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Market Intelligence

Aflac Incorporated NYSE:AFL

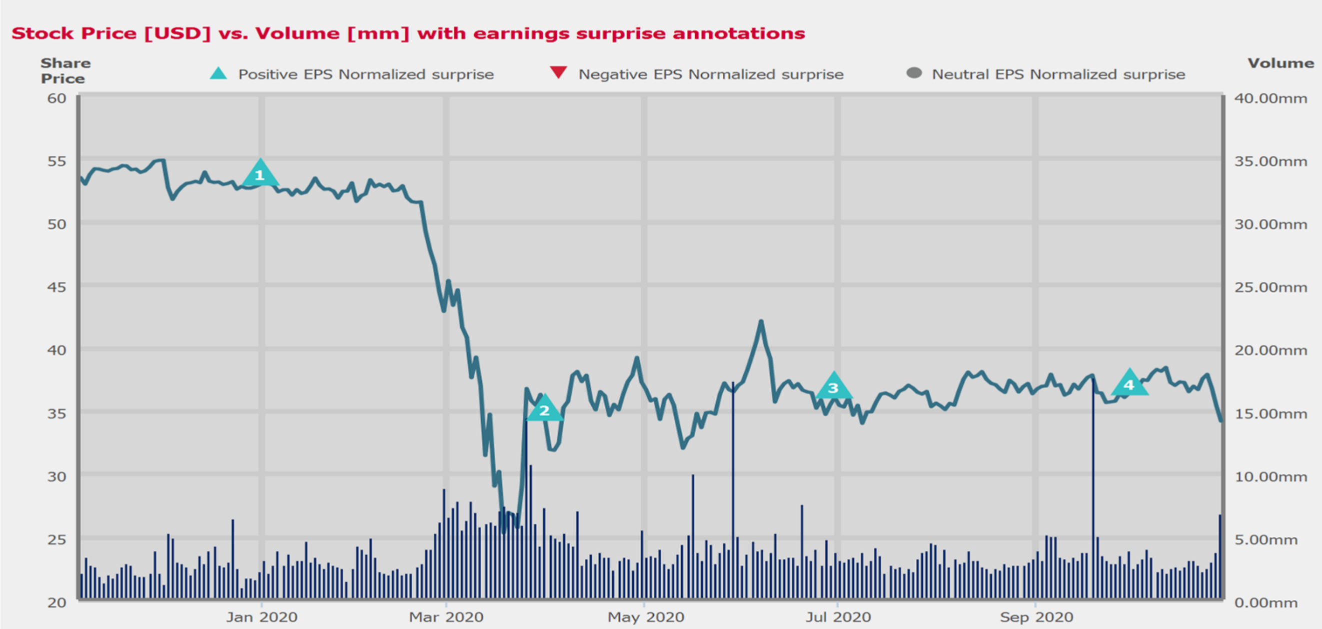
FQ3 2020 Earnings Call Transcripts

Wednesday, October 28, 2020 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2020-			-FQ4 2020-	-FY 2020-	-FY 2021-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.14	1.39	▲21.93	1.06	4.82	NA
Revenue (mm)	5502.20	5665.00	▲2.96	5483.54	22151.40	NA

Currency: USD
Consensus as of Oct-28-2020 8:27 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2019	1.02	1.03	▲1 0.98 %
FQ1 2020	1.10	1.21	▲2 10.00 %
FQ2 2020	1.05	1.28	▲3 21.90 %
FQ3 2020	1.14	1.39	▲4 21.93 %

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Call Participants

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Presentation

Operator

Good day, everyone, and welcome to Aflac Third Quarter 2020 Earnings Call. [Operator Instructions] Thank you. I would now like to turn the call over to your host, David Young, Vice President of Aflac Incorporated Investors Relations. Please go ahead, sir.

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

Thank you, Adrianne. Good morning and welcome to Aflac Incorporated's third quarter earnings call. As always, we have posted our earnings release and financial supplement to investors.aflac.com.

This morning, we will be hearing remarks about the quarter as well as our operations in Japan and the United States amid the COVID-19 pandemic. Dan Amos, Chairman and CEO of Aflac Incorporated, will begin with an overview of our operations in Japan and the U.S. Fred Crawford, President and COO of Aflac Incorporated, will then touch briefly on conditions in the third quarter and discuss how we are navigating the pandemic, including some key initiatives. Max Brodén, Executive Vice President and CFO of Aflac Incorporated, will then conclude our prepared remarks with a summary of third quarter financial results and current capital and liquidity.

Joining us this morning during the Q&A portion are members of our executive management team in the U.S. Teresa White, President of Aflac U.S.; Eric Kirsch, Global Chief Investment Officer and President of Aflac Global Investments; Rich Williams, Chief Distribution Officer; 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 in Tokyo at Aflac Life Insurance Japan; Charles Lake, Chairman and Representative Director, President of Aflac International; Masatoshi Koide, President and Representative Director; Todd Daniels, Director and CFO; and Koji Ariyoshi, Director and Head of Sales and Marketing.

