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Aflac, Inc. (AFL) CEO Daniel Amos on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-24-19 Earnings Summary

Press Release SEC *10-Q*

EPS of $1.16 beats by $0.09 | Revenue of $5.54B (-0.74% Y/Y) beats by $17.18M

Earning Call Audio

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Aflac, Inc. (NYSE:AFL) Q3 2019 Earnings Conference Call October 25, 2019 9:00 AM ET

Company Participants

David Young - VP, Investor & Rating Agency Relations

Daniel Amos - Chairman, President & CEO

Frederick Crawford - EVP & CFO

Richard Williams - EVP & Chief Distribution Officer

Teresa White - President, Aflac US

Masatoshi Koide - President, Representative Director & COO, Aflac Japan

Conference Call Participants

Jamminder Bhullar - JPMorgan Chase & Co.

Nigel Dally - Morgan Stanley

Thomas Gallagher - Evercore ISI

Suneet Kamath - Citigroup

John Barnidge - Sandler O'Neill

Andrew Kligerman - Crédit Suisse

Humphrey Lee - Dowling & Partners Securities

Taylor Scott - Goldman Sachs Group

Erik Bass - Autonomous Research

John Nadel - UBS Investment Bank

Ian Ryave - Bank of America Merrill Lynch

Operator

Welcome to the Aflac's Third Quarter 2019 Earnings Conference Call. [Operator Instructions]. Please be advised, today's conference is being recorded.

I would now like to turn the call over to Mr. David Young, Vice President of Aflac investor and Rating Agency Relations.

David Young

Good morning, and welcome to our third quarter call. This morning we will be hearing remarks from Dan Amos, Chairman and CEO of Aflac Incorporated, about the quarter as well as our operations in Japan and the United States. Then, Fred Crawford, Executive Vice President and CFO of Aflac Incorporated, will follow with more details about our financial results.

In addition, joining us this morning during the Q&A portion are members of our executive management team in the United States, Teresa White, President of Aflac U.S.; Eric Kirsch, Global Chief Investment Officer; Rich Williams, Chief Distribution officer; Al Riggieri, Global Chief Risk Officer and Chief Actuary; and Max Broden, Deputy CFO and Treasurer.

We are also joined by members of our executive management team in Tokyo at Aflac Life Insurance Japan; Charles Lake, Chairman and Representative Director, President of Aflac International; Masatoshi Koide, President and Representative Director; Todd Daniels, Director and CFO; Koji Ariyoshi, Director and Head of Sales and Marketing.

Before we start, let me remind you that some statements in this teleconference are forward-looking within the meaning of federal securities laws. Although we believe these statements are reasonable, we can give no assurance that they will prove to be accurate because they are prospective in nature. Actual results could differ materially from those we discuss today. We encourage you to look at our annual report on Form 10-K for some of the various risk factors that could materially impact our results. The earnings release is available on the Investors page of Aflac's website at investor.aflac.com and includes reconciliations of certain non-GAAP U.S. GAAP measures.

I'll now hand the call over to Dan.

Daniel Amos

Thank you, Dave, and good morning, and thank you for joining us. Let me start by saying that the third quarter of 2019 concluded in another strong first nine months of the year for Aflac in terms of earnings, capital generation and overall financial strength.

Financially, Aflac is as strong as we've ever been in our 64-year history. Pretax margins are stable and as strong as any in the industry. Our capital provision by any measure is robust. Our investments are high quality and diversified and we have among the highest return on capital and the lowest cost of capital in the industry. Our strong earnings results in the first nine months prompted us to upwardly revised our 2019 adjusted earnings per diluted share outlook, yet we still face some challenges to the top line. We addressed some of these challenges at the financial analyst briefing last month, and they are some was evident in the third quarter sales results.

Turning to operations, Aflac Japan, our largest earnings contributor, generated strong financial results. In the yen terms, results on an adjusted basis were better than expected for the quarter with Japan segment posting strong profit margins. Brad will provide more information. As you know, we take a longer-term perspective when it comes to our business. Our focus at Aflac Japan remains on maintaining our leadership in third sector insurance products that are less interest-rate sensitive and have strong and stable margins. At the same time, we complement this core business with similarly profitable first sector protection products.

