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Market Intelligence

Aflac Incorporated NYSE:AFL

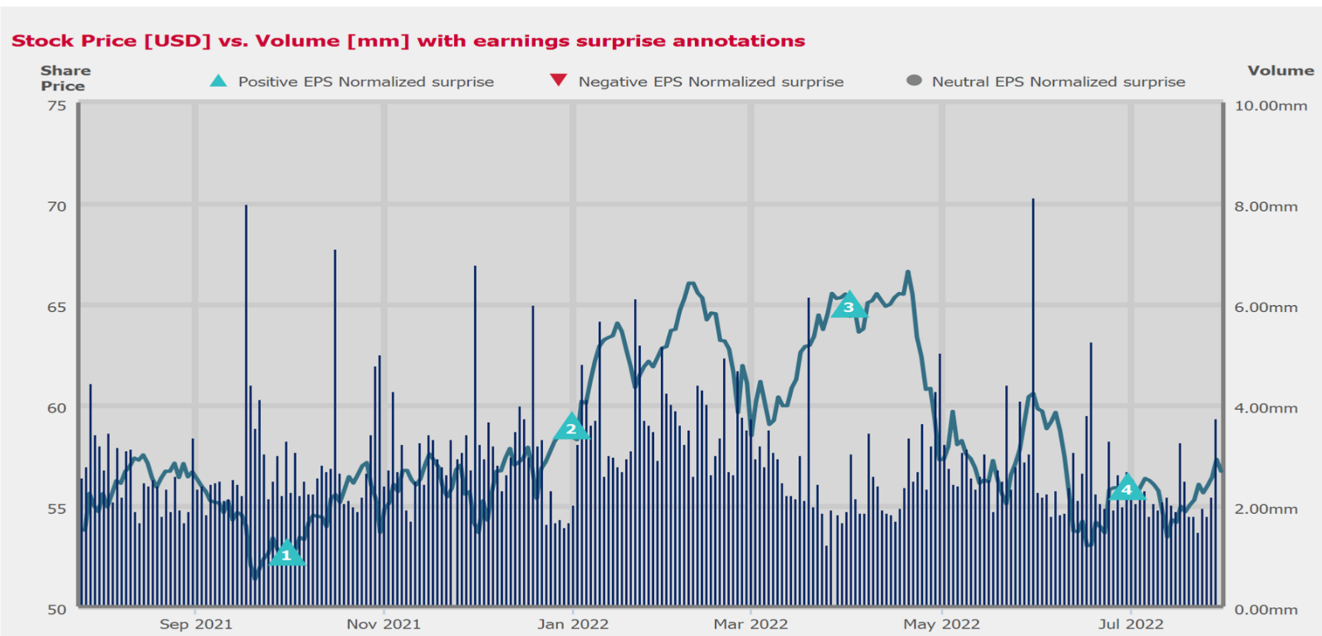
FQ2 2022 Earnings Call Transcripts

Tuesday, August 02, 2022 12:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2022-			-FQ3 2022-	-FY 2022-	-FY 2023-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.28	1.46	▲14.06	1.25	5.23	NA
Revenue (mm)	4786.84	5400.00	▲12.81	4615.86	19058.73	NA

Currency: USD
Consensus as of Aug-02-2022 10:30 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2021	1.32	1.56	▲1 18.18 %
FQ4 2021	1.26	1.33	▲2 5.56 %
FQ1 2022	1.37	1.42	▲3 3.65 %
FQ2 2022	1.28	1.46	▲4 14.06 %

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Daniel Paul Amos
Chairman & CEO

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

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Teresa Lynne White
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Presentation

Operator

Good morning, and welcome to the Aflac Incorporated Second Quarter 2022 Earnings Conference Call. [Operator Instructions] Please note, this event is being recorded.

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

David Young

Thank you, Andrea. This morning, we will be hearing remarks about the quarter related to our operations in Japan and the United States from Dan Amos, Chairman and CEO of Aflac Incorporated. Fred Crawford, President and COO of Aflac Incorporated, will then touch briefly on conditions in the quarter and discuss key initiatives.

Yesterday, after the close, we posted our earnings release and financial supplement to investors.aflac.com along with a video with Max Broden, Executive Vice President and CFO of Aflac Incorporated, providing an update on our quarterly financial results and current capital and liquidity. Max will also be joining us for the Q&A segment of the call along with other members of our U.S. executive management: Teresa White, President of Aflac U.S.; Virgil Miller, Deputy President of Aflac U.S.; Eric Kirsch, Global Chief Investment Officer and President of Aflac Global Investments; Brad Dyslin, Deputy Global Chief Investment 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 at Aflac Life Insurance Japan: Charles Lake, Chairman and Representative Director, President of Aflac International; Masatoshi Koide, President and Representative Director; Todd Daniels, Director and CFO; Koichiro Yoshizumi, Director, Deputy President and Director of Sales and Marketing.

Before we begin, some statements in the 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 can materially impact our results.

As I mentioned earlier, the earnings release is available on investors.aflac.com and includes reconciliations of certain non-U.S. GAAP measures.

I'll now hand the call over to Dan. Dan?

Daniel Paul Amos
Chairman & CEO

Good morning, and thank you for joining us. As I reflect on the second quarter of 2022, our management team, employees and sales force have continued to adapt more tirelessly to be there for the policy holders when they need us the most, just as we promised.