Before we begin, some statements in this teleconference are forward-looking within the meaning of federal securities laws. Although we believe these statements are reasonable, we can give no assurance that they will prove to be accurate because they are prospective in nature. Actual results could differ materially from those we discuss today. We encourage you to look at our annual report on Form 10-K for some of the various risk factors that could materially impact our results. As I mentioned earlier, the earnings release is available on investors.aflac.com and includes reconciliations to certain non-U.S. GAAP measures. I'll now hand the call over to Dan. Dan?

Daniel Paul Amos
Chairman & CEO

Thank you, David, and good morning. Thank you for joining us. As we all know, COVID-19 pandemic has ushered in some of most difficult times for so many people around the globe, and we continue to pray for all of those affected. I'd like to share my appreciation for our employees and sales force in Japan and the United States for their tireless work in helping our policyholders and communities impacted by the pandemic.

During this difficult time, it's important to note that we remain focused on doing what we do best, that is, providing protection products to help consumers when they need it most. This morning, I'll provide an overview of the quarter and how we performed by operating segments. Financially, Aflac continues to be impacted by the pandemic, but remains strong in terms of capital and liquidity. In addition, our investments are high quality, diversified, and they're among the highest return on capital and lowest cost of capital in the industry.

Amid the challenges of COVID-19, this quarter was also significantly impacted by the release of favorable U.S. tax regulations related to the utilization of foreign tax credits. You'll recall that our Japanese subsidiary is taxed as a U.S. domestic company for U.S. tax purposes. In the quarter, we recognized a cumulative year-to-date benefit from these regulations of $202 million or $0.28 per share compared to our previous run rate. Max will provide additional details.

Turning to our operations, starting with Aflac Japan, the effects of COVID-19 continues noticeably impacted our results, as seen in the third quarter, with sales decreasing 32%. We continue to have around 50% of the workforce working from home in Japan. And in September, traffic coming into the shops remained at 70% of pre-pandemic levels. While these sales results represent sequential improvements relative to the last quarter, the effects of the reduced face-to-face activities are evident, and we continue to provide virtual sales.

2020 has also ushered in a change on the Japanese political front. Prime Minister Abe was Japan's longest-serving prime minister and a source of political stability with nearly 8 years in office. Mr. Suga was a core member of Abe's administration leadership team serving as the Chief Cabinet Secretary. We believe Mr. Suga's administration will carry on skilled leadership. This will continue to promote a good business environment in Japan and emphasize policies in terms of the response to the COVID-19 and economic policies. Prime Minister Suga is accelerating efforts to move toward -- to move forward with regulatory reforms for a post-pandemic world, promoting digital transformation. In that respect, I am pleased that Aflac Japan's paperless initiatives is well underway, and Fred will share more.

Turning to Aflac U.S. The effects of COVID-19 continue to noticeably impact our results in this segment as well. Largely due to reduced face-to-face activity, third quarter sales were down 35.7%. In the U.S., we continue to feel the impact of temporary business closures and lack of access to the work site, especially among our career agents who have historically relied upon face-to-face meetings to engage our small business owners and their employees. At the same time, the fourth quarter, typically, when we see strong results in the broker-driven group market, which has generally been more resilient to face-to-face and nonface-to-face conditions. As a result, we remain cautiously optimistic for modest sequential sales improvement for Aflac U.S. in the fourth quarter compared to the second and third quarter, contingent upon the pace of the economic recovery.

We are also on track to close our acquisition of Zurich Group Business Benefits soon, which allows us to extend our distribution reach and appeal to brokers and large employers. While having little effect on the fourth quarter, the acquisition positions us for expanded capacity as we look forward to 2021.

To place Aflac in a position of strength, we know that we must balance investing in growth with an eye toward reducing expenses in the long run. As such, we took an opportunity to offer a very generous voluntary separation package to eligible employees who expressed an interest. As a result, we have achieved an approximate 9% reduction in our U.S. and corporate workforce with expected onetime expenses of $45 million in the fourth quarter. This allowed us to thank employees for their years of faithful service and dedication as they pursue a new path or open up the next chapter.

You'll recall that the U.S. benefit ratio was significantly affected by policyholder's limited visits to the doctor. With this in mind, we launched a U.S. initiative early in the third quarter to remind policyholders of the value of their wellness benefits attached to their products. The wellness benefits pays on certain routine doctor, dentist and hospitalization visits. In addition, we make sure that it pays a benefit for COVID-19 testing. The wellness initiative has been a success. We are glad we emphasize this important aspect of our policy as it reinforces how we are there for the policyholder when they need us most. This wellness campaign and the voluntary separation programs were a couple of near-term headwinds to the profit margin. However, we expect that they will serve us well as we enter 2021.

To conclude our operational discussion, as I've said before, we want to be where the people want to purchase insurance. That applies to both Japan and the U.S. In the past, this has meant meeting face-to-face with individuals to understand their situation, propose a solution and close the sale. However, the pandemic clearly demonstrates the need for virtual needs. In other words, nonface-to-face sales to reach potential customers and provide them with the protection that they need. Therefore, we have accelerated investments to enhance the tools available to our distribution in both countries.

As always, we are committed to prudent liquidity and capital management. This includes maintaining strong capital ratios on behalf of the policyholders in both the U.S. and Japan and a tactical approach to capital allocation. It goes without saying that we treasure our record of dividend growth. With the fourth quarter declaration, 2020 will mark the 38th consecutive year of dividend increases. Our dividend track record is supported by the strength of our capital and cash flows. At the same time, we have remained tactical in our approach to share repurchase, buying back $400 million of our shares in the third quarter. We have also focused on integrating the growth investments that we have made in our platform. By doing so, we look to emerge from this period of continued position of strength and leadership.

