S&P Global
Market Intelligence

Aflac Incorporated NYSE:AFL

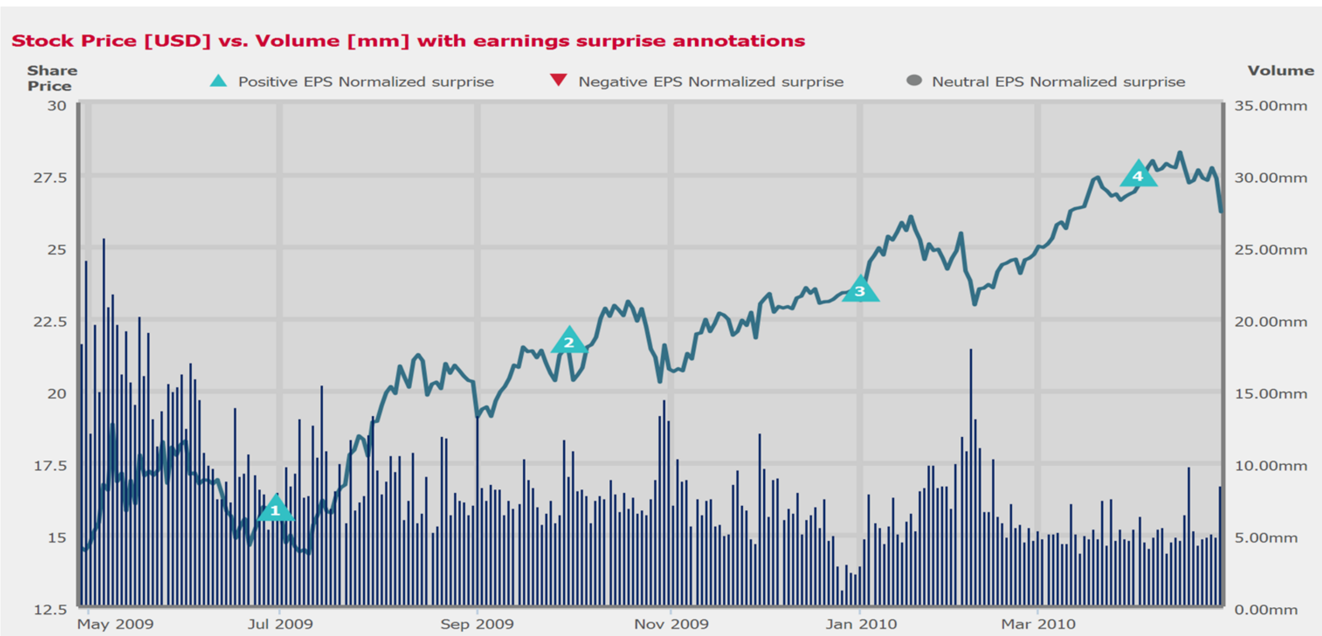
FQ2 2010 Earnings Call Transcripts

Wednesday, July 28, 2010 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2010-			-FQ3 2010-	-FY 2010-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	GUIDANCE
EPS Normalized	0.67	0.68	▲1.49	0.68	2.73	2.67
Revenue (mm)	5035.35	4980.00	▲(1.10 %)	5175.79	20562.55	-

Currency: USD
Consensus as of Jul-28-2010 1:51 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2009	0.56	0.60	▲7.14 %
FQ3 2009	0.60	0.62	▲5.00 %
FQ4 2009	0.58	0.59	▲1.72 %
FQ1 2010	0.66	0.70	▲7.58 %

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Call Participants

EXECUTIVES

Charles Lake

Dan Amos

Jerry Jeffery

Ken Janke

Kriss Cloninger

Tohru Tonoike

ANALYSTS

Andrew Kligerman
UBS

Colin Devine
Citi

Edward Spehar
Bank of America

Jeffrey Schuman
KBW

Jimmy Bhullar
JPMorgan

Nigel Dally
Morgan Stanley

Randy Binner
FBR Capital Markets

Steven Schwartz
Raymond James

Presentation

Operator

Good morning and welcome to the Aflac's second quarter earnings conference call. Your lines have been placed on listen-only until the question-and-answer session. Please be advised today's conference is being recorded.

I would now like to turn the call over to Mr. Ken Janke, Senior Vice President of Investor Relations. Sir, you may now begin.

Ken Janke

Thank you, Tray. Good morning, everybody, and thanks for joining us for our second quarter conference call. With me today in Columbus are Dan Amos, Chairman and CEO; Kriss Cloninger, President and CFO of Aflac Incorporated; Paul Amos, President of Aflac and Chief Operating Officer of our US Operations and Jerry Jeffery, Senior Vice President and Chief Investment Officer. From Tokyo we are joined by Tohru Tonoike, who is President and COO of Aflac Japan.

Before we begin, let me remind you that some of the statements in this teleconference are forward-looking within the meaning of federal securities laws. Although we believe these statements are reasonable, we can give you no assurance they will prove to be accurate because they are prospective in nature. The actual results in the future could differ materially from those we discuss today. So I'd encourage you to look at our quarterly press release last night for some of the various risk factors that could materially impact our future results.

With that, I'll turn the program over to Dan who will talk about the quarter and our outlook for the year and I'll follow up with some highlights, and then we'll take your questions. Dan?