Aflac Incorporated reported solid results for the second quarter with net earnings per diluted share of $2.16 and $3.73 year-to-date. Adjusted earnings per diluted share were solid at $1.46 in the second quarter and $2.88 for the first 6 months, supported in part by the continuation of the low benefit ratio associated with the pandemic conditions. Also contributing was a better-than-expected investment income, including returns from alternative investments. We remain cautiously optimistic as our efforts focus on growth and efficiency initiatives amid this evolving pandemic backdrop.

Looking at our operation in Japan in the second quarter. Aflac Japan generated strong overall financial results with a profit margin of 27.4%. This was again above the outlook range we provided at the November 2021 financial analyst briefing. Persistency remains strong. However, sales continued to be somewhat constrained as the pandemic conditions that impact our ability to meet face-to-face with customers. Also contributed to the quarterly results was the 2021 comparison following the launch of our new medical product.

Regarding Japan Post strategic alliance, as part of our ongoing collaboration and governance framework, I traveled to Japan towards the end of June to meet with Japan Post Holdings' CEO, Mr. Masuda, along with the presidents of Japan Post Postal and Insurance Companies. We had an understanding and productive visit discussing our plans. This included a renewed commitment from executive management to drive sales with a focus on distribution, growth and marketing of cancer insurance.

Aflac Japan has continued to offer sales support to Japan Post, especially after the new fiscal year began in April of 2022 and following Japan Post sales structure transformation. This support includes further aligning of our sales offices with Japan Post regional offices to strengthen support and to share our best practices. As you may recall, under the new structure, sales employees focus solely on selling Japan Post insurance products and Aflac Japan's cancer insurance product.

We have made gradual progress towards providing cancer insurance protection to more consumers, demonstrated by the increased proposal activity and sequential monthly sales growth during the second quarter. There is more progress to be made, and we continue to work to strengthen the strategic alliance to create a sustained cycle of growth for both companies. We believe that sales through Japan Post Group will improve in the second half of the year as sales employees gain more experience and momentum.

As we look forward to 2023, we will introduce our new cancer insurance product through Japan Post likely in the second quarter. This will allow both entities to invest in a more complex, coordinated required by the distribution system of this size. We plan to launch our revised cancer product and agencies in the second half of 2022, and we continue to expect stronger overall sales in the second quarter of the year. This assumes that pandemic conditions do not escalate and that sales productivity continues to improve at Japan Post Group and that we execute on our product introductions and refreshment plans.

Turning to the U.S., we saw a solid profit margin of 21.4%. I'm pleased with the U.S. sales momentum has continued with a 15.6% sales increase in the second quarter. This reflects continued adaptation to the pandemic conditions, growth in the core products and our investment and build-out of growth initiatives. While Aflac network dental and vision and group premier life, asset management and disability solutions, which we call PLADS, a relatively small part of our sales, we are pleased with how they are contributing to our growth.

Our growth initiatives modestly impacted the top line in the short term, but also tend to be accompanied by the sale of our core supplemental health products. In combination with our core products, they also better position Aflac U.S. for future long-term success. The need for our products we offer is as strong or stronger than ever before. At the same time, we know consumers' habits and buying preferences have been evolving. We remain focused on being able to sell and service customers whether in person or virtually. This is part of the ongoing strategy to increase access, penetration and retention.

Turning to capital deployment. We placed significant importance on continuing to achieve strong capital ratios in the U.S. and Japan on behalf of our policyholders and shareholders. We continue to generate strong investment results while remaining in a defensive position as we monitor evolving economic conditions. In addition, we've taken proactive steps in recent years to defend cash flow and deployable capital against a weakening yen. When it comes to capital deployment, we pursue value creation through a balance of actions, including growth investments, stable dividend growth and disciplined and tactical stock repurchase. It goes without saying that we treasure our 39-year track record of dividend growth, and we remain committed to extending it, supported by the strength of capital and cash flows.

In 2022, we remained in the market repurchasing shares with a tactical approach. In the second quarter, Aflac Incorporated deployed $650 million in capital to repurchase 11.2 million of its common shares, bringing the 6-month total to $1.15 billion in purchase and 19.2 million of the shares. With this approach, we look to emerge from this period in a continued position of strength and leadership. Keep in mind, in addition, we have among the highest return on capital and the lowest cost of capital in the industry.

We've also focused on integrating the growth investments that we've made. We are well positioned as we work towards achieving long-term growth while also ensuring we deliver on our promise to the policyholders. I don't think it's a coincidence that we have achieved success while focusing on doing the right things for the policyholders, shareholders, employees, sales distribution, business partners and communities. I'm proud of what we've accomplished in terms of both our social purpose and financial results, which have ultimately translated into strong long-term shareholder return.

We also believe that the underlying strength of our business and our potential for continued growth in Japan and the United States, the 2 of the largest life insurance markets in the world. Thank you again for joining us this morning. And now I'm going to turn it over to Fred. Fred?

Frederick John Crawford
President & COO

Thank you, Dan. Before commenting on our results, let me start with some perspective on how we're positioned when considering current U.S. economic conditions. We have not witnessed this level of inflation in the U.S. in many years, and we are closely monitoring conditions. Wage inflation and full employment is generally supportive of growth in worksite benefits. However, when considering voluntary product, there is a question as to how much of any increased income is available for supplemental products as real wages are likely neutral to down.