To that end, we will continue to refine our existing product portfolio and introduce innovative new products that our policyholders want and need. We are also continuing to fully engage our wide-reaching distribution network. Our traditional agencies have been and remain viable to our success as do our alliance partners. We continue to be Japan's number one provider of cancer and medical insurance, insuring one out of four households.

As you saw in the quarter, sales for the third sector and first sector protection products were down 21.5%, largely driven by the decline in cancer insurance sales, which were down 37.7% relative to the third quarter of 2018. As we reiterated on September 30, Aflac Japan released the results of a voluntary review of cancer insurance sales through Japan Post. While this matter includes issues related to a 0.006% of policies reviewed, we know that even one issue with a policy is one too many. As such, we continue to work tirelessly and steadfastly to resolve these matters with the customers who were impacted.

As we communicated at the Financial Analyst Briefing last month, we've experienced a significant decline in applications through the Japan Post channel. Assuming a continuation of the trend to date for the rest of the year, we anticipate that sales in Japan Post channel may decline as much as 50% from a very strong 2018 given our refreshed cancer product. Keep in mind that Japan Post Holding plans to report on its investigation at the end of December. While it is challenging to have full visibility into the time line for recovery, we look forward to working with Japan Post Group to continue our efforts to provide Japan's citizens with peace of mind and financial health Aflac's cancer insurance protection offers.

With respect to Aflac Japan's medical insurance products, we began the year with a strategy to attach riders to the whole life medical product and then refreshed our existing nonstandard medical policies in June of this year. As a result, we are pleased with a 24.5% increase in medical insurance sales relative to the third quarter of 2018, and we expect a positive trend to continue into the fourth quarter.

Taking factors -- all factors into consideration, we continue to expect full year Aflac Japan third sector and first sector protection sales to be down in the mid-teens with earned premium growth in the range of 1%.

Now turning to the U.S. operations. We are pleased with the financial performance. The pretax profit margin exceeded our expectations both for the quarter and for the first nine months of the year. This is particularly significant because these results continue to reflect ongoing investment in our platform, distribution and customer experience.

With respect to sales, they too have been somewhat challenged in 2019 coming off a record sales performance in '18. The third quarter was weaker than expected. As a result, we anticipate full year results to be flat to down slightly for the year. Ultimately, we seek to grow profitable earned premium, which we expect to be in the range of 2% in 2019. There are clearly macro elements at play. Strong employment means fewer people are willing take an independent commission sales role. This dynamic continues to constrain both sales agent recruiting and ultimately, sales to some degree.

Additionally, the review of the partnership in the second quarter resulted in some short-term disruption. But keep in mind, workers continue to convey a significant need for Aflac's benefit solutions in the workplace and we are well positioned to capitalize on this opportunity. Our broker strategies are working well and we are growing at a much better rate than in the industry. We have been encouraged by the advancement in our direct-to-consumer platform and associated partnerships, which are still in the initial stages. Taking all factors into account and to put this in perspective, we expect to recover in 2020, which is important to the overall long-term health of our distribution platform.

As we said, we remain focused on initiatives designed to drive growth in both the U.S. and in Japan. Our announcement to acquire Argus Dental & Vision is a prime example of build to -- of buy-to-build strategy to do just that. This planned acquisition is also consistent with our approach to balancing our financial strength with reinvesting in our business, increasing the dividend and repurchasing shares.

Aflac historically has been known for its organic growth. However, we recognize that prudent investment is critical to our growth strategy to driving efficiencies that will impact the bottom line for the long term.

With this in mind, we look for other opportunities to accelerate growth through measured buy-to-build transactions that enhance our opportunity and core competency in supplemental insurance and leverage our powerful brand and distribution strengths without requiring extensive amounts of capital. At the same time, we remain committed to maintaining strong capital ratios on behalf of our bondholders, shareholders and policyholders. Of course, it goes without saying that we treasure our record of dividend growth.

