive announcements. When we entered back into the market, we tactically elected not to pressure our trading volume and are spreading repurchase out over the course of the year. Including our dividend, we are reaffirming our guidance of deploying $2 billion to $2.2 billion to shareholders in 2017.

Finally, I want to reiterate our 2017 earnings guidance of $6.40 to $6.65 per share on a currency neutral basis. While affirming our operating EPS guidance, we are certainly tracking to the high side of our range, but we are only midway through the year, and we'll update accordingly.

Looking ahead, we remain well positioned in terms of our core margins and capital strength, consistent or tracking favorable to our December outlook call guidance.

I'll now hand off 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. But first, let me remind you that, to be fair to everybody, please limit yourself to 1 initial question and only 1 follow-up that relates to that initial question. We will now take the first question.

Question and Answer

Operator

Our first question is from Jimmy Bhullar with JPMorgan.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

I had a question for Teresa, your U.S. sales obviously, still modest but they seem like they're getting a little bit better. To what extent are you confident that this is the beginning of a turnaround or do you still have to wait and see how things progress in the second half of the year and in the fourth quarter to be comfortable with your -- that you'll be able to meet or exceed your guidance?

Teresa Lynne White
President of Aflac US

Jimmy, thank you for the question. I feel good about -- I feel there's some positive results underlying metrics that we're seeing right now. I do, however, and I've said in a previous conference call, I want to see the last half of the year. I want to see how that materializes. I believe that we've seen traction with regard to the career agent side, where we've improved our veteran engagement. They are generally the sales force that's writing in our existing account, but we're seeing that underlying metric move in positive direction. We talked about the conversion of new associates to producers. I mean, in 2015, if you recall, we adjusted the compensation to ensure that we were paying for a producer versus a recruit. And we've seen some positive traction there. But then, I think, I talked about 2 other things, the broker channel that mid-market channel, we called out as an area that we needed to work on. We've increased staff there by 25%. Those folks are onboarded, they've been trained, they're now in the market working with those market directors. That needs to materialize and I feel good about what I'm seeing so far. And then the last thing was public sector that was an area that we said we needed to ensure that we defended that part of our in-force and continue to grow. We have hired a department head for public sector. We've developed a strategy that we believe is going to be competitive in that market space, and we're already starting to see some traction as it relates to new RFPs or quotes in that sector. So again, I think that we're going in the right direction, I feel pretty good about that. But I do -- I would like to see how all of this materializes in the fourth quarter -- in the third and fourth quarter.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

And on the sales reps that you added for mid-size brokers, or did any -- did that contribute at all to second quarter results or were they not on-boarded for most of the quarter?

Teresa Lynne White
President of Aflac US

They were not onboarded for most of the quarter but I will say that the focus on mid-market brokerage did helped us -- help us with a lift. But I would not say that they contributed terribly in the second half or in the second quarter.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

And then lastly, just on the talk about healthcare reform. Have you seen or do you expect to see

[Audio Gap]

Nigel Phillip Dally
Morgan Stanley, Research Division

I mean, well below your original guidance. So hoping to get some color on what's driving that and the sustainability looking forward.