Dan Amos

Thank you, Ken. Good morning and thank you for joining us today. I'm pleased with Aflac's overall financial performance in the second quarter. Now, half the year behind us, I believe we've established a solid foundation toward achieving our annual operating earnings goal and capital strength objectives.

Let me start this morning's call with a review of the insurance operations beginning with Aflac Japan. Aflac Japan produced strong financial results for both the second quarter and the first six months of the year.

We experienced good improvement and premium income growth reflecting our strong sales over the last several quarters. In addition, our pre-tax profit margin continue to expand as expected resulted in solid earnings growth for the quarter and for the first half of the year.

I was especially pleased with continued sales momentum in the second quarter. Total new annualized premium sales in yen were up 12.6% for the second quarter to ¥33.9 billion, which was a record for the second quarter production. For the first half of the year, total annualized sales rose 11.4%.

You'll recall in March of 2009 we introduced the child endowment policy, which is a popular means in Japan for savings for children's future education. Since that time, child endowment has done solid job.

Not only does our product feature the highest return ratio in the industry but we successfully link the marketing of our child endowment product to the new government subsidy that was first sent in June to families with the age of children of 15 of younger. This strategy has been especially effective in bank channel.

As a result, ordinary life emerged as our number one product category in the second quarter with child endowment accounting for about half of the ordinary life category.

Although child endowment product has a lower profit margin than the health products, the premium is almost three times higher than our cancer or medical products. As such, it's a solid contributor to both the top and bottom lines. Because of the relevance, simplicity and universal appeal to families with young children, we expect our child endowment product to remain an important part of the life insurance sales category.

Medical sales also remain strong and rose 23.5% in the second quarter. This increase was largely attributable to the successful revision and the promotion of our popular medical product ever.

As you know, maneki-neko duck or cat duck advertising campaign became an overnight sensation in Japan last year. We have shifted some of the promotional spendings from maneki-neko advertising to support other new product introductions. So even so the popularity of the advertising featuring the maneki-neko duck remains effective in generating sales.

In addition to product development and the expansion of our traditional sales force, we've established a very strong position with the bank channel. We continue to have significantly more bank selling our third sector products than any other insurer operating in Japan.

At the end of June, Aflac was represented by 354 or 88% of the total number of banks in Japan. Our estimated market share for cancer and medical sales was combined at 60% in the second quarter.

As we expected, we continue to experience strong sales gains through the bank channel. Sales in the second quarter were a record ¥3.9 billion, which represents a 177.7% increase over the second quarter of 2009, and a 26% increase over the first quarter of this year.

In June, we introduced a revision to general EVER, our nonstandard medical product. This new product offers more benefits than the original nonstandard medical product that we rolled out in 2007. We believe it will continue to meet the needs of the consumers who cannot qualify for our base EVER plan.

We also introduced a product called Corsage in June, which is a female-specific rider to cancer insurance. In Japan, young women are more likely to suffer from cancer than young men. Corsage provides benefits that address the early detection of cancer and the high cost of female-specific cancers.

As the No. 1 provider of cancer insurance in Japan, we believe this new product will get consumers' attention or the strengthening our brand and most importantly provide valuable benefits to the consumers who are looking for solutions to cancer-related costs.

Following very good news results in 2009, I am thrilled by Aflac Japan's marketing and sales execution this year. We have developed a strong and balanced product line, which we have continued to enhance. Our distribution system is also performing very well and we are especially pleased with the sales momentum in the bank channel.

Clearly, we are significantly ahead of our annual sales objective of 0% to 5% increase in sales. However, let me remind you that the second half of the year becomes much more challenging in terms of sales comparisons. That's especially true in the fourth quarter when we'll be going up against a 15% increase in sales resulting from the successful introduction of the new EVER product.

As we discussed, we're also expecting much lower sales contributions from our largest telemarketing-based agencies and Dai-ichi Life for the full year. Yet, I remain confident that Aflac Japan will achieve its sales target for the year. We continue to believe Japan is a vast market for protection products and we believe we will retain our number-one position within the third sector products.

Now let me turn to our US operation. From a financial perspective, Aflac US continues to perform at expectations. Although, weaker sales have slowed top line growth somewhat over the last few years, we've experienced a significant improvement in persistency compared with the first quarter and a year ago. In addition, with lower benefits and expense ratios in the quarter, we produced a sharp increase in pre-tax operating earnings.

As have been the case in the US market for the several years, we continue to face sales challenges. Aflac US sales were again impacted by difficult worksite conditions related to the weak economy.

Total new annualized premium sales in the second quarter were $333 million or at 2.4% lower than a year ago. We did have two additional production days in the quarter from last year which benefited our sales growth by 2 percentage points.

For the six months, sales were 6.3% lower than a year ago. As you likely know, businesses with fewer than a 100 workers have traditionally been our bread and butter, accounting for about 90% of our total payroll accounts.

In stronger economies, small businesses help drive economic growth. But today, these small businesses have proven to be especially vulnerable to the recession. Repeated reading from the Indexes of Small Business Optimism that are lower than 90 has been unprecedented in survey history, yet that's exactly what we have been facing.

The overall lack of employment growth has been leaving our associates with fewer employees to call on during reenrollments. As we've discussed, this has been especially true with veteran agents who account for 70% of our sales in Aflac U.S.