With the fourth quarter's declaration, 2019 will mark the 37th consecutive year of dividend increases. As we move through a period of market volatility, our dividend track record is a nice reminder of the relative stability of our business model and earnings. As we communicated last year, the Board reset the review cycle of the dividend increase for the first quarter of each year and reserves the right to examine the dividend on a quarterly basis. We continued to be on track to repurchase in the range of $1.3 billion to $1.7 billion of shares in 2019. This range allows us to be more tactical in our deployment.

Looking ahead, we believe our strong earnings growth will reflect on the underlying earnings power of our insurance operations in Japan and the U.S. It also reflects on our prudent approach to deploying excess capital in a way that balance the interest of all stakeholders. As always, we are working to achieve our earnings per share objective, while also ensuring we deliver on our promise to our policyholders.

Now I'll turn the program over to Fred, who'll cover the financial results. Fred?

Frederick Crawford

Thank you, Dan. Results for the third quarter set the stage for a strong year on the earnings front. Adjusted earnings per share of $1.16 represents a 12.6% increase over the 2018 quarter. Earnings benefited from continued strong margins both in Japan and the U.S. with the year-to-date core ratios performing consistent with forecast provided at our September Financial Analyst Briefing. Our reported results were impacted by strengthening of the yen as compared to the 2018 period, increasing earnings by $0.02 per share in the quarter.

There were two notable earnings items in the quarter. We negotiated a partial call on a single legacy private placement that had been previously impaired. Thus, reducing a concentrated below-investment-grade exposure and producing outsized call income of $25 million pretax in the quarter. In addition, our building alternative investment portfolio had another strong quarter, generating approximately $8 million pretax in variable income above our planned expectations. Together, these items contributed roughly $0.03 to the adjusted earnings per share.

Turning to our Japan segment, earned premium for our first sector protection and third sector products increased 1.2%. We are focused on maintaining growth recognizing near-term weakness in the Japan Post cancer sales and to pay medical policies sold in 2017 reaching paid-up status. We are focused on the quality or value of new business in Japan and continuing to grow third sector and first sector protection earned premium. As Dan noted in his comments, we expect full year third sector and first sector protection earned premium to grow in the range of 1% to 2%.

Japan's total benefit ratio came in at 70% for the quarter. We continue to enjoy strong third sector benefit ratio trends and associated reserve adjustments. The majority of impact in the quarter can be attributed to a continued shift in business mix from first sector towards third sector, which carries a lower benefit ratio and higher expense ratio. Our expense ratio in Japan was 20.6%. We expect our expense ratio will rise in the fourth quarter with anticipated timing of technology investments and sales and marketing spend.

Net investment income contributed to our strong results of 4% in yen terms. The quarter's favorable calling come ran through the Japan segment, along with the majority of alternative investment income. The build in our floating rate portfolio over 2018 also has contributed to our results in 2019. Recall from Eric's comments at our Financial Analyst Briefing, we previously locked in approximately 75% of Japan's floating rate income and 91% of our hedge cost for 2019. Overall, in Japan, we reported a very strong pretax profit margin of 21.4% and towards the high end of our forecasted range.

Turning to U.S. results, earned premium was up 1.3%, reflecting weaker sales results and a modest decrease in persistency. We see reduced persistency as temporary and a result of a large case volatility and replacement of an administrative partner. Both impact persistency in the short run, but are designed to ensure profitable earned premium growth in future periods.

Our total benefit ratio came in at 49.1% and while at the low end of range, generally consistent with recent claims trends and our mix of business. Our expense ratio in the U.S. was 35.9%. Year-to-date, we are running below the midpoint of our range. However, we expect our fourth quarter expense ratio to come in above the high end of our range due to timing and the pace of investment in the platform. The full year is expected to remain within the range.

Net investment income in the U.S. is running a bit ahead of our plan for the year due to part -- due in part to higher allocation to corporate bonds and variable investment income. We've done a nice job of defending income in the face of lower rate environment and the reduction of excess capital in the U.S. subsidiaries. Overall, in the U.S. segment, we recorded a strong pretax profit margin of 20.6% at the high end of our forecasted range.

In our Corporate segment, the main driver of improved earnings is higher levels of invested capital and liquidity and amortized hedge income driven by corporate hedging program. Amortized hedge income contributed $21 million on a pretax basis to the quarter's earnings with a notional position of $3.5 billion.