Our benefits are defined at time of purchase and do not adjust for health care inflation. Therefore, we do not expect any measurable impact on claims. In terms of recruiting and retaining agents, it can be more of a challenge as agents are commission-only and need to keep pace with any increase in costs. When looking at enterprise margins, the impact of inflation does apply upward pressure on expenses. However, this is mitigated by rising rates and additional investment income, having built a significant floating rate loan portfolio.

In terms of the risk of economic slowdown and recession, our business model is generally defensive in nature with low asset leverage and exposure to risk assets. Profits and cash flow are driven largely by morbidity margins that tend to remain stable during periods of economic volatility. While employment levels may decrease, we often benefit in the recruiting side during an economic slowdown versus today's tight labor markets.

Max spoke in his recorded comments to the work we have done to defend our cash flow from weakness in the yen, we have built a sizable unhedged US-dollar portfolio in Japan, shifted most of our senior debt to yen for both hedging and cost of capital purposes and maintain a flexible hedging position at the holding company. It's important to understand what makes all this possible: significant economic value, strong capital ratios and predictable cash flow out of Japan.

Overall, in recognizing the balance we have in operating in the U.S. and Japan, we like how we are positioned to defend our performance under today's U.S. inflationary conditions and the potential for economic slowdown. We see no interruption in our core margins and return of capital to shareholders, including dividend pattern and share repurchase.

Turning back to our businesses and beginning with Japan. COVID cases have surged again with daily new cases reaching 200,000, up significantly from already elevated levels earlier in July and considerably higher than levels experienced in the second quarter. However, hospitalization and deaths remain low. Based on commentary from the Japanese government, there does not appear to be plans to introduce a nationwide state of emergency, which are typically triggered by both increasing cases and declining hospital capacity.

We continue to experience elevated COVID-incurred claims, driven by its designation as an infectious disease and deemed hospitalization, which allows for payment of claims for care outside the hospital. We would expect the recent surge in COVID cases to apply pressure to near-term benefit ratios. While not guaranteed, this may be partially offset by other drivers of hospitalization and care, which have remained low during periods of higher COVID. Our data suggests this is driven by increased and less expensive outpatient treatments as policyholders and their doctors seek to avoid going to the hospital with COVID cases on the rise.

With respect to COVID's classification under the Infectious Disease law, August 1, a special committee of the Ministry of Health, Labor and Welfare started reviewing COVID's classification under the law. Revision of the classification requires amending the law, which is expected to be discussed at the extraordinary Diet session beginning in September at the earliest.

Having just spent a few weeks in Japan, the general population remains cautious with respect to the potential for COVID infection. With widespread infection, this is not simply a matter of customer behavior and face-to-face interaction but also agents who are sidelined temporarily with COVID. As a result, we typically experience reduced proposal volumes during periods of elevated cases, an early indication of potential sales weakness.

While COVID conditions remain outside our control, our work continues to position Japan for sales recovery in the second half of the year and as we move into 2023. These actions include items that Dan referenced in his comments, such as accelerating the launch of our new cancer product, direct marketing campaigns more closely tied to targeted TV advertising and adjusting our distribution model for better alignment with our third-party partners.

We continue to review our broader product portfolio, both first and third sector, for enhancements designed to increase the value proposition for our policyholders, offer a broad product lineup for our core distribution partners and secure our competitive position in the market. We have been making investments in technology and in working with our distribution partners to reduce launch costs associated with product refreshment and development. It's becoming clear that both the competitive environment and our broader product line creates a product refreshment cycle that is more continuous in nature.

Separately, our incubated businesses continue to develop. We are seeing favorable results piloting Hatch Healthcare, our provider of noninsurance support, to develop the ecosystem for both cancer and nursing care policyholders and expect to expand availability in early 2023. Our short-term insurance subsidiary, [Sidachi], was launched in early 2021 and currently offers 2 products: a substandard medical product and a disability product aimed at the contingent or freelance workforce in Japan. [Sidachi] serves 2 strategic purposes: to grow and develop these specialized markets; and second, as a proof-of-concept platform for product innovation that may become more broadly popular in the future. We can't control COVID conditions but we are not standing still. We will develop these themes in more detail at our financial analyst briefing in November.

Turning to the U.S., and as you are aware, COVID conditions are also elevated. This is not currently causing any issue in terms of either our operations or distribution in the U.S. We saw persistency recover to more normal levels when isolating results in the quarter and accounting for seasonality. Account persistency has remained stable through the year. So we believe this is driven by an increase in employee turnover with tight labor markets. There are moving parts when looking year-over-year, including the retirement of state mandates that serve to reduce lapsation.

As Dan noted in his comments, we continue to deliver a balanced performance. We see recovery in the small business market with growth in veteran average weekly producers while also continuing to strengthen relationships with our broker partners. For example, split by product type, group voluntary was up 16%; individual benefits, up 11%; split by channel, agent sales were up 11% and broker up 22%.

The combination of network dental and vision and premier life and disability were ahead of our plan as we continue to see strong performance with our buy-to-build properties. We were up 175%, albeit off a smaller but building base. Direct-to-consumer is down 7% and largely the result of the increase in costs associated with organically generating, purchasing and converting leads and meeting our return expectations.

In terms of the U.S. expense ratio, it's important to identify the impact of our build investments. We have 3 important business initiatives underway that are essential to the future growth of the company. These investments include group life, disability and asset management, network dental and vision and having a digital direct-to-consumer platform to reach consumers that are outside the traditional workforce.

