Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is intended to inform the reader about matters affecting the financial condition and results of operations of AFLAC Incorporated and its subsidiaries for the three-year period ended December 31, 2002. As a result, the following discussion should be read in conjunction with the related consolidated financial statements and notes.

Company Overview

AFLAC Incorporated is the parent company of American Family Life Assurance Company of Columbus, AFLAC. Our principal business is supplemental health and life insurance, which is marketed and administered through AFLAC. Most of AFLAC's policies are individually underwritten and marketed at worksites through independent agents, with premiums paid by the employee. Our operations in Japan (AFLAC Japan) and the United States (AFLAC U.S.) service the two markets for our insurance business.

Critical Accounting Estimates

We prepare our financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP). The estimates discussed below are critical to an understanding of AFLAC's results of operations and financial condition. The preparation and evaluation of these critical accounting estimates involves the use of various assumptions developed from management's analysis and judgments. The application of these critical accounting estimates determines the values at which 94% of our assets and 82% of our liabilities are reported and thus have a direct effect on net earnings and shareholders' equity. Subsequent experience or use of other assumptions could result in significantly different results.

Investments

Our investments in debt and equity securities include both publicly traded and privately issued securities. For privately issued securities, we receive pricing data from external sources that take into account each security's credit quality and liquidity characteristics. We also routinely review our investments that have experienced declines in fair value to determine if the decline is other than temporary. These reviews are performed with consideration of the facts and circumstances of an issuer in accordance with Staff Accounting Bulletin (SAB) No. 59, Accounting for Non-Current Marketable Equity Securities; Statement of Financial Accounting Standards (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities; and related guidance. The identification of potentially impaired investments, the determination of fair value if not publicly traded, and the assessment of whether a decline is other than temporary involve significant management judgment and require evaluation of factors including but not limited to:

- percentage decline in value and the length of time during which the decline has occurred,
- recoverability of principal and interest,
- market conditions,
- ability and intent to hold the investment,
- a pattern of continuing operating losses of the issuer,
- rating agency actions that affect the issuer's credit status,
- adverse changes in the issuer's availability of production resources, revenue sources, technological conditions, and
- adverse changes in the issuer's economic, regulatory or political environment.

Deferred Policy Acquisition Costs and Policy Liabilities

AFLAC products are generally long-duration fixed-benefit indemnity products. As such, our products are accounted for under the requirements of SFAS No. 60, Accounting and Reporting by Insurance Enterprises. We make estimates of certain factors that affect the profitability of our business in order to match expected policy benefits and expenses with expected policy premiums. These assumptions include persistency, morbidity, mortality, interest rates and expenses. If actual results mirror the assumptions used in establishing policy liabilities and the deferral and amortization of acquisition costs, profits will emerge as a level percentage of premium revenue. However, because actual results will vary from the assumptions, the level of profits as a percentage of premium revenue will vary from year to year.

We calculate future policy benefits based on assumptions of morbidity, mortality, persistency and interest established at the time a policy is sold. Generally, changes to these assumptions are not allowed unless it is determined that the policy reserves are not adequate due to actual results varying from original assumptions.

We measure the adequacy of our policy reserves and recoverability of deferred policy acquisition costs (DAC) annually by performing gross premium valuations on our business. The valuations are performed using a number of different assumption scenarios. Our testing indicates that our insurance liabilities are adequate and that our DAC is recoverable.

Deferred Policy Acquisition Costs

Under the requirements of SFAS No. 60, certain costs of acquiring new business are deferred and amortized over the policy's premium payment period in proportion to anticipated premium income. Future amortization of DAC is sensitive to our estimates of persistency, interest and future premium revenue at the time of policy issuance. However, the unamortized balance of DAC reflects the actual persistency to date. As presented in the following table, the ratio of DAC to annualized premium in force has been relatively stable for AFLAC U.S. and has trended down for AFLAC Japan over the last three years.

Deferred Policy Acquisition Cost Ratios

(In millions)	AFLAC Japan			AFLAC U.S.		
	2002	2001	2000	**2002**	2001	2000
Deferred policy acquisition costs	**¥343,845**	¥325,960	¥310,461	**$1,410**	$1,181	$ 979
Annualized premiums in force	**834,424**	782,249	740,445	**2,674**	2,238	1,861
Deferred policy acquisition costs as a percentage of annualized premiums in force	**41.2%**	41.7%	41.9%	**52.7%**	52.8%	52.6%

Policy Liabilities

Our policy liabilities include two primary components: future policy benefits and unpaid policy claims, which account for 91% and 5% of total policy liabilities at December 31, 2002, respectively. Future policy benefits represent our estimate of claims that will occur in the future and are generally calculated as the present value of expected benefits to be paid less the present value of expected net premiums, including a provision for adverse deviation. Unpaid policy claims include those claims that have occurred and are in the process of payment as well as an estimate of those claims that have occurred but have not yet been reported to us. Assumptions underlying the estimate of the unpaid policy claims are updated annually and incorporate our historical experience as well as other data that provides information regarding our outstanding liability.

Due to changes in health care delivery and financing practices in Japan, we have experienced a change in the characteristics and timing of our policy benefits. Our review indicated that we have experienced a decline in the average number of hospital days associated with the typical cancer treatment period in Japan. We believe this trend has emerged as a result of the Japanese government's effort to curb the medical cost increases under the national health care system. The government now provides incentives to hospitals to shorten the number of days of confinement per occurrence by providing higher reimbursement rates for shorter hospital stays. However, our preliminary claims statistics indicated the declines in the average number of days per hospitalization were generally offset by an increase in the average number of hospitalizations required for the treatment of cancer such that the total expected hospital days per claimant has not changed proportionally. Since our unpaid policy claims liability primarily includes the unpaid costs associated with a current treatment period, the reduction in the average hospital stay has resulted in a decrease in the average liability for unpaid policy claims. Accordingly, in 2002, we transferred $291 million from unpaid policy claims to the liability for future policy benefits to reflect the anticipated decrease in costs associated with the current treatment period and the associated increase in costs expected in future treatment periods. These changes had no effect on net earnings.

Results of Operations

We evaluate our overall operations using a non-GAAP financial performance measure called operating earnings and our business segments using pretax operating earnings. Our definition of operating earnings starts with net earnings and excludes the following items on an after-tax basis: realized investment gains/losses, the change in fair value of the interest rate component of cross-currency swaps beginning in 2001, the charge for the Japanese policyholder protection fund in 2002, and the gain from the termination of a retirement liability in 2000. We then exclude income taxes related to operations to arrive at pretax operating earnings. We believe that the analysis of operating earnings and pretax operating earnings, in addition to net earnings as determined in accordance with GAAP, provides information that may enhance an investor's understanding of our underlying profitability and results of operations. Our discussion of earnings and comparisons thereof focuses on pretax operating earnings and operating earnings. References to operating earnings per share are based on the diluted number of average outstanding shares, unless stated otherwise. The difference between the percentage changes in operating earnings and operating earnings per share can be impacted by the share repurchase program, reissued treasury stock, and the dilutive effect of stock options. The table on the following page sets forth the results of operations by business segment for the three-year period ended December 31, 2002.

Summary of Operating Results by Business Segment

(In millions except for per-share amounts)	Percentage change over previous year		Years ended December 31,		
	2002	2001	**2002**	2001	2000
Operating earnings:					
AFLAC Japan	**13.9%**	6.7%	**$ 938**	$ 823	$ 771
AFLAC U.S.	**16.7**	18.7	**402**	345	290
Other business segments			**1**	(8)	(6)
Total business segments	**15.5**	10.0	**1,341**	1,160	1,055
Interest expense, noninsurance operations	**(1.0)**	(1.7)	**(16)**	(16)	(16)
Corporate and eliminations	**(46.7)**	(28.4)	**(49)**	(33)	(26)
Pretax operating earnings	**14.8**	9.6	**1,276**	1,111	1,013
Income taxes	**15.4**	9.5	**451**	391	356
Operating earnings	**14.5**	9.7	**825**	720	657
Reconciling items, net of tax:					
Realized investment gains (losses)			**(15)**	(34)	(69)
Change in fair value of the interest rate component of the cross-currency swaps			**37**	1	–
Japanese policyholder protection fund provision			**(26)**	–	–
Termination of retirement liability			**–**	–	99
Net earnings	**19.5%**	–	**$ 821**	$ 687	$ 687
Operating earnings per basic share	**16.1%**	10.5%	**$ 1.59**	$ 1.37	$ 1.24
Operating earnings per diluted share	**16.4**	11.7	**1.56**	1.34	1.20
Net earnings per basic share	**21.4%**	.8%	**$ 1.59**	$ 1.31	$ 1.30
Net earnings per diluted share	**21.1**	1.6	**1.55**	1.28	1.26

The following table presents a reconciliation of operating earnings per share to net earnings per share for the three-year period ended December 31, 2002.