The employees are still employed and accessible to our sales associates are likely to be cautious about increasing their spending on voluntary insurance products in the time of uncertainty. However, as I mentioned at the Analyst Meeting in May, we've seen data that suggests veteran agents are doing somewhat better than a year ago.

Historically, we've counted on our ability to expand distribution through recruiting to offset the impact of the weak economy. As we discussed on our first quarter conference call, we've had record recruiting in the first half of 2009. At that time, we targeted significant number of people who've just been laid off from large employers.

We also rely heavily on the Internet recruiting. Those recruits were successfully generating large number of new agents, but not necessarily the quality or long-term potential of candidates we've historically hired in the past.

Reflecting the difficulties of the comparison to last year's results, recruiting was down sharply again in the second quarter, although it was fairly consistent with our expectations.

To improve our recruiting results in the second half of the year and beyond, we have shifted the bonus structure from our state and regional coordinators from one that based entirely on sales to a structure that incorporates the people-driven development component. We've also initiated a national recruiting contest that will help producers recruit.

In addition, we've been a rolling out a recruiting workshop that focuses on improving coordinator productivity through recruiting candidates interviewing and contract acceptance.

Beyond just expanding the size and capabilities of our traditional sales force, we're excited about the opportunities to broaden our distribution by pursuing and strengthening the relationship with insurance brokers.

In January of 2009, we launched Aflac for Brokers and began building the infrastructure needed to support our expansion in the broker market. Although our entry into the distribution outlet is fairly recent, our efforts are translating into sales. Total broker sales were up 43.1% in the second quarter. On a pro forma basis, including Aflac Group in the second quarter of 2009, broker sales were still up 9.5%.

We're convinced that Aflac Group Insurance is the right component to our core strategy of enhancing product line and expanding our distribution. We believe the addition of the Group product platform is an important piece to give the brokers the type of products they know and prefer. At the same time, we expect group products to enhance our sales opportunities for our traditional sales force of individual associates.

Our 2010 sales objective for Aflac US enable officers to earn a small bonus if sales were flat to down 5% in the first half of the year with the portion only being paid if sales then were flat to up 5% in the second half. Clearly, a decrease of 6.3% did not meet the bonus objectives for the first half of the year.

For the third quarter, we expect sales to be down compared with a year ago. We still hope to see sales improvement in the second half of the year, but we believe sales are more likely to improve in the fourth quarter.

For that to occur, we need to see veteran agents do well in their account reenrollments later this year. We need to see solid results from our current recruiting activities. We need to see continued positive of the broker distribution and successful of the sales of group products and, of course, it would be nice to see the confidence improve for employers and employees, as well as some strengthening in the labor market.

Although, our sales outlook for Aflac US remains cautious in short term, our view on the US market has not changed for the long term. We believe the US provides a vast underpenetrated market for our products.

And following the passage of Healthcare Reform earlier this year, we believe employers and consumers will better understand the need for our products just as they have in Japan. We also believe that brokers will increasingly view Aflac's products as meaningful, relevant and beneficial to their business and beneficial to their clients' needs.

Overall, we're pleased with Aflac's consolidated financial performance in the second quarter and the first half of the year, excluding the benefit of the stronger yen, operating earnings per diluted share rose 10.8% in the second quarter, and 11.2% in the first half of 2010. That keeps us on track for achieving our earnings growth objective for this year.

We also remain pleased with the quality of our balance sheet and our capital position. As we discussed, we do not believe a massive re-risking or restructuring of our portfolio is likely or necessary. However, you'll recall that we've indicated that we would selectively de-risk if opportunities arose or if the credit view of a specific holding changed. That is precisely what happened in the second quarter.

As we announced in June, we exchanged a perpetual upper Tier II security of European financial institution for a higher-rated fixed maturity senior debt instrument. We also reduced our perpetual holdings of another European bank through a privately-negotiated transaction.

In addition, we sold our entire holdings of the Greek sovereign debt. Through these three transactions, we enhanced the quality of the balance sheet and our risk-based capital ratio. Maintaining an RBC ratio remains a priority for us, and you'll recall that this is a primary component of the management incentive plan for all officers.

Our official objective for 2010 is to maintain a ratio in the range of 375 to 475. However, we plan to work toward finishing 2010 with a higher RBC ratio than the year end of 2009, a ratio of 479. Based on the preliminary statutory numbers, we estimate that our risk-based capital ratio exceeds 560 at the end of June, compared to 539 at the end of the first quarter.

Historically, our strong capital generation has allowed us to maintain a policy of increasing the cash dividend in line with our earnings growth before the effect of the yen.

As I have conveyed over the last several quarters, we would like to return to that policy, when we believe it's prudent to do so, extending our lengthy record 27 consecutive annual increases in the cash dividend that it is important to us and to our owners.

Along those lines, I fully expect the Board of Directors to approve a modest increase in the cash dividend effective with the fourth quarter of this year. Additionally, we continue to believe that share repurchase is an effective means for enhancing shareholder value.

As you know, we have taken a conservative approach during the financial crisis by focus on capital preservation. I'm still convinced it makes sense to maintain a high degree of conservatism given the economic uncertainties around the globe. However, with the year generally developing as we had hoped, it's increasingly likely that we will resume our share repurchase activities in early 2011.