In the quarter, investment in these efforts impacted our expense ratio by 280 basis points, and we would expect this pace of investment to continue for the rest of 2022 and into 2023. Our 2021 outlook for a 3% to 5% compound annual growth rate in revenue through 2026 is largely driven by these 3 growth platforms and related halo impact of cross-sell and retention of core voluntary products.

In the next 3 years, we expect a natural swing in these platforms from contributing to an elevated expense ratio to being the principal driver of returning to more normalized levels. In the interim, we are navigating investment in the future growth, advancements in our digital platform while maintaining strong profitability.

Turning to Global Investments. With the rise in short-term interest rates driven by Federal Reserve as they combat inflation, together with deployment activity, net investment income generated from our $12 billion floating rate portfolio is currently estimated to increase approximately $160 million for the year as compared to our original plan. As mentioned last quarter, we have locked in the favorable LIBOR curve on a large portion of our portfolio and expect continued tailwinds to floating rate income going into 2023. Along with being an attractive asset class and strategic to our U.S. dollar program in Japan, our floating rate book acts as a logical hedge against inflationary cost pressure.

We maintain a book of foreign exchange hedge instruments on our U.S. dollar portfolio in Japan that is also impacted by inflation as the cost of these forward contracts are generally aligned with short-term rates in the U.S. However, we have locked in those costs for 2022 and have offsetting hedge instruments at the holding company that serve to neutralize the impact to the enterprise.

Our alternatives portfolio continues to deliver strong results. We fully expect lower valuations of these portfolios in the second half of the year as private equity marks track public equity valuations, likely resulting in giving back much of their 2022 gains. There is a well-understood lag in reporting numbers on private equity, and this is a natural expectation given private equity's correlation to the public equity returns.

Naturally, we are closely monitoring economic conditions and the chance of recession. We maintain a defensive position to risk assets in terms of private and real estate equity, our investment thesis and risk appetite remains the same. We are willing to accept some equity market volatility to earn 10-plus percent over the long term, adding to NII or net investment income, on a risk-adjusted basis. We maintain a conservative allocation of under 3% of our invested assets with marginal growth expected over the next 5 years.

We closely monitor our middle market and transitional real estate portfolios where recessionary impacts could be felt sooner. We expect these portfolios to perform well given their senior, secured, first lien structure, protective covenants, reasonable leverage and private equity sponsorship for middle-market loans as well as a high degree of diversification. The portfolio has performed well during the stressful period of COVID, and we expect they will continue to.

I'll now hand the call back to David to take us to Q&A. David?

David Young
Thank you, Fred. Now we are ready to take your questions. [Operator Instructions] Andrea will now take the first question.

Question and Answer

Operator

Our first question will come from Nigel Dally of Morgan Stanley.

Nigel Phillip Dally
Morgan Stanley, Research Division

So I wanted to touch on U.S. losses. Last quarter, it was a little troubling. In this quarter it seems to have returned to more normal levels. Can you talk a little more about what was driving that? Was it purely just macro conditions? Or -- I know you're looking at various initiatives to help improve it. Was that a play as well? And then also looking forward, do you expect higher inflation have an impact on activity as well?

Frederick John Crawford
President & COO

Nigel, it's Fred. Let me comment on lapse rates. When we talk about -- as you know, we report our lapse rates on a trailing 12-month basis. And as a result, you'll see pressure in our reported lapse ratios year-over-year. And so what we have done is looked at our quarterly lapse rates seasonally adjusted when we make our comments about a recovery in lapse rates. And let me give you an idea.

Our lapse rate in the quarter, or said differently, our persistency in the quarter -- for the second quarter only was around 79%. And that is approximately equal to the pre-COVID levels of lapse rates that we tend to enjoy or persistency that we tend to enjoy in the second quarter. To give you an idea, before COVID, we would travel again around that 79% rate. It rose up into the 81% territory over the last couple of years, and we believe that's largely related to the state mandates that require keeping policies in place. As those started to expire and have now largely expired, we've traveled back into normal persistency.

In the first quarter, what spooked us is that our persistency in that quarter was around 74.5%, and that seasonally adjusted was about 200 basis points lower than we expect. We always expect the first quarter persistency to be lower because it has implications. It's timed related to annual enrollment process and year-end process, so it's normally a lower persisting quarter. But in this case, it traveled about 200 basis points lower than we would have expected, and that's what gave rise to our comments last quarter. So we're very pleased to see it recover back to normal seasonal adjustments in the second quarter, and that would be my comment there. We'll have to obviously monitor it as we go forward.

To my comments on inflation, I would tell you that we don't see necessarily the implications of inflation impacting lapse rates, per se. Right now, we haven't seen any evidence of that. But it's a very unusual inflationary period, and quite honestly, we don't have a lot of history of inflation at these levels and watching how our business behaves. And that's why I have some of the cautionary language. Thus far, I would tell you, we don't see any acute implications from inflation, but we simply want to note the fact that we're going to monitor that. Again, we see offsetting dynamics related to inflation, so we don't see this as having an impact to overall U.S. financial performance.

Operator

The next question comes from Jimmy Bhullar of JPMorgan Securities.

Jamminder Singh Bhullar
JPMorgan Chase & Co, Research Division

So I had a question on sales trends in the U.S. and in Japan, and if you could talk about how sales trended through the quarter. And specifically on Japan, it seems like your comments are pretty positive on an expected improvement in sales. Are you seeing that? Or are you just hopeful that things will get better? And then just relatedly, any impact that you're seeing on your production activities in Japan because of the recent increase in COVID cases?