As always, we are working to achieve our earnings per share objective, while also ensuring we deliver on our promise to our policyholders. We look forward to going into greater detail on our strategic growth plans and efforts to drive efficiency at the financial analyst briefing conference call in a few weeks. So now I'd like to turn the program over to Fred. Fred?

Frederick John Crawford

President & COO

Thank you, Dan. I'm going to touch briefly on conditions in the third quarter and how we're navigating the pandemic. I'll also provide an update on key initiatives in Japan and the U.S. to include our approach to managing expenses.

There are currently approximately 97,000 COVID-19 cases and 1,730 deaths in all of Japan. Through the third quarter, Aflac Japan COVID-19 impact totaled 1,750 unique claimants with incurred claims totaling approximately JPY 550 million in the quarter and JPY 760 million year-to-date. In short, we are tracking well below our stress assumptions with no measurable impact from COVID-19 claims. However, reduced sales and delaying the promotion of the new cancer rider and refreshed medical product are contributing to revenue pressure. This pressure is offset somewhat by favorable persistency. COVID-related expenses in the quarter totaled JPY 1.7 billion, which included the rollout of virtual distribution tools, employee teleworking equipment and distribution support.

In the U.S., the dynamics are understandably more complex. COVID-19 case levels in the U.S. now exceed 8.5 million with deaths nearing 230,000. Through the end of the third quarter, COVID-19 claimants in the U.S. totaled 12,800 with incurred claims of approximately $23 million in the quarter and year-to-date, approximately $57 million. We are closely monitoring the recent surge in infections but continue to see the rate of hospitalization, length of stay in the hospital and transition to ICU traveling below our expectations. We believe this is attributed to advancements in treatment and the nature of the work site, which is generally younger and healthier population of policyholders.

As Dan noted in his comments, we launched an initiative early in the third quarter to remind policyholders of their wellness benefits, which drove increased utilization. This effort involved connecting with 2.7 million accident and hospital policyholders through a combination of e-mail and direct mail in the month of August. This impacted our benefit ratio in the period but is designed to reinforce the value proposition of our products. We have thus far seen limited impact to persistency. However, we believe this is partially attributed to state executive orders requiring premium grace periods. These executive orders are still in place in 13 states as of the end of the quarter. In those states where the executive orders have expired, we have reduced pressure on lapse rates through proactive outreach to policyholders and employers, actively converting policyholders from payroll deduction to direct bill and notifying policyholders of their wellness benefits.

Turning to key operating initiatives. In both Japan and the U.S., we are balancing investments in growth while addressing our expense structure. A material driver of elevated expense ratios in Japan and the U.S. is weakness in revenue, thus the need for a balanced approach. Beginning with Japan, we are set to promote a simplified cancer rider in the fourth quarter and launching our refreshed medical product in the first quarter of 2021. Rolled out in late October, we have the technology in place to pivot from face-to-face to virtual sales and an entirely digital customer experience. We continue with direct mail campaigns aided by data analytics that serve to enhance the close rate. We expect the combination of product development, a recovery in pandemic conditions and our alliance with Japan Post to be important growth drivers as we make our way through 2021.

We view the pandemic as a call to action on accelerating investment in our digital road map and related process improvement. On our second quarter call, I noted our paperless initiative across all operations in Japan. This is a 3-year and roughly JPY 10 billion investment with approximately JPY 2 billion spent in the third quarter, along with another JPY 3.6 billion estimated spend in the fourth quarter. While elevating our 2020 expenses, this effort will reduce the production and circulation of 80 million pieces of paper per year with run rate savings in the range of JPY 3 billion annually.

As we move to the fourth quarter, we have budgeted an increase in general administration expenses over our third quarter of approximately JPY 6 billion. This includes 50% of our 2020 annual advertising spend, concentrated in the quarter to raise new product awareness as well as a stepped-up level of investment in the paperless initiative. We are effectively accelerating investments in our digital platform into 2020 and 2021.

Turning to the U.S. The buildout of Network Dental and Vision remains on track. We have successfully filed our new Network products in 48 states, with approvals received in 37 states. We are up and running with sales in 10 states and expect to ramp this up as we move into 2021. Our Consumer Markets platform remains on track with hospital accident and cancer product filings expected to be completed in early 2021. We also plan to include life insurance in 2021, recognizing that as a natural product to sell digitally and powered by the Aflac brand.

Finally, we will soon close on our Zurich Benefits acquisition, having successfully completed the required regulatory approvals. Along with efforts to improve overall persistency, these are the 3 largest incremental drivers to earn premium growth in the coming years.