As I'm sure you know, the other primary component of the officers' management incentive plan is to grow operating earnings per diluted share before the impact of foreign currency. In that regard, I think it's reasonable to see our operating earnings per share up 10% this year before the impact of the yen.

That result would be consistent with our objective of a 9% to 12% increase this year. Our objective for 2011 remains the increase of 8% to 12% in operating earnings per diluted share before the impact of the yen.

As we look to the balance sheet of this year and beyond, we continue to believe that Japan and the United States each have characteristics that make them ideally suited for the products we offer.

Aflac has earned the distinction of being the best branded company for voluntary supplemental products in each country. Importantly, both markets offer opportunities for growth. In pursuing our growth objective it's clear that we continue to face challenges, particularly in the United States.

However, our business is strong from an operational perspective and we have confidence in our business model and our people. We also have the strength in our balance sheet that will allow us to continue to build the promises that we've made to our customers and the expectations of our shareholders. Ken?

Ken Janke

Thank you, Dan. Before we get to your questions, let me share with you just a few of the financial highlights for the quarter beginning with Aflac Japan.

In terms of revenues in yen the top line grew at 3.2% for the quarter. Investment income rose 3%. The persistency rate actually improved a bit in the quarter and for the first half of the year on an annualized basis, the persistency rate excluding annuities was 94% compared with 93.9% a year ago.

In terms of the quarterly operating ratios, the benefit ratio continued to improve over last year and was 59% in the quarter compared with 60.4% a year ago. The expense ratio for the quarter was unchanged at 19.9%. Reflecting the lower benefit ratio, pre-tax margin rose from 19.7% to 21.1% in the quarter. With the expansion of the margin, pre-tax operating earnings increased 10.8% for the quarter in yen.

For the quarter, we invested our cash flow in yen securities at an average rate of 2.55% and including dollars, the blended new money rate was 2.77%. The portfolio yield stood at 3.71% at the end of June, which is down 4 basis points from the end of March and 14 basis points lower than a year ago.

For Aflac U.S., revenues rose 5.1% for the quarter. As Dan mentioned, the persistency rate improved significantly and was about 74% for the quarter. The annualized rate for the six months was 71.1%, up from 69.6% a year ago.

For Aflac US operating ratios, the benefit ratio was 51% compared with 51.6% a year ago. The operating expense ratio decreased from 32.3 to 31.3 due to lower DAC amortization related to the persistency improvement.

The profit margin for the quarter was 17.7%, up from 16.1% a year ago. As a result, pre-tax operating earnings rose 15.0% for Aflac US in the quarter.

The new money rate for Aflac US investments was 6.11%, down from 7.45% a year ago. The yield on the portfolio at the end of June of 7.04%, down 2 basis points from the first quarter and 18 basis points lower than a year ago.

Looking at some other segment or line items. Non-insurance interest expense in the second quarter was $31 million compared with $17 million a year ago, which reflects our debt issuance in 2009.

Parent company and other expenses rose from $6 million to $16 million in the second quarter of 2010. I'd point out that parent company expenses were unusually low a year ago. In addition, the higher parent company expenses reflected lower realized foreign currency gains and also lower parent company investment income compared with the year ago.

Total company operating margins rose reflecting the improved profitability of both Aflac Japan and Aflac US. The pre-tax margin rose from 18.2% to 19.3%. The after-tax margin increased from 12.0% to 12.6%. On an operating basis, the tax rate was slightly higher at 34.7% compared with 34.2% a year ago.

Net earnings per diluted share for the quarter were $1.23 compared with $0.67 in 2009. Total net realized investment losses were $0.12 compared with $0.53 per share in 2009.

Before the impact of ASC 810, we had a realized investment gain of $8 million or $0.02 per diluted share in the second quarter. We realized investment gains of $81 million in a quarter from the exchange of two perpetual securities, the sales of our Greek sovereign debt resulted in an after-tax loss of $67 million. We also had $6 million of other losses on smaller transactions.

The impact of ASC 810 produced an after-tax loss of $66 million or $0.14 per diluted share. That loss was attributable to the valuation of foreign currency interest rate and credit default swaps. I'd point out this is a GAAP-only issue and has no impact on our Japanese financial results or our US statutory results, and the bonds related to those swaps were in an unrealized gain position at the end of June.

As reported, operating earnings per diluted share rose 12.5% to $1.35. The stronger yen increased operating earnings by $0.02 per diluted share and as Dan mentioned excluding the effect of the yen, earnings were up 10.8% for the quarter.

In terms of the outlook for the balance of the year, as you've heard, we've affirmed our objective of 9% to 12% increase in operating earnings per diluted share before the effect of the yen this year, although as Dan mentioned at our Analyst Meeting again today, we expect that the full year will be close to 10% increase for the full year before currency fluctuations. That would equate to $5.34 for the full year assuming no change in currency from last year's average rate.

If we achieve the 10% increase and the yen average is 90 for the balance of the year, we would expect operating earnings to be $5.44 for the full year, and using that same foreign currency rate assumption, we would expect third quarter operating earnings to be $1.35 to $1.38. I'd note that our current first call estimate is $1.36.
We'd now be happy to take any questions that you have. Again, if you would, please try and limit your question to one, so we can get through everyone that has a question, and Tray, I'll turn it back to you.