Turning to capital, Japan's estimated solvency margin ratio remains in the 1000% range. Our estimated U.S. risk-based capital ratio is approximately 660%. We continue to target an RBC ratio of 500% in the U.S. for the year-end 2019.

We ended the quarter with approximately $3.4 billion of capital and liquidity at the holding company. Subsidiary dividends for 2019 are concentrated in the second half of the year, so we are building excess capital above our $2 billion minimum capital and liquidity policy.

In the quarter, we repurchased 5.9 million shares for approximately $310 million. There is no change to our guidance for repurchase of $1.3 billion to $1.7 billion in 2019. In terms of our EPS outlook, as Dan noted, we have revised our 2019 guidance, increasing the range to $4.35 to $4.45 per share.

Reflecting on the year, this range includes $0.05 a share of notable items that has benefited EPS thus far in 2019. While this solves for a wider range in the fourth quarter, we are assuming investment income normalizes and expenses come in at elevated levels both in the U.S. and in Japan. As we make our way through the planning process and prepare for our 2020 outlook call, I'd like to reiterate some of the key messages from our Financial Analyst Briefing and how they influenced earnings and earnings per share heading into the next year.

In terms of revenue, earned premium faces headwinds in the form of a declining book of Japan first sector savings business, the dynamic of paid-up policies impacted reported earned premium and weakness in third sector sales during the period of recovery in the Japan Post system. In the U.S., we expect sales results in 2019 and into 2020 will be a headwind to earned premium growth in the short run, but expect higher growth rates beyond 2020 as we gain traction in dental and vision and direct-to-consumer.

In terms of investment income, with derisking activities and the low rate environment, we will be working hard to defend investment income at normalized 2019 levels. We do not think it's a good time to be aggressive in the search for yield. In fact, in some cases, our efforts to de-risk the portfolio provide a bump to current earnings and reduce run rate income, for example, this quarter's outsized call income and reinvestment of proceeds. Core benefit ratios are expected to remain strong and a contributor to margins. However, investment is needed to build -- to both digitize and -- our platform and address revenue growth. Our strategy of buying to build lowers the capital at risk of large-scale acquisitions, while at the same time weighing down on margins as we invest in organic growth. For example, in the U.S., if we are successful in our direct-to-consumer and dental and vision build out, you should expect some margin pressure in the early years followed by measurable earned premium growth.

Capital generation is expected to remain strong with a building level of excess capital. This affords us the capacity to invest in growth initiatives and opportunistic investments without disrupting our plans to return capital to shareholders. Therefore, absent compelling alternatives, we see 2020 repurchase activities supporting EPS in the face of any margin pressure. In closing, earnings have performed very well throughout 2019 and again, in the third quarter, but we need to actively invest and deliver on growth. We'll spend more time on the 2020 drivers with associated detail during our December outlook call.

I'll hand the call back now to David to begin our Q&A. David?

David Young

Thank you, Fred. We are now ready to take your questions, but first let me ask that you limit yourself to one initial question and one related follow-up to allow other participants an opportunity to ask a question. We'll now take the first question, operator?

Question-and-Answer Session

Operator

First question is from the line of Jimmy Bhullar of JPMC.

Jamminder Bhullar

I had a question on first the Japan Post, then Dan or someone else, maybe if you could comment on your thoughts on whether sale through the Post will return to a more normal level within the next year? Or do you think volumes through the channel are going to be depressed for a lot longer given the negative publicity and potential changes in sales practices at the Post?

Daniel Amos

Well, of course, that's the hard -- difficult question for us to be sure about. My gut tells me that it will go back to the normal production levels because in today's world, new cycles are relatively short compared -- because there's so much news out there today that what used to be important is just doesn't last for as long. My sense is in Japan, it's quiet right now in regard to these issues until the December report comes out. When the December report comes out from Japan Post, there'll then be activity for a period of time and hopefully, they will have addressed all the issues which I expect them to do and then for it to calm down and go back.