	2002	2001	2000
Operating earnings per diluted share	**$ 1.56**	$ 1.34	$ 1.20
Reconciling items, net of tax:			
Realized investment gains (losses)	**(.03)**	(.06)	(.12)
Change in fair value of the interest rate component of the cross-currency swaps	**.07**	–	–
Japanese policyholder protection fund provision	**(.05)**	–	–
Termination of retirement liability	**–**	–	.18
Net earnings per diluted share	**$ 1.55**	$ 1.28	$ 1.26

In 2002, we recognized pretax impairment losses of $58 million. These impairment losses were primarily related to the corporate debt security of a Japanese issuer and various equity securities we believe experienced other than temporary declines in fair value. These impairment losses and other investment transactions in the normal course of business decreased net earnings by $15 million ($.03 per diluted share).

In 2001, we recognized pretax impairment losses of $86 million. These impairment losses were primarily related to the corporate debt securities of a U.S. issuer and a European issuer, both of which experienced credit rating downgrades, and our investment in two human resource service companies. We also realized investment gains in connection with a change in the outside investment manager of a portion of our U.S. equity securities portfolio. These gains and impairment losses, when included with other investment transactions in the normal course of business, decreased net earnings by $34 million ($.06 per diluted share).

During 2000, the North American issuers of two debt securities that we owned experienced credit rating downgrades. We sold one security reported as available for sale at a pretax loss of $34 million and recognized a pretax impairment loss of $57 million on the other security, which was then transferred from held to maturity to available for sale. These losses and other investment transactions in the normal course of business decreased net earnings by $69 million ($.12 per diluted share).

For the year ended December 31, 2002, we recognized an after-tax gain of $37 million ($.07 per diluted share) in connection with the change in fair value of the interest rate component of the cross-currency swaps on our senior notes payable, compared with an after-tax gain of $1 million (nil per diluted share) in 2001. This gain was included in other income in the consolidated statements of earnings. (See Notes 1 and 4 of the Notes to the Consolidated Financial Statements.)

In December 2002, the members of the Life Insurance Policyholder Protection Corporation approved the Financial Services Agency's (FSA) proposal, which requires the industry to contribute an additional ¥78 billion (approximately $651 million using the December 31, 2002 exchange rate) to Japan's policyholder protection fund. Our estimated share of the assessment decreased 2002 net earnings by $26 million ($.05 per diluted share).

For the year ended December 31, 2000, the termination of an accrued unfunded liability for projected retirement payments increased net earnings by $99 million ($.18 per diluted share). (See Note 10 of the Notes to the Consolidated Financial Statements.)

Foreign Currency Translation

Due to the relative size of AFLAC Japan, fluctuations in the yen/dollar exchange rate can have a significant effect on our reported results. In years when the yen weakens, translating yen into dollars causes fewer dollars to be reported. When the yen strengthens, translating yen into dollars causes more dollars to be reported. Our business, in functional currency terms, continued to be strong in 2002, and we believe it is more appropriate to measure our performance excluding the effect of fluctuations in the yen/dollar exchange rate in order to understand the basic operating results of the business. (See Note 2 of the Notes to the Consolidated Financial Statements.)

The following table illustrates the effect of foreign currency translation by comparing selected percentage changes of our actual operating results with those that would have been reported had foreign currency exchange rates remained unchanged from the previous year.

Foreign Currency Translation Effect on Operating Results

(Years ended December 31)

	Including Foreign Currency Changes			Excluding Foreign Currency Changes**		
	2002	2001	2000	**2002**	2001	2000
Premium income	**6.6%**	(2.0)%	13.4%	**8.9%**	7.6%	8.5%
Net investment income	**4.1**	–	13.2	**5.8**	7.2	9.6
Operating revenues	**6.3**	(1.8)	13.5	**8.5**	7.4	8.8
Total benefits and expenses	**5.2**	(3.1)	13.0	**7.4**	6.4	8.0
Operating earnings*	**14.5**	9.7	19.4	**15.9**	15.4	16.5
Operating earnings per share*	**16.4**	11.7	20.0	**17.9**	17.5	18.0

* See page 23 for our definition of operating earnings.

** Amounts excluding foreign currency changes were determined using the same yen/dollar exchange rate for the current year as each respective prior year.

The weighted-average yen/dollar exchange rate weakened in 2002, compared with 2001. Weighted-average yen/dollar exchange rates were 125.15 in 2002, 121.54 in 2001 and 107.83 in 2000. In 2002, the weaker yen decreased operating earnings by approximately $.02 per diluted share, when compared with 2001. The weaker yen in 2001, compared with 2000, decreased operating earnings by approximately $.07 per diluted share for the year. The stronger yen in 2000 increased operating earnings per diluted share by $.02, compared with 1999. Operating earnings per diluted share increased 16.4% to $1.56 in 2002, 11.7% to $1.34 in 2001 and 20.0% to $1.20 in 2000.

Our primary financial objective is the growth of operating earnings per diluted share, excluding the effect of foreign currency fluctuations. Our objective for 2002 was to increase operating earnings per diluted share by 15% excluding the impact of currency translation. However, as a result of favorable sales and claims trends in our insurance operations, we exceeded our goal. Excluding the effect of foreign currency fluctuations, operating earnings per diluted share increased 17.9% in 2002 compared with 2001, 17.5% in 2001 compared with 2000, and 18.0% in 2000 compared with 1999.

2003 Operating EPS Scenarios

Weighted-Average Yen/dollar Exchange Rate	Operating Diluted EPS	% Growth Over 2002	Yen Impact on EPS
115.00	$1.88	20.5%	$.08
120.00	1.84	17.9	.04
125.15*	1.80	15.4	–
130.00	1.77	13.5	(.03)
135.00	1.74	11.5	(.06)

* Actual 2002 weighted-average exchange rate

For 2003, our objective is to increase operating earnings per diluted share by 15% to 17% excluding the impact of currency translation. Our objective for 2004 is to increase operating earnings per diluted share by 15% excluding the impact of currency translation. Our specific objective for 2003 is to achieve operating earnings per diluted share of at least $1.80, excluding the impact of currency translation. If we achieve that objective, the table above shows the likely results for 2003 operating earnings per diluted share, including the impact of foreign currency translation using various yen/dollar exchange rate scenarios.

Income Taxes

Our combined U.S. and Japanese effective income tax rates on operating earnings were 35.3% in 2002 and 35.2% in both 2001 and 2000. Japanese income taxes on AFLAC Japan's operating results accounted for most of our income tax expense.

Insurance Operations, AFLAC Japan

AFLAC Japan operates as a branch of AFLAC and is the principal contributor to our earnings. Based on financial results determined in accordance with FSA requirements for the six months ended September 30, 2002, AFLAC Japan ranked first in profitability among all foreign life insurance companies operating in Japan and 11th in terms of assets among all life insurance companies operating in Japan.

AFLAC Japan Pretax Operating Earnings

Changes in AFLAC Japan's pretax operating earnings and profit margins are affected by investment yields, morbidity, mortality, persistency and expense levels. Continuing favorable claims trends and the shift in our product mix to lower loss ratio products contributed to the decline in the benefit and claims ratios. We expect the aggregate benefit ratio to continue to decline in future years, along with the shift to newer products and riders. Our persistency has declined only slightly over the last three years. The operating expense ratio declined in 2002 primarily as a result of decreased expenditures for advertising. Operating expense ratios increased in 2001 and 2000 primarily as a result of increased expenditures for sales promotion, marketing and advertising. We expect the operating expense ratio to be relatively stable in the future. The expansion of the profit margins during the past three years was largely attributable to the declining benefit ratio. Our profit margins are also affected by the spread between investment yields and required interest on policy reserves (see table and discussion on page 31). The table below presents a summary of AFLAC Japan's operating results.

