# UNITED STATES SECURITIES AND EXCHANGE COMMISSION
## Washington, D.C. 20549

# FORM 10-Q

(Mark One)
[ X ] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2005

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ____________ to ______________

# Aflac Incorporated

(Exact name of Registrant as specified in its charter)

| | | |
|---|---|---|
| **GEORGIA** | **001-07434** | **58-1167100** |
| (State or other jurisdiction of incorporation or organization) | (Commission File Number) | (IRS Employer Identification No.) |

| | |
|---|---|
| **1932 Wynnton Road, Columbus, Georgia** | **31999** |
| (Address of principal executive offices) | (Zip Code) |

**706.323.3431**

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes _X_ No ___

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act)
Yes _X_ No ___

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class | August 1, 2005 |
|---|---|
| Common Stock, $.10 Par Value | 501,700,209 shares |

**Aflac Incorporated and Subsidiaries**
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Items other than those listed above are omitted because they are not required or are not applicable.



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## PART I. FINANCIAL INFORMATION

**Item 1. Financial Statements.**

**Aflac Incorporated and Subsidiaries**
**Consolidated Statements of Earnings**

| (In millions, except for share and per-share amounts - Unaudited) | Three Months Ended June 30, **2005** | Three Months Ended June 30, 2004 | Six Months Ended June 30, **2005** | Six Months Ended June 30, 2004 |
|---|---|---|---|---|
| **Revenues:** | | | | |
| Premiums, principally supplemental health insurance | **$ 3,020** | $ 2,768 | **$ 6,061** | $ 5,541 |
| Net investment income | **518** | 484 | **1,033** | 957 |
| Realized investment gains (losses) | **11** | (5) | **15** | 1 |
| Other income (losses) | **18** | (14) | **18** | 14 |
| Total revenues | **3,567** | 3,233 | **7,127** | 6,513 |
| **Benefits and expenses:** | | | | |
| Benefits and claims | **2,229** | 2,068 | **4,495** | 4,146 |
| Acquisition and operating expenses: | | | | |
| Amortization of deferred policy acquisition costs | **134** | 127 | **270** | 258 |
| Insurance commissions | **334** | 308 | **667** | 619 |
| Insurance expenses | **324** | 289 | **611** | 556 |
| Interest expense | **6** | 6 | **11** | 11 |
| Other operating expenses | **24** | 22 | **50** | 43 |
| Total acquisition and operating expenses | **822** | 752 | **1,609** | 1,487 |
| Total benefits and expenses | **3,051** | 2,820 | **6,104** | 5,633 |
| Earnings before income taxes | **516** | 413 | **1,023** | 880 |
| Income taxes | **180** | 155 | **359** | 317 |
| Net earnings | **$ 336** | $ 258 | **$ 664** | $ 563 |
| **Net earnings per share:** | | | | |
| Basic | **$ .67** | $ .51 | **$ 1.32** | $ 1.11 |
| Diluted | **.66** | .50 | **1.30** | 1.09 |
| **Common shares used in computing earnings per share (In thousands):** | | | | |
| Basic | **501,426** | 508,353 | **502,063** | 509,138 |
| Diluted | **508,002** | 517,860 | **508,722** | 518,607 |
| **Cash dividends per share** | **$ .11** | $ .095 | **$ .22** | $ .19 |

*Prior year amounts have been adjusted for adoption of SFAS 123R on January 1, 2005.*

*See the accompanying Notes to the Consolidated Financial Statements.*



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## Aflac Incorporated and Subsidiaries
## Consolidated Balance Sheets

| (In millions - Unaudited) | **June 30, 2005** | December 31, 2004 |
|---|---|---|
| **Assets**: | | |
| Investments and cash: | | |
| Securities available for sale, at fair value: | | |
| Fixed maturities (amortized cost $25,454 in 2005 and $26,138 in 2004) | **$ 29,139** | $ 29,166 |
| Perpetual debentures (amortized cost $3,996 in 2005 and $3,952 in 2004) | **4,245** | 4,019 |
| Equity securities (cost $32 in 2005 and $34 in 2004) | **79** | 77 |
| Securities held to maturity, at amortized cost: | | |
| Fixed maturities (fair value $11,855 in 2005 and $10,522 in 2004) | **11,140** | 10,080 |
| Perpetual debentures (fair value $4,748 in 2005 and $4,924 in 2004) | **4,468** | 4,759 |
| Other investments | **48** | 41 |
| Cash and cash equivalents | **1,428** | 3,813 |
| Total investments and cash | **50,547** | 51,955 |
| Receivables, primarily premiums | **579** | 417 |
| Accrued investment income | **497** | 495 |
| Deferred policy acquisition costs | **5,586** | 5,595 |
| Property and equipment, at cost less accumulated depreciation | **477** | 515 |
| Other | **309** | 349 |
| Total assets | **$ 57,995** | $ 59,326 |