We've seen no changes in persistency at Japan Post level that makes me think that the brand has been hurt in any way. Certainly, we know that people want these answers to their questions resolve in what did take place. But all in all, my sense is that they will go back, but when and how, I'm not exactly sure. I think it's not going to be -- remember that in December, the report will come out, probably the end of December, then you're going to have a little bit of period of time where there'll be discussions about, well, the enactment, all those issues. And so I would think first quarter still may have softness to it and then hopefully, we'll see it kick back up in the second quarter, maybe the second half, and then I'm hoping it will move back to more normal channels for the long term. Anybody from Japan want to comment on that?

Unidentified Company Representative

We do not have any additional comment.

Jamminder Bhullar

Okay. And maybe if I could ask just one more, on your U.S. sales, they've been weaker than expected in the past couple of quarters, but it seems like from your guidance, you're assuming that you'll see a pickup with the broker channel in the fourth quarter. On that channel, do you have enough insight so far, like we're halfway through the quarter already, do you have any enough insight to be confident in your projections? Or do more of the sales actually come in the later part of the year, so you'll have to sort of wait and see?

Richard Williams

As we shared at the Financial Analyst Briefing, we did experience weaker than expected sales in the third quarter, primarily driven by faster decline in average weekly producers, which is really the net effect of decline in recruiting in the first half of 2019. Some positives that we did see, we saw recruiting growth pick back up in the third quarter on top of recruiting growth in the third quarter of '18 and productivity continues to be an area of growth.

In terms of the fourth quarter and the full year, just as a point of context Dan shared, flat to down slightly for the full year. And what that would mean to get to flat is 3.3% growth in the fourth quarter. And as context, in the fourth quarter of '18, we had 4.2% growth and in the fourth quarter of '17, we had 6.7% growth. So again, we work with quarterly sales guidance, but that gives you a sense of reasonables.

Daniel Amos

One other thing, Jimmy, I wanted to point out about the brand and your interest and Koide can respond to Japan Post. But I can tell you, from our perspective, our other sales projections outside Japan Post are right on target. So we've had no deterioration in anything that we can see from a new sales perspective in the other channels.

Operator

Next question is from Nigel Dally from Morgan Stanley.

Nigel Dally

Just on Japan Post, again. I think in the past, you've been talking about 2009 as being a planning year to develop other strategic relationships or initiatives, 2020 being an execution year. Would we right to think that those initiatives are now being pushed back? 2020 is more about the sales recovery in Japan Post rather than executing on anything else to drive additional growth?

Daniel Amos

Yes, I think that's going to be the case. Koide, any comments you would like to make?

Masatoshi Koide

This is Koida. In regards to the third pillar of our strategy alliance of the four initiatives. And in terms of joint investment, be it Japan Post and, of course, with Aflac, there are some results. So there are fruitful results of the two companies, Japan Post and Aflac, making investments to start-ups in September and October and this has been publicly announced and these are to the two companies of the start-ups. And in terms of other initiatives, as we've been saying, we are still continuing to our discussion. That's all from me.

Daniel Amos

But Nigel, one thing I will say is, it's pretty obvious, but first half will be the biggest challenge because we're going against the hardest comparisons. And the second half going to be relatively easy with Japan Post, because were going against such poor sales in the third quarter and we expect it to continue into the fourth quarter.

Nigel Dally

Great. Second quarter question kind of related. Just the regulatory response to Japan Post. Clearly, the regulators have been involved throughout this process, but are you hearing anything from the regulators that would suggest that they're trying to push forward some changes in the way that insurance products are generally distributed that could have an impact on your distribution channels going forward?

Daniel Amos

Koide?

Masatoshi Koide

Could you please repeat the question again? This is from Japan.

Nigel Dally

Your question is on the regulatory response, to what's been happening at Japan Post. Are the regulators looking to change in any means the way that insurance products are being distributed, trying to push through some changes in the regulations as to what's appropriate with regards to sales practices?

Masatoshi Koide

Well, first of all, what the regulators are saying to Japan Post is not something that we know. We were not in a position to be mentioning about it. However, what we know is that there is no change that we know so far in terms of the insurance solicitation based on what has happened this time. Regulation, there's no regulatory changes that we know.

Daniel Amos

And I have been with FSA this year and there's no major issues other than the fix issue there with Japan Post, which, as Koide says, we don't know all the details or how they're handling that. But no one's mentioned to us that there is anything on the horizon that we need to do to change our sales practices in any way.