Daniel Paul Amos
Chairman & CEO

Let me let ask Yoshizumi to answer that.

Koichiro Yoshizumi
Dep. President, Dir. of Sales & Marketing and Dir. Alliance Strategy - Aflac Life Insurance Japan

[Interpreted] This is Yoshizumi. Let me answer your question. For the second quarter of 2022, so a downturn continuing from first quarter, as sales of the new medical insurance product had run its course after its release in January last year. Additionally, COVID-19 continue to have a negative impact on sales activities as the number of new cases increased 8.2x compared to the same period last year, although intensive infection prevention measures have been lifted.

While COVID-19 infections have been rapidly increasing since the start of July, Japan is experiencing its seventh wave and uncertainty remains. While having said that, from the third quarter, we are hopeful that sales will exceed last year's results, building on the new cancer insurance product launch and the gradual recovery of Japan Post Group sales. That's all for me.

Teresa Lynne White
President of Aflac US

I'll ask Virgil to respond to the U.S. sales question.

Virgil R. Miller
Deputy President Of Aflac U.S.

Thank you, Teresa. As Fred and Dan shared earlier, we did see a 15.6% increase in sales. Very pleased with the second quarter performance. I think Fred said it well, though. It's a combination of what we're seeing from our distribution channels. If you think about the small market, which was disrupted quite heavily at the beginning from COVID, we've seen a solid recovery. It's really driven by our veterans returning to producing. We saw another increase in our veteran average week of producers, and we saw an increase in productivity from our veterans.

And then when you look at the large case space, it was less disrupted by COVID. We continue to see great performance from our broker partners in that space. We saw a 24% quarter-over-quarter increase in production from our brokers. So when you look at it, how we're going to the market in large with our brokers, large case space with our brokers and continue to see recovery in the small market with our veterans, overall, we're pleased with that quarter.

Operator

The next question comes from Alex Scott of Goldman Sachs.

Alexander Scott
Goldman Sachs Group, Inc., Research Division

First one I had is on the Japan benefit ratios. I guess when I think about the, I think it was 190 basis points you caught out of unfavorable COVID claims and -- but then the normalized benefit ratio that's materially higher, could you help us think through, I think it was over a 400 basis point delta associated with these IBNR releases, when you sort of go through that. And I struggle with it because I know you guys have had favorable IBNR over time. I mean, do you have any way of sort of breaking that apart a little for us and helping us think through like what portion of it is more the outpatient treatments associated with COVID specifically? I mean, any help with how to sort of figure out where things should be on a run rate basis.

Max Kristian Broden
Executive VP & CFO

Thank you, Alex. If you start with -- obviously, you make the walk from the reported benefit ratio of 67.4% to adjusting for all the sort of special factors in the quarter, you get to 69.8%. What I think is reasonable to sort of add back is the sort of run rate more permanent or somewhat permanent reserve releases that we have experienced from favorable hospitalization trends, et cetera. Those added up in the quarter to about 170 basis points. And that's what we have seen historically run through our results.

So if I were to adjust for that to sort of get to -- sort of adding back what we normally see as an ongoing reserve release in each quarter, you get back to 68.1% in sort of an adjusted underlying benefit ratio for the quarter. Going forward, over time, these reserve releases have been running relatively high recently, and we would expect those to continue, maybe not at the level of 170 basis points, but we certainly expect an element of that going forward.

Alexander Scott
Goldman Sachs Group, Inc., Research Division

Got it. That was really helpful. Next one I had is just on inflation and the expenses. I heard some of the comments that, that could put upward pressure on expenses. I mean, is that material enough for us to think about maybe a different range for expense ratios? I know things are a little more focused on the back half or expenses as well. So I was just wondering if there's any update to sort of the expense ratio guide that you guys have out there.

Frederick John Crawford
President & COO

I think essentially, where we face inflation is in just a couple of areas. One, predominantly is simply wage inflation, so your overall headcount and what we're all experiencing and seeing in the market with wage inflation and salary inflation. And we've got to do that. We've got to fall in line to retain and keep our talent, and we'll do so.

Having said that, for a company our size, our employment levels are quite manageable. I mean, we're a very large U.S. and Japan company, but we have 5,300 employees in the U.S. and approximately 7,000 in Japan. And so we don't have the type of business model that is overly concentrated from that perspective. And so therefore, the wage inflation numbers, while they do apply pressure, they're more manageable.

There's also certain contracts that we have, and quite frankly, the industry has that will have inflation riders. And so certain IT and servicing contracts often have inflationary provisions that kick into place when inflation gets out of control. That can also calm back down as inflation gets back into control. Overall, what I would tell you is inflation in and of itself is not causing us to rethink our guidance on expense ratios.

The bigger moves on expense ratios is what I noted in the fact that we're heavily investing in growth platforms. We're very pleased to see that the growth is coming through in those platforms, as I mentioned in my comments. But it's going to -- that's really going to weigh on expense ratios in the U.S. more than inflationary pressure issues.

Max Kristian Broden
Executive VP & CFO

And just to add one reminder. Obviously, expense ratio, it's a ratio. And you have net investment income coming into play here as well, and it helps boost the top line, and therefore, gives you some relief on the expense ratio when you think about the inflationary pressures. And the last piece is that, yes, we do obviously acknowledge that it is putting upward pressure on expenses in dollar terms as well, and we are taking active actions in order to combat that as well.