AFLAC Japan Percentage Changes Over Prior Year

(Yen Operating Results)

	Including Foreign Currency Changes			Excluding Foreign Currency Changes**		
	2002	2001	2000	**2002**	2001	2000
Net investment income	**6.5%**	10.5%	7.4%	**5.6%**	6.9%	9.3%
Total operating revenues	**5.6**	5.9	7.0	**5.5**	5.3	7.3
Pretax operating earnings*	**17.4**	20.6	12.3	**16.1**	15.2	15.3

* See page 23 for our definition of operating earnings.

** Amounts excluding foreign currency changes on dollar-denominated items were determined using the same yen/dollar exchange rate for the current year as each respective prior year.

In 2002, the 2.9% weakening of the weighted-average yen/dollar exchange rate caused AFLAC Japan's comparative rates of growth in yen terms to be slightly higher due to the dollar-denominated investment income from its holdings of dollar-denominated assets and reverse-dual currency securities (yen-denominated fixed-maturity securities with dollar coupon payments). Dollar-denominated investment income accounted for approximately 29% of AFLAC Japan's investment income in 2002. As a result, translating AFLAC Japan's dollar-denominated investment income into yen magnified the increases in net investment income, total operating revenues and pretax operating earnings in yen terms when the yen weakened. The table above illustrates the impact on AFLAC Japan's yen operating results from translating its dollar-denominated investment income and related items by comparing certain yen operating results with those that would have been reported had yen/dollar exchange rates remained unchanged from the previous year.

AFLAC Japan Summary of Operating Results

(In millions)	**2002**	2001	2000
Premium income	**$ 6,373**	$ 6,217	$ 6,668
Net investment income	**1,276**	1,234	1,261
Other income	**1**	1	7
Total operating revenues	**7,650**	7,452	7,936
Benefits and claims	**5,231**	5,170	5,632
Operating expenses	**1,481**	1,459	1,533
Total benefits and expenses	**6,712**	6,629	7,165
Pretax operating earnings*	**$ 938**	$ 823	$ 771
Weighted-average yen/dollar exchange rates	**125.15**	121.54	107.83

	In Dollars			In Yen		
Percentage changes over previous year:	**2002**	2001	2000	**2002**	2001	2000
Premium income	**2.5%**	(6.8)%	12.9%	**5.5%**	5.1%	6.8%
Net investment income	**3.4**	(2.2)	13.5	**6.5**	10.5	7.4
Total operating revenues	**2.7**	(6.1)	13.0	**5.6**	5.9	7.0
Pretax operating earnings*	**13.9**	6.7	18.6	**17.4**	20.6	12.3

Ratios to total revenues in dollars:	**2002**	2001	2000
Benefits and claims	**68.4%**	69.4%	71.0%
Operating expenses	**19.3**	19.6	19.3
Pretax operating earnings*	**12.3**	11.0	9.7

* See page 23 for our definition of operating earnings.

AFLAC Japan Sales

AFLAC Japan produced better-than-expected total new annualized premium sales in 2002 as a result of a strong demand for our products and riders. Total new annualized premium sales were: $867 million in 2002, up 14.8% from 2001; $755 million in 2001, down 18.0% from 2000; and $921 million in 2000, up 20.4% from 1999. Total new annualized premium sales in yen were: ¥108.3 billion in 2002, up 17.9% compared with 2001; ¥91.9 billion in 2001, down 7.9% compared with 2000; and ¥99.8 billion in 2000, up 14.6% compared with 1999.

The percentage increases in premium income reflect the growth of premiums in force. The increases in annualized premiums in force in yen of 6.7% in 2002, 5.6% in 2001 and 6.3% in 2000 reflect the high persistency of AFLAC Japan's business and the sales of new policies. Annualized premiums in force at December 31 were: ¥834.4 billion in 2002, ¥782.2 billion in 2001, and ¥740.4 billion in 2000. Annualized premiums in force, translated into dollars at year-end exchange rates were: $7.0 billion in 2002, $5.9 billion in 2001, and $6.5 billion in 2000.

AFLAC Japan's sales mix as measured in yen has been shifting during the last few years. Rider MAX accounted for 31% of total sales in 2002, 25% in 2001, and 41% in 2000. After a difficult year in 2001, Rider MAX sales improved in 2002, primarily as a result of conversions of the original term policy to the newly introduced whole life version. For policy conversions, new annualized premium sales include only the incremental annualized premium amount over the original term policy. Conversion activity accounted for approximately 35% of total Rider MAX sales in 2002. We expect that these conversions will have less of an effect on total new annualized premium sales in future periods.

We were also pleased with sales of EVER, a whole life fixed-benefit medical product, which we introduced in the first quarter of 2002. We believe consumer response to EVER has been favorably impacted by health care legislation that will increase out-of-pocket costs for approximately 63% of Japanese consumers in April 2003. EVER accounted for 17% of total sales in 2002. We believe that EVER will continue to be a popular product and a solid contributor to sales.

Cancer life sales accounted for 35% of total sales in 2002, 52% in 2001, and 40% in 2000. Ordinary life and annuities accounted for 14% of total sales in 2002, compared with 19% in 2001 and 14% in 2000.

We continue to be pleased with the results of our marketing alliance with Dai-ichi Mutual Life Insurance Co., which formally began in April 2001. In 2002, Dai-ichi Life sold 359,500 of our cancer life policies, compared with 265,200 in 2001. Dai-ichi Life sales of our cancer policies accounted for 11% of total new annualized premium sales in both 2002 and 2001.

We also continued to grow our distribution system in Japan. During 2002, the number of licensed sales associates rose 11% over 2001. We believe that new agencies and sales associates will continue to be attracted to AFLAC Japan's high commissions, superior products, customer service and brand image. Our objective for 2003 is to increase total new annualized premium sales 5% to 10% in yen.

AFLAC Japan Investments

Growth of investment income in yen is affected by available cash flow from operations, investment yields achievable on new investments, and the effect of yen/dollar exchange rates on dollar-denominated investment income. Reflecting the continued weakness in Japan's economy, investment yields on yen-denominated debt securities remained low in 2002. However, we were able to achieve a return on average invested assets, net of investment expenses, of 4.67% in 2002, compared with 4.81% in 2001 and 4.82% in 2000 by focusing on selected sectors of the fixed maturity market.

We purchased yen-denominated securities at an average yield of 3.65% in 2002, compared with 3.58% in 2001 and 3.57% in 2000. Including dollar-denominated investments, our blended new money yield was 3.93% in 2002, compared with 3.86% in 2001 and 3.78% in 2000. At December 31, 2002, the yield on AFLAC Japan's fixed-maturity portfolio (including dollar-denominated investments) was 4.73%, compared with 4.89% in 2001 and 5.02% in 2000.

AFLAC Japan has invested in privately issued securities to secure higher yields than Japanese government or other corporate bonds would have provided, while still adhering to prudent standards for credit quality. All of our privately issued securities are rated as investment grade at the time of purchase by S&P, Moody's or the Securities Valuation Office of the National Association of Insurance Commissioners (NAIC). These securities are generally issued with standard, medium-term note documentation and have appropriate covenants. We continue to believe that we can invest new money in the near term at an adequate spread over policy premium pricing assumptions and assumed interest rates for policy liabilities on new business. To compensate for lower investment yields, we have increased premium rates for our new business over the last several years, which contributes to the stability of our profit margin.

Insurance Deregulation in Japan

In January 2001, Japan's insurance market was deregulated, and we experienced an increase in the number of companies selling products that compete with our policies. However, based on our growth of premiums in force, producing agents and customer accounts, we do not believe that our market position has been significantly impacted by increased competition as a result of deregulation. Furthermore, we believe the continued development and maintenance of operating efficiencies will allow us to offer affordable products at a better value to consumers.

Japanese Economy

Japan's economy continued to struggle during most of 2002 and the outlook for 2003 indicates continued weakness. In its December 2002 Monthly Report, The Bank of Japan noted that the economy had stabilized, albeit with substantial uncertainty as to any recovery. Weak private consumption, high unemployment, declining household income and slowing public investment were countered by a slight recovery in corporate profits and improving business sentiment. As a result, the problems created by excessive employment and debt continue to preclude the momentum needed for a self-sustaining recovery, and any recovery is still largely dependent on global conditions. As we have indicated in years past, Japan's weak economy has created a challenging environment for AFLAC Japan, and the time required for an economic recovery remains uncertain.