Operator

Next question is from the line of Tom Gallagher of Evercore.

Thomas Gallagher

Dan, as you go through this transition in Japan, would you expect cancer sales to fall further as the medical sales ramp up? Or do you think you've bottomed out with cancer here? And I guess, relatedly since Japan Post only sells the cancer product, is there a new product that you've planned for that channel after they get through their review?

Daniel Amos

Well, as you know, we've said all along, we would like to get a new product or rider or something and we are working on that prior to these issues that came up. I think we'll pick that back up as soon as this is resolved in December. I won't know when exactly. But again, I'm expecting things to go back to normal, except corrected from the standpoint of what the FSA is required. So I do think that any way you look at it, Japan Post is Japan incorporated. It's so much a part of society that it has to be fixed and it will continue. So I do expect that to happen.

In regard to cancer sales, Tom, as I said, I expect cancer sales to be lower in the first half, my guess is, and then to be higher in the second half, and the balance is just too early to tell. I can make a guess, but that's all it is. And I don't think it would behoove you and/or me to do that, but better to delay it out and show you what the situation is and you can come to your own conclusion. But my conclusion is, it will resolve itself and we can give you much more clarity at the end of the fourth quarter when January result -- I mean we closed out the end of the year and that date of January, once passed, and the reports are out, we'll give you much more of a sense of it.

Operator

Next question is from the line of Suneet Kamath of Citi.

Suneet Kamath

Here's again on japan Post. Are you sort of through conducting your own reviews of their sales practices or you still pursuing such reviews?

Daniel Amos

No, we're not doing their practices. It's not our responsibility per se. We have to let the FSA, who's already in the process of doing that, from their own. And for us to get in the middle of it, I think, would cause us problems. We have, as you well know, reviewed any issues concerning policies that were written. And as I told you, it was 0.006%, so a very small fraction. And so we are confident that there is not a big problem based on that alone, but we will wait till their report is out. And if the FSA wants more, we'd be glad to help them, but we do not see this as being our issue but really their issue that they are handling.

Operator

Next question is from the line of John Barnidge from Sandler O'Neill.

John Barnidge

As you prepare for the rollout of the 10 states with the Argus product next year, how would this change the dynamics in your own conversations with maybe existing broker partners and potential new partners as we reach year-end 2019?

Richard Williams

John, really this further expands our value proposition to be number one distributor of benefits solutions. It gets us on the discussion of front page benefits. And so not only with brokers but also with small businesses with our existing associates. So we are actually excited about it. Obviously, it's measurable route, so that we can get a good sense on how to roll this out nationally in 2021. But it is definitely further expanding our value proposition.

Teresa White

And certainly, this is one of the things that I hired Rich for. Rich is absolutely working with not just the brokers, but the career agency side to ensure that this Argus -- the Argus transition works well. So I'm very excited about that.

Operator

Next question is from the line of Andrew Kligerman with Crédit Suisse.

Andrew Kligerman

I'm curious about the competitive landscape in the United States and how that's affecting your -- how pricing is being affected? And when you're going up to renew accounts, is there a potential persistency issue?

Richard Williams

Thank you, Andrew. So first of all, in the U.S., we continue to see an abundance of opportunity and need for our products and services, so we're very encouraged in the marketplace by that. In terms of just pricing and competitive nature, that tends to be more on the broker distribution marketplace and really more upmarket. And we've said it like in the prior quarter, we experience large case volatility from time to time because there will be some irrational pricing in the market, and we're going to be measured and we're not going to make poor decisions there. So -- but overall, an abundance of opportunity, lots of opportunities in the mid-market and then we will be selective upmarket, but again, very encouraged.

Operator

Next question is from the line of Humphrey Lee of Dowling & Partners.

Humphrey Lee

Just a question for -- in terms of the buy-and-build appetite. So looking at your current product portfolio, what areas would you be interested in those buy-and-build opportunities? And how should we think about any kind of in terms of buys, like what is your appetite for those?

