S&P Capital IQ

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Aflac Incorporated NYSE:AFL

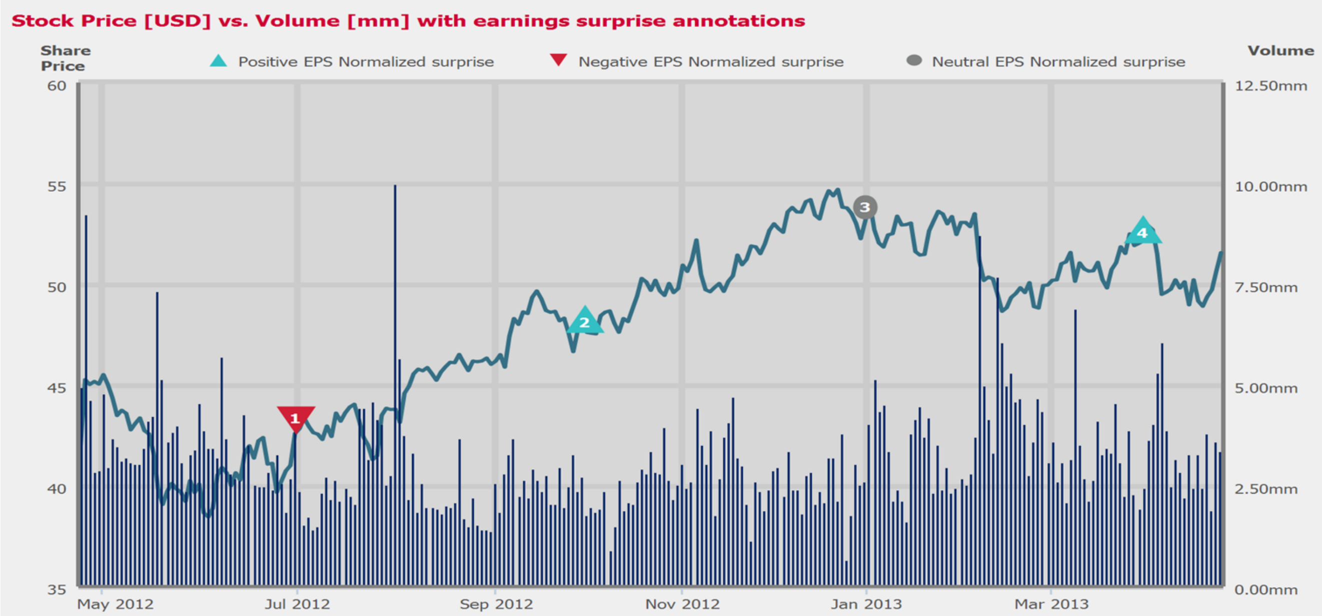
FQ2 2013 Earnings Call Transcripts

Wednesday, July 31, 2013 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2013-			-FQ3 2013-	-FY 2013-	-FY 2014-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.51	1.62	▲7.28	1.51	6.19	6.51
Revenue (mm)	5861.77	6044.00	▲3.11	5890.92	23756.84	24628.64

Currency: USD
Consensus as of Jul-31-2013 12:55 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ2 2012	1.62	1.61	▼(0.62 %)
FQ3 2012	1.66	1.77	▲6.63 %
FQ4 2012	1.48	1.48	0.00 %
FQ1 2013	1.62	1.69	▲4.32 %

Call Participants

EXECUTIVES

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Chairman of Aflac Japan & President of Aflac International

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Chairman & CEO

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Kenneth S. Janke
Former Executive Vice President and Head of Corporate Finance & Development

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Tohru Tonoike
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Presentation

Operator

Welcome to the Aflac second quarter earnings conference call. [Operator Instructions] Please be advised that today's conference call is being recorded. I would now like to turn the call over to Ms. Robin Wilkey, Senior Vice President of Aflac Investor and Ratings Agency Relations. Ma'am, you may begin.

Robin Y. Wilkey
Former Senior Vice President of Investor & Rating Agency Relations

Thank you. Good morning, and welcome to our second quarter call. Joining me this morning is Dan Amos, Chairman and CEO; Kris Cloninger, President and CFO; Paul Amos, President of Aflac; Ken Janke, President of Aflac U.S., Executive Vice President and Deputy CFO of Aflac Incorporated; Eric Kirsch, Executive Vice President and Global Chief Investment Officer. Also joining us today from Japan are Toru Tonoike, President and Chief Operating officer of Aflac Japan; and Charles Lake, Chairman of Aflac Japan.

Now before we start, let me remind you that some statements in this teleconference are forward-looking within the meaning of Federal Securities Law. Although we believe these statements are reasonable, we can give no assurance that they will prove to be accurate because they're prospective in nature. Actual results could differ materially from those we discussed today. We encourage you to look at our quarterly release for some of the various risk factors that could materially impact our results.

Now I'll turn the program over to Dan, who will begin this morning with some comments about the quarter and our operations in Japan and the United States. I'll then follow up with a few financial highlights for the quarter, and then we will take your questions. Dan?

Daniel P. Amos
Chairman & CEO

Thank you, Robin. Good morning, and thank you for joining us today. I am very pleased that we met and, in many cases, exceeded our financial targets for the second quarter. Let me begin with an update on Aflac Japan, our largest earnings contributor. Pretax earnings in yen were up 20.1% for the quarter, primarily reflecting lower benefit and expense ratios. Additionally, revenues continued to be strong, growing about 10%.

Given these results, we expect the expense ratio to increase in the second half of the year when we step up our spending. With the new medical product launch in August, we'll be increasing advertising and promotional expenditures. Additionally, we anticipate increasing spending on projects that improve our business over the long run.