*Prior year amounts have been adjusted for adoption of SFAS 123R on January 1, 2005.*
*See the accompanying Notes to the Consolidated Financial Statements.*

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## Aflac Incorporated and Subsidiaries
## Consolidated Balance Sheets (continued)

| (In millions, except for share and per-share amounts - Unaudited) | **June 30, 2005** | December 31, 2004 |
|---|---|---|
| **Liabilities and shareholders' equity**: | | |
| Liabilities: | | |
| Policy liabilities: | | |
| Future policy benefits | **$ 38,671** | $ 39,360 |
| Unpaid policy claims | **2,482** | 2,355 |
| Unearned premiums | **578** | 593 |
| Other policyholders' funds | **1,337** | 1,248 |
| Total policy liabilities | **43,068** | 43,556 |
| Notes payable | **1,369** | 1,429 |
| Income taxes | **3,049** | 2,581 |
| Payables for return of cash collateral on loaned securities | **901** | 2,887 |
| Other | **1,149** | 1,297 |
| Commitments and contingent liabilities (Notes 8 and 9) | | |
| Total liabilities | **49,536** | 51,750 |
| Shareholders' equity: | | |
| Common stock of $.10 par value. In thousands: authorized 1,000,000 shares; issued 653,360 shares in 2005 and 652,628 shares in 2004 | **65** | 65 |
| Additional paid-in capital | **730** | 677 |
| Retained earnings | **7,339** | 6,785 |
| Accumulated other comprehensive income: | | |
| Unrealized foreign currency translation gains | **164** | 221 |
| Unrealized gains on investment securities | **2,938** | 2,417 |
| Minimum pension liability adjustment | **(28)** | (28) |
| Treasury stock, at average cost | **(2,749)** | (2,561) |
| Total shareholders' equity | **8,459** | 7,576 |
| Total liabilities and shareholders' equity | **$ 57,995** | $ 59,326 |
| Shareholders' equity per share | **$ 16.88** | $ 14.90 |

*Prior year amounts have been adjusted for adoption of SFAS 123R on January 1, 2005.*
*See the accompanying Notes to the Consolidated Financial Statements.*



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**Aflac Incorporated and Subsidiaries**
**Consolidated Statements of Shareholders' Equity**

| (In millions, except for per-share amounts - Unaudited) | Six Months Ended June 30, **2005** | 2004 |
|---|---|---|

| | | |
|---|---|---|
| **Common stock:** | | |
| Balance, beginning and end of period | **$ 65** | $ 65 |
| **Additional paid-in capital:** | | |
| Balance, beginning of period | **677** | 417 |
| Cumulative effect of change in accounting principle | **-** | 175 |
| Exercise of stock options, including income tax benefits | **25** | 10 |
| Share-based compensation | **14** | 18 |
| Gain on treasury stock reissued | **14** | 20 |
| Balance, end of period | **730** | 640 |
| **Retained earnings:** | | |
| Balance, beginning of period | **6,785** | 5,885 |
| Cumulative effect of change in accounting principle | **-** | (173) |
| Net earnings | **664** | 563 |
| Dividends to shareholders ($.22 per share in 2005 and $.19 per share in 2004) | **(110)** | (97) |
| Balance, end of period | **7,339** | 6,178 |
| **Accumulated other comprehensive income:** | | |
| Balance, beginning of period | **2,610** | 2,493 |
| Change in unrealized foreign currency translation gains (losses) during period, net of income taxes | **(57)** | 5 |
| Change in unrealized gains (losses) on investment securities during period, net of income taxes | **521** | (846) |
| Minimum pension liability adjustment during period, net of income taxes | **-** | 11 |
| Balance, end of period | **3,074** | 1,663 |
| **Treasury stock:** | | |
| Balance, beginning of period | **(2,561)** | (2,214) |
| Purchases of treasury stock | **(225)** | (178) |
| Cost of shares issued | **37** | 28 |
| Balance, end of period | **(2,749)** | (2,364) |
| Total shareholders' equity | **$ 8,459** | $ 6,182 |