Frederick Crawford

Yes, let me make -- this is Fred, let me make a comment and then I'll welcome Teresa or Rich to comment. But -- the areas of interest on buy-to-build play off of Rich's comments and that is we have concluded that it is important for our overall core business to have good solutions on the so-called first page of the benefit enrollment platform. And this would include dental and vision but also would include areas of True Group Life and Disability, where we currently have partnerships in place but would look to advance the ball in that area. And so that's where we tend to look. The important dynamic of buy to build is that we don't think it makes sense to be writing big checks on large-scale platforms. And the reason for that is because we bring so much to the table in the way of client list and brand and distribution capability and brokerage relationships that it's far more economic for us to build that value organically once we have the platforms in place and the expertise.

The other dynamic I would tell you that's unique to Aflac is of the 470-or-so thousand businesses that we do business with in U.S., the vast majority of them are small businesses. And one of the things you'll find characteristically when you move towards the first page of the enrollment platform is you also tend to be moving up into not only the brokerage space but into the large case space. That business tends to be dominated in the 1000 and up category of workforce and we have built the company on the basis of small businesses.

And so the reason why buy to build makes particular sense for us is because we are often needing to shape or reshape the platform to be particularly interesting, if you will, to go down market. And the vast majority of these platforms are built for the upmarket, large case, and quite honestly, there isn't often a lot of growth there. It's more exchanging cases between competitors, whereas the small business dynamic in the U.S. is a pure growth opportunity.

So there's a lot of strategic reasons as well as financial reasons why buy to build makes sense. As I said in my comments though, the good news, perhaps as an investor, is you avoid things like large goodwill and execution risk and integration challenges, and that's good news when it comes to the balance sheet and use of capital and capital at risk. The "bad news" is you have to saddle up to a level of expense and margin compression in the short run, while you go to organically build up that platform. And what we are charged with doing is defining that spend as well as the benefits or the growth in incremental earned premium that comes from the investment.

Teresa White

I'll just mention a couple of things. Fred talked about the small business and the number of small businesses that we have relationships with. I also feel that buy-to-build strategy gives us unique opportunity to develop an ecosystem that will help us to better serve the small business as well. And so those are things that we look at as we look at this strategy.

Operator

Next question is from the line of Alex Scott of Goldman Sachs.

Taylor Scott

Actually, I had my question answered, sorry about that.

Operator

Next question is from the line of Erik Bass of Autonomous Research.

Erik Bass

On U.S. earned premiums, I think they dipped a bit sequentially, which I believe was related to both sales as well as some producer actions you took. So can you just provide a bit color there? And then based on Fred's comments, am I right to see these as modest headwinds persisting into 2020?

Teresa White

Do you want to start with the sales piece and then I'll pick up on the producer?

Richard Williams

Yes, absolutely. So as we said, at the end of the second quarter, obviously, we made some business decisions around partnerships to exit that were not profitable and that certainly impacted not only persistency but translates into earned premium as well as some large case volatility. So that right there, sort of, took our trajectory short term down. So Teresa, I don't know if you want to comment.

Teresa White

Yes, I'll be a little bit more specific. We stopped doing business with a billing partner and this partner provided unique services for Aflac. At the end of the day, we just did not see the economics work for our business. And so you'll see that go through our persistency; you'll see that go through our premium. And, again, we believe it's a right decision to make for the enterprise and for the platform, but you will see some short-term volatility in those numbers.

Operator

Next question is from the line of John Nadel of UBS.

John Nadel

My focus this morning is on U.S. sales. And I guess, I have a couple of questions that are all related and I'd like to get them all in before the operator cuts me off. But I guess -- I'm trying to understand, in a down 4% or 4-and-change percent year-over-year quarter, and I guess, for the year, you are slightly down on a year-to-date basis, can you bifurcate for us, either over the short term, the discrete quarter or on the year-to-date basis or both, what the performance looks like for the broker channel versus your traditional or historical agent channel?

And then, along with that, how much of an impact is this single partner relationship that you've exited and how can we think about the impact that, that is having on sales just given that partnership is no longer in place and I assume contributed some level of sales to the year-ago period and will have done so through what the first quarter of 2020 or second quarter of 2020? I guess if you could speak to those couple of issues then I think, it would help just maybe get a little bit of confidence on -- the fourth quarter is so important at this point given the contribution from the broker channel.