Frederick John Crawford
Executive VP & CFO

Sure, Nigel, it's Fred. We did indeed experience favorable benefit ratios in the quarter, let me just start with the U.S. We are tracking a bit below our 52% to 53% range, as I mentioned. And that's really related to favorable claims trends, but also coupled with a natural slowing of IBNR build as those favorable claims trends play out. I would say that it's not uncommon in any particular quarter that things may break to the positive or break to the negative when it comes to the various IBNR adjustments in particular, that you make, and claims trends. In this particular quarter, certainly, we experienced trends breaking to the positive. But having said that, we've had sustained period of benefit ratio performance, really at that low end of the range I mentioned. And that would be our expectation as we go through the year. So we are expecting to see benefit ratios climb back towards our range guidance for the U.S. But should end the year at the favorable side of that range of 52% to 53%. In Japan, we got a different dynamic going on. And that is, yes, we have continued favorable trends and related claims and IBNR-related activity. And certainly, you saw it actually dipped down a little bit in the quarter. But what we really have going on right now is a bit of a business mix issue. And as we see the premium levels come down in first sector, particularly related to the WAYS paid up product and a out-performance on the sales side and really a continuous level of out-performance building the earned premium on third sector, that shift in mix is causing there to be downward pressure on the benefit ratio. We would estimate for example, in the quarter, roughly 100 basis points, perhaps 100 to 120 basis points or so of benefit ratio improvement, just related to that shift in mix between third sector and first sector premium. Because we're in this peak period of paid up policies throughout 2017, that favorable pressure on our benefit ratio may continue for a period throughout this year. And so, that's why, we're suggesting that we are probably going to end up at the low side of our benefit ratio range and Japan as well. That outlook call range was 71% to 73%. Now having said that, third sector benefit ratios were effectively flat. So we are seeing favorable claim activity, but this had really more to do with the mix issue than necessarily materially improved claims trends in the quarter itself.

Operator

Our next question is from Seth Weiss with Bank of America.

Seth M. Weiss
BofA Merrill Lynch, Research Division

I want to start first with guidance and reiterating guidance. Considering the strong beats in both the first quarter and second quarter, reiteration of guidance, even if we look at the very high end of the range, so it just probably a slower pace in the back half of the year than I think most of us were modeling. Just curious if this is a matter of, call it prudence not changing guidance midway through the year? Or is this a reflection of a much heavier ramp up in investment spend than perhaps, we originally anticipated?

Frederick John Crawford
Executive VP & CFO

Yes. What you should not read into our holding to guidance or what I said, the high side of our guidance, what you should not read into it is some sort of sharp right or left turn in our strategy or pace of investment in the second half of the year. Really, what you have going on is a few things. One, as mentioned, we've kicked off in the first of the year at a relatively lower rate of hedge costs. We would expect that to naturally build up as we go throughout the year. Now granted, we're running at or may be slightly below our guidance range of 250 to 270. But we would expect that to build naturally. And that has a lot to do with the pace of build out of our floating-rate portfolio, which would expect to be 100% hedged. We also have been gradually locking in more of our long-term hedge costs, which is a bit more expensive and while we're experiencing favorable pricing, that will pressure a little bit of your expenses as you go throughout the year. So that will be in front of us on the back half as I've mentioned in my comments. In our press release and in my comments, we've talked about the fact that there will be a gradual pick up in the level of expenses in the business. This is not really abnormal, we tend to see this every year. Some of it is related to promotional spend, new product launch spend in Japan, in particular. But also, the natural progress of various initiatives across the company related to IT and operations, particularly in the U.S. So we'll see that climb in pressure a bit as we go. But to your question of conservatism, when your out-performance is largely on the back of strong benefit ratios in the U.S. and Japan, it stands to reason that you're going to be somewhat cautious in your expectation for reverting back to your long-term views of benefit ratios. And so we absolutely are assuming that there'll be migration back to probably the low end of our benefit ratios in Japan and the U.S., and that will be different than what we experienced in the second quarter. So that's what's in our numbers. But we'll do what we always do. It is midway through the year and as we continue to see the business progress, and we see more permanency in the numbers, particularly around benefit ratios, we'll update accordingly.

Seth M. Weiss
BofA Merrill Lynch, Research Division

That's very helpful. And then, if I could just follow up on the last question on Japan margins. And the commentary about the 100 to 120 basis points improvement due to the mix is really helpful. Is that sort of a re-base that becomes permanently part of the earning stream? Or is there some dynamic in terms of how that deferred profit liability amortizes in where that slows and the benefit ratio kind of naturally rises if we look in outer years?