Insurance Operations, AFLAC U.S.

AFLAC U.S. Pretax Operating Earnings

Changes in AFLAC U.S. pretax operating earnings and profit margins are affected by morbidity, mortality, persistency, investment yields and expense levels. The aggregate benefit ratio and our overall policy persistency have been relatively stable during the last three years. We expect the operating expense ratio, excluding discretionary advertising expenses, and the pretax operating profit margin to remain relatively level in 2003. The following table presents a summary of AFLAC U.S. operating results.

AFLAC U.S. Summary of Operating Results

(In millions)	**2002**	2001	2000
Premium income	**$ 2,221**	$ 1,844	$ 1,554
Net investment income	**331**	303	277
Other income	**9**	8	5
Total operating revenues	**2,561**	2,155	1,836
Benefits and claims	**1,359**	1,132	969
Operating expenses	**800**	678	577
Total benefits and expenses	**2,159**	1,810	1,546
Pretax operating earnings*	**$ 402**	$ 345	$ 290
Percentage changes over previous year:			
Premium income	**20.5%**	18.6%	14.4%
Net investment income	**9.2**	9.6	13.2
Total operating revenues	**18.8**	17.4	14.3
Pretax operating earnings*	**16.7**	18.7	13.3
Ratios to total revenues:			
Benefits and claims	**53.1%**	52.5%	52.8%
Operating expenses	**31.2**	31.5	31.4
Pretax operating earnings*	**15.7**	16.0	15.8

* See page 23 for our definition of operating earnings.

AFLAC U.S. Sales

Total new annualized premium sales continued to experience strong growth in 2002. Total new annualized premium sales were: $1.1 billion in 2002, up 16.4%; $919 million in 2001, up 29.1%; and $712 million in 2000, up 28.3%.

The percentage increases in premium income reflect the growth of premiums in force. The increases in annualized premiums in force of 19.5% in 2002, 20.3% in 2001 and 16.9% in 2000 were favorably affected by increased sales at the worksite primarily through cafeteria plans and a slight improvement in the persistency of several products. Annualized premiums in force at December 31 were: $2.7 billion in 2002; $2.2 billion in 2001; and $1.9 billion in 2000.

The sales mix of our products has remained relatively consistent during the last three years. Accident/disability coverage continued to be our best-selling product category, accounting for 51%, 52% and 55% of total sales in 2002, 2001 and 2000, respectively. Cancer expense insurance was also a solid contributor to sales, accounting for 21% of total sales in 2002, 24% in 2001 and 23% in 2000. Fixed-benefit dental coverage, introduced in July 2000, continued to sell well, accounting for 7% of total sales in 2002 and 2001 and 3% in 2000. Our hospital indemnity product category also contributed strongly to sales in 2002 as a result of our newly introduced personal sickness indemnity plan. Hospital indemnity products accounted for 10% of total sales in 2002 and 6% in both 2001 and 2000.

An integral part of our strategy for continued growth in the United States is our focus on expanding our distribution system. Additionally, we view our advertising program as an important competitive strength and a key component of our future sales growth. Our advertising program greatly benefited not only our brand and product awareness but also the growth of our distribution system. AFLAC again continued to rapidly expand its sales force. During 2002, the average number of associates producing business on a monthly basis increased 21% to more than 15,800 agents, compared with 13,000 agents in 2001.

During the last two years, we began providing our insurance products to employees of larger businesses, which reinforces our opinion that AFLAC continues to be the leading supplemental insurance provider in the United States. We view the United States as a vast and underpenetrated market for the sale of our insurance products. Further, we continue to believe that we are strongly positioned to continue our record of growth by marketing high-quality affordable insurance products at the worksite. Our objective for 2003 is to increase total new annualized premium sales by approximately 15%.

AFLAC U.S. Investments

The overall return on average invested assets, net of investment expenses, was 7.56% in 2002, compared with 7.67% in 2001 and 7.62% in 2000. During 2002, available cash flow was invested at an average yield of 7.58%, compared with 7.80% during 2001 and 8.22% during 2000. At December 31, 2002, the yield on the fixed-maturity portfolio of AFLAC U.S. was 7.98%, compared with 8.02% in 2001 and 8.01% in 2000.

Other Operations

Corporate operating expenses consist primarily of personnel compensation, benefits, and facilities expenses. Corporate expenses, excluding investment income, were $56 million in 2002, $46 million in 2001 and $38 million in 2000. Investment income included in reported corporate expenses was $7 million in 2002, $13 million in 2001 and $12 million in 2000. The increase in corporate expenses in 2002, when compared with 2001, was primarily attributable to the parent company's share of the costs to dissolve a human resource service company in which it had invested. The increase in corporate expenses in 2001, when compared with 2000, was primarily due to higher retirement benefit expenses.

New Accounting Pronouncements

In December 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure. This standard, which is effective for years ending after December 15, 2002, amends the transition and disclosure issues associated with the voluntary adoption of SFAS No. 123, Accounting for Stock-Based Compensation. We have no plans to adopt the fair value provisions of SFAS No. 123. As a result, the requirements of this standard are not expected to have a material impact on our financial position or results of operations.

We adopted SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended, effective January 1, 2001. Under this standard, derivatives are reported at fair value as assets or liabilities on the balance sheet. Changes in fair value are reported in net earnings or other comprehensive income depending on the derivative instrument and its intended use. The fair value of derivatives can increase or decrease as exchange rates, interest rates and general economic conditions change. The adoption of this accounting standard introduced additional volatility into reported net earnings and other comprehensive income, which may continue depending on market conditions and our hedging activities. However, the changes required by SFAS No. 133 are expected to affect only the reporting of noncash gains and losses. For additional information, see Notes 1 and 4 of the Notes to the Consolidated Financial Statements.

In November 2002, the FASB issued Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. The disclosure provisions of this interpretation are effective for fiscal years ending after December 15, 2002. The initial recognition and measurement provisions of this interpretation apply to guarantees issued or modified after December 31, 2002, on a prospective basis. This interpretation is not expected to have a material impact on our financial position or results of operations.

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities. This interpretation addresses consolidation and disclosure issues associated with variable interest entities. We are currently evaluating our investments in variable interest entities. The requirements of the interpretation, however, are not expected to have a material impact on our financial position or results of operations.

During the last two years, the FASB has issued a number of other statements that have had no impact on our financial position or results of operations. See Note 1 of the Notes to the Consolidated Financial Statements.

Analysis of Financial Condition

During the last two years, our financial condition has remained strong in the functional currencies of our operations. The yen/dollar exchange rate at the end of each period is used to translate yen-denominated balance sheet items to U.S. dollars for reporting purposes. The exchange rate at December 31, 2002, was 119.90 yen to one U.S. dollar, or 10.1% stronger than the December 31, 2001, exchange rate of 131.95. The stronger yen increased reported investments and cash by $2.9 billion, total assets by $3.2 billion, and total liabilities by $3.1 billion, compared with the amounts that would have been reported for 2002 if the exchange rate had remained unchanged from year-end 2001 See Note 2 of the Notes to the Consolidated Financial Statements.

Market Risks of Financial Instruments

Our financial instruments are exposed primarily to three types of market risks. They are currency risk, interest rate risk, and equity price risk.

Currency Risk

The functional currency of AFLAC Japan's insurance operation is the Japanese yen. All of AFLAC Japan's premiums, claims and commissions are received or paid in yen as are most of its investment income and other expenses. Furthermore, most of AFLAC Japan's investments, cash and liabilities are yen-denominated. When yen-denominated securities mature or are sold, the proceeds are generally reinvested in yen-denominated securities. AFLAC Japan holds these yen-denominated assets to fund its yen-denominated policy obligations. In addition, AFLAC

Incorporated has yen-denominated notes payable and cross-currency swaps related to its senior notes.

Although we generally do not convert yen into dollars, we do translate financial statement amounts from yen into dollars for financial reporting purposes. Therefore, the translation of the reported amounts is affected by foreign currency fluctuations. We report unrealized foreign currency translation gains and losses in accumulated other comprehensive income.

On a consolidated basis, we attempt to match yen-denominated assets to yen-denominated liabilities in order to minimize the exposure of our shareholders' equity to foreign currency translation fluctuations. We accomplish this by investing a portion of AFLAC Japan's investment portfolio in dollar-denominated securities (see Note 2 of the Notes to the Consolidated Financial Statements) and by the parent company's issuance of yen-denominated debt (see Notes 4 and 6 of the Notes to the Consolidated Financial Statements). As a result, the effect of currency fluctuations on our net assets is diminished.