*Prior year amounts have been adjusted for adoption of SFAS 123R on January 1, 2005.*
*See the accompanying Notes to the Consolidated Financial Statements.*



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**Aflac Incorporated and Subsidiaries**
**Consolidated Statements of Cash Flows**

Six Months Ended June 30,

| (In millions - Unaudited) | **2005** | 2004 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net earnings | **$ 664** | $ 563 |
| Adjustments to reconcile net earnings to net | | |
| cash provided by operating activities: | | |
| Change in receivables and advance premiums | **(1)** | 100 |
| Increase in deferred policy acquisition costs | **(218)** | (208) |
| Increase in policy liabilities | **1,692** | 1,461 |
| Change in income tax liabilities | **205** | 283 |
| Realized investment (gains) losses | **(15)** | (1) |
| Other, net | **29** | 51 |
| Net cash provided by operating activities | **2,356** | 2,249 |
| **Cash flows from investing activities:** | | |
| Proceeds from investments sold or matured: | | |
| Securities available for sale: | | |
| Fixed maturities sold | **539** | 557 |
| Fixed maturities matured | **372** | 493 |
| Perpetual debentures sold | **35** | - |
| Costs of investments acquired: | | |
| Securities available for sale: | | |
| Fixed maturities | **(1,516)** | (1,947) |
| Perpetual debentures | **(286)** | (282) |
| Securities held to maturity: | | |
| Fixed maturities | **(1,723)** | (1,371) |
| Perpetual debentures | **-** | (129) |
| Cash received as collateral on loaned securities, net | **(1,956)** | 609 |
| Other, net | **(8)** | (13) |
| Net cash used by investing activities | **$ (4,543)** | $ (2,083) |

*Prior year amounts have been adjusted for adoption of SFAS 123R on January 1, 2005.*
*See the accompanying Notes to the Consolidated Financial Statements.*

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**Aflac Incorporated and Subsidiaries**
**Consolidated Statements of Cash Flows (continued)**

| | Six Months Ended June 30, | |
|---|---|---|
| (In millions - Unaudited) | **2005** | 2004 |
| **Cash flows from financing activities:** | | |
| Purchases of treasury stock | **$ (225)** | $ (178) |
| Change in investment-type contracts, net | **127** | 109 |

| | | |
|---|---|---|
| Dividends paid to shareholders | **(105)** | (92) |
| Treasury stock reissued | **27** | 25 |
| Principal payments under debt obligations | **(4)** | (7) |
| Other, net | **26** | 11 |
| Net cash used by financing activities | **(154)** | (132) |
| Effect of exchange rate changes on cash and cash equivalents | **(44)** | (14) |
| Net change in cash and cash equivalents | **(2,385)** | 20 |
| Cash and cash equivalents, beginning of period | **3,813** | 1,052 |
| Cash and cash equivalents, end of period | **$ 1,428** | $ 1,072 |
| **Supplemental disclosures of cash flow information:** | | |
| Income taxes paid | **$ 181** | $ 42 |
| Interest paid | **11** | 10 |
| Noncash financing activities: | | |
| Capitalized lease obligations | **1** | 5 |
| Treasury shares issued to AFL Stock Plan for: | | |
| Associate stock bonus | **18** | 18 |
| Shareholder dividend reinvestment | **5** | 5 |
| Share-based compensation grants | **1** | - |

*Prior year amounts have been adjusted for adoption of SFAS 123R on January 1, 2005.*
*See the accompanying Notes to the Consolidated Financial Statements.*