Question and Answer

Operator

(Operator instructions). Our first question does come from Andrew Kligerman of UBS. Your line is open.

Andrew Kligerman
UBS

With regards to the child endowment product, there was a change in control and there was also a talk about the benefit of moving from 13,000 yen per child to 26,000. What do you think the probability is now given that change in the diet? And then just following along those lines, clearly your sales were extremely strong in that product line. Do you think that given that you introduced it in March of '09 that the momentum will continue?

Dan Amos

I'd like Charles to answer that.

Charles Lake

The political outcome of the election is in many ways going to lead to the initial policy decision that led to the payment whether it'd be expanded to double the amount or not, that is up in the air, because of the outcome of the election. The question also affects the fiscal discipline of the budget and so on, and that is going to be the subject that'll be debated in the coming session. So no decision has been made on that.

Andrew Kligerman
UBS

Charles, can you handicap it or give us a little sense of how you feel which way it's going to go?

Charles Lake

Watching Japanese politics over the years, I definitely am not going to be handicapping it. But one thing I should say though is that, this was one of the most important key promises and goals that DPJ, Democratic Party of Japan, has articulated, and as you know, despite the Upper House election outcome, the Lower House election that resulted in the strong majority for the Democratic Party of Japan will maintain DPJ in power until another election is held in the Lower House. So you can expect that DPJ will want to try to maintain as much as possible this program, because it was such a key aspect of their initial policy execution.

Andrew Kligerman
UBS

And then the growth?

Charles Lake

The growth in the amount you mean?

Andrew Kligerman
UBS

No, no, no. I mean the growth in the product sales.

Dan Amos

I think, Tohru, may want to comment, but I think the growth is going to continue for some time, certainly through this year, because it's really just kicked off in June with them receiving funds, and so the driver has really been the bank channel of this product. So, Tohru, do you have any other comments about it?

Tohru Tonoike

No. I agree with you that we have been seeing a steady growth of the child endowment fund this year. So we have no reason to think that that momentum would change in the near future. I expect to see a relatively strong sales of this product going forward.

Andrew Kligerman
UBS

And then the follow-on is just given that you mentioned the margin of this product is lower but the premiums are 3x, I don't know if this is the question for Kriss. Well, you've seen steady increases in the Japanese benefit ratio for so many years, does this signal the beginning of that leveling of the benefit ratio or maybe even a decline in the improvements?

Kriss Cloninger

Andrew, it will put a bit of a drag on the benefit ratio itself. The underlying improvement in the health product benefits will not be affected by this child endowment. The increase in total profit is a function of the increase in revenues and the change in the margin. So what we're doing here is increasing revenues faster than we were and we're accepting a slightly lower margin, but we are improving the overall profitability of the company in aggregate. We're adding value to the company. So there is a little give and take between revenue growth and margin expansion. But in all, the profits are going up.

Operator

Our next question does come from Nigel Dally of Morgan Stanley. Your line is open.

Nigel Dally
Morgan Stanley

Great. Thanks and good morning, everyone. On the US recruiting, I know it's a tough year ago comparison, but still somewhat weak results in the high unemployment rate. Hoping to get some color on why we're not seeing more recruiting in the current environment.

Also, is it possible for you to provide an early rate on which is the new bonus structure to promote recruiting is having the desired impact? I know it wasn't in place for the full quarter, but any initial color on whether the program is meeting your expectations would be helpful. Thanks.

Dan Amos

Obviously, recruiting comparables were extremely difficult. When you look at the quarter sequentially in terms of total recruits, the number fell lower than we had hoped, but in line with our expectations from a total bandwidth standpoint. The lack of coordinators that we mentioned in the previous quarter's call definitely had an impact on the total recruiting.

And honestly, in terms of what I'm hearing out there from some people across the country the continued extension of unemployment benefits is having some adverse effect. People believe that if they go out and take a commission-only job, they're going to lose their unemployment benefits and the continued extension of doing so has provided many people to believe that they're going to continue to be able receive those benefits for an undetermined period of time, so that has had some adverse effect based on what I'm being told.

In terms of the bonus structure itself, we do believe that it's grasping hold. As any bonus change, it takes some time for people to understand it and what all it means to adjust their business accordingly. I believe we began to see that adjustment in the second quarter. We'll continue to see it in the third quarter and I hope to begin to see incremental improvement in our recruiting numbers.

I think that the things that we mentioned that we're doing, the recruiting context, the additional training, the bonus structure change, all will begin to take an effect. Can you give you a direct answer on how quickly that will turn? No, I cannot. 13 weeks is just too shorter timeframe to really give you that turnaround, but I do expect in the coming quarters that recruiting will begin to turn and become better results than what we're seeing today.

Operator

Our next question does come from Jimmy Bhullar of JPMorgan. Your line is open.

Jimmy Bhullar
JPMorgan

Thank you. Good morning. I had a question on the capital deployment. Your RBC obviously slightly north of 560%. I think by year end it could get close to 600%. So assuming stable macro trends, how much are you likely to deploy towards the buybacks next year? Would it just be the capital that you generate next year or would you also draw down on your RBC ratio?