At December 31, consolidated yen-denominated net assets were $991 million in 2002 and $785 million in 2001. AFLAC Japan's yen-denominated net assets were $2.3 billion at December 31, 2002, compared with $1.9 billion a year ago. AFLAC Incorporated's yen-denominated net liabilities were $1.3 billion at December 31, 2002, compared with $1.1 billion a year ago. The table to the left compares the dollar values of our yen-denominated assets and liabilities and our net yen-denominated asset exposure at various exchange rates.

Dollar Value of Yen-Denominated Assets and Liabilities at Selected Exchange Rates

(December 31)

(In millions)		**2002**			2001	
Yen/dollar exchange rates	**104.90**	**119.90***	**134.90**	116.95	131.95*	146.95
Yen-denominated financial instruments:						
Assets:						
Securities available for sale:						
Fixed maturities	**$ 18,152**	**$ 15,881**	**$ 14,115**	$ 16,303	$ 14,450	$ 12,975
Perpetual debentures	**2,703**	**2,365**	**2,102**	2,493	2,210	1,984
Equity securities	**155**	**136**	**121**	116	103	92
Securities held to maturity:						
Fixed maturities	**9,594**	**8,394**	**7,460**	6,112	5,417	4,864
Perpetual debentures	**4,229**	**3,700**	**3,289**	3,730	3,306	2,969
Cash and cash equivalents	**1,260**	**1,102**	**979**	799	708	636
Other financial instruments	**9**	**8**	**8**	6	5	4
Subtotal	**36,102**	**31,586**	**28,074**	29,559	26,199	23,524
Liabilities:						
Notes payable	**987**	**863**	**767**	855	758	680
Cross-currency swaps	**529**	**463**	**412**	475	421	378
Obligation for Japanese policyholder protection fund	**260**	**227**	**202**	209	186	167
Subtotal	**1,776**	**1,553**	**1,381**	1,539	1,365	1,225
Net yen-denominated financial instruments	**34,326**	**30,033**	**26,693**	28,020	24,834	22,299
Other yen-denominated assets	**4,429**	**3,874**	**3,444**	3,756	3,329	2,989
Other yen-denominated liabilities	**(37,622)**	**(32,916)**	**(29,256)**	(30,890)	(27,378)	(24,583)
Consolidated yen-denominated net assets subject to foreign currency fluctuation	**$ 1,133**	**$ 991**	**$ 881**	$ 886	$ 785	$ 705

* Actual year-end exchange rates

We are only exposed to economic currency risk when yen funds are converted into dollars. This primarily occurs when we convert yen funds that have been transferred from AFLAC Japan to AFLAC U.S. The exchange rates prevailing at the time of transfer may differ from the exchange rates prevailing at the time the yen profits were earned. It has been our practice to transfer yen funds each year from AFLAC Japan to AFLAC U.S. Generally, these yen fund repatriations have represented an amount less than 80% of AFLAC Japan's prior year FSA-based earnings. Typically, a portion of the yen funds transfer is used to service AFLAC Incorporated's yen-denominated notes payable and the remainder is converted into dollars.

For information regarding the effect of foreign currency translation on operating earnings per share, see Foreign Currency Translation on pages 24 and 25, and Note 2 of the Notes to the Consolidated Financial Statements.

Interest Rate Risk

Our primary interest rate exposure is a result of the effect of changes in interest rates on the fair value of our investments in debt securities. We use modified duration analysis, which measures price percentage volatility, to estimate the sensitivity of our debt securities' fair values to interest rate changes. For example, if the current duration of a debt security is 10, then the fair value of that security will increase by approximately 10% if market interest rates decrease by 100 basis points, assuming all other factors remain constant. Likewise, the fair value of the debt security will decrease by approximately 10% if market interest rates increase by 100 basis points, assuming all other factors remain constant.

The estimated effect of potential increases in interest rates on the fair values of our debt securities, notes payable, cross-currency swaps and our obligation for the Japanese policyholder protection fund follows:

Sensitivity of Fair Values of Financial Instruments to Interest Rate Changes

(December 31)

	2002		2001	
(In millions)	**Market Value**	**+100 Basis Points**	Market Value	+100 Basis Points
Debt securities:				
Fixed-maturity securities:				
Yen-denominated	**$ 24,480**	**$ 22,075**	$ 19,711	$ 17,856
Dollar-denominated	**6,778**	**6,261**	5,951	5,497
Perpetual debentures:				
Yen-denominated	**5,960**	**5,361**	5,477	4,909
Dollar-denominated	**365**	**345**	344	302
Total debt securities	**$ 37,583**	**$ 34,042**	$ 31,483	$ 28,564
Notes payable*	**$ 1,333**	**$ 1,280**	$ 1,181	$ 1,135
Cross-currency swaps assets	**$ 25**	**$ 27**	$ 33	$ 36
Obligation for Japanese policyholder protection fund	**$ 227**	**$ 227**	$ 186	$ 186

* Excludes capitalized lease obligations

Changes in the interest rate environment have contributed to significant unrealized gains on our debt securities. However, we do not expect to realize a majority of these unrealized gains because we have the intent and ability to hold these securities to maturity. Should significant amounts of unrealized losses occur because of increases in market yields, we would not expect to realize significant losses because we have the ability to hold such securities to maturity.

We attempt to match the duration of our assets with the duration of our liabilities. For AFLAC Japan, the duration of policy benefits and related expenses to be paid in future years is longer than that of the related invested assets due to the unavailability of acceptable long-duration yen-denominated securities. The average duration of policy benefits and related expenses to be paid in future years was approximately 12 years in both 2002 and 2001. The average duration of the yen-denominated debt securities was approximately 10 years in both 2002 and 2001. The average duration of premiums to be received in the future was approximately nine years in both 2002 and 2001. The following table shows a comparison of average assumed interest rates for future policy benefits and investment yields, based on amortized cost, for the years ended December 31.

Comparison of Interest Rates for Future Policy Benefits and Investment Yields

(Net of investment expenses)

	2002		2001		2000	
	U.S.	**Japan***	U.S.	Japan*	U.S.	Japan*
Policies issued during year:						
Required interest on policy reserves	**6.48%**	**2.98%**	6.43%	2.99%	6.48%	3.00%
New money yield on investments	**7.52**	**3.59**	7.73	3.51	8.15	3.51
Policies in force during year:						
Required interest on policy reserves	**6.39**	**5.02**	6.41	5.12	6.42	5.21
Net investment yield	**7.56**	**4.40**	7.67	4.40	7.62	4.55

* Represents yen-denominated investments for AFLAC Japan that support policy obligations and therefore excludes AFLAC Japan's dollar-denominated investments and related investment income

Over the next two years, we have several yen-denominated securities that mature with yields in excess of AFLAC Japan's current net investment yield of 4.40%. These securities total $939 million at amortized cost and have an average yield of 6.14%. These maturities will contribute to a continued decline in our overall portfolio yield. Currently, when our debt securities mature, the proceeds may be reinvested at a yield below that of the interest required for the accretion of policy benefit liabilities on policies issued in earlier years. However, the investment yield on new investments has exceeded interest requirements on policies issued in recent years. Since 1994, premium rates on new business have been increased several times to help offset the lower available investment yields. Also in recent years, our strategy of developing and marketing riders as attachments to our older policies has helped offset the negative investment spread. And despite the negative investment spreads, adequate overall profit margins still exist in AFLAC Japan's aggregate block of business because of profits that have emerged from changes in mix of business and favorable mortality, morbidity and expenses.

Equity Price Risk

Equity securities at December 31, 2002, totaled $258 million, or .7% of total investments and cash on a consolidated basis. We use beta analysis to measure the sensitivity of our equity securities portfolio to fluctuations in the broad market. The beta of our equity securities portfolio was .92 at December 31, 2002. For example, if the overall stock market value changed by 10%, the value of AFLAC's equity securities would be expected to change by approximately 9.2%, or $24 million.

Investments and Cash

Our investment philosophy is to maximize investment income while emphasizing liquidity, safety and quality. Our investment objective, subject to appropriate risk constraints, is to fund policyholder obligations and other liabilities in a manner that enhances shareholders' equity. We seek to meet this objective through a mix of investments that reflects the characteristics of the liabilities they support and diversification of investments by interest rate, currency, liquidity, credit and equity price risk.