Frederick John Crawford
Executive VP & CFO

Eventually, the numerator and denominator dynamics of premium falling off with paid-up status and the amortization of the deferred profit liability will eventually slow in pace in accordance with the policies reaching paid off. I might note that even though it's far off in the distance, we have not only 5 pay ways but 10 pay ways, and so we'll come back to this equation down the road as 10-pay products start to reach paid-up status albeit, I don't think as pronounced as the 5-pay product. But I would say is in our future, is that, as time goes on, we would expect to see a fundamental change in the mix of earned premium, if you will, between third sector and first sector. And that will influence and be more a permanent part, if you will, of our benefit ratios. I do want to remind you that, while first sector product carried higher benefit ratios it also carried lower expense ratios, and so, you will see that dynamic play out. In my mind, and what we're doing as the management team is, in the face of obviously, some slowed revenue increase related to our first sector strategy, we have to be attentive over time to our expense structure and continue to manage that. And we certainly are paying attention to that. The team in Japan is actively working and engaged to expel more of that out as we move forward. But that's something we have to be careful about and are paying attention to. But overall, profit margins are expected to remain strong and we're very pleased with the results. And we also think that shift is very much in the best interest to shareholders. One thing you don't see in our results is the gradual lift in cash flow and FSA earnings, which comes from shifting our mix to a lower capital intensive product and better profitability. And that will pay dividends as time goes on.

Operator

Our next question is from John Nadel with Crédit Suisse.

John Matthew Nadel
Crédit Suisse AG, Research Division

So 2 questions. One just wanted to talk about the U.S. dollar denominated investments hedged in Aflac Japan. Could you just give us an update on what the total dollar amounts of the hedge program was in 2Q? And where you expect that to end the year as you continue to work on the floating-rate portion? And I assume that dollar amount will grow?

Frederick John Crawford
Executive VP & CFO

It will grow. I'll ask Eric to comment on the trajectory of the build in the portfolio.

Eric Mark Kirsch
Executive VP, Global Chief Investment Officer & President of Aflac Global Investments

John, current size is about $22.8 billion. By year end, based on current projections, it would probably get to about $24.5 billion or so. And the majority of the new assets that will go in will be floating-rate assets between transitional real estate and middle-market loans.

John Matthew Nadel
Crédit Suisse AG, Research Division

Just as a real quick follow up on that one, Eric, that's the total size of the U.S. dollar denominated program, but that's not the hedge piece, is it?

Eric Mark Kirsch
Executive VP, Global Chief Investment Officer & President of Aflac Global Investments

That's correct, I apologize. So currently, about 52% is hedged and 49% is unhedged.

John Matthew Nadel
Crédit Suisse AG, Research Division

Got it. And that ratio should increase, I assume?

Daniel Paul Amos
Chairman, President & CEO

It should because what we are building in the floating-rate portfolio is, by definition, intended to be 100% hedged. The only thing that would change that is that if we were to make tactical decisions around the hedge ratio. But if you just roll the ball forward or play the ball forward, the portfolio grows to $24.5 billion because it's growing on the back of a couple billion growth rate in the floating-rate portfolio, and that is 100% hedged. You'll see the notional climb from its roughly $11 billion range, up towards $12.5-ish-plus billion.

Eric Mark Kirsch
Executive VP, Global Chief Investment Officer & President of Aflac Global Investments

And that was -- those changes are already contemplated in forecasts in our full year hedged forecast, which Fred mentioned earlier.

John Matthew Nadel
Crédit Suisse AG, Research Division

Yes, I appreciate that. That's helpful. And then back to Japan in the margins, Fred. Just quick one, thinking about that, it's sort of a natural shift. So certainly, seeing the impact on the benefit ratio that's come down. And I think you mentioned, maybe 100 or 120 basis points. So the lion's share of that improvement in the benefit ratio really driven by shift as opposed to favorable claims activity. What I guess, we're really not seeing and I'm wondering if you expect that we should see more of it is the expense ratios up a little bit on a year-over-year basis if I think of first half versus first half. Should we expect that the expense ratio is going to increase you a little bit more, again driven by that shift?