Consistent with our expectation, Japan's new annualized premium sales in the second quarter were down 43.1% to JPY 30.3 billion, with WAYS production down sharply in the quarter. We had anticipated this decline for a couple of reasons. First, you will recall that at the beginning of the quarter, premium rates for the first sector products, including WAYS, increased to reflect lower assumed interest rates. Second, improved investment returns prompted many of the customers and banks to turn from WAYS-type insurance products to investment trust.

As we've said, we expect the sales of the first sector products, primarily WAYS, will continue to be down substantially for the remainder of the year. However, I want to remind you that for this year, our sales target is based on Aflac Japan's third sector products, which include cancer and medical insurance. Third sector sales were down 4.9% for the quarter, which was in line with our expectations and an improvement over the first quarter.

Remaining the leading provider of third sector products is important to us and is the foundation of our product portfolio. We believe consumers will respond favorably to the new medical product we'll be introducing in mid-August. We expect this product will appeal especially to consumers in their 20s to 40s, an area of which we are currently underpenetrated. I believe our 2013 objective of flat to up 5% increase in third sector sales is reasonable and achievable.

As we look ahead with regard to cancer insurance sales, I am pleased with the new alliance agreement Aflac Japan signed with Japan post group last week. The new agreement will further expand our partnership with Japan Post, which was initially established in 2008, enabling each company to maximize synergies in the insurance business.

Japan Post has a nationwide distribution network that has earned the trust of Japanese consumers, and Aflac Japan is the industry leader in cancer insurance. Through this alliance, Japan and Post intends to expand the number of post offices that offer Aflac's cancer products, gradually increasing from 1,000 post office outlets to 20,000 outlets.

Also, subject to regulatory approval, Aflac Post insurance, also known as Kampo, will enter into an agency contract with Aflac Japan to begin distributing Aflac Japan's cancer insurance products at all of Kampo's 79 directly managed sale offices.

Upon consultation with Japan Post Group, Aflac Japan will also consider developing an exclusive cancer product for both Japan Post and Kampo. This new alliance agreement enhances our distribution and allows us to reach new consumers with the cancer insurance products. I believe Japan Post can and will become a meaningful contributor to our sales over the next several years.

Let me remind you that cancer is the leading cause of death in Japan. With an aging population, the average incident rate of cancer will only increase in the future, and cancer is the most expensive illness to treat. We believe our products can be a part of the solution for people battling cancer and their related out-of-pocket expenses, and this alliance will help us reach more people.

Now let me turn to the U.S. operation. Pretax earnings were up 9.9%, reflecting an improved benefit ratio. Keep in mind, we will increase spending in the second half of the year, especially with the initiatives related to the preparation of the implementation of the Affordable Care Act. Premium income rose 3.5% with policy persistence remaining strong. Aflac U.S. new sales increased 1.4% for the quarter and for the first half of the year, they were down 1.9%.

As you've heard me say many times before, we don't want anything to get between us and the customers. Our job is to be multi faceted in our distribution to make sure we have a presence where consumers want to purchase our products. But there are different distribution possibilities we continue to work on, including creating private exchange that will help employers, our field force and the brokerage community. While we're busy laying the groundwork for the future, we're still working hard to achieve our annual sales target.

Having covered operations, now let me turn to investments. I am very pleased that for the first 6 months, our net investment income is ahead of plan. Our new money yield for the first half of the year in Japan was 3.02%, which is significantly higher than our new money yield of 2% in the first half of 2012. Currently, we are pursuing several strategies to accommodate the impact of the changing rate environment on the SMR, which we mentioned in our press release last night.

Additionally, we are reweighting the current asset allocation for new money investments in Japan. You'll recall at the Analyst Meeting, we discussed that our plan was to designate 2/3 of our new money to U.S. corporate bonds and 1/3 to JGBs. Our investment team is revisiting our asset allocation for new money investments and expects to allocate the majority of the third quarter cash flow to JGBs and underweight in the allocation of the U.S. corporate bond hedge.

Just as the markets are fluid, we remain agile to respond properly -- appropriately to the changing investment landscape. We will continue to consider diversification and liquidity as we approach various investment options. We also expect to come in close to our budget for the new money yield for the year.

Turning to Aflac Incorporated. Our consolidated financial performance was very strong for the quarter. Excluding the impact of foreign currency, operating earnings per diluted share rose 14.3% for the quarter and 9.9% for the first 6 months of the year. While this puts us significantly ahead of the annual operating earnings per share objective, the comparison for the operating earnings per share in the third quarter will be difficult due to the tax benefit of $0.10 per diluted share recognized last year in the third quarter. I also want to remind you of what I said earlier. We will increase spending in the second half of the year in both Japan and the United States.

As such, our target remains to increased operating earnings per share in the range of 4% to 7%, excluding the impact of the yen. Within that range though, we anticipate operating earnings to increase approximately 5% for the full year before the impact of foreign currency.

As we have communicated, given our capital structure, our ability to repurchase shares is largely tied to profit repatriation. Just last week, we repatriated JPY 76.8 billion. You'll recall that we entered into a hedging transaction with a vast majority of our anticipated repatriation at a weighted average exchange rate of JPY 96.4 to the dollar. In dollar terms, this profit repatriation was $795 million.

As we've said for many years, when it comes to deploying excess capital, we still believe that growing the cash dividend and repurchasing our shares are the most attractive means. And those are the avenues we will continue to pursue. Our objective remains to grow the dividend at a rate that is in line with our operating earnings per share growth before the impact of the yen.

Aflac repurchased approximately $129 million or 2.3 million shares of its common stock in the second quarter. For the first half of the year, the company purchased $279 million or 5.3 million of its shares. We have a lot of flexibility at the parent company in terms of liquidity, and it's still our intention to repurchase $600 million of our shares for the full year. Additionally, our current plan remains to increase our share repurchase next year by repurchasing $600 million to $900 million of our shares.