Anticipating further pressure on near-term earned premium as we move into 2021, we are addressing expenses in the U.S. with a sense of urgency. We are addressing expenses across 2 horizons. Horizon 1 is near-term focused and includes a series of actions in 2020 designed to take out approximately $100 million of annualized run rate expenses as we enter 2021. This includes both the U.S. platform and corporate expenses. Early in the fourth quarter, we completed a voluntary separation plan for eligible employees, which will result in a 9% reduction to our U.S. workforce. We expect to record a onetime separation expense of approximately $45 million in the fourth quarter, and we'll realize annualized run rate savings in the $45 million to $50 million range. Horizon 2 expense initiatives elevate near-term expenses until such time the investment is complete. Legacy platforms are decommissioned and business processes are adjusted. The most significant investment is in our group business in migration of an old administrative platform onto a new platform. In addition, we are completing a broader digital road map, which includes approximately $25 million of accelerated investment in 2020, much of that investment coming in the fourth quarter.

As I noted, we need to balance these expense initiatives with investment in growth. We have adopted a buy-to-build acquisition strategy. While a tactical and prudent use of excess capital, this is not an inexpensive effort in the early years. These build efforts include dental and vision, direct-to-consumer and group benefits and, taken together, impacted our expense ratio in the third quarter by 110 basis points and are expected to impact the fourth quarter by approximately 160 basis points.

I'll conclude my comments with investment conditions. Our global investment team remains focused on asset quality, monitoring economic conditions and sourcing new investment opportunities in a low interest rate environment. Our firm view is that we will experience a checkmark-shaped recovery, meaning a slow road to recovery with pockets of volatility along the way. Our actions prior to the pandemic to tactically improve the risk profile of our portfolio, combined with some additional derisking earlier this year, has served us well with only modest losses on the sale of securities, impairments and loss reserve increases. These actions have also positioned the portfolio defensively, should we see a second surge in the virus impact economic conditions. We continue to watch closely our middle market loan and transitional real estate portfolios. While we have seen credit rating downgrades, our middle market loan portfolio is more resilient, consisting of first lien loans to high-quality borrowers backed by strong equity sponsors. In the case of transitional real estate, our portfolio is also consisting of only first lien positions and is diversified with strong loans to value.

We continue to explore ways to optimize currency hedging. Overall, no material change, but we are further refining our approach to managing the unhedged dollars in Japan. These unhedged dollars provide diversification and income benefits as well as lowering our enterprise exposure to the yen.

As we look towards 2021, we will reset 2020 hedges on our floating rate portfolio and currency hedges at materially lower rates. While we do not see this impacting net investment income to any great degree, you will see line item impacts to Japan's net investment income, hedge costs and corporate investment income.

Wrapping up my comments, we are not backing off critical investments to drive long-term growth and efficiency in the face of what we believe to be temporary weakness in sales results and earned premium. We will provide further detail around this when we meet for our annual financial investor conference in the coming weeks. And we'll talk about the details of investments and when we expect them to turn the corner to having a positive impact on growth and profits.

I'll now pass on to Max to discuss financial perform in more detail. Max?

Max Kristian Brodén
Executive VP & CFO

Thank you, Fred. Let me begin my comments with a review of our third quarter performance with a focus on how our core capital and earnings drivers have developed.

For the third quarter, adjusted earnings per share increased 19.8% to $1.39, with no significant impact from FX in the quarter. Adjusted book value per share, including foreign currency translation gains and losses, grew 17.4%, and the adjusted ROE, excluding the foreign currency impact, was a strong 16.8%, a material spread to our cost of capital. This quarter was significantly impacted by the release of favorable U.S. tax regulations related to the utilization of foreign tax credits. As a reminder, our Japanese subsidiary is taxed as a U.S. domestic company for U.S. tax purposes.

In the quarter, we recognized a cumulative year-to-date benefit from these regulations, which lowered our tax rate on adjusted earnings for the quarter to 4.1%, a benefit of $0.28 versus our previous run rate. Our tax rate for the quarter further benefited from tax credits in our solar and historic rehabilitation investments, which lowered our tax expense by approximately $20 million more than in a normal quarter. In addition, variable investment income came in $6 million above our long-term return expectations. And together, these 2 items boosted current quarter EPS by about $0.03. On a go-forward basis and under the current U.S. corporate tax regime, we would expect our go-forward tax rate on adjusted earnings to be approximately 20%.

Turning to our Japan segment. Total earned premium for the quarter declined 3.3%, reflecting mainly first sector policies paid up impacts, while earned premium for the third sector products was down 1.7%. Japan's revenue trends should be considered in the light of impact of paid-up policies. For example, year-over-year earned premium was down 3.3% in the quarter, while policies in force were down a little less than 1%. This disconnect masks the strength of persistency, which has been rising during the pandemic. In short, expenses related to managing our in-force tend to hold steady despite the drop in reported earned premium, putting pressure on our expense ratio. Japan's total benefit ratio came in at 71.3% for the quarter, up 130 basis points year-over-year. And the third sector benefit ratio was 61.7%, up 170 basis points year-over-year. The main driver for the increase was lower lapses associated with policyholders updating their coverage.

Given the current lower new business activity, this naturally pushes up our benefit ratio due to lower reserve releases, decreases DAC amortization and improves reported persistency. We did experience all of this in the third quarter, manifested by our persistency improving by 80 basis points year-over-year. The IBNR was also less favorable this quarter. We've seen a drop in paid claims during the pandemic, more so in our medical coverages. Our IBNR estimate has only partially reflected this drop, given there is not much data to base an adjustment on. We continue to monitor experience and will adjust our pay data as it gets more complete.