Frederick John Crawford
Executive VP & CFO

Yes. The expense -- the way I would think about the expense ratio, now remember, expense ratio is up against total revenue. So you also have that investment income playing into that, which also includes hedge cost now. So with the switch trade for example, and sort of a slowing down of net investment income to then build back up, you'll see some natural short-term pressure to that expense ratio. But as we see premium levels pressured because of the paid-up status throughout this year, and continues on a bit into next year, and net investment income while recovering, still being down from historical standards, we would expect the expense ratio to still be pressured and remain in that range that we've forecasted, of 19% to 20% range. So it may climb before it comes down. What we are busy working on is IT and operational investments that we would expect over time to start to pay off in the way of yielding expense benefits. And we're going to need to be attentive about -- attentive to the overall expense structure we have that's surrounded in particular first sector savings product as that starts to ratchet back. Now we continue to launch new product. The income product that Dan mentioned, we continue to refresh our core medical and cancer product, and we're always exploring where there may be new avenues of growth rate on the third sector side. And so we may have some reallocation of expenses over time, but we have to be attentive to the revenue realities and that will mean managing expenses. So right now, I would stick to this notion of 19% to 20%, we're traveling a bit on the low side of that, but I would expect it to probably pick up a bit as we go throughout the year.

Operator

Our next question is from Mr. Humphrey Lee with Dowling & Partners.

Humphrey Lee
Dowling & Partners Securities, LLC

Just to follow on the benefit ratios dynamic in Japan. So I appreciate the comment about the ways -- the 5 pay ways, kind of getting to pay up status and how they are going to shifting the dynamics little bit. But at the same time, I would expect that within your expectation kind of factoring into the 2017 guidance. So looking at your third sector sales being more robust in kind of the first half of the year, how much of that helped accelerated the mid-shift that we're seeing in here in year-to-date

Frederick John Crawford
Executive VP & CFO

So I mean, the way I would think about it is when we went into our outlook call and therefore our guidance, we guided to a range of 71% to 73% for our benefit ratio in Japan. In the first quarter, we posted 71.7% and then in the second quarter, we dipped down to 70.5%. And so there's obviously, a lot of attention being paid to the second quarter and whether there was something of a more permanent nature there, but I'll just remind you of the fact that, we did, in fact, see a good level of paid-up policies in the first quarter and our benefit ratios was 71.7%. So our view is that we will travel on the low end of that range of 71% to 73%. But we would expect the benefit ratio to kind of come back to those 71%, 72% levels as we go throughout the year. So we did, in fact, see good favorable claims results in the second quarter, that then led also to IBNR breaking to the positive, if you will, i.e. lowering IBNR, IBNR trends are slowing the pace of increase in IBNR. So you did have some of those what I would call, normal positive or favorable results. But it was just pumped up by, really, the mix now really taking traction and bringing it down by another 100 points. So hopefully, that helps. But you are seeing some favorability, as I mentioned, I do expect to travel the low end of our range, but I would expect a bit of a tick up from what we're seeing in the second quarter.

Humphrey Lee
Dowling & Partners Securities, LLC

So in other words, the strong sales that we.

[Audio Gap]

Seeing in the fourth quarter or account of the first the -- the pay-up status of those 5 pay ways. Is that correct?

Frederick John Crawford
Executive VP & CFO

Yes, that's right. You can sort of see it this quarter. The strength of our third sector sales contributed a bit over JPY 5 billion to the earned premium, while the paid-up status of our product dropped the first sector savings premium by JPY 14.5 billion. So there's a bit of a disproportionate amount of shift because we're in that peak year of paid-up policies here in 2017. So that will start to calm down.

Humphrey Lee

Dowling & Partners Securities, LLC

And then just to stay on third sector sales a little bit. So sales continue to be pretty strong, even though my understanding is that the Japanese market is getting more competitive in this third sector products as many other players are shifting their focused to this area. Can you just talk about in addition to the success relationship with Japan Post, anything that is notable that you're seeing that helped you to deliver such as a strong third sector sales in the first half of the year?