For 2002, the increase in investments and cash reflected the effect of a stronger yen/dollar exchange rate, general levels of investment yields for debt securities, the substantial cash flows in the functional currencies of our operations, and an increase in cash collateral from loaned securities at year-end. See Capital Resources and Liquidity on page 35 for additional information.

The following table presents an analysis of investment securities at December 31:

	AFLAC Japan		AFLAC U.S.	
(In millions)	**2002**	2001	**2002**	2001
Securities available for sale, at fair value:				
Fixed maturities	**$ 18,036**	$ 16,342	**$ 4,623***	$ 4,058*
Perpetual debentures	**2,569**	2,399	**161**	155
Equity securities	**136**	103	**122**	142
Total available for sale	**20,741**	18,844	**4,906**	4,355
Securities held to maturity, at amortized cost:				
Fixed maturities	**8,394**	5,417	**–**	–
Perpetual debentures	**3,700**	3,306	**–**	–
Total held to maturity	**12,094**	8,723	**–**	–
Total investment securities	**$ 32,835**	$ 27,567	**$ 4,906**	$ 4,355

* Includes securities held by the parent company of $207 in 2002 and $243 in 2001

Privately issued securities, at amortized cost, accounted for $20.6 billion, or 60.2%, of total debt securities as of December 31, 2002, compared with $16.7 billion, or 57.1%, at December 31, 2001. Privately issued securities held by AFLAC Japan at amortized cost accounted for $19.3 billion, or 56.3%, and $15.4 billion, or 52.5%, of total debt securities at December 31, 2002 and 2001, respectively. Of the total privately issued securities, reverse-dual currency debt securities accounted for $4.7 billion, or 22.6%, as of December 31, 2002, compared with $4.2 billion, or 25.2%, at December 31, 2001. AFLAC Japan has invested in yen-denominated privately issued securities to secure higher yields than those available from Japanese government bonds. Our investments in yen-denominated privately issued securities consist primarily of non-Japanese issuers, which helps reduce our exposure to Japanese corporate issuers. These non-Japanese issuers are willing to issue yen-denominated securities with longer maturities, thereby allowing us to improve our asset and liability matching and our overall investment returns.

We continue to adhere to prudent standards for credit quality. Most of our privately issued securities are issued under medium-term note programs and have standard covenants commensurate with credit ratings, except when internal credit analysis indicates that additional protective and/or event-risk covenants are required. AFLAC invests primarily within the debt securities markets, which exposes us to credit risk. Credit risk is a consequence of extending credit and/or carrying investment positions. We require that all securities be rated investment grade at the time of purchase. We use specific criteria to judge the credit quality and liquidity of our investments and use a variety of credit rating services to monitor these criteria. The percentage distribution of our debt securities, at amortized cost, by credit rating as of December 31 was as follows:

	2002	2001
AAA	**2.3%**	2.4%
AA	**34.6**	39.9
A	**36.8**	36.2
BBB	**24.0**	20.3
BB	**2.3**	1.2
	100.0%	100.0%

Debt security purchases were as follows:

	2002	2001
AAA	**1.7%**	2.6%
AA	**21.1**	12.5
A	**47.5**	49.1
BBB	**29.7**	35.8
	100.0%	100.0%

The overall credit quality of our portfolio remains high. Our investment policy prohibits us from purchasing below-investment-grade securities. In the event of a credit rating downgrade, we do not automatically liquidate our position. Rather, investment management carefully reviews the investment and updates its credit analysis to determine if the investment should be impaired and/or liquidated.

Net unrealized gains of $3.3 billion on investment securities at December 31, 2002, consisted of $4.3 billion in gross unrealized gains and $1.0 billion in gross unrealized losses. Net unrealized gains of $2.2 billion on investment securities at December 31, 2001, consisted of $3.1 billion in gross unrealized gains and $869 million in gross unrealized losses. Gross unrealized losses on investment-grade securities were $870 million in 2002 and $841 million in 2001.

Net unrealized losses of $156 million on our below-investment-grade securities at December 31, 2002 consisted of $163 million of gross unrealized losses and $7 million of gross unrealized gains. Net unrealized losses of $7 million on below-investment-grade securities at December 31, 2001 consisted of $28 million of gross unrealized losses and $21 million of gross unrealized gains. These below-investment-grade securities, which are held in our available-for-sale portfolio, comprise 2.3% of total investment securities at amortized cost, compared with 1.2% in 2001. Below-investment-grade securities owned as of December 31 were as follows:

Below-Investment-Grade Securities

	2002		2001	
(In millions)	**Amortized Cost**	**Fair Value**	Amortized Cost	Fair Value
KLM Royal Dutch Airlines	**$ 250**	**$ 158**	$ *	$ *
Levi Strauss & Co.	**117**	**117**	106	108
BIL Asia Group	**133**	**124**	189	163
Asahi Finance Limited	**42**	**46**	*	*
LeGrand	**86**	**66**	*	*
Cerro Negro Finance	**67**	**40**	*	*
Tennessee Gas Pipeline	**40**	**33**	–	–
PDVSA Finance	**32**	**25**	*	*
KDDI	**22**	**21**	20	18
Other	**2**	**5**	40	59
Total	**$ 791**	**$ 635**	$ 355	$ 348

* Investment-grade prior to 2002

As part of our investment activities, we have investments in several fixed-maturity yen-denominated variable interest entities (VIEs). See Notes 1 and 3 of the Notes to the Consolidated Financial Statements for additional information.

For the Japanese reporting fiscal year ended March 31, 2002, new Japanese accounting principles and regulatory requirements became effective that impact investment classifications and solvency margin ratios on a Japanese accounting basis as prescribed by the FSA. As a result of these new requirements, we re-evaluated AFLAC Japan's investment portfolio and our intent related to the holding period of certain investment securities. In order to minimize fluctuations in our Japanese solvency margin ratio, we reclassified debt securities with amortized cost of $1.8 billion from the held-to-maturity category to the available-for-sale category as of March 31, 2001. We also reclassified debt securities with a fair value of $2.3 billion from the available-for-sale category to the held-to-maturity category as of March 31, 2001.

Mortgage loans on real estate and other long-term investments remained immaterial at both December 31, 2002 and 2001. Cash, cash equivalents and short-term investments totaled $1.4 billion, or 3.5% of total investments and cash, as of December 31, 2002, compared with $853 million, or 2.6% of total investments and cash, at December 31, 2001.

For additional information concerning investments and fair values, see Notes 3 and 4 of the Notes to the Consolidated Financial Statements.

Deferred Policy Acquisition Costs

Deferred policy acquisition costs totaled $4.3 billion at December 31, 2002, an increase of $626 million, or 17.1% for the year. AFLAC Japan's deferred policy acquisition costs were $2.9 billion at December 31, 2002, an increase of $397 million, or 16.1% (5.5% increase in yen). At December 31, 2002, deferred policy acquisition costs of AFLAC U.S. were $1.4 billion, an increase of $229 million, or 19.4%. The increase in deferred policy acquisition costs was primarily driven by increases in new annualized premium sales. The stronger yen at year-end also increased reported deferred policy acquisition costs by $262 million.

Policy Liabilities

Policy liabilities totaled $32.7 billion at December 31, 2002, an increase of $5.1 billion, or 18.6% for the year. AFLAC Japan's policy liabilities were $29.4 billion at December 31, 2002, an increase of $4.7 billion, or 19.2% (8.3% increase in yen). At December 31, 2002, policy liabilities of AFLAC U.S. were $3.3 billion, an increase of $397 million, or 13.8%. The stronger yen at year-end increased reported policy liabilities by $2.7 billion. The aging of policies in force and increases from new business also contributed to the increase in policy liabilities.

Notes Payable

In September 2000, the Parent Company filed a shelf registration statement with Japanese regulatory authorities to issue up to ¥100 billion of yen-denominated Samurai notes in Japan. These securities are not for sale to U.S. residents or entities. In 2000, we issued ¥30 billion of 1.55% Samurai notes due October 2005 ($250 million using the December 31, 2002 exchange rate). In 2001, we issued ¥40 billion of .87% Samurai notes due June 2006 ($334 million using the December 31, 2002 exchange rate). In 2002, we issued ¥30 billion of .96% Samurai notes due June 2007 ($250 million using the December 31, 2002 exchange rate). All three issues are redeemable at our option at any time with a redemption price equal to the principal amount of the notes being redeemed plus a premium. Proceeds were used for various corporate purposes.