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**Aflac Incorporated and Subsidiaries**
**Consolidated Statements of Comprehensive Income**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| (In millions - Unaudited) | **2005** | 2004 | **2005** | 2004 |
| Net earnings | **$ 336** | $ 258 | **$ 664** | $ 563 |
| **Other comprehensive income before income taxes:** | | | | |
| Foreign currency translation adjustments: | | | | |
| Change in unrealized foreign currency translation gains (losses) during period | **10** | 36 | **27** | 15 |
| Unrealized gains (losses) on investment securities: | | | | |
| Unrealized holding gains (losses) arising during period | **756** | (1,507) | **800** | (1,227) |
| Reclassification adjustment for realized (gains) losses included in net earnings | **(11)** | 5 | **(15)** | (1) |
| Minimum pension liability adjustment during period | **-** | - | **1** | 18 |

| | | | | |
|---|---|---|---|---|
| Total other comprehensive income (loss) before income taxes | **755** | (1,466) | **813** | (1,195) |
| Income tax expense (benefit) related to items of other comprehensive income (loss) | **298** | (460) | **351** | (364) |
| Other comprehensive income (loss) net of income taxes | **457** | (1,006) | **462** | (831) |
| Total comprehensive income (loss) | **$ 793** | $ (748) | **$ 1,126** | $ (268) |

*Prior year amounts have been adjusted for adoption of SFAS 123R on January 1, 2005.*

*See the accompanying Notes to the Consolidated Financial Statements.*



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## Aflac Incorporated and Subsidiaries

## Notes to the Consolidated Financial Statements

### 1. BASIS OF PRESENTATION

We prepare our financial statements in accordance with U.S. generally accepted accounting principles (GAAP). These principles are established primarily by the Financial Accounting Standards Board (FASB) and the American Institute of Certified Public Accountants. The preparation of financial statements in conformity with GAAP requires us to make estimates when recording transactions resulting from business operations based on information currently available. The most significant items on our balance sheet that involve a greater degree of accounting estimates and actuarial determinations subject to changes in the future are the valuation of investments, deferred policy acquisition costs, and liabilities for future policy benefits and unpaid policy claims. These accounting estimates and actuarial determinations are sensitive to market conditions, investment yields, mortality, morbidity, commission and other acquisition expenses, and terminations by policyholders. As additional information becomes available, or actual amounts are determinable, the recorded estimates will be revised and reflected in operating results. Although some variability is inherent in these estimates, we believe the amounts provided are adequate.

The consolidated financial statements include the accounts of Aflac Incorporated (the "Parent Company"), its majority-owned subsidiaries and those entities required to be consolidated under applicable accounting standards. All material intercompany accounts and transactions have been eliminated.

In the opinion of management, the accompanying unaudited consolidated financial statements of Aflac Incorporated and subsidiaries (the "Company") contain all adjustments, consisting of normal recurring accruals, which are necessary to fairly present the consolidated balance sheets as of June 30, 2005, and December 31, 2004, and the consolidated statements of earnings and comprehensive income for the three- and six-month periods ended June 30, 2005, and 2004, and consolidated statements of shareholders' equity and cash flows for the six-month periods ended June 30, 2005, and 2004. Results of operations for interim periods are not necessarily indicative of results for the entire year. As a result, these financial statements should be read in conjunction with the financial statements and notes thereto included in our annual report to shareholders for the year ended December 31, 2004.



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**New Accounting Pronouncements:** In December 2004, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 123 (revised), Share-Based Payment (SFAS 123R). This standard amends SFAS No. 123, Accounting for Stock-Based Compensation, and supercedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and its related implementation guidance. SFAS 123R establishes the accounting for grants of stock options and other transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. SFAS 123R requires that companies use a fair value method to value stock options and recognize the related compensation expense in net earnings. The provisions of SFAS 123R, as amended by the Securities and Exchange Commission, are effective as of the beginning of the first fiscal year after June 15, 2005, although earlier application is encouraged. In accordance with the standard's early adoption provisions, we began accounting for stock options and other share-based payments using the modified-retrospective application method effective January 1, 2005. Prior year results have been adjusted to reflect the expensing of stock options in accordance with this new standard (see Note 7).

For additional information on new accounting pronouncements and their impact, if any, on our financial position or results of operations, see Note 1 of the Notes to the Consolidated Financial Statements in our annual report to shareholders for the year ended December 31, 2004.



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## 2. BUSINESS SEGMENT INFORMATION

The Company consists of two reportable insurance business segments: Aflac Japan and Aflac U.S., both of which sell individual supplemental health and life insurance.