In addition, for our cancer claims that are more than 3 years old, we extended the completion of claims, which led to a smaller release in IBNR compared to 2019. Our expense ratio in Japan was 21.7%, up 110 basis points year-over-year. Our paperless initiative kicked in at a higher gear as we digitize our operations and drive efficiencies throughout the value chain to a future state with significantly reduced paper usage. Overall, when considering COVID-related spend, promotional spend and digital and paperless initiatives, we anticipate expense ratios in Japan to remain elevated in the 22% range for the remainder of 2020.

Net investment income declined 0.2% in yen terms despite the higher variable investment income as our yen-denominated portfolio generated lower yields due to lower call income in this quarter. The pretax margin for Japan in the quarter was 19.4%, impacted by both the higher benefit ratio as well as a higher expense ratio in the quarter.

Turning to U.S. results. Earned premium was down 2.6% due to weaker sales results. Premium persistency improved 80 basis points to 78.8% as our efforts to retain accounts and keep premium in force show early positive results. As Fred mentioned, there are still 13 states with premium grace periods in place at the end of Q3, so we are monitoring these developments closely. Our total benefit ratio came in at 48.3%, which was 80 basis points lower than Q3 2019. We have seen a normalization of claims activity across our portfolio compared to the second quarter. In order to improve customer experience and persistency, we conducted an extensive policyholder communication campaign, highlighting the embedded wellness benefit in our accident product, and we encourage policyholders to utilize this benefit. We estimate this initiative drove incremental claims of approximately $14 million and impacted our benefit ratio in the range of 100 basis points over what we would normally expect. But we believe our efforts will add value for the customer and improve their experience along with improved long-term persistency.

Our expense ratio in the U.S. was 37.2%, up 130 basis points year-over-year. The inclusion of Argus added 80 basis points in the quarter, and a decline in revenues roughly explains the residual year-over-year impact. The impact from declining revenues has become more pronounced on our ratios in this quarter relative to prior quarters. We anticipate expense ratios in the U.S. to remain elevated in the 39% range for the full year 2020, driven by near-term weakness in revenue, uptick in seasonal business activity and expected inclusion of the Zurich Group Benefits acquisition.

Net investment income in the U.S. was down 4.4% due to a 14 basis points contraction in portfolio yield year-over-year. Profitability in the U.S. segment remains healthy at 20.5%, with a low benefit ratio as the core driver. In our corporate segment, amortized hedge income contributed $22 million on a pretax basis to the quarter's earnings with an ending notional position of $5 billion.

Our capital position remains strong, and we ended the quarter with an SMR north of 900% in Japan and an RBC of approximately 700% in Aflac Columbus. Our RBC is temporarily boosted by delaying statutory subsidiary dividends to Q4. We still expect to end the year with an RBC in the range of 550% to 600%.

Holding company liquidity stood at $3.8 billion, $1.8 billion above our minimum balance. This is down compared to earlier in the year, but reflects our decisions to delay regular Q3 subsidiary dividends to Q4. On an annual basis, we expect uninterrupted dividend flows to continue from our subsidiaries. Leverage improved to a comfortable 22.9% due to the increase in shareholders' equity, driven by the release of the tax valuation allowance of $1.4 billion. While we remain cautious in terms of monitoring the pandemic, we have comfort in the strength of our capital ratios, excess capital, statutory earnings and dividend capacity and our ability to navigate any current and future stress brought on by the pandemic or associated economic conditions.

In the quarter, we repurchased $400 million of our own stock and paid dividends of $192 million. We will continue to be flexible and tactical in how we manage the balance sheet, and deploy capital in order to drive a strong risk-adjusted return on equity with a meaningful spread to our cost of capital.

Let me now turn it over to David to begin Q&A.

David A. Young
Vice President of Investor & Rating Agency Relations
Thank you, Max. We're now ready to take your questions. [Operator Instructions] Adrianne, we'll now take that first question.

Question and Answer

Operator

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

Nigel Phillip Dally
Morgan Stanley, Research Division

My question is on expenses. You announced the U.S. expense reduction initiative together with paperless initiative in Japan, but you're also talking about ramping higher investments in other digital and growth initiatives. I appreciate the color for the fourth quarter, but how should we be thinking about expense ratios in 2021? Should we see some of the benefit of those initiatives flow through to the bottom line or still elevated expense ratios looking forward?

Frederick John Crawford
President & COO

I would -- Nigel, this is Fred. I would say, in general, both in 2000 -- both in the case of the U.S. as well as Japan in 2021, you should anticipate a continuation of elevated expenses as these investments will continue at their current pace. And in fact, in the U.S., we will particularly be building more proactively on the dental and vision, the consumer markets and then now adding the Group Benefits business. So you'll see the pace of investment improve. When it comes to business as usual expenses or what we would call our general operating expenses, that's where you'll see improvement, particularly in the U.S. as we take action around staffing models, headcount and other related cost savings efforts. So it's a balancing act.

We'll give more color on our expense ratios, both in Japan and the U.S., at the financial analyst briefing, as we traditionally do. So I don't want to get out in front of that, but I can certainly answer your question that the pace of investment will continue to go forward, but it's really directed towards growth as well as efficiency, remembering there's 2 components to the expense ratio. And one of the things weighing on our expense ratios right now in Japan and the U.S. is weakness in revenue. So we've got to drive these expenses through to generate revenue improvement over time. That will be the path to victory on expense ratios ultimately.