Daniel Paul Amos
Chairman, President & CEO

Well, I would say that my meeting with Japan Post CEO was a very strong meeting, and one that is encouraging to continue to see growth in the cancer insurance market with them, and the potential seems to be even stronger than what we first thought. And have a longer tail on it in terms of continued penetration. Maybe, Koide would like to make some comment from Japan. Koide, are you on?

Masatoshi Koide
President, Representative Director & COO of Aflac Japan

[Foreign Language] This is Koide from Aflac Japan. [Foreign Language] So as Dan mentioned, the reason why we have been very successful in the first half of this year is; one is, of course, JP. [Foreign Language] Another contributor the new medical product that we've launched in February. [Foreign Language] So this is because of the new product effect. And that's it for me.

Operator

Our next question is from Mr. Ryan Krueger with KBW.

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

I had a follow-up on the medical product, the revised EVER. I guess, the sales you talked in past about shorter sales cycle for medical products because it's been a few months now. Hoping for some perspective on how much longer you think the new product can resonate before kind of it reaches the end of the natural selling cycle for medical in Japan?

Daniel Paul Amos
Chairman, President & CEO

Well, the nice thing about adding a third pillar would allows us to cycle different products at different times. So it's not just medical but then we introduce a new cancer and then we back off and then go to a new medical again. But Todd, you want to make any comment about the life expectancy of the product?

Todd Daniels

Sure, thanks, Dan. I think if you go back and look at what we had in our FAB Sup materials, you can see how many quarters you get from a repricing. Back in 2015, you can see third quarter medical sales around JPY 9.1 billion. And that stays at a relatively high amount until we came out with a substandard medical in second quarter 2016. So you're going to see that the natural pacing of the product probably for few quarters. But one thing I'd point out, with this is the channel differences. So we're focused on Japan Post selling the cancer product and the good results we saw there. But what we have different now that we haven't had in the past is the associate channel is focused on selling the medical product while contributing to cancer sales. So you have both cancer and medical products up for the year, which is something we haven't been able to enjoy in the past.

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

Then a quick one for Eric. Can you just what -- give us a sense of what new hedges are costing at this points that you're putting on for the U.S. dollar portfolio and then how much of the 2018 costs are locked in?

Eric Mark Kirsch
Executive VP, Global Chief Investment Officer & President of Aflac Global Investments

Sure. First, the second question about 51%, 52% of '18 is locked in. As Fred mentioned, we continually look at that throughout the year so we'll expect to even make more deposits on that and get that locked in percentage higher as we get into FAB into the earnings outlook call. With respect to current cost, we've been fortunate because it kind of peaked at the end of last year. And if you think about the macros the U.S. had an outlook at year end of very high growth, the Fed lifting rates perhaps 3 times. Japan being stabilized, the cross-currency basis came in a bit. So hedge costs are actually running lower now than they were at the beginning of the year in our forecast. When you look at longer term hedges, which is a place we're focused for the longer-dated asset that you're looking at a little over 2%, like 2.05% when you looking at shorter-dated hedges, like 3-month hedges which was what we'll be focused on later in the year for our floating rate assets. You're currently looking at about 170 basis points.

Operator

Our next question is from Sean Dargan with Wells Fargo Securities.

Next question is from Mr. Suneet Kamath with Citi.

Suneet Laxman L. Kamath
Citigroup Inc, Research Division

Question for Teresa on the U.S. business. Good to hear that things are moving in the right direction, but if I think of your 3% to 5% sales growth, long-term target, it's quite a bit lower than where I would argue [UNAM] has been running and I would say that there's a lot of similarities in terms of the business mix is. One thing that [UNAM] does differently is I think, they really separate the brokerage business from the traditional agent channel. So just wondering if that's a strategy that maybe you guys should be thinking about in terms of more of a delineation between the 2 channels, given prior comments around channel conflict.