Operating business segments that are not individually reportable are included in the "Other business segments" category. We do not allocate corporate overhead expenses to business segments. We evaluate and manage our business segments using a financial performance measure called pretax operating earnings. Our definition of operating earnings as presented in this report excludes the following items from net earnings on an after-tax basis: realized investment gains/losses, the impact from SFAS 133 and the gain from the Japanese pension obligation transfer. We then exclude income taxes related to operations to arrive at pretax operating earnings. Information regarding operations by segment follows:

| (In millions) | Three Months Ended June 30, 2005 | Three Months Ended June 30, 2004 | Six Months Ended June 30, 2005 | Six Months Ended June 30, 2004 |
|---|---|---|---|---|
| **Revenues:** | | | | |
| Aflac Japan: | | | | |
| Earned premiums | **$ 2,217** | $ 2,042 | **$ 4,471** | $ 4,105 |
| Net investment income | **412** | 385 | **822** | 761 |
| Other income | **7** | 3 | **15** | 7 |
| Total Aflac Japan | **2,636** | 2,430 | **5,308** | 4,873 |
| Aflac U.S.: | | | | |
| Earned premiums | **803** | 726 | **1,590** | 1,437 |
| Net investment income | **104** | 98 | **206** | 195 |
| Other income | **3** | 3 | **5** | 5 |
| Total Aflac U.S. | **910** | 827 | **1,801** | 1,637 |
| Other business segments | **8** | 8 | **18** | 17 |
| Total business segment revenues | **3,554** | 3,265 | **7,127** | 6,527 |
| Realized investment gains (losses) | **11** | (5) | **15** | 1 |
| Japanese pension obligation transfer | **-** | - | **-** | 6 |
| Corporate* | **16** | (15) | **19** | 7 |
| Intercompany eliminations | **(14)** | (12) | **(34)** | (28) |
| Total revenues | **$ 3,567** | $ 3,233 | **$ 7,127** | $ 6,513 |

**Includes for the three-month periods, investment income of $2 in 2005 and $1 in 2004, and $4 and $2 for the six-month periods in 2005 and 2004, respectively. Also, includes for the three-month periods, a gain of $4 in 2005, compared with a loss of $24 in 2004 related to the impact from SFAS 133, and for the six-month periods, losses of $9 in 2005 and $12 in 2004.*



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| (In millions) | Three Months Ended June 30, **2005** | 2004 | Six Months Ended June 30, **2005** | 2004 |
|---|---|---|---|---|
| **Pretax earnings:** | | | | |
| Aflac Japan* | **$ 387** | $ 339 | **$ 787** | $ 679 |
| Aflac U.S. | **130** | 120 | **263** | 241 |
| Other business segments | **1** | - | **1** | - |
| Total business segments | **518** | 459 | **1,051** | 920 |
| Interest expense, noninsurance operations | **(5)** | (5) | **(10)** | (10) |
| Corporate and eliminations | **(12)** | (12) | **(24)** | (24) |
| Pretax operating earnings** | **501** | 442 | **1,017** | 886 |
| Realized investment gains (losses) | **11** | (5) | **15** | 1 |
| Impact from SFAS 133 | **4** | (24) | **(9)** | (12) |
| Japanese pension obligation transfer | **-** | - | **-** | 6 |
| Total earnings before income taxes | **$ 516** | $ 413 | **$ 1,023** | $ 880 |

** Includes charges of $18 in 2005 and $26 in 2004 related to the write down of previously capitalized systems development costs for Aflac Japan's administration system.*

*** Income taxes applicable to pretax operating earnings for the three-month periods were $175 in 2005 and $158 in 2004, and for the six-month periods were $356 in 2005 and $317 in 2004. The effect of foreign currency translation increased operating earnings for the three-month periods by $3 in 2005 and $11 in 2004, and for the six-month periods by $8 in 2005 and $26 in 2004.*