Generally -- generating an industry-leading return on equity, excluding the yen impact, is also important. On an operating basis, our second quarter annualized ROE was 22.1%. Keep in mind, Aflac's ROE is sensitive to current fluctuations because we are largely hedged, our equity, in dollars, but not all of our earnings. That means that when the yen weakens, our ROE declines. Had the yen remained unchanged since the end of March, operating ROE would have been 26.4% in the second quarter. Based on our year-to-date returns, I expect to meet or exceed our ROE target of 20% to 25%, excluding the impact of foreign currency for the full year.

Overall, I am pleased with Aflac's position in Japan and the United States, the 2 largest insurance markets in the world. First and foremost, we are focused on protecting our policyholders and providing value to our investors. We are fortunate that we have the privilege of providing financial protection for more than 50 million people worldwide in the process.

Now I'll turn the program back over to Robin. Robin?

Robin Y. Wilkey
Former Senior Vice President of Investor & Rating Agency Relations

Thank you, Dan. Let me go through some brief numbers for the quarter, starting with Aflac Japan. Beginning with the currency impact, during the quarter, the yen weakened against the dollar 18.8%. For the first 6 months of the year, the yen weakened against the dollar 16.4%. In terms of top line growth in yen terms, revenues as reported were up 10% for the quarter. Excluding the impact of currency, revenues were up in the quarter 8.6%. The annualized persistency rate, including annuities in the quarter, showed strong improvement at 95.1% compared to 94.7% last year.

Net investment income as reported increased 16.6% for the quarter. If you exclude the benefit of the weaker yen in the quarter on Aflac Japan's dollar-denominated investment income, our net investment income rose 6.8%.

In terms of the quarterly operating ratio, the benefit ratio to total revenues declined over last year going from 62.0% a year ago to 61.5% in the second quarter. Excluding the impact of the weaker yen, the benefit ratio for the quarter was 62.3%.

The expense ratio for the quarter was 17%, down from 18.4% a year ago. As a result of the lower expense ratio, pretax earnings increased 20.1% in the quarter. Excluding the impact of the yen, pretax earnings in the quarter increased 13.5%.

Now let me turn to a few highlights for Aflac U.S. The benefit ratio to total revenues decreased over last year, going from 51.1% to 49.1% in the second quarter. This was primarily the result of a favorable industry-wide health care usage trend during the quarter.

The annualized persistency rate for the first 6 months remained strong at 76.3%. The expense ratio for the quarter was 34% -- 31.4%, up from 30.6% a year ago. However, it was low compared with expectations for additional spending later in the year. The profit margin for the quarter increased to 19.5% compared to 18.3% a year ago.

Turning to investment activity for the quarter, starting with Aflac Japan. For the quarter, approximately $3 billion of Aflac Japan's new cash flow was invested in our hedged U.S. corporate bond program for a gross yield of 3.51% and an annualized hedge cost of 22 basis points. The yield net of hedging cost was 3.29%. This brings the year-to-date total cash flow invested in the U.S. corporate bond program to approximately $4.9 billion with the total yield on the corporate bond portfolio of 3.59%, excluding hedge cost.

Since the inception of the program, the total cash flow invested in the U.S. corporate bond program is approximately $11.8 billion, which is -- with a total yield of 3.44%, excluding hedge cost. This is in line with our annual allocation expectation for this program. Approximately 27% of new cash flow was invested in JGBs in the second quarter with an average yield of 1.68%.

In terms of U.S. investments, the new money yield for the quarter was 3.70%, an increase of 1 basis points from the first quarter. The yield on the portfolio at the end of June was 6.11%, down 8 basis points from the first quarter and 43 basis points from a year ago.

Turning to some other items in the quarter. Noninsurance interest expense in the second quarter was $48 million compared to $45 million a year ago. At the end of the quarter, cash and cash equivalents at the parent company level were $1.3 billion. On an operating basis, the tax rate decreased from 34.9% a year ago to 34.4%. Operating ROE as reported for the quarter was 22.1%. And excluding the impact of the yen, operating ROE for the quarter was 26.3%. During the quarter, we also executed on a securities lending transaction of $1.2 billion. This was a short-term transaction that will mature in the third quarter.

One of the strategies that we're pursuing to accommodate the impact of the changing rate environment on our SMR is policy reserve matching or PRM. The PRM investment strategy is a gauge accounting treatment that considers the financial characteristics of insurance companies and is widely used in Japan by other companies. The PRM also promotes asset and liability management. This method provides better liquidity and is not subject to the mark-to-market accounting treatment of the available for sale.

Lastly, let me comment on our earnings outlook for the remainder of 2013. You heard us affirm our annual objective to increase the operating EPS 4% to 7% with the expectation of a 5%, excluding the impact to the yen. If the yen averages JPY 95 to JPY 105 for the full year, we would expect to report operating earnings of $5.83 to $6.37 per diluted share for the full year. For the third quarter, using that same currency assumption, we would expect the operating earnings to be in the range of $1.41 to $1.51 per diluted share.
Now we'd be happy to take your questions. [Operator Instructions] We're ready to begin now.

Question and Answer

Operator

[Operator Instructions] First question, Yaron Kinar from Deutsche Bank.

Yaron Joseph Kinar
Deutsche Bank AG, Research Division

I wanted to touch a little bit more on the Japan Post deal. And first of all, I understand it's the 0 to 5% guidance for third sector growth in sales. Is that at all impacted by that deal?

Daniel P. Amos
Chairman & CEO

No, that does not include anything with Japan Post. But Charles Lake and Toru are on the line, and the 3 of us were at the news conference on Friday. So let me see if they want to add anything to that.