Daniel Paul Amos
Chairman & CEO

And I'll also remind you that 1.5 years ago, we had a voluntary program for retirement in the U.S., and about 10% of our workforce retired. So we -- this is not something that has not been top of mind. If...

[Technical Difficulty]

Max Kristian Broden
Executive VP & CFO

Operator?

Operator

The next question comes from Erik Bass of Autonomous Research.

Erik James Bass
Autonomous Research LLP

I was hoping you can provide a little bit more detail on the NII outlook. I think Fred mentioned $160 million of higher expected NII in 2022 than the original plan. Just wanted to confirm, is this gross or net of hedge costs? And then how should we think about the impact moving into 2023 when, I guess, floating rate NII should continue to build but hedge costs will also reset and probably move higher?

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

Fred, would you like me to take that?

Frederick John Crawford
President & COO

Yes, please, Eric.

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

Sure thing. The numbers that Fred quoted are gross of currency hedge costs. They are net of interest rate hedging because we've done some interest rate hedging with respect to the floating rate book. So I just want to bifurcate those 2 buckets. And as a reminder, for this year, our FX hedge costs are primarily locked in, like 95%, 98% of those hedge costs are pretty locked in. Clearly, going into next year, the cost of hedging is substantially higher, and we still carry about $4.1 billion or so forwards on the Japan dollar program. So the hedge costs next year will certainly go up. But as a reminder, we have what we call the back-to-back program or sort of countering forwards at inc.

So for the enterprise, the FX hedge cost from a forward perspective should stay relatively stable on a net basis. We do have some FX options on the book as well that help us with tail protection for the unhedged portion of the dollar program in Japan. And those are based on options pricing. We do expect those to go up, which won't necessarily have an offset, but we do often look at our hedge ratios and how much we want hedged. So the amount of that could be a variable but we would expect the option costs to go up as well.

And then more broadly speaking, when you look at next year's forecast from the perspective of where do we think our floating rate income is going, as Fred said, we still expect tailwinds. The forward curve for LIBOR is still upward sloping. We're all watching the Fed. And assuming it stays where it is, we would expect further tailwinds in floating rate income for next year. But again, the Fed is moving with inflation in the markets. The latest Fed meeting was a little bit more dovish than hawkish for the future. So it's -- so that's going to be a moving target, if you will.

However, having said that, and we reported on this before, on our floating rate book, we have put on interest rate hedges. And we did that because at the beginning of the year with the aggressive Fed hikes, an increase in LIBOR, when we do our financial planning over a 3- and 5-year period, we saw that there's a substantial increase based on the forward curves in that floating rate income over that time period. But we also know that there's no guarantee we'll get that. It all depends on where LIBOR is at that time.

So the purpose of the interest rate hedge was to say, given that potential large increase in income, why not lock in a good portion of it and put better surety around that, which we did. So it gives us great protection now in case in the future there's recession and the Fed starts to lower rates. But we didn't hedge all of it. So we still have some upside as well if rates should continue to go up. So that's a picture, if you will, of the future and some specifics on the hedge cost.

Erik James Bass
Autonomous Research LLP

That's helpful. And just to confirm then, given the back-to-back program, should we really think of most of the kind of NII uplift from the higher floating rate yields dropping to the bottom line at an enterprise level, realizing it may not -- you may see less of an impact in the Japan segment and more of it in corporate?

Frederick John Crawford
President & COO

That's correct. Basically, you would see as the locked-in hedge costs roll off and we go into a new level of hedge costs in Japan, you would see those hedge costs increase. But then that same increase would be offset by increased hedge income at the corporate level so that there'd be no effective impact to the enterprise. And then also keep in mind what Eric said, that of the $12 billion in floating rate portfolio, our hedge instruments are around $4 billion notional. And so we still have an ability to enjoy outside net investment income despite the rise in hedge costs.

Operator

The next question comes from Suneet Kamath of Jefferies.

Suneet Laxman L. Kamath
Jefferies LLC, Research Division

Just a follow-up on Eric's question. So if we're getting $160 million of higher NII from the floaters, does that influence your thinking around expense initiatives, maybe an opportunity to accelerate that in order to generate maybe faster growth going forward?

Frederick John Crawford
President & COO

Well, they are 2 different topics. What I would tell you -- if what you're saying is would you accelerate your initiatives and actually increase the pace of investment with added net investment income, we're not really adjusting our plans around NII up or down. The plans we have around investing in our platform are really related to core growth in earned premium, policies in force, sales and overall efficiency measures. So it really would not render any impact on those plans.

And I do want to highlight, as Dan mentioned in his comments, we are very much at work in terms of addressing the long-term expense structure, both in Japan and in the U.S., and have several initiatives underway to drive productivity improvements and efficiency improvements. Those do require near-term investment, but we have plans in place to help our expense dynamics and certainly combat any inflationary pressure as we go forward. But none of that, Suneet, is really impacted by watching NII move up and down.

Suneet Laxman L. Kamath
Jefferies LLC, Research Division

Okay. Got it. And then just shifting to Japan. I was hoping to get a little bit more color on this COVID as an infectious disease policy that the government has. Maybe what are your expectations for the, I guess, early September conversation around this that the government will have? And I believe that your products have certain caps in terms of number of days where benefits can be drawn. Is there any risk to potentially that changing in the future?