Assets were as follows:

| (In millions) | **June 30, 2005** | December 31, 2004 |
|---|---|---|
| **Assets**: | | |
| Aflac Japan | **$ 48,140** | $ 47,556 |
| Aflac U.S. | **9,345** | 11,393 |
| Other business segments | **87** | 85 |
| Total business segment assets | **57,572** | 59,034 |
| Corporate | **10,096** | 9,288 |
| Intercompany eliminations | **(9,673)** | (8,996) |
| Total assets | **$ 57,995** | $ 59,326 |

## 3. INVESTMENTS

Realized Investment Gains and Losses

During the quarter ended June 30, 2005, we realized pretax investment gains of $11 million (after-tax $7 million, or $.01 per diluted share) as a result of securities sales. For the six months ended June 30, 2005, we realized pretax investment gains of $15 million (after-tax $9 million, or $.01 per diluted share). For the quarter ended June 30, 2004, we realized pretax investment losses of $5 million (after-tax $3 million, or $.01 per diluted share) and pretax investment gains of $1 million (after-tax $3 million, or nil per diluted share) for the six months ended June 30, 2004, all as a result of securities sales.





Unrealized Investment Gains and Losses

The net effect on shareholders' equity of unrealized gains and losses from investment securities at the following dates was:

| (In millions) | **June 30, 2005** | December 31, 2004 |
|---|---|---|
| Unrealized gains on securities available for sale | **$ 3,981** | $ 3,138 |
| Unamortized unrealized gains on securities transferred to held to maturity | **486** | 544 |
| Deferred income taxes | **(1,529)** | (1,265) |
| Shareholders' equity, net unrealized gains on investment securities | **$ 2,938** | $ 2,417 |

During the first quarter of 2004, we reclassified the debt security of a Japanese issuer from held to maturity to available for sale as a result of the issuer's credit rating downgrade. At the time of transfer, the debt security had an amortized cost of $118 million. Included in accumulated other comprehensive income immediately prior to the transfer was an unamortized gain of $24 million related to this security. This gain represented the remaining unamortized portion of a $32 million gain established in 2001, when we reclassified this investment from available for sale to held to maturity.

Special Purpose and Variable Interest Entities

As part of our investment activities, we own investments in qualified special purpose entities (QSPEs). At June 30, 2005, available-for-sale QSPEs totaled $1.5 billion at fair value ($1.5 billion at amortized cost, or 3.4% of total debt securities), compared with $1.4 billion at fair value ($1.4 billion at amortized cost, or 3.0% of total debt securities) at December 31, 2004. Each QSPE has a default trigger whereby default on any of the underlying notes would force dissolution of the QSPE, distribution of the underlying securities, and termination of the related swaps. We have no equity interests in any of the QSPEs, nor do we have control over these entities. Therefore, our loss exposure is limited to the cost of our investment.

We also own yen-denominated investments in variable interest entities (VIEs) totaling $1.9 billion at fair value ($1.9 billion at amortized cost, or 4.3% of total debt securities) at June 30, 2005. We have concluded that we are the primary beneficiary of VIEs totaling $1.7 billion at fair value ($1.7 billion at amortized cost) and we have consolidated our interests in these VIEs in accordance with FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities. The activities of these VIEs are limited to holding debt securities and utilizing the proceeds from the debt securities to service our investments therein. The terms of the debt securities mirror the terms of the notes held by Aflac. The consolidation of these investments does not impact our financial position or results of operations. We also have interests in VIEs that we are not required to consolidate totaling $243 million at fair value ($235 million at amortized cost) as of June 30, 2005. The notes representing our interests in these VIEs are reported as fixed-maturity securities on the balance sheet. The loss on any of our VIE investments would be limited to its cost.

Security Lending

We lend fixed-maturity securities to financial institutions in short-term security lending transactions. These securities continue to be carried as investment assets on our balance sheet during the term of the loans and are not recorded as sales. We receive cash or other securities as collateral for such loans. These short-term security lending arrangements increase investment income with minimal risk. At June 30, 2005, we had security loans outstanding with a fair value of $881 million, and we held cash in the amount of $901 million as collateral for these loaned securities. At December 31, 2004, we had security loans outstanding with a fair value of $2.9 billion, and we held cash in the amount of $2.9 billion as collateral for these loaned securities. For additional information, see Notes 1 and 3 of the Notes to the Consolidated Financial Statements in our annual report to shareholders for the year ended December 31, 2004.