Tohru Tonoike
Vice Chairman of Aflac Japan

Yes, this is Toru Tonoike. And that is correct. Our original expectation of 0 to 5% growth for the third sector does not include that -- anything from the Japan Post. And at the same time, I have to remind you that we start on the operation under the new agreement, beginning October 1 this year. But we will start by adding, not all of the 2,000 -- 20,000 offices, but just only a part of it because we want to make sure that we will have the Japan post offices start selling our products. After -- both Japan Post and we are comfortable that we have provided sufficient training to the employees regarding the features of a product and the new market conduct rules. So we will begin that operation and then, this will increase over time.

Daniel P. Amos
Chairman & CEO

Let me make a couple of comments about Japan Post business. Number one is it's the largest insurance company in the world with over $1 trillion in assets. It also has -- is the largest company in terms of employees. And remember that these 79 agencies at the insurance company of Japan Post is never sold for us. And these agencies would be equivalent to mega agencies in the United States. So as I said on CNBC this morning, this is a game changer for us in terms of what can take place in the future. Charles, you were very instrumental in this. Any comments from you?

Charles Ditmars Lake
Chairman of Aflac Japan & President of Aflac International

I think you outlined everything, but I think the important point also is to talk about is the fact that this is a corporate group, Japan Post Group. So this alliance deal was not only with Japan Post, the network, and Japan Post Insurance but Japan Post Group as a whole. Dan, you signed that document with the CEO of the Japan Post Group, so that makes this -- the agreement even stronger in my view.

Operator

Our next question comes from Jimmy Bhullar from JPMC.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

Just a question on U.S. sales. Dan, you mentioned that you're still comfortable that sales will pick up in the second half of the year. I would have assumed that with the health care reform coming on, that smaller employers would be more preoccupied with that and wouldn't really want to put on or enhance their offering and put on new products on the shelves. So I just was wondering what gives you the comfort that sales in the U.S. won't actually deteriorate in the second half, just given all this uncertainty that health care reform is going to create.

Daniel P. Amos
Chairman & CEO

Well, I as I said, I still -- because right now, we're within 1%, I think, down, I think it's a reasonable assessment that we can achieve it. I am -- I do not have the comfort level with the U.S. as I do with Japan in terms of achieving the objectives. I am very comfortable, even though Japan looks like it's coming further from behind. Because of this new product that they're getting this month, I feel very good, and Paul could relate more to that because he's been more involved. But with the U.S., Jimmy, I am concerned that because of the delays and the other things, it can have an impact. But we've got some things that we're working on like, for example, we have a toll-free number that will go on line effective the middle of August, to where our agents can call in and ask questions. I think some of our agents are a little bit reluctant to go out and talk about health care reform with the fear that they won't know all the answers. But we'll have this safety net of this watch -- of this toll-free number they can call that will allow them to feel more comfortable calling on the employers, new and old, old for re-enrollment, new for -- to do that, that may help us in the second half. So I am counting on that as being something that will help us. But your concern is something we, too, worry a little bit about.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

And then just -- you had that you have -- you've already -- obviously, you had started the hedge capital repatriation and your repatriated amount for 2013. But what are your thoughts on capital repatriation for 2014, and whether you want to hedge that for currency moves?

Kenneth S. Janke
Former Executive Vice President and Head of Corporate Finance & Development

Well, Jimmy, this is Ken. Let me comment on that. As I had mentioned at the Analyst Meeting in May, we had begun to hedge a portion of our expected 2014 repatriation. You may recall that I talked about the possibility of about JPY 96 billion to JPY 98 billion in repatriation next year. As of today, and we'll probably hold with this for the time being, we've hedged JPY 47 billion. And as far as what we ultimately pull out, the same commentary that we would have said a year ago applies to now, meaning we have to see how the macro market -- the macro environment changes between now and next June and what the impact might be on realized or unrealized gains and making the final determination about how much we pull up. But that's where we stand today.

Operator

Our next question comes from Christopher Giovanni from Goldman Sachs.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

I guess I'm trying to better understand the investment strategy and kind of the capital interplay here. I mean, obviously, the bond program was successful, you had the 150, 200 basis point pick up related to JGBs, which I think you felt good about given the excess liquidity it gave you in the diversification. But now with the move up in rates, shifting back to that JGB strategy, so just some additional commentary there, and then thoughts on kind of the PMR-type strategy versus available for sale or held to maturity. I think others have looked at this, but what are some restrictions there, I think, potentially things need to be sold and rebought, which you might not want to do kind of given the move up in rates? So just any thoughts there on the interplay.