Operator

Your next question comes from the line of Jimmy Bhullar with JPMorgan Securities LLC.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

I had a question just on the U.S. business. Obviously, sales have been pretty weak recently. And I'm assuming that 4Q will be a little bit better just given that a majority of the sales are broker sales and that channel doesn't seem to be as impacted by sort of social distancing and stuff. But what's your next sort of path to an improvement in sales beyond that if -- because I'm assuming even though businesses are starting to open up, most of them are going to be reluctant to have salespeople come in and pitch products or enroll people. So what's -- just a few comments on what you feel is going to drive a recovery in your sales in the U.S. beyond just sort of a vaccine or just normalization of social and business trends?

Daniel Paul Amos
Chairman & CEO

I'm going to have Rich answer that.

Richard L. Williams
Executive VP & Chief Distribution Officer

Okay. Thank you, Jimmy. As Dan noted in his comments, we expect modest sequential improvement in the fourth quarter compared to the second and the third quarter. And as you recall, the fourth quarter for us is more heavily weighted to broker sales, roughly about 50% of our quarter. And that's where less face-to-face enrollment is utilized as well as larger cases. So I think those are sort of the support points, to Dan's comments, around modest sequential improvement. I think secondly, we will reserve comments around 2021 for our outlook call and financial analyst briefing. And we look forward to that discussion then.

Daniel Paul Amos
Chairman & CEO

Teresa, do you want to add anything?

Teresa Lynne White
President of Aflac US

No, I think Rich covered it. Thank you.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

And maybe just another one on the U.S. on your persistency. Can you talk about what you've seen in terms of persistency in the regions where premium grace periods have expired? Are you seeing an uptick in lapses there or not?

Teresa Lynne White
President of Aflac US

Overall, we -- thanks, Dan. Overall, we've not seen a notable increase in policy lapses given the stability in our persistency ratio. But we continue to monitor, especially with the small business side. It's important to note that small business is a large part of our in-force. However, the premium is more balanced across small and large cases. So really, we're not seeing what we thought we would see, but we're continuing to monitor this, and we'll give more insight at the investor conference as well.

Daniel Paul Amos
Chairman & CEO

And I think the wellness benefit and our ability to pay claims for it, although it ticked up our benefit ratio, which we wanted to happen, we believe it will also have a positive impact on persistency as people realize they need the product.

Operator

The next question comes from the line of Suneet Kamath with Citi.

Suneet Laxman L. Kamath
Citigroup Inc., Research Division

So I think you had said you expect some new products in Japan in the first quarter. So just curious, normally, when you launch a new product, we see almost an immediate pickup in sales. Just given the pandemic and how the sales dynamic has changed, should we expect the same sort of trend that we've seen historically? And will you be selling this new medical product in the Japan Post -- sorry, the cancer product in the Japan Post channel.

Daniel Paul Amos
Chairman & CEO

Koide?

Masatoshi Koide
President & Representative Director

Koji will answer to that question.

Daniel Paul Amos
Chairman & CEO

Okay.

Koji Ariyoshi
Executive VP, Director and Director of Sales & Marketing of Aflac Life Insurance Japan

[Interpreted] Well, in terms of medical insurance, as we have already started with our cancer insurance, we have implemented web serve facilitation as well as application -- insurance application system from October, and this will allow reduction of COVID-19 risk like having social distance.

And on top of that, this medical insurance product that we plan to launch is a competitive product. So we will be able to win in the competition. And that way, we should be able to increase our share in the medical market.

Our new product has a broad range of coverage to really be able to respond to various types of customers. For example, a lot of the customers have concerns about 3 dread diseases, which we will cover further in this new product as well as short-term coverage in the medical insurance. And at the same time, those customers who really do not want to just keep on paying premium and gain nothing, we do have some no claim bonus rider that can be added to this rider. So we should be able to respond to various needs of customers.

We would like to use this new medical insurance product as sort of the engine to start our sales in 2021. And with this web virtual sales, we should be able to minimize the negative impact of the risk of COVID-19. So we'd like to really use this to harness our sales.

Suneet Laxman L. Kamath
Citigroup Inc., Research Division

Okay. And then I guess for Max on the tax rate change. Was any of this related to the Trump tax cuts? And then accordingly, is there any risk that under a different administration, this tax ruling that you got could be reversed?

Max Kristian Brodén
Executive VP & CFO

Yes. No, it's not related to the Trump tax cuts. This is related to a new regulation issued by the U.S. Treasury and the IRS that came out on September 29.

Operator

Your next question comes from the line of John Barnidge with Piper Sandler.

John Bakewell Barnidge
Piper Sandler & Co., Research Division

How should we be thinking about the permanence of some of the declines in utilization in the U.S. from maybe changed behavior from COVID, principally maybe telemedicine driving down the benefits ratio?

Daniel Paul Amos
Chairman & CEO

Well, I think it's still in limbo in terms of what we're absolutely sure will happen. Certainly, we have seen when, let's say, April, May, June, people were staying inside more. They were not going to the doctor. We saw a drop-off in the claims. The idea of the wellness benefit is to get them back to a doctor twofold. One, to have utilization of the policy and therefore, improve persistency, raise the loss ratio some, but also prevent people from -- I mean, I have a friend whose wife was diagnosed with a Stage 3 cancer. And if they had gone to the doctor as they should have but couldn't because of COVID, they could have caught it much earlier.