Teresa Lynne White
President of Aflac US

Well, certainly, so what I'd look at is the market and I get your question. The market's forecast grow at about 6%, broker growth is about 8% to 9%. And Aflac broker growth is already within that range. So we are internally looking at the broker's side of the business as well as the career side of the business. But we have the fortune of having one of the largest distribution forces and career agents, spilling over 70% of our business. So that's a large base to grow over and so that's why when we looked at our guidance, we believe that the guidance of 3% to 5% is reasonable. And it's really the difference in our distribution mix at this point in time. So I think, that's kind of what I'll share as it relates to distribution mix.

Daniel Paul Amos
Chairman, President & CEO

I'd like to make one other comment. The thing that's so great about our company is our brand. But it also is a liability in one respect. Certain companies can break their brands apart with different ones, but the companies don't necessarily have a great brand recognition themselves, so it doesn't make a difference. In our case, everyone wants Aflac and wants the Aflac just because they know our name. So in our case, with brokers and individual agents, no one wants for example, CAIC, which is our Aflac group, they don't want it named CAIC, they want to be named Aflac group. Because of that brand. So our channel conflict is somewhat to do with the brand itself and that if we have separate brands -- and we thought about that. But as you can imagine, everyone likes to be able to go into an account and be able to say the name of the company and they immediately know who it is and what -- and like the brand. So that does give us some pause, but at the same time, it's worth -- because we feel like, on the other hand, that's why we're #1 in the market by far in terms of what we're doing.

Suneet Laxman L. Kamath
UBS Investment Bank, Research Division

Got it and then just a follow-up on that, from time to time, we do hear about acquisition possibilities on the group side, particularly in the brokerage business. I know you did CAIC a while ago, but would it make sense to think about something a little bit bigger to kind of jump start your brokerage sales, acknowledging that Teresa said, that you're already running a little bit higher than the market overall?

Frederick John Crawford
Executive VP & CFO

Yes, this is Fred. I'll take that question and Teresa welcome any comments you have. But the most common discussion around our name from time to time has been a notion of true group, if you will, as opposed to differentiated from the group business we have in South Carolina. This would be true group life, short- and long-term disability. And we have for a while had to contemplate strategically the importance of that product and how it plays into our business model, particularly if you go up market and into the brokerage space. And we effectively had what amounted to a build, buy, or partner decision framework. The build was not very practical because it would take a lot of time, nor do we possess necessarily the expertise and infrastructure to support that type of business. The buy is not appealing because the premiums associated with purchasing large group players is very significant comes with integration issues and risks. And we don't think argues for the company's capital. And so what we have done is we are on the path of partnering on true group products, such that we can offer that product to the brokerage space under the Aflac name by partner meaning we partner on the administrative side but also on the risk taking side. When you're Aflac looking at that business, the thin margins and occasionally volatile results that come with true group aren't particularly appealing, they may be appealing to a company that is in other types of business and looking to diversify. But to us, they don't necessarily argue for our capital, let alone overpaying or paying a tremendous premium for the property. So we've gone down the partner route, and you'll hear more about that over time. I think thus far, the only announcement we've made is with Trustmark, on a life/LTC-related product. I came out of Lincoln so those of you familiar with Money Guard, know it's that type of a product offering, which has become popular on the work site. And that's the type of partnering we'll do as we go forward to measure up against the market. But it just doesn't argue for our capital to be a buyer at this time and take on that risk nor can we afford the time it takes to build. So we've chosen the partner route.

Teresa Lynne White
President of Aflac US

I think the only thing I'll add to that is, in September, I think, we can bring a little bit more color to the question of broker versus career and the strategy overall. So we'll do that.

Operator

Our next question is from Erik Bass with Autonomous Research.

Erik Bass

Dan, I was hoping you could expand in your comments about looking for ways to strengthen the partnership with Japan Post. Just wondering are there potential new product opportunities or other potential opportunities to expand that, if you could comment on a little bit?