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

Sure. Chris, it's Eric. I'll grab that one and then Ken or Chris may jump in on the SMR side. But to take a step back on the investment strategy, just to remind everybody, we did a very thorough strategic asset allocation project back in 2012, which took into account liabilities, assets, our surplus, and basically created our guidepost in terms of an optimal portfolio that economically, over the long term, would help us grow the surplus with minimal volatility. But an SAA, as you know, is a guidepost. It's a long-term range plan. Important in our investment decisions is what we call tactical asset allocation. So just because we have the guidepost, we have to sit down as investors in my group and think about the macro environment of the world, credit fundamentals and whether or not, in any particular day, month or quarter, keeping to that exact guidepost makes sense or making some adjustments. And I think we've always said, part of the buildout of our investment function is to be more flexible, so that we're not buying whole, but rather buying managed and be able to adapt to different market environments. I think it's no surprise to anybody on the phone that we have just gone through, in the second quarter, one of the highest rates of volatility relative to rates that we have seen since 2008. So if you go back to the financial crisis and you look at treasury volatility options, you'll see the greatest amount of volatility when the fed came in and plunged trillions of dollars into the system and at that time, you saw rates plummet. That was their intent. We're seeing the unwinding of that as we saw the Federal Reserve coming to the market in May or so and announced the potential for tapering the QE3 program, and that caused from peak to trough, the 10-year treasury go from 170 to 270. So in our view, from a tactical standpoint, we're in the volatile interest rate environment and I should say, Japan as well. Because of these intra-bank policies, we saw our deals on April 5 plummet and then come back up. And if anything, if Japan is successful, there'll be some pressure on their rates too. So with that in mind and with the growth of the corporate program, which has grown on the trajectory we expected -- in fact, it's a little ahead of our projection. With the fact that, from this standpoint, as Dan mentioned, our investment yields and net investment income, we're actually running ahead of budget. We made the tactical decision to sit on the sidelines for now, reweighed that allocation more heavier towards JGBs for the third quarter and let's see what happens with the Federal Reserve in September. As you know, today, economic numbers on GDP were strong, the Treasury is backing up. Tomorrow, we may get some weak economic numbers. So our standpoint is we'd rather stand on the sideline through the volatility because we're performing on all of our metrics. And even if we stated this new allocation, we still expect the range of the percentage allocation to the corporate program by the end of the year to be very close to our expected ranges because we are a little ahead in terms of the funding of that. So that's a little background on the decision around the asset allocation. Now let me turn to some of your questions on PRM, AFS, HTM and SMR. So historically, here, as you know, we're -- we've used HTM, held to maturity, both for a big portion of our JGBs. And historically, our private placements, a large percentage went in HTM. On the outlook, as you know, we have low liquidity needs. We don't have a lot of liquidity needs and we really can't afford to hold assets for a long time. Nevertheless, we did learn, as we went through the financial crisis, particularly with non-JGBs. HTM is very difficult because if you do need to make credit adjustment, the accountants really put collars on you in terms of your ability to get it out of HTM and make an adjustment. So the corporate program really was designed to be in AFS, so we can buy and manage it and not have that on us going forward. Where SMR is today and the large rate rise that we saw in U.S. rates and rates rising in Japan, in terms of the impact to our SMR, we fully anticipate it with that kind of rate rise which our SMR dropped to where it is today. But as Dan mentioned and Kriss as well, it's within the range we expected, 500% to 600%. Nevertheless, our sensitivity now to can rates continue to go up is higher from our standpoint and the sensitivity to our available-for-sale portfolio feeds into the SMR calculations going forward. So in that respect, we are pursuing a couple of hedging strategies, if I call it that, so that if rates should continue to rise, whether in Japan or the U.S., we have some built-in protections to the portfolio, which will directly impact and benefit the SMR. So specifically, Robin's talked about PRM, policy reserve matching. Now PRM, for most of our Japan peers, is the more commonly used method as opposed to HTM. PRM is favorable in that, unlike HTM, we do get the favorable accounting treatment if we have an asset, JGBs. In PRM, we don't have to mark them to market for purposes of SMR. However, we're allowed to trade those JGBs for asset liability management purposes. That's a valuable tool to us. Our liabilities can change as rates go up and down, so that gives us more flexibility than HTM. So to mitigate interest rate risk to the yen market, it is our plan to move a number of our JGBs from the existing AFS into PRM, and that will help mitigate interest rate risk. That will happen over the next few months as we certainly want to be cognizant of the transaction costs. With respect to U.S. rates, we are exploring interest rate hedging strategies. We can't really put U.S. corporate assets in PRM. That's not an appropriate place for them if the PRM was built and the rules are around JGBs. So we're looking at more interest rate hedging strategies. And as all of you recollected FAB, I talked about currency hedging strategies, which we're now moving into our pilot programs and collars and different options. That same concept is what we're applying to interest rates. So we're working carefully with our management and team in Japan, our management here in the U.S., to calibrate the sensitivity of SMR, if you will, to changes in these different risk factors, yen rates and U.S. rates primarily, to come up with the right percentages at these hedging techniques, once accounting, PRM, hedging strategies for U.S. would be more economic, if you will. But due to the flexibility, if rates rise, we'll have protections against declining values in the AFS security. So let me stop there and see if anybody wants to add anything, or any other questions on that.

Kenneth S. Janke
Former Executive Vice President and Head of Corporate Finance & Development

This is Ken. I think that's a pretty thorough answer. The one thing I'd point out is, not only are the dollar -- the corporate dollar has -- it's not an appropriate investment for PRM. It's been our policy historically to not put them in HTM as well. Our dollar assets are typically kept in AFS. And that's one of the reasons that the unusual spike in rates had the impact that did on SMR because we have more exposure to AFS.

Christopher Giovanni
Goldman Sachs Group Inc., Research Division

Understood, very helpful. And then just one follow-up question here on the August product. I guess, can you comment a little bit about maybe pricing changes there. Some of the press has reported, I guess, 30% declines in rates for maybe a younger consumer, which, I think, is maybe a bit more than we would have thought, but consistent with, Dan, your comments at the FAB meeting that maybe the younger age cohorts needs to pay a little less and the older group needs to pay a little more. So just some pricing comments around the different age cohorts will be helpful.

Daniel P. Amos
Chairman & CEO

Toru?

Tohru Tonoike
Vice Chairman of Aflac Japan

Yes, I think that is correct. The new product is focused on the relatively young age customer. So we have chosen the characteristics which we think would be -- would appeal to that age group. So there are some adjustments in the pricing that are based on the ages. But overall, profitability are pretty much the same as before. So we do not expect any substantial change in the overall profitability.

Kriss Cloninger
President & Director

This is Kriss. I'll second Toru's comments on that. I think what we found is that relative to competition, we think we've perhaps overcharged the lower premium rate classifications and undercharged the higher premium rate classifications for expenses. You can spread expenses any number of ways, but we've found that we tend to be more competitive at the higher premium rates and less competitive at the lower premium rates. And we tried to move toward a better balance between the higher and lower premium rates relative to our competition. So the lower rates went down some, the higher rates went up some in aggregate. Based on the distribution we expect to sell, we ought to have about the same profitability on the new product as the old.