So one of the things that we're watching is, is to see whether or not there's a tail on this. And that's why we're trying to encourage people to go ahead now and go back to the doctor, use these wellness benefits, get the exams you should get. And hopefully, that brings down the tail on the business. So we know that it's already picking back up in terms of people going back to the doctor, but it's not back to the normal amount that it was running pre-COVID.

John Bakewell Barnidge
Piper Sandler & Co., Research Division

Okay. And then a follow-up. It does, it's very helpful. The wellness initiative had trimmed 100 basis points on the benefits ratio. Has that completely played out? Or could there be still more to come?

Teresa Lynne White
President of Aflac US

We believe that there is still more to come. Sorry, Fred. Go ahead.

Frederick John Crawford
President & COO

No, it's okay.

Teresa Lynne White
President of Aflac US

But the answer is we believe that there could still be more to come there.

Operator

The next question comes from the line of Erik Bass with Autonomous Research.

Erik James Bass
Autonomous Research LLP

Do you intend to let all of the tax benefit drop to the bottom line? Or do you see opportunity to either accelerate investment or adjust product pricing to boost growth?

Max Kristian Brodén
Executive VP & CFO

We obviously have multiple initiatives in place in order to drive growth, as Fred outlined. And that is pushing up our expense ratio and have -- that's been in play for the last couple of years, and we see that ongoing. So generally, I would characterize this benefit as dropping to the bottom line.

Frederick John Crawford
President & COO

One thing I would add, though, and this goes to the previous question to about how to think about future corporate tax rate changes, is that we do have to be mindful of that. This effectively just creates an even playing field for the way in which we report our effective tax rate and cash tax payments. In other words, we are effectively paying a 21% corporate tax rate as being a U.S. taxpayer at Aflac. And so to the degree there is a change in tax law going forward, we'll be impacted much like any other corporate taxpayer in the U.S. And so we do have to be mindful of that, and we'll be watching that carefully.

Having said that, though, there's a very real benefit to us both cash wise and effective tax rate for a period of time, including going back and grabbing some cash flows that we had previously paid out in the way of tax payments. So it's a real benefit, but one that you want to be careful about taking into the future if you believe there could be changes in the corporate tax rate going forward.

Erik James Bass
Autonomous Research LLP

And then can you talk a little bit about the recruiting and licensing backdrop for new agents?

Daniel Paul Amos
Chairman & CEO

Rich?

Richard L. Williams
Executive VP & Chief Distribution Officer

Absolutely. So first of all, recruiting continues to be a very important part of our element and strategy going forward. We saw improvement in the third quarter compared to the second quarter. And we -- at the beginning of 2020, we implemented significant alignment from a compensation program to drive producer growth and to drive recruiting. And so the anticipation on recruiting for the fourth quarter is we expect to see moderate improvement compared to the second and third quarter. And then as we look to 2021, we'll clearly talk about that more at the investor conference, but it will be a key part of our strategy.

Operator

The next question comes from the line of Humphrey Lee with Dowling & Partners.

Humphrey Lee
Dowling & Partners Securities, LLC

My first question is related to the expenses in Japan. I heard that you talked about the JPY 1.7 billion for the COVID-related expenses in the quarter and then also there was JPY 2 billion related to the paperless initiatives. But just looking at the sequential increase in expenses, still those 2 pieces only explain half of the increase. So I was just wondering what's the other driver for the much higher expenses in the quarter?

Max Kristian Brodén
Executive VP & CFO

The main driver continues to be, in terms of the expense ratio, is the decline in revenues. So you have the increased spending, but also the function of lower revenues is impacting the expense ratio.

Humphrey Lee
Dowling & Partners Securities, LLC

I'm just referring to the notional general expense amount of JPY 72 billion.

Frederick John Crawford
President & COO

I think that much of that has to do with just seasonal dynamics related to direct mail spend as well as other promotional initiatives in the quarter related to -- as compared to last year. So I think some of it is just natural fluctuation. The 2 main drivers, and maybe I would add a third, are not only COVID-related expenses and the paperless initiative, but we also continue to accelerate certain digital investment in the quarter. And those are the primary drivers of just an incremental increase in general operating expenses.

Humphrey Lee
Dowling & Partners Securities, LLC

Okay. And then in terms of the Zurich addition in the fourth quarter, how should we think about the size of the premium add? And then also by extension, the expense impact of that platform? And also kind of what's your expectation on a full year premium basis for that business?

Frederick John Crawford
President & COO

That business has been running at around, I believe, in the $75 million to $100 million in annualized premium range. As you can expect, that's a lumpy business because it's largely a startup at Zurich, and it tends to focus in on large accounts. But it's also a very persistent business. So there's high persistency with that business. So I would expect, on an annualized basis, it's in that range. So it will have a modest impact to annual earned premium.

In terms of the overall P&L impact on it, as we mentioned when we announced the transaction, we would expect there to be roughly $0.05 dilution on an annualized basis related to that transaction. And that's largely because as they are still ramping up the business, their revenue is not enough to offset their cost structure because it's in a growth mode. And so -- and we expect, obviously, an intent to continue that growth mode going forward. So that's essentially the nature of the business. It's modestly dilutive to earnings and modestly accretive to earned premium.