Kriss Cloninger

Well, we've been patient in building capital so far this year. As you say, we're improving RBC ratio. If what you speculate comes to pay us and we end up at say around 600 at the end of the year, we'll be taking a look at it. Historically, we were on a run rate of about 12 million shares a year of share repurchase. We've said maybe 6 million shares to 12 million shares is kind of a resumption level if things continue to be stable to improve. I want to be cautious though and say we're still waiting for another quarter or two.

We like the improvement in the securities values that we've seen, the relative stabilization I think in the fair value of the portfolio and the improvement in the unrealized loss position. We also like the fact that we've reduced our exposure to perpetuals and the like over the last 12 months. So, that's maybe a little bit of a long answer to say, we intend to get back to historical repurchase levels if conditions warrant.

Jimmy Bhullar
JPMorgan

And then I just wanted to follow up on your comments on, like just the momentum in Japan and like in the child endowment product continuing. If I'd look at your sales year-to-date, I think you are up around 11.4% roughly in Japan in the first half. So obviously, comps will gets tougher in the fourth quarter, but the zero to 5% guidance, is that ultra conservative or is there some amount of conservatism built into that or was there something in the first half other than just easy comps that might not repeat in the second half?

Dan Amos

Tohru, you want to answer that?

Tohru Tonoike

Yes, I think given the result of the first six months, the sales is up by 11.4%. We are feeling very comfortable in achieving the goal of 0% to 5% for the full year. Of course, we are expecting to have a very difficult comparison, particularly in the fourth quarter that makes that gross number lower than we are seeing now. I don't see any reason why we should be expecting our sales going down further. So, in short, I think we're feeling very comfortable in achieving the goal. Maybe I could say that it is somewhat conservative, but I don't see it as future conservative, because I know that the fourth quarter last year was a very strong quarter.

Dan Amos

I'll make one other comment. The third quarter will be the telling quarter because the fourth quarter I would take flat to a small increase right now, because it was such a big quarter. It was the biggest fourth quarter I think we ever had, and we won't have the momentum of that new product and the new ad campaign, so that's the reason of our conservatism at this particular point.

Jimmy Bhullar
JPMorgan

Yes, the reason I asked is, let's say, you're 10% up in the third quarter, even with the flat fourth quarter, you would end-up up 8% for the year. So any comment you could make on your sales in the first month of the third quarter or is that too early?

Dan Amos

No, we can't do that.

Operator

Our next question does come from Jeffrey Schuman of KBW. Your line is open.

Jeffrey Schuman
KBW

Couple for Kriss, you talked about this a little bit at the Investor Day, but can you remind us really what the difference is in life margin or life ROE versus the health. I think we have the chart that shows the different benefit ratios, but it's pretty wide range and I'm not sure that maps well if you kind of bottom line margin or ROE differences. So how much really is the difference in profitability between life and health?

Kriss Cloninger

I'll tell you the average expected margin on the health products is probably in the 15% of premium neighborhood. The traditional ordinary life is around 10%. The child endowment is somewhat intro sensitive, and it's priced at 1.85% assumption. If we are able to earn 2.5%, the profit margins around 5% of premium, if we're able to earn 3% new money, the profit margin increases to about 9%.

So you can see it somewhat less than traditional ordinary life, but the premium is significantly higher, so the profit for policy-written is comparable to the health policy. But as I said, on average it's going reduce the overall margin of the business a little bit, but it's going to grow the revenue faster, and it's going to add to the profitability of the overall block, so I hope that gives you a sense.

Jeffrey Schuman
KBW

Yes. It's very helpful on the margin and then if we're translating to ROE, is it proportionate? In other words, if the historical traditional life policy was 10% margin and health was 15%, at two-thirds, I mean is the ROE also two-thirds or not?

Kriss Cloninger

Well, I hesitate to ask, because we don't use ROE as a primary driver of our pricing and profitability analysis. We do look at how much capital we have to invest in each product category and I try to make sure that the capital investment required from a regulatory reporting point of view is similar or that no product presents a particular capital drain on us.

I want the capital investment for each product to return within a reasonable period of time. Generally, it's less than five years. Most products, it's less than two years, because I don't want to have to allocate sales based on committed capital. So we try to avoid doing that and that's just not a primary focus that we have. To us, return on capital is a byproduct of our primary pricing algorithm of looking at return on premium.

Jeffrey Schuman
KBW

And then just lastly a quick follow-up on Jimmy's question on the share repurchase. I think if you get back to 12 million shares, the current price is at $600 million, dividend is $500 million-ish, net earnings at $2 billion-ish, I guess we need to budget for debt service in there. But if you get back to 12 million shares, it would seem that you would still be building capital. I mean is that the simple correct math? Or is that still where you'd be heading in 2011 is just the build capital?

Dan Amos

Yes, I think so. Our interest expense is higher than it has been, because we've had to use dollar debt instead of yen debt, and that slowed growth a bit, but yes, you're in a ballpark with those kind of numbers and we're still going to be cognizant that there is still some potential downgrades out there and the like that could impact RBC through higher capital requirements.

Quite frankly, we're keeping an eye on any changes to the solvency margin requirements in Japan because we have not only RBC to watch but we've also got solvency margin measures on the FSA reporting basis that we have to pay attention to. We're in good shape with that now. We are over 939% or so and that's okay for the big Japanese life operations, but we are not in the upper half of those solvency margins and I still want to make sure that we are in good shape from a Japan reporting point of view too. So, that's something we haven't talked about a lot, but it's an element of the equation that's out there.