Frederick John Crawford
President & COO

I think perhaps Koide-san can address that. We can add our color here in the U.S., But Koide-san, maybe address your views of the Diet conversation in September.

Masatoshi Koide
President, CEO & Representative Director

Yes. This is Aflac Japan, Koide. [Interpreted] So as Fred mentioned earlier, the discussion and deliberation related to COVID-19 infection disease law discussion is really gaining momentum. And in light of the situation, experts from the government subcommittee on countermeasures against infectious disease [indiscernible] coronavirus and the National Governors Association have proposed a review of the classification.

And also, as Fred mentioned earlier, starting from August 1, a special committee of the Ministry of Health, Labor and Welfare started reviewing COVID-19's classification under the law. And revision of the classification under the infectious disease law requires amending the law, which is expected to be discussed at the extraordinary Diet session beginning in September at the earliest.

So we cannot predict the outcome of the Diet discussion, and we would highlight that it is not focused on the insurance industry. Rather, it is focused on how the law has pressured the overall health care system. However, we feel it is a positive development that a dialogue is taking place on the issue. That's all for me.

Frederick John Crawford
President & COO

So I would also just note something that I think is perhaps obvious, but just to be clear. This is really not uniquely an Aflac issue. The major insurance companies in Japan are all facing substantial increased claims activity on medical policies. In fact, we're not even among the top few in terms of the volume of claims we have relative to other peers in the industry, domestic insurers with large platforms. So this is really broadly based.

We can't confirm some of these statistics, but there's been recent news articles suggesting that the amount of claims paid in the month of June, for example, under medical policies was up nearly twelvefold over the same time period last year this time. So it is absolutely pressuring the system. And we think that the legislative community in Japan is taking this under consideration and realizing they've got to contemplate a change in the law.

Daniel Paul Amos
Chairman & CEO

While saying that, we're still very comfortable with our projections for 2022. So I want to make sure you grasp that.

Operator

The next question comes from Ryan Krueger of KBW.

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

I guess, first, could you just give us some sense of how much NII uplift in the current quarter did you realize from higher short-term rates on the floating portfolio?

Frederick John Crawford
President & COO

Go ahead, Eric.

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

It's Eric. It was about $38 million for the quarter, but that's in total for the portfolio. But just from rates alone, it's around $2 million to $4 million. And that's pretty logical because if you think about the ascent of LIBOR, it really didn't start increasing until February, March, April, and these are 1 month of quarterly reset. So the impact from just rates alone on the floaters was rather small, but we did have other portfolio activity around deployment. The new money yield on deployment was better than planned. We were able to purchase some floating rate assets ahead of plan from a particular provider. So a number of portfolio activities really added to most of that increase. But as the year goes by, the impact from rates alone just continues to get higher because of that substantial rise in LIBOR.

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

I guess just to clarify, is the $38 million part of the $160 million? Or should we think about the $2 million to $3 million as...

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

$38 million is part of the $160 million, that's just for the second quarter. And the $160 million is for the full year forecast.

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

Okay. Understood. And then I guess, in the U.S. did you see any normalization in the benefit ratio as we went through the quarter or [it was pretty spread] throughout?

Max Kristian Broden
Executive VP & CFO

I think it's relatively well spread out over the quarter. There was no specific movements between the different reporting months in the quarter.

Frederick John Crawford
President & COO

One thing back on Japan to just make sure that you're capturing is, again, when it comes to these COVID cases we're talking about, just want to make sure you take to heart Max's comments and Dan's comments and my script comments, and that is the very same dynamic that is giving rise to these higher infectious disease COVID claims, we believe are absolutely impacting the rate of hospitalization on other claims activities, not the least of which is cancer insurance related claims.

And remember, again, as you all know, we are a dominant cancer insurance provider. And so when the world of Japan health care moves to more outpatient treatment, that has material implications for your cancer claims and how they trend over time. So this is why, despite all of the comments around COVID claims and increases in medical claims, you still see a low benefit ratio in Japan even by historical standards. There's no guarantee of that direct correlation, but it's certainly what we have seen in the data thus far.

Operator

The next question will come from Tom Gallagher of Evercore ISI.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

First question, back on the floating rate portfolio. The -- so the $12 billion floating rate portfolio in the transitional real estate, Eric, how do you feel about the quality of those portfolios if we do enter into a recession? Would you expect the higher yield you're getting on to keep the higher yield on a net basis? Or would you expect some portion of that is going to be given back through impairments? And are you looking to grow that portfolio or you're keeping it steady?

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

Sure thing. And Tom, actually, since we have Brad Dyslin on the call, who's my deputy but also in charge of credit, I'm going to shift that question over to Brad.

Bradley Dyslin

Thank you, Eric. And thank you for the question, Tom. We're definitely paying very close attention to both of these portfolios. As I think Fred mentioned in his opening comments, we think this is where as the economy slows down, we could see the first sign of any issues. We're really focused, as you would expect, on their ability -- especially in our middle-market loan portfolio, their ability to pass along these cost increases and absorb higher financing costs.

We've worked very closely with our managers. We stressed the portfolio for some very severe outcomes, and we think any potential loss is going to be very manageable. When you look across the space, we feel we have a relatively high-quality portfolio across middle-market lending. It's all first lien. We have modest leverage. It's a very well-diversified portfolio.