Operator

Our next question, John Nadel from Sterne Agee.

John Matthew Nadel
Sterne Agee & Leach Inc., Research Division

Just a real quick numbers question. So the JPY 76.8 billion repatriation this month or just shy of $800 million, that seems like, if I recall, that's a bit above where you were expecting that repatriation to come in. Can you just help us understand what drove the upside? And then can you just level set where's parent company cash, including the repatriation? Is that $2.1 billion?

Kenneth S. Janke
Former Executive Vice President and Head of Corporate Finance & Development

John, this is Ken. First, at the Analyst Meeting, we've said then that we estimated repatriation would be JPY 70 billion to JPY 75 billion and that's 80% of estimated FSA earnings. Though FSA earnings came a little bit better, I can't point to any specific reason why, but we retained the 80% remittance and that's what drove it up to JPY 76 billion.

John Matthew Nadel
Sterne Agee & Leach Inc., Research Division

And the cash at the holding company then is, I just add the $800 million to the $1.3 billion at the end of the quarter and we're there?

Kenneth S. Janke
Former Executive Vice President and Head of Corporate Finance & Development

Well, it's not all at the parent at this point. So right now, if you look at it on an operating basis, we had $576 million at the parent company at the end of June. Now that excludes the net proceeds from the debt issuance we had because that's basically pledged toward debt servicing in future periods. The repatriation that we brought back, the $795 million, right now, is warehoused at Aflac. And then, on a quarterly basis, as we dividend up for the parent company's needs, it will be moved up to the parent company to support things like share repurchase and dividends. So it's not all there right now.

John Matthew Nadel
Sterne Agee & Leach Inc., Research Division

Got it. That's helpful. Then the -- I guess the second question is, if I just take a step back and think about this quarter and you're delivering operationally, I think, on every single metric or exceeding on every single metric, maybe there's a little bit of touch, weakness on sales, but it seems like you've got confidence in the back half. So your stock is down and I think that's all about this SMR. I mean, can you just help us understand -- I know you just went through the strategy, this PRM, maybe a few other things you're considering on the U.S. side to hedge against rates. How much urgency is there inside the company to get this done and help your investors be very confident that, that SMR is going to be stable at or near the upper end of your targeted range from here? I mean, 10-year treasury yields are up 8 basis points today, just off of GDP, et cetera, so it's moving quickly. I just wonder how quickly Aflac is moving.

Kriss Cloninger
President & Director

This is Kriss. I'll a take a stab at that. It's a little ironic to me, John, as I was reflecting on last quarter's conference call where you all were giving me grief that the SMR was too high and we needed capital out of Japan. This quarter, as Eric summarized, we have this significant spike in interest rates, so that drove the value of AFS assets down from the level it was at March 31. But I do want to point out that the fair value, the yen-denominated AFS assets are still right at par. We had a significant unrealized gain at the end of the first quarter that basically went away in the second quarter. And I tried to tell the investment community on the first quarter call that we don't tend to count on unrealized gains as a major source of capital. We know they're variable, they fluctuate, they go up and down. They went down this quarter. So instead of being way over the 500% to 600% target, which we worked in the first quarter, we're down at the high end of the 500% to 600% target. All that being said, we do feel some sense of urgency to protect our SMR levels from further deterioration associated with marketing AFS assets to market. I will say, again, on a soapbox a little bit, this is more of an accounting issue to me than a capital adequacy issue. If you look at our RBC ratio, we went over 700% at June 30. Now I know you all are going to give me grief for -- how can you let RBC go over 700%? And why is SMR down if RBC is up? And the answer is it's all related to accounting for those AFS classified assets and marketing one group to market for FSA purposes and incur in the same group at amortized cost for U.S. statutory purposes. So all that being said, we've got to pay attention to SMR. We're doing it in addition to the accounting issues. And I hate to let accounting drive economics, but I've got to be mindful that accounting is important. We are -- we've got multiple levers that we're analyzing in terms of the cost-benefit relationship of exercising some of our options to insulate SMR at any further significant declines beyond our target range. And what we're trying to do is get comfortable that we're pursuing the most efficient approach from a cost-to-capital point of view. Some of the strategies don't cost anything, that's the PRM that Eric summarized. Other strategies have some modest cost, but relatively immaterial. And then some other strategies, we will probably only look at if we felt pressed, shall I say. So we've got a number of levers we're trying evaluate, John. And I know you know that this is what we're paid to do, so we're after it.

John Matthew Nadel
Sterne Agee & Leach Inc., Research Division

And just real quick, so if we fast forward to this time 3 months from now and we're on the conference call, is it fair for us to assume that one or more of those levers will have been pulled?

Kriss Cloninger
President & Director

Yes.

Operator

Next question, Mark Finkelstein from Evercore.

A. Mark Finkelstein
Evercore ISI, Research Division

Maybe I'll ask a follow-up to Nadel's question. Just I guess, maybe if we think about it this way, a 100 basis point move-in rate is roughly 200 SMR points, give or take. Based on these strategies that you're undertaking, how would you -- what is your target for that same sensitivity?

Kriss Cloninger
President & Director

Well, I think one of the things we're doing is working on what the people are calling risk appetite statements. And I think within the framework of risk appetite statements, we will provide guidelines to our operating people regarding our target values, minimum target values for items like SMR. And the 500% to 600% range we've quoted have been kind of an informal statement of risk appetite. So we're just kind of -- I mean, we've communicated a lot of financial targets in the past and that's pretty much what we operate on. So we're going to try to stay in those zones. We obviously won't avoid concern on the part of the regulators, so that's an overriding objective, too. Ken, you've got any other thoughts on that?

Kenneth S. Janke
Former Executive Vice President and Head of Corporate Finance & Development

I don't know that I can add to that.