Daniel Paul Amos
Chairman, President & CEO

Well, we didn't really go there at this particular time when we were having our meetings because we think there's still an enormous amount of potential with cancer insurance. But certainly, we would like to have discussions in that area, but as you know they sell their own medical product right now. So I think that, that would be a much harder thing to consider for anyone, including us. So right now, we just want to get to those 20,000 offices and make sure we're penetrating it, and they are committed to continue that going forward. But you are exactly right. As big as that distribution channel is we're always keeping our ears open to see if they ever have any consideration for doing that. We would do everything we could to open that channel and open that door with them.

Erik Bass

I know you can't comment on specific sales levels for the post, but can you give any sense of how penetrated you are in the channel today? I mean, now that you've had the access to the full 20,000 post locations for a bit. How close are you to being fully penetrated in the channel?

Daniel Paul Amos
Chairman, President & CEO

I really -- I can't speak on that, but I don't know either. Because it's something new that's never -- there's never been a partnership like this. They've never done a deal where they let everybody have all 20,000 post offices. So what the penetration is, I don't know, but the thing I will reiterate is, here we are, been in this program this long and we hit a record this quarter. So I don't think it's over is the main thing. Everybody's wondering when it's going to head down, and it doesn't seem to be headed down, it seems to be going up, of course, that can't go on forever. But I'm certainly encouraged about that. The one thing that we always talk about on these calls is how the negative interest rates or low-interest rates are killing us, everybody, not just our [staff of Aflac], but the industry as a whole, it's terrible, dada, dada. But the products that we sell in the third sector are less interest rates sensitive, and so it helped us with our alliance partners, all of them, that -- here's a product that they can sell that will help them financially, help us financially, and it's a win-win. So I think that will continue going forward, and I'm excited about that.

Operator

Our next question is from Mr. Sean Dargan with Wells Fargo Securities.

Sean Robert Dargan
Wells Fargo Securities, LLC, Research Division

I had a question about the income support product. Ultimately, what will this do to the benefit ratio? Will this change that mix shift at all? How big can this product get? I guess this is my question.

Frederick John Crawford
Executive VP & CFO

I'll let Todd answer. Don't hold of your breath on the income product adjusting our benefit ratio anytime soon, just given the sheer size of the earned premium build it over but...

Daniel Paul Amos
Chairman, President & CEO

And I'd let Koide to talk about the potential of the product. But why don't you go ahead and answer the benefit ratio.

Todd Daniels

Okay. The benefit ratio for the income support is expected to be in line with our other third sector products, somewhere between medical and cancer. So -- and again, because of the sheer size of it today, there would have to be a material amount of sales of income support, which I think we'd all enjoy in order to affect the benefit ratio in any way that a regular third sector sale would.

Daniel Paul Amos
Chairman, President & CEO

Koide, would you like to comment on the potential of the market?

Masatoshi Koide
President, Representative Director & COO of Aflac Japan

Yes. [Foreign Language] Right now, this income support product market itself is still in development stage and we tend on developing it into third pillar over the mid-to long-term perspective. [Foreign Language] That's all from us.

Daniel Paul Amos
Chairman, President & CEO

It's just too early to tell at this particular point. And we're encouraged with it, initially. Anytime a new product comes out, they generally have a spike in it. And our agents go to the path of least resistance. So as you've seen in the past when we introduced some medical cancer drops off, we introduced the new cancer medical drops off, we introduce this, it hurts the others. So they moved, and we've never cared as a company where they go. But the potential of tacking this on to this large customer base of ours has enormous potential, but it's still too early to tell how successful it's going to be. But I'm certainly excited about it and think it has a potential long-term.

Operator

At this point, speakers, there are no questions in the phone.

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

Thank you very much. Before we end the call today, I'd like to remind every one of our upcoming -- for further details or any questions, please contact our Investor and Rating Agency Relations Department, and we hope to see you all there. Thank you very much.

Operator
And that concludes today's conference. Thank you for your participation. You may now disconnect.