Richard Williams

Okay, so I'd also like to take those two questions. So first of all, of our sales holistically are impacted really by the average weekly producer year-to-date. Dan has alluded in his comments that we've seen our broker distribution continue to perform above the market, and so that's really how I would bifurcate that.

And again, average weekly producer is really impaired or impacted just by the decline in first half of the year on recruiting. So I think recruiting is about a six month lag and so I think that's how you can think about what's happening there. As we think about the partner and the exit of that particular relationship, fortunately, the sales are not a significant percentage of the overall sales of Aflac U.S. However, they do impact our associates who have existing clients and re-enrollments. And so that does take some of their focus off of that. And obviously, the exit of that partnership, because it's been a partnership for several years, has enforced premium ramifications. And so that's how -- why you see it working itself through earned premium.

Daniel Amos

I want to say one thing about the broker business. Our agents are still key because they represent 2/3 of our business, but the broker business for us is doing great. I mean it's growing at twice the rate of the industry right now, and so we're very pleased with that. And we believe that -- and our focus is not just on broker, our focus is on our agents and our distribution channel there as well and the point being that when you're at full employment, it is harder to recruit people from a commission standpoint. And I've experienced that over the years. And that's why I've always said there is a balance. When it's a bad economy, there's not as many people at the worksite working, but it's easier to hire. When it's a full economy, which we haven't seen very often, there are plenty of people at the worksite, but it gets the people to call on them that we can hire. So it's a mix bag. So I do think we're doing all the right things. And there's some similarities with this and Japan and that the corporate agency structure has been the slow part but it has been these outside like for example, Japan Post, that has driven the growth. What's really been driving the growth, even though not as much as we want, has been the broker channel. And this other partner thing is a small detail that only because this is all in one quarter that you noticed it as much, it won't -- next year, you won't even see it.

Teresa White

And it'll just arrive through our 12 month rolling persistency and that's where you'll see it go through the numbers. But you're right, you won't see from a sales perspective.

Daniel Amos

Yes, you won't see it from a sales perspective.

Operator

Next question is from the line of Ian Ryave of Bank of America.

Ian Ryave

Just first on hedge cost in Japan. They went up sequentially. Is it just really a function of growing out the dollar investment portfolio? And I realize you locked in a lot of those hedge costs. Is it really a change in the hedge ratio? Or is it a factor in the market environment? What are the key drivers that they get higher or lower?

Daniel Amos

Ian, you did a great job actually. You hit it on the head. There's nothing from our perspective really unexpected. It ties back to our investment plan and the growth of the dollar assets, particularly the loan portfolio throughout the year. So in our investment planning, we knew as we progress throughout the year and buy those assets, come around the third quarter, our hedge costs would be higher. So it is volume related but planned volume. The other thing I should mention, just to attach to that, as a reminder, if hedge costs go up and the way it went up because it's related to volume, it also means our income went up attached to it. So our net of those two numbers is more or less precisely within our planning throughout the year or so. That's exactly what it is.

Operator

Last question is from John Barnidge of Sandler O'Neill.

John Barnidge

So as we look towards next year, Tokyo is having Olympics, is there planning around marketing? And do you view that as a good platform to engage with potential audience to buy the products? And what your plans are for that?

Daniel Amos

Koide or whoever would like to take that question?

Masatoshi Koide

And in terms of Olympics, there is really no plan [Technical Difficulty].

Frederick Crawford

I think we can probably finish the answer to the question for you. There'll be a very modest level of normal activity that takes place from a marketing perspective with groups of individuals and key clientele and all that, but there is no major plan dynamics around the Tokyo Olympics at this time that would be any sort of measurable impact to our financials.

David Young

At with that, I think, that is our last call and our last question. I want to thank everyone for joining us this morning. And remind you that we will be having our 2020 outlook call on December 2nd. That morning, we will provide more details of the coming weeks. And please feel free to contact our Investor and Rating Agency Relations department for more information and with any questions that you may have. We look forward to speaking to you soon. Thank you.

Operator

Thank you. That concludes today's conference. Thank you for participating. You may now disconnect.