Kriss Cloninger
President & Director

Okay. Mark, I don't if that was responsive, but...

A. Mark Finkelstein
Evercore ISI, Research Division

Well, I guess, maybe just -- if you don't want to give a number, can we say that, that sensitivity will be likely substantially reduced when we look at kind of March 31 statement?

Daniel P. Amos
Chairman & CEO

That will be our objective, yes. That will be our objective, it's to reduce the sensitivity.

Kenneth S. Janke

Former Executive Vice President and Head of Corporate Finance & Development

But the overriding objective is to keep the SMR within the 500% to 600% target at various interest rate scenarios, both yen and dollars. That's what we're looking, it's what keeps it in that range.

A. Mark Finkelstein
Evercore ISI, Research Division

And I think I heard you, Kriss, say that the cost on the JGB side is 0, and the cost to, I guess, execute the strategy on the corporate bond side is immaterial. I think I heard you say that. I guess the obvious question is, why haven't we've been doing this all along then?

Kriss Cloninger
President & Director

Well, we haven't seen the volatility in interest rates, for example. I think the thing we're looking at on the corporate bond strategy is probably interest rate hedging strategies. That has a cost associated with it, depending on the level of risk and sensitivity we want to retain. We're going through kind of a cost effectiveness modeling exercise on that strategy. The PRM does have some cost to it because we wouldn't have to do some JGB transactions. You just can't reclassify them accounting-wise, you've got to classify them when you require them. So we would have to sell some JGBs and buy similar replacements and the like to get them reclassified, but the cost in material considering overall effect. I think it's something like 1 to 2 basis points on the trade. Eric, do you have any other comments?

Eric M. Kirsch
Global Chief Investment Officer and Executive VP

Yes. I'd like to add, Mark, just a couple of comments to put in context and we've been very, very open since I've been here around our transformation. So taking a step back, as you know, historically, before I got here, the investment strategy was just very focused on either JGBs or private placements and HTM. The tools and the sophistication and the intellectual capital to do interest rate hedging strategies, which obviously encompass doing derivative-type strategies, modeling your portfolios, understanding these sensitivities are quite complex, as you can all appreciate. 2 years ago, when I got here, we were just not equipped to do that, whether it be the systems, the technology, having the appropriate operation set up to do all that, the legal agreements with broker-dealers is this, et cetera. But part of our transformation program, a big part, is designed so we can do all the investment techniques in the market that are necessary to run a large balance sheet. The good news that I could tell you is we do have that intellectual capital now. We have the systems capabilities to do the modeling and we're doing that with the highest priority, which is what Kriss commented on before. But these are new for Aflac, so it has to go through the appropriate governance procedures. We have to ensure the appropriate operational capabilities are set up to hit that aspiration. And all those things -- the good news is we're well along in our transformation where we can -- in fact, we've been working on these things, but we've got a little bit more to go before we'd be prepared to execute it. But as Kriss said, by the time we have this call in the third quarter, we'll be able to tell you about the progress of PRM because that's why that's moving along as we speak. And the analysis and ability to the interest rate hedging on the U.S. portion is well along in its analysis. And in a few weeks, we'll be able to move to our ability to execute and do transactions to do that. So I think we'll have good news for you by the end of the quarter, but that gives you the answer to why it hasn't been done before, hopefully.

A. Mark Finkelstein
Evercore ISI, Research Division

Okay. One very, very quick follow-up. I know that on WAYS sales, you kind of gave a couple different reasons, one of which was the shift to kind of trust. I'm just actually curious if you've seen any changes in surrender activity on the product you sold in '11 and '12 with that just kind of change in Japanese markets?

Kriss Cloninger
President & Director

No, we haven't. I think it's too early to see that. Our products have significant surrender charges on them prior to the time they become paid up, and that really won't occur until 2016, 2017.

Operator

Our next question comes from Jeff Schuman from KBW.

Jeffrey R. Schuman
Keefe, Bruyette, & Woods, Inc., Research Division

I was wondering if you could give us a little bit more big picture perspective on Japan Post. I think it's pretty widely understood that Japan Post wanted to manufacture their own cancer product. I'm wondering if we should think of your arrangement as maybe a temporary one until the IPO, at which point, they might reconsider competing against you with your own products? Or how should we think about it, the relationship, longer term?

Daniel P. Amos
Chairman & CEO

I'm going to let Charles Lake answer that.

Charles Ditmars Lake
Chairman of Aflac Japan & President of Aflac International

Yes, this deal was structured as a long-term relationship deal and it is deep down in that regard. It is an exclusive agreement that makes it very clear that Japan Post Group, including Japan Post Insurance, will be offering Aflac cancer products. And again, I may be repeating what Toru and Dan talked about, but Japan Post Group has Japan Post Insurance, as well as Japan Post, the network company. That network company has 20,000 post offices that has 100,000 licensed agents. So as Toru talked about, we will be training them and so on, but they are already insurance agents that are trained. So they are going to be selling eventually. When we reach 20,000, that is 100,000 agents gradually down the road, Aflac Insurance and Aflac-branded insurance that will jointly develop those. The third component of this deal that was announced, again, makes that very clear. That is it is a long-term relationship that we have structured here, that this is a special product that we will work with them, hear their views, and then -- but it is an Aflac-branded product. So in many ways, as Dan talked about this deal, it is a game changer. It is indeed a precedent setting. Other insurance companies have had some access to the channel, but we are making, in many ways, setting a precedent here in a way that makes this a very, very big deal in Japan. If media coverage in Japan, all the front page articles that appeared when the deal was announced, is any indication, all primetime news covering this deal is any indication, that kind of a deal is not going to be a 2-year, 3-year deal that only when structured for the IPO. So hopefully, I've given you enough or some of the flavor of the nature of the deal in a way and why we believe it's a long term.