Operator

The next question comes from the line of Andrew Kligerman with Crédit Suisse.

Andrew Scott Kligerman
Crédit Suisse AG, Research Division

So the first question is around the benefits ratio. And I'm wondering, as we look out in the U.S. at a 48.3%, down from 49.1% year-over-year and then, of course, 44.3% quarter-over-quarter, have we reached kind of the stable zone now? How would you expect it to trend over the course of the next several quarters?

Frederick John Crawford
President & COO

Well, I mean, in general, we would expect it to trend up but really up to previous reported numbers prior to the pandemic. And that's simply because of what Dan outlined in his comments that they'll be naturally a gradual increase in utilization, but really back to normal levels and still overall favorable relative to going back in history. So you'll see it trend up. Wellness-related impacts will subside. We certainly hope, but frankly, we're monitoring, as you can imagine, given the news, COVID-related cases. But overall, we would expect utilization to find its more normal levels over time. We are bringing on businesses that tend to have higher benefit ratios and lower expense ratios, Network Dental and Vision, for example, and then, of course, Group Benefits.

So over time, you'll eventually have a bit of a mix play in our benefit ratio to be aware of. But that's unlikely to be material over the -- certainly over the next several quarters and in 2021. But you'll see that play out over time. And we'll, of course, be able to report that out and let you know what's influencing the benefit ratio and expense ratio.

Andrew Scott Kligerman
Crédit Suisse AG, Research Division

Right. And earlier in the year, you provided a credit stress scenario of about $680 million of credit losses. Has that changed, improved, worsened? What's kind of the outlook there? And what are you seeing into 2021?

Daniel Paul Amos
Chairman & CEO

Eric, why don't you take that?

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

Sure thing. Thank you, Andrew. Naturally, we continue to analyze our portfolio of stress scenarios, inclusive of how our portfolio actually performed over these past 6 months and looking forward, including assumptions about a second wave and economic and market impact. In fact, our portfolio has performed very well through the first part of the pandemic and better-than-expected relative to our stress test. In addition, as you may recollect, in the second quarter, we did some marginal derisking and risk reduction, and there were particular names in the stress test that, in essence, were impacted or went away. Having said that, we're completing our newest stress test and intend on presenting that at this upcoming FAB. So if you could be patient for about another month, you'll see some of the new results.

Operator

The final question comes from the line of Tom Gallagher with Evercore ISI.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

First question, Max, can you give a sense for how the cash tax benefits will compare to the reduction in the GAAP tax rate? And how we should think about that playing out over time?

Max Kristian Brodén
Executive VP & CFO

So cash taxes will always be volatile, and there will be timing differences between our GAAP and our cash taxes. But over time, I would expect them to have about the same impact from this change in tax regulation.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Well, would you expect there to be a meaningful difference in the first couple of years and converge over time? Or is it going to be, would you say, directionally similar with some volatility around it, if you know what I mean?

Max Kristian Brodén
Executive VP & CFO

Yes. It will be the latter. It will not be any material significant difference and certainly not over as long period as a number of years. It's more the latter where we might, in the short term, have some timing differences. But generally speaking, we would expect our cash taxes to come down as well.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Got you. And then my follow-up is, can you talk -- just given the increase in the benefit ratio in Japan this quarter, the 150 basis points to 200 basis points, can you talk about -- and I know you had referenced that was somewhat related to the slowdown in sales and the impact of lapse in reissue. Can you talk -- given that sales are likely to remain at least somewhat lower relative to historical levels, can you talk about whether you would still expect to see the broader trend of benefit ratio improving here over the next couple of years? Or are we likely to see that maybe go the other way?

Max Kristian Brodén
Executive VP & CFO

Todd, why don't you take a crack at that?

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

Okay. Thanks, Max. Really, when we look forward for our persistency, and as Max alluded to, it's totally related to sales activity and about 80 basis points in the benefit ratio for the quarter is attributed to lack of, what I will call, lapse in reissue activity. So as we introduced product in the first quarter, I would expect that to tick up somewhat for the medical block. So I would really anticipate, as we go through next year, that you see more of a normalized termination rate, which will lead to a more normal-looking benefit ratio, especially as it pertains to the policy reserve aspect of it.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Got you. And Todd, would you still expect a broader trend over multiple years of improvement in the benefit ratio?

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

I think as we see claims come in and our trends that we have in our cancer and medical blocks, that will be reflected in the benefit ratio going forward.

Max Kristian Brodén
Executive VP & CFO

Tom, we will address some of the underlying drivers in terms of hospitalizations and duration of hospital space, et cetera, at FAB. So we'll give you a little bit more insight into that.

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

And that leads us to the top of the hour. Before concluding, I just want to remind you that we have combined our financial analyst briefing and our 2021 outlook call into a special webcast event on the morning of November 19, at 8 a.m. Eastern Time. For more details, please reach out to Investor Relations here. And we thank you all for joining us today and look forward to speaking with you soon, and wish you all continued good health. Thank you.

Operator

This concludes today's call. Everyone may now disconnect.
[Portions of this transcript that are marked [Interpreted] were spoken by an interpreter present on the live call.]