In 1999, we issued $450 million of senior notes with a 6.50% coupon, payable semiannually, due April 2009. At December 31, 2002, the outstanding principal, less unamortized discount, was $449 million. The notes are redeemable at our option at any time at a redemption price equal to the principal amount of the notes being redeemed plus a make-whole amount. The proceeds were used for various corporate purposes. We entered into cross-currency swaps that effectively convert the dollar-denominated principal and interest of these notes into yen-denominated obligations. The notional amount of the cross-currency swaps is $450 million (¥55.6 billion) with a blended fixed interest rate of 1.67% in yen. At December 31, 2002, the fair value of the swaps was an asset of $25 million, compared with $33 million in 2001.

For our yen-denominated loans, the principal amounts as stated in dollars fluctuate due to changes in the yen/dollar exchange rate. We have designated these yen-denominated borrowings and the cross-currency swaps as a hedge of our investment in AFLAC Japan. We translate the outstanding principal and related accrued interest payable of these yen-denominated obligations into dollars using end-of-period exchange rates. The resulting foreign currency translation gains/losses are included in accumulated other comprehensive income.

The ratio of debt to total capitalization (debt plus shareholders' equity, excluding the unrealized gains on investment securities) was 24.8% as of December 31, 2002 and 25.4% as of December 31, 2001.

The following table summarizes our major contractual obligations apart from those arising from our insurance product and investment purchase activities as of December 31, 2002.

Distribution of Payments by Period

(In millions)	Total	Less than one year	One to three years	Four to five years	After five years
Long-term debt	$ 1,284	$ –	$ 250	$ 584	$ 450
Capitalized lease obligations	29	14	14	1	–
Operating lease obligations	97	37	24	9	27
Policyholder protection fund	227	9	41	47	130
Total contractual obligations	$ 1,637	$ 60	$ 329	$ 641	$ 607

As of December 31, 2002, we had no material unconditional purchase obligations that were not recorded on the balance sheet. Additionally, we had no material letters of credit, standby letters of credit, guarantees or standby repurchase obligations.

Security Lending

AFLAC Japan uses short-term security lending arrangements to increase investment income with minimal risk. For further information regarding such arrangements, see Note 3 of the Notes to the Consolidated Financial Statements.

Defined Benefit Pension Plans

AFLAC U.S. and AFLAC Japan have defined benefit pension plans that cover substantially all full-time employees. General market conditions and the actuarial assumptions used to value our plans' assets and liabilities have a significant impact on plan costs and the reported values of plan assets and liabilities. Generally, the plans are funded annually, with minimum contributions required by applicable regulations, including amortization of unfunded prior service cost. We believe the discount rates, as supported by our consulting actuaries and used in the valuations of our U.S. and Japanese plans, are reasonable.

At December 31, 2002, other liabilities included a liability for both plans in the amount of $39 million, compared with $20 million a year ago and shareholders' equity reflected a noncash charge of $8 million for the minimum pension liability associated with our U.S. plan. In 2002 consolidated pension expense was $12 million, compared with $8 million in 2001. Pension expense for 2003 is expected to be approximately $8 million for the U.S. plan and ¥800 million ($7 million using the December 31, 2002 exchange rate) for the Japanese plan. We expect to make cash contributions in 2003 of approximately $4 million for the U.S. plan and ¥871 million ($7 million using the December 31, 2002 exchange rate) for the Japanese plan.

Policyholder Protection Fund and State Guaranty Association Assessments

In 1998, the Japanese government established the Life Insurance Policyholders Protection Corporation (LIPPC). Funding by the life insurance industry is generally made over a ten-year period. We recognize charges for our estimated share of the industry's obligation once it is determinable. We review the estimated liability for policyholder protection fund contributions on an annual basis and report any adjustments in net earnings.

In December 2002, we received a formal proposal regarding additional funding for the LIPPC. The proposal was drafted by the FSA and submitted to AFLAC through the Life Insurance Association of Japan and Japan's LIPPC. The proposal included an extension of the Japanese government's pledge to enact fiscal safety-net measures of up to ¥400 billion until March 2006, and for the industry to contribute an additional ¥78 billion to the LIPPC. In addition to the bankruptcy laws that allow for the rehabilitation of life insurers, these funds will be used to support policyholder obligations of failed life insurance companies. Despite our vote against the proposal, it passed when members of the LIPPC voted on December 27, 2002. We recorded an after-tax charge of $26 million, or $.05 per diluted share, for our estimated portion of the additional industry contribution.

Under insurance guaranty association laws in most U.S. states, insurance companies doing business in those states can be assessed for policyholder losses up to prescribed limits that are incurred by insolvent companies with similar lines of business. Such assessments have not been material to us in the past. We believe that future assessments relating to companies in the United States currently involved in insolvency proceedings will not materially impact our financial position or results of operations.

Capital Resources and Liquidity

The principal sources of cash for our insurance operations are premiums and investment income. The primary uses of cash by our insurance operations are policy claims, commissions, operating expenses, income taxes and payments to AFLAC Incorporated for management fees and dividends. Both the sources and uses of cash are reasonably predictable.

Our investment objectives provide for liquidity through the ownership of investment-grade debt securities. AFLAC insurance policies generally are not interest-sensitive and therefore are not subject to unexpected policyholder redemptions due to investment yield changes. Also, the majority of AFLAC's policies provide fixed-benefit amounts rather than reimbursement for actual medical costs and therefore generally are not subject to the risks of medical-cost inflation.

The Nebraska insurance department imposes certain limitations and restrictions on payments of dividends, management fees, loans and advances by AFLAC to AFLAC Incorporated. The Nebraska insurance statutes require prior approval for dividend distributions that exceed the greater of the net gain from operations, which excludes net realized investment gains, for the previous year determined under statutory accounting principles, or 10% of statutory capital and surplus as of the previous year-end. In addition, the Nebraska insurance department must approve service arrangements and other transactions within the affiliated group. These regulatory limitations are not expected to affect the level of management fees or dividends paid by AFLAC to AFLAC Incorporated. A life insurance company's statutory capital and surplus is determined according to rules prescribed by the National Association of Insurance Commissioners (NAIC), as modified by the insurance department in the insurance company's state of domicile. Statutory accounting rules are different from GAAP and are intended to emphasize policyholder protection and company solvency.

The continued long-term growth of our business may require increases in the statutory capital and surplus of our insurance operations. AFLAC's insurance operations may secure additional statutory capital through various sources, such as internally generated statutory earnings or equity contributions by AFLAC Incorporated from funds generated through debt or equity offerings. The NAIC's risk-based capital formula is used by insurance regulators to facilitate identification of inadequately capitalized insurance companies. The formula evaluates insurance risk, business risk, asset risk and interest rate risk by weighing the types and mixtures of risks inherent in the insurer's operations. AFLAC's NAIC risk-based capital ratio remains high and reflects a very strong capital and surplus position. Currently, the NAIC has ongoing regulatory initiatives relating to revisions to the risk-based capital formula as well as numerous initiatives covering insurance products, investments, and other actuarial and accounting matters. We believe that we will continue to maintain a strong risk-based capital ratio and statutory capital and surplus position in future periods.

In addition to restrictions by U.S. insurance regulators, the FSA may not allow transfers of funds from AFLAC Japan if the transfers would cause AFLAC Japan to lack sufficient financial strength for the protection of policyholders. The FSA maintains its own solvency standards, a version of risk-based capital requirements. AFLAC Japan's solvency margin ratio significantly exceeds regulatory minimums. Payments are made from AFLAC Japan to AFLAC Incorporated for management fees and to AFLAC U.S. for allocated expenses and remittances of earnings. During 2002, AFLAC Japan paid $25 million to AFLAC Incorporated for management fees, compared with $20 million in both 2001 and 2000. In 2002, expenses allocated to AFLAC Japan were $22 million, compared with $24 million in 2001 and $22 million in 2000. During 2002, AFLAC Japan also remitted profits of $383 million (¥45.3 billion) to AFLAC U.S., compared with $185 million (¥23.0 billion) in 2001 and $157 million (¥17.0 billion) in 2000. For additional information on regulatory restrictions on dividends, profit transfers and other remittances, see Note 9 of the Notes to the Consolidated Financial Statements.