Jeffrey R. Schuman
Keefe, Bruyette, & Woods, Inc., Research Division

That's all very helpful. And just to be crystal clear, so when you say exclusive, that clearly means they won't sell products from other third parties, but are they precluded from manufacturing their own product?

Charles Ditmars Lake
Chairman of Aflac Japan & President of Aflac International

They are -- it is an exclusive deal that Japan Post Insurance will not be developing its own cancer product.

Operator

Next question, Steven Schwartz from Raymond James & Associates.

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

Follow-up on that one. I guess 2 things. The original deal was structured in 2007. Obviously, this deal has more of the Post outlets, but I think the assumption had been that you are going to expand from the original amount. So I guess my first question is -- this didn't really sell well the first time around. I guess, what's different this time?

Daniel P. Amos
Chairman & CEO

I want to answer that.

Charles Ditmars Lake
Chairman of Aflac Japan & President of Aflac International

I think that it -- okay, Dan.

Daniel P. Amos
Chairman & CEO

I want -- and then, you can, Charles. If you will remember, when we announced, I specifically said don't get your hopes up too high on Japan Post. I specifically said that the banks would be much bigger than would be the post office. And everyone got really excited and our stock hit all-time highs at that time. And I was -- always felt that we needed to temper it because we did not have the -- we did not have the network, or the group as we call it, we only had one part of it. And the insurance company and these agencies were not a part of it. So we never knew exactly what would happen would the Post develop their own product, would they not. This is now totally different. And now, I'm willing to say, this is a big deal, and so I'm very excited about that.

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

Okay. Unless somebody else is going to chime in, back in 2007, if I remember correctly, Dan, and I do remember that you're talking about the banks first, the post office and the banks being much bigger. But I do think you were thinking at the time that the post office might be as big as Dai-ichi back in the day, which was about JPY 10 billion or so. Is that reasonable to think about?

Daniel P. Amos
Chairman & CEO

We're not going to make any comments on numbers at this point. We're in too early stage, but as I told -- I said on CNBC, this is a game changer and I'm willing to make that comment, but I can't quote numbers at this point. We've agreed to wait and see with Japan Post, and so it would be improper at this time.

Operator

Our last question today comes from Suneet Kamath from UBS.

Suneet Laxman L. Kamath
UBS Investment Bank, Research Division

Quick follow-up on Japan Post and then another on the SMR. On the Post, it seems like another difference this time around is the 79 direct sales outlets that come with the deal. So when is your expectation that you'd start to sell through those outlets?

Daniel P. Amos
Chairman & CEO

Charles?

Kenneth S. Janke
Former Executive Vice President and Head of Corporate Finance & Development

Charles will answer that.

Charles Ditmars Lake
Chairman of Aflac Japan & President of Aflac International

Yes. Yes, that's an arrangement, that will be an agency arrangement between 2 insurance companies. And that just as it was the case with Dai-ichi, it requires an approval from FSA. So we will be working on that. So pending approval for FSA, as soon as we receive that approval, we'll begin that process. And again, I think Dan hit all the key points and maybe I'm repeating what he said, but this deal with the entire group, with the holding company that ultimately makes it an integrated deal, makes it special. So it's not just the Japan Post agency, Japan Post Insurance agency, but the Japan Post network, both combined in a coherent strategy to implement as a group an exclusive deal to sell Aflac cancer product. That's what makes it a game changer.

Daniel P. Amos
Chairman & CEO

Charles, you might mention about new management.

Charles Ditmars Lake
Chairman of Aflac Japan & President of Aflac International

Yes, that's a very important point. Mr. Nishimuro, the new CEO of Japan Post Holding, one of the most highly respected international business persons in Japan, former CEO of Toshiba and former CEO of Tokyo Stock Exchange, and he has taken on this leadership role and he has expressed his vision for the IPO and working together with different companies and we're one of the first companies that -- he structured the deal and made the announcement. Very -- he also made a very kind statement in the press release that we issued. So this is a private sector CEO with demonstrated record of success in a global economy. And Dan and Nishimuro-san had a wonderful meeting, and we are looking forward to that strategic cooperation in that regard as well with this new management team. I also want to mention Mr. Ishii, who is the President of Japan Post Insurance, Mr. Takahashi from Japan Post Network Company. All are combined, working together as a team with us. Toru and I had a number of meetings with them and we are very much looking at this as a long term and working in a way that will make this a big success. So all of this is very positive in our view.

Suneet Laxman L. Kamath
UBS Investment Bank, Research Division

Okay. And I guess, maybe I'll just follow up on Japan Post. So when we went down this road with the banks, it turned out that the banks wanted a really different product than what you guys were selling through your other channels, both in terms of how the product was structured, I believe, also in terms of how they were paid, commission-wise. So I guess that initially, you're going to sell -- I believe, what you're going to sell through Japan Post is the same cancer product that you're selling today. But I guess, as we think about Japan Post wanting to create their own product, also going public and wanting to be profitable, could we see something similar as we saw with the banks in terms of maybe a modified product that may not be similar to the cancer insurance products that you guys have sold through other channels?

Daniel P. Amos
Chairman & CEO

No. It will be very -- it will be similar, but it will have Japan Post stamp on it. That is what they want. But it will be same profit margins and much -- it will still be a cancer policy. It's not like we're all of a sudden going to be in WAYS or somewhere else. This is going to be very similar as how you would view it from an analyst perspective.

Suneet Laxman L. Kamath
UBS Investment Bank, Research Division

Got it. So same margins, same benefit ratio, all that stuff?

Daniel P. Amos
Chairman & CEO

Exactly.

Robin Y. Wilkey
Former Senior Vice President of Investor & Rating Agency Relations

All right. Thank you very much. I appreciate all of you joining us today. If you'd like to follow-up with any questions, I'll be available. So thank you very much. Bye-bye.

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