Jeffrey Schuman
KBW

Thanks a lot.

Operator

Our next question does come from Colin Devine of Citi. Your line is open.

Colin Devine
Citi

Good morning. I was wondering if we could talk a little bit about the investment portfolio, Kriss. First, just to clarify on the sale of perpetuals in the second quarter, what the statutory impact was? And also, I know you reported the capital gain on the sale, but unless I'm mistaken weren't those previously impaired positions, so it was more of a recovery on a prior write-down than a gain on selling those?

And then I guess, I want to understand what happened between the end of the first quarter and I suppose early June that caused you to sell the HBOS piece locking the lives and why you hadn't impaired that on a statutory basis earlier and if you're now starting to reexamine your policy of not impairing the perpetuals on a statutory basis.

And then, if we could also just focus on how you're looking at your impairments? Unless I'm mistaken, there is about $1.2 billion of investments you're carrying today that are trading I guess on average through positions at about a third of their carrying value, is that the other issue that's out there that could put some very real pressure on your statutory RBC ratios?

Kriss Cloninger

There are a lot of questions there, Collin. Let me start and I may ask Jerry Jeffery to chime in with some details. But first, relative to our impairment policy on statutory, that's credit oriented. We carried most of our debt securities on an amortized cost basis for statutory purposes until we have reason to believe that they are impaired from a credit perspective.

As you know, GAAP requires us on our perpetual holdings to use an equity-oriented impairment method, where if the security is trading below par value by a certain percent for a fixed amount of time, then we're compelled to recognize another temporary impairment for GAAP purposes. But that can occur even if we believe that we're going to get all our money back on these securities.

Now, you mentioned some securities trading at significant discounts to par that we haven't written down for statutory and specifically those are probably the three Greek banks that we continue to hold.

And as we'll report in our 10-Q, we've done our own stress testing and credit analysis on those three Greek banks assuming some level of restructuring of the Greek sovereign bonds, and in our opinion, those banks will continue to be financially solvent and able to service their debt to us. So, we don't see the need to write down those securities for statutory purposes.

Let me go back to Jerry for comments relative to HBOS. It's true that the capital gain that we realized on a couple of the perpetual exchanges we did in the second quarter generated a capital gain for GAAP because we had previously impaired them, and they generated a capital loss for statutory, but let me ask Jerry for comments maybe on the details of that.

Jerry Jeffery

Yes, Colin, just to talk a bit about what prompted the exchanges and the sale. In the case of the two exchanges that Ken described earlier, well, the one exchange that took place in the second quarter was, it enabled us to move up in the capital structure and it also actually gave us a net increase in investment income. So that was an extremely compelling situation and it improved our overall portfolio condition.

In terms of the HBOS, the decision to sell was really motivated based on our concentration in that name. We're comfortable with HBOS. The particular security we sold was and is a must-pay security. So we were extremely comfortable that we would not need to impair from a statutory basis, but we did think it made a great deal of sense from a concentration perspective to sell that particular holding.

Kriss Cloninger

Reduction in concentration did benefit our risk-based capital ratio to some extent and in fact those exchanges the net result on a statutory basis was a modest improvement in RBC.

Colin Devine
Citi

Can you just clarify what the statutory loss, because I think that's the bottom line here rather than reporting it as a gain? When it's all said and done, what did you loose on the HBOS position and I guess I'm not clear why it wasn't impaired in the first quarter on a statutory basis since you made the decision to sell it.

Kriss Cloninger

Well, the decision to sell was made in the second quarter, Colin, not the first quarter and the statutory loss on a pre-tax basis was slightly in excess of $100 million.

Colin Devine
Citi

Finally, could you discuss the level of the low investment Greek bonds seem to be continuing to rise despite the sales that you've undertaken?

Kriss Cloninger

That percentage did increase only because of the downgrading of the three Greek banks.

Operator

Our next question does come from Steven Schwartz of Raymond James. Your line is open.

Steven Schwartz
Raymond James

Hey, good morning, everybody. Just wanted to talk quickly about Japan, particularly Corsage, I want to follow up on that. Was that introduced in June? It wasn't clear to me

Dan Amos

Yes. Tohru, you want to make any comments.

Tohru Tonoike

Yes, it was introduced in June, that's true.

Dan Amos

And it's really just getting kicked off, but conceptually, we found that the females are continuing to be the decision makers on cancer policies and therefore these writers and these new concepts are to get female's attention of what's being offered. Also at the banks, it's very positive from that standpoint, so that's the driver behind this.

Steven Schwartz
Raymond James

Just to follow up on that, my impression had been that the cancer policies were mostly bought by older Japanese, yet I think you were citing younger Japanese females possibly buying that. Was I wrong about my initial assumption?

Dan Amos

Go ahead, Tohru.

Tohru Tonoike

Yes, you're right. Historically, our older people tend to buy more cancer policies than the younger people. So we wanted to expand our sales to the younger generation, and in particular, this year, in accordance with the Japanese government promotion of the national anticancer program. Many municipalities are taking up the program and have introduced their own version of the anticancer and those movements are typically focusing on the prevention of the cancers of younger women. So our introduction, of course, is in accordance to the movement of these government promotions.