For the Japanese reporting fiscal year ended March 31, 2002, AFLAC Japan adopted a new Japanese statutory accounting standard regarding fair value accounting for investments. Previously, debt securities were generally reported at amortized cost for FSA purposes. Under the new accounting standard, AFLAC Japan's debt securities have been classified as either available for sale or held to maturity.

Under this new regulatory accounting standard, the unrealized gains and losses on debt securities available for sale are reported in FSA capital and surplus and reflected in the solvency margin ratio. This new accounting standard may result in significant fluctuations in FSA equity, AFLAC Japan's solvency margin ratio and amounts available for annual profit repatriation.

AFLAC Incorporated's insurance operations continue to provide the primary sources of its liquidity through dividends and management fees. We occasionally access debt and equity security markets to provide additional sources of capital. (See discussion on page 33 under notes payable.) Capital is primarily used to fund business expansion, capital expenditures and our share repurchase program. We believe outside sources for additional debt and equity capital, if needed, will continue to be available.

AFLAC Incorporated received dividends from AFLAC in the amount of $358 million in 2002, compared with $204 million in 2001 and $234 million in 2000. The increase in dividends resulted from management's decision to remove excess capital from Japan in an effort to achieve better investment returns in the United States. In 2002, we issued ¥30 billion of yen-denominated Samurai notes in Japan (approximately $254 million at that date). AFLAC Incorporated received approximately $333 million (¥40 billion) in 2001 from the issuance of Samurai notes in Japan. In 2000, we issued ¥30 billion of yen-denominated Samurai notes in Japan (approximately $277 million at that date).

Rating Agencies

AFLAC is rated "AA" by both Standard & Poor's and Fitch Ratings for financial strength. During 2002, Moody's upgraded AFLAC's financial strength rating from "Aa3" to "Aa2." A.M. Best assigned AFLAC an "A+, Superior" rating for financial strength and operating performance. AFLAC Incorporated's credit rating for senior debt is "A" by Standard & Poor's, "A+" by Fitch Ratings, and "A2" by Moody's.

Other

For information regarding commitments and contingent liabilities, see Note 11 of the Notes to the Consolidated Financial Statements.

Consolidated Cash Flows

We translate operating cash flows for AFLAC Japan's yen-denominated items into U.S. dollars using weighted-average exchange rates. In years when the yen weakens, translating yen into dollars causes fewer dollars to be reported. When the yen strengthens, translating yen into dollars causes more dollars to be reported. The following table summarizes consolidated cash flows by activity for the years ended December 31:

Consolidated Cash Flows by Activity

(For the years ended December 31)

(In millions)	**2002**	2001	2000
Operating activities	**$ 3,038**	$ 2,849	$ 3,245
Investing activities	**(2,274)**	(2,473)	(3,059)
Financing activities	**(320)**	(42)	(130)
Exchange effect on cash and cash equivalents	**83**	(91)	(63)
Net change in cash and cash equivalents	**$ 527**	$ 243	$ (7)

Operating Activities

In 2002 consolidated cash flow from operations increased 6.6% to $3.0 billion, compared with $2.8 billion in 2001 and $3.2 billion in 2000. Net cash flow from operations other than Japan increased 10.9% in 2002 to $521 million, compared with $470 million in 2001 and $348 million in 2000. Net cash flow from operations for AFLAC Japan increased 5.8% in 2002 to $2.5 billion, compared with $2.4 billion in 2001 and $2.9 billion in 2000. The increase in Japan cash flows in 2002 was primarily attributable to the growth of our business partially offset by the weaker yen/dollar exchange rate. The decrease in cash flows in 2001 was primarily attributable to the effect of the weaker yen/dollar exchange rate, an increase in tax payments in Japan and increased expenditures for the new computerized policy administration system for AFLAC Japan. The weakening of the yen decreased AFLAC Japan's cash flows by $75 million in 2002 and $303 million in 2001. The strengthening of the yen in 2000 increased AFLAC Japan's cash flows by $156 million. Excluding the effect of foreign currency translation, AFLAC Japan's cash flows increased 8.9% in 2002, compared with a decrease of 7.4% in 2001, and an increase of 11.0% in 2000. AFLAC Japan contributed 83% of the consolidated cash flow from operations in 2002, 84% in 2001 and 89% in 2000.

Investing Activities

Operating cash flow is primarily used to purchase debt securities to meet future policy obligations. Consolidated cash flow used by investing activities decreased 8.1% to $2.3 billion in 2002, compared with $2.5 billion in 2001 and $3.1 billion in 2000. AFLAC Japan accounted for 81% of the consolidated net cash used by investing activities in 2002, compared with 83% in 2001 and 90% in 2000.

When market opportunities arise, we dispose of selected debt securities that are available for sale to improve future investment yields and/or improve the duration matching of our assets and liabilities. Therefore, dispositions before maturity can vary significantly from year to year. Dispositions before maturity ranged between 3% and 8% of the annual average investment portfolio of debt securities available for sale during the three years ended December 31, 2002.

Net additions to property and equipment, including capitalized lease obligations, were $33 million in 2002, $62 million in 2001, and $51 million in 2000.

Financing Activities

Net cash used by financing activities was $320 million in 2002, $42 million in 2001 and $130 million in 2000. In 2002, we received net proceeds of $254 million in connection with the issuance in Japan of .96% Samurai notes due in 2007. We also paid in full, $221 million, our revolving credit agreement. In 2001, we received net proceeds of $333 million in connection with the issuance in Japan of .87% Samurai notes due in 2006. We also paid $103 million in connection with the scheduled maturity of our yen-denominated unsecured credit agreement. In 2000, we received net proceeds of $277 million in connection with the issuance in Japan of 1.55% Samurai notes due in 2005. Treasury stock purchases were $346 million (12 million shares) in 2002, compared with $350 million (12 million shares) in 2001 and $239 million (10 million shares) in 2000. We issued treasury shares for certain AFLAC stock option exercises, additional stock purchases by shareholders in the dividend reinvestment plan and stock issued to sales associates.

Dividends to shareholders in 2002 were $119 million ($112 million paid in cash; $7 million through issuance of treasury shares under the dividend reinvestment plan). Dividends to shareholders in 2001 were $101 million ($95 million paid in cash; $6 million through issuance of treasury shares under the dividend reinvestment plan). Dividends to shareholders in 2000 were $87 million ($82 million paid in cash; $5 million through issuance of treasury shares under the dividend reinvestment plan). The 2002 dividend of $.23 per share increased 19.2% over 2001. The 2001 dividend of $.193 per share increased 15.6% over 2000. The 2000 dividend of $.167 per share increased 13.6% over 1999.

Forward-Looking Information

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" to encourage companies to provide prospective information, so long as those informational statements are identified as forward-looking and are accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those discussed. We desire to take advantage of these provisions. This report contains cautionary statements identifying important factors that could cause actual results to differ materially from those projected in this discussion and analysis, and in any other statements made by company officials in oral discussions with the financial community and contained in documents filed with the Securities and Exchange Commission (SEC). Forward-looking statements are not based on historical information and relate to future operations, strategies, financial results or other developments. Furthermore, forward-looking information is subject to numerous assumptions, risks, and uncertainties. In particular, statements containing words such as "expect," "anticipate," "believe," "goal," "objective," "may," "should," "estimate," "intends," "projects," or similar words as well as specific projections of future results, generally qualify as forward-looking. AFLAC undertakes no obligation to update such forward-looking statements.

We caution readers that the following factors, in addition to other factors mentioned from time to time in our reports filed with the SEC, could cause actual results to differ materially from those contemplated by the forward-looking statements:

- legislative and regulatory developments,
- assessments for insurance company insolvencies,
- competitive conditions in the United States and Japan,
- new product development,
- ability to attract and retain qualified sales associates,
- ability to repatriate profits from Japan,
- changes in U.S. and/or Japanese tax laws or accounting requirements,
- credit and other risks associated with AFLAC's investment activities,
- significant changes in interest rates,
- fluctuations in foreign currency rates,
- deviations in actual experience from pricing and reserving assumptions,
- level and outcome of litigation,
- downgrades in the company's credit rating,
- changes in rating agency policies or practices,
- subsidiary's ability to pay dividends to parent company, and
- general economic conditions in the United States and Japan.