We think there's some inherent characteristics that allowed us to perform well during COVID, and we -- the COVID shock, and we think it will continue to support the portfolio with a downturn. Now of course, we don't expect to come through entirely unscathed. We would be surprised that we didn't have a few losses if we get the kind of downturn that is possible. But we don't expect it to be overly material.

In the real estate portfolio, again, it all boils down to the quality of assets you underwrite, the leverage you have, and in the case of transitional real estate, how well we underwrite the actual transition of the asset, the strength of the sponsor and the strength of the business plan. Again, we stressed this portfolio with our managers and we feel really good about how we're positioned and don't currently expect we'll have any losses in real estate. But of course, we're keeping a very close eye on it.

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

Tom, I would also just add to Brad's remarks. Just as a reminder, for our TREs and middle-market loans, these are first lien, senior secured assets. We take a more conservative approach to those asset classes. We definitely earn higher yields and spreads, but that's to offset the risk that we're taking. The other reminder is just from a financial standpoint, we do take a CECL reserve for these asset classes. And those are, generally speaking, based on long-term historical default rates.

Based on Brad's comments and our actual expected performance, while certainly we won't come out of this unscathed, my suspicion is we will outperform those CECL reserves. And in essence, while there could be some losses in the future depending on how deep a recession is, how long it will be, it will be much better performance than the expected CECL reserves that we've taken already.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Okay. Just one quick follow-up. The U.S. earned premium is still modestly declined despite the sales recovery and some improved persistency, and I know there's a bit of a lag here in terms of how that earns in. But based on what you're seeing now, would you expect earned premium to begin to grow again in the second half and then maybe pick up in 2023?

Max Kristian Broden
Executive VP & CFO

We would expect an improvement throughout the year and then that it really picks up in 2023 as lapses come down and we continue to see sales growth.

Operator

The next question comes from John Barnidge of Piper Sandler.

John Bakewell Barnidge
Piper Sandler & Co., Research Division

Can you maybe talk about foot traffic in shops in Japan in 2Q versus 1Q? Because I know that's a metric you've discussed previously.

Frederick John Crawford
President & COO

Are you talking about our walk-in shops and shop traffic? Is that the question?

John Bakewell Barnidge
Piper Sandler & Co., Research Division

Yes, that's correct.

Frederick John Crawford
President & COO

Yes. I think I would ask Yoshizumi-san in Japan to answer that question. I don't have that data right in front of me. Yoshizumi-san, do you have any data on the level of traffic through our retail shops?

Koichiro Yoshizumi
Dep. President, Dir. of Sales & Marketing and Dir. Alliance Strategy - Aflac Life Insurance Japan

Thank you, Fred. [Interpreted] Let me answer the question. This is Yoshizumi. Well, the number of customers in-store or the shop in the second quarter was at the same level as the previous year, and which indicates a recovery from the first quarter when we had a negative 9.3%. That said, this figure has not yet returned to pre-COVID-19 levels, and we will continue monitoring the trend in the number of visiting customers. That's all for me.

Operator

The next question comes from Michael Ward of Citi.

Michael Augustus Ward
Citigroup Inc., Research Division

I just wanted to expand on the concept of delayed cancer screenings. I think Dan was actually talking about this on CNBC this morning. But just wondering if you could maybe give an update on what you're seeing in terms of cancer severity and the impact -- potential impact from delayed screening in the U.S. and Japan?

Daniel Paul Amos

Chairman & CEO

Well, I mentioned it on CNBC when I was talking to Joe. And we have not seen an enormous jump of any kind that was not actuarially computated. So we're falling within our ranges. Saying that, it's now getting -- from the original, it's getting out to be 2.5 years it's been. So I think the chances are less and less as we move forward. But at the same time, it's just to show you how you don't know what you have ahead of you. And -- but all of our tracking says that we should have seen more if it was going to really spike by now. And I've got a guy that knows all the actuarial computation is shaking his head, that's correct. So that's the answer.

Max Kristian Broden
Executive VP & CFO

One thing I would add to that answer is that we have seen first occurrence coming back to more normal levels. And obviously, that tends to be -- should be a leading indicator for our overall total cancer claims. So overall, we're still running a little bit low where we would expect to be in the low pre-pandemic levels, but in component of first diagnosis and first occurrence, is generally back both in the U.S. and in Japan to more normal levels.

And we've said before and we still expect that there is sort of a level of cancer out there to be detected within our policyholder base that we think will come our way at some point. We just haven't seen the full impact of that yet. And all of that is incorporated in our guidance for benefit ratios going forward.

Daniel Paul Amos
Chairman & CEO

But I think most people that were going to the doctor and, whatever, they were having checkups, are now back to normal. And it's been going on probably for a year or so. So we feel pretty good about those numbers. And that's one reason we said, overall, we feel good about even the issue in Japan regarding the government's move here and how we can handle those claims. So we feel well positioned.

David Young

All right. Thank you, Mike, and thank you, Andrea. I believe that was our last question, and we're a little past the top of the hour. I want to thank you all for joining us. I hope you'll mark your calendars for Tuesday, November 15, for our financial analyst briefing. And we look forward to seeing and talking to you then. Until then, please reach out to Investor and Rating Agency Relations with any questions that you may have, and we look forward to talking to you soon. Take care.

Operator

The conference has now concluded. Thank you for attending today's presentation, and you may now disconnect.
[Portions of this transcript that are marked [Interpreted] were spoken by an interpreter present on the live call.]