Steven Schwartz
Raymond James

And then one more if I may, on the, I wasn't quite clear Dan, your statement about the maneki-neko duck and advertising. You were saying you are moving resources, are you moving away from the maneki-neko duck or are you expanding that to other products?

Dan Amos

What I was saying is this because we've now been pushing the endowment plan, it does not have the maneki-neko duck connected to it. So it's been some shift in actually selling it a little bit more. So we are trying to find ways to keep it in product consumers because they like it.

But a lot of our advertising in Japan, if you remember, is product-specific, and it has different types of campaigns, whether it'd be that Japanese celebrities, we have a particular female that pushes the cancer product and we have a male that does some other things, so it varies a little bit. But I was just pointing out that there was a little bit of shift in that.

The only other point I want to make on that Tohru was talking about, remember the actual number of policies sold because the premium in Japan is age-specific. I mean yen basis, it's much higher because they are older in terms of premium coming in, but we've always done very well on younger ages in Japan, as well as older ages. So we've just never been skewed just older ages buying cancer policies. We've had a lot of success with 30 year olds in Japan buying our cancer policies.

Operator

Our next question does come from Randy Binner of FBR Capital Markets. Your line is open.

Randy Binner
FBR Capital Markets

I think this one is for Kriss or Jerry. But just thinking about new money yields at the Investor Day that you laid out for both Japan and U.S., new money yields, for 2010 and 2011, both in US and Japan the ten-year government bonds are yielding lower and that's a widespread concern. So I'd just be interested to think about how long we could sustain lower market yields and still adhere to the new money yield guidance you gave at the Investor Day?

Kriss Cloninger

The new money yield guidance we gave I think for Japan was in the 2.75% to 3% range. We're at the lower end of that today or actually below the lower end of that right at the moment. We did in the first half of this year though buy more JGBs and Jerry may want to comment on that. We had a several product placements that generated yields between 2.75% and 3%, but we also bought a fair number of JGBs. I'll just say that we're spending additional resources, both primarily personnel and evaluating our investment strategy and trend to look at some of the alternatives in front of us.

So, I'll say that we've been trying to look at more non-financial names for example. But one of the effects of that is to lead as to somewhat shorter duration securities than we've historically purchased from the financial names. We're looking at some other strategies to try to maintain those ranges of new money yields that I quoted in the analyst speech. Jerry, do you want to add?

Jerry Jeffery

Yes, actually one thing I should say is that, I think our new money yield forecast for Japan was 2.5% for 2010, and at the moment we are slightly ahead of that for the first six months of the year. It is true that we, I think, have adjusted approximately 60% of our second quarter new money in JGBs, and the simple reason is, we did not want to be chasing yields and taking necessary risks.

So we were still able to achieve our new money yield targets and not take what we thought were unwanted risks. Obviously, I think going forward we've got a challenge ahead of us, but our net of investment income remains on target and on budget. So, I think we are going to struggle, but as Kriss mentioned, we are looking at other ideas, some of them shorter duration ideas. There are opportunities out there and we are still hitting on targets.

Kriss Cloninger

Yes. Ken pointed out to me that I misstated the range that we presented in FAB; it was 2.5 to 3 instead of 2.75. We had reduced it this year for the first time just to reflect current economic conditions. So, I apologize for the misstatement.

Randy Binner
FBR Capital Markets

Yes. No problem at all. I guess the follow-up I would have is that if the 10-year benchmarks in both countries stayed at their current level through the end of the year, I guess not withstanding new opportunities, do you think it will be realistic to be able to hold the low end of that guidance or would it potentially have to slip?

Kriss Cloninger

I think we can still meet the guidance even with the rates where they are today. Today, they are as low as they've been in several years ever in the U.S., but notwithstanding that given what we've been able to achieve and given what I am seeing that we're confident in investing, I still think 2.5 is achievable in Japan.

Operator

Our next question does come from Edward Spehar of Bank of America. Your line is open.

Edward Spehar
Bank of America

Kriss, I want to go back to the capital discussion, and I guess, you report good earnings. I think stock is down a couple of percent I think, perhaps I have some concerns about lower margin child endowment sales, or I would suggest that maybe the market is also a little frustrated about the discussion around capital and I guess the issue is that if the math is potentially being at a 600 RBC by the end of this year, I think is reasonable. I think with the type of share buyback, you could be contemplating based on your comments a 700 RBC by the end of 2011 is potentially a reasonable expectation as well.

So I'm just wondering how do we think about this because it seems to me that have to address this capital situation at some point or else that RBC ratio was going to explode and I mean there has to be an issue for return at some point down the line, especially if some of the sales are in some lower margin businesses? Probably not a short answer, but I think it is a very important issue for everybody.

Kriss Cloninger

It's a shorter answer than you'd probably expect. I think it's unreasonable to think that we would allow RBC to explode and to have us sit on capital at a level that essentially remains parallel. We're just looking for the comfort level and then we'll turn it loose.

Ken Janke

Well, thank you all for joining us again. If you have any additional questions or follow-up, please feel free to give me a call or send me an email. Thanks and we hope to talk to you soon.

Operator

Today's conference has ended. All participants may disconnect at this time.