## 4. FINANCIAL INSTRUMENTS

We have only limited activity with derivative financial instruments. We do not use them for trading purposes, nor do we engage in leveraged derivative transactions.

We have outstanding cross-currency swap agreements related to the $450 million senior notes (Note 5). We have designated the foreign currency component of these cross-currency swaps as a hedge of the foreign currency exposure of our investment in Aflac Japan. The notional amounts and terms of the swaps match the principal amount and terms of the senior notes.

The components of the fair value of the cross-currency swaps were reflected as an asset or (liability) in the balance sheet as follows:

| (In millions) | **June 30, 2005** | December 31, 2004 |
|---|---|---|
| Interest rate component | **$ 12** | $ 21 |
| Foreign currency component | **(51)** | (91) |
| Accrued interest component | **4** | 4 |
| Total fair value of cross-currency swaps | **$ (35)** | $ (66) |

The following is a reconciliation of the foreign currency component of the cross-currency swaps as included in accumulated other comprehensive income for the six-month periods ended June 30.

| (In millions) | **2005** | 2004 |
|---|---|---|
| Balance, beginning of period | **$ (91)** | $ (69) |
| Increase (decrease) in fair value of cross-currency swaps | **31** | (4) |
| Interest rate component not qualifying for hedge accounting reclassified to net earnings | **9** | 13 |
| Balance, end of period | **$ (51)** | $ (60) |

## 5. NOTES PAYABLE

A summary of notes payable follows:

| (In millions) | **June 30, 2005** | December 31, 2004 |
|---|---|---|
| 6.50% senior notes due April 2009 (principal amount $450) | **$ 450** | $ 449 |
| Yen-denominated Samurai notes: | | |
| 1.55% notes due October 2005 (principal amount 30 billion yen) | **271** | 288 |
| .87% notes due June 2006 (principal amount 40 billion yen) | **362** | 384 |
| .96% notes due June 2007 (principal amount 30 billion yen) | **271** | 288 |
| Capitalized lease obligations payable through 2009 | **15** | 20 |
| Total notes payable | **$ 1,369** | $ 1,429 |

The Parent Company has three issues of yen-denominated Samurai notes totaling 100 billion yen outstanding in Japan issued under a Shelf Registration Statement filed with Japanese regulatory authorities in 2000. These issues may only be redeemed prior to maturity upon the occurrence of a tax event as specified in the respective bond agreement and are not available to U.S. residents or entities. In 2003, the Parent Company filed a second 100 billion yen Shelf Registration Statement with Japanese regulatory authorities (see Note 10).

For our yen-denominated loans, the principal amount as stated in dollar terms will fluctuate from period to period due to changes in the yen/dollar exchange rate. We have designated these yen-denominated notes payable as a hedge of the foreign currency exposure of our investment in Aflac Japan.

In 1999, we issued $450 million of 6.50% senior notes due April 2009. The notes are redeemable at our option at any time with a redemption price equal to the principal amount of the notes being redeemed plus a make-whole premium. We have entered into cross-currency swaps related to these notes (see Note 4).

We were in compliance with all of the covenants of our notes payable at June 30, 2005. No events of default or defaults occurred during the six months ended June 30, 2005.





## 6. SHAREHOLDERS' EQUITY

The following is a reconciliation of the number of shares of our common stock for the six months ended June 30.

| (In thousands of shares) | **2005** | 2004 |
|---|---|---|
| **Common stock - issued**: | | |
| Balance, beginning of period | **652,628** | 651,554 |
| Exercise of stock options | **732** | 841 |
| Balance, end of period | **653,360** | 652,395 |
| **Treasury stock**: | | |
| Balance, beginning of period | **149,020** | 141,662 |
| Purchases of treasury stock: | | |

| | | |
|---|---|---|
| Open market | **5,582** | 4,405 |
| Other | **68** | 42 |
| Shares issued to AFL Stock Plan | **(825)** | (825) |
| Exercise of stock options | **(1,416)** | (938) |
| Grants of restricted stock | **(241)** | - |
| Balance, end of period | **152,188** | 144,346 |
| Shares outstanding, end of period | **501,172** | 508,049 |

In February 2004, the board of directors authorized the purchase of up to an additional 30 million shares of our common stock. As of June 30, 2005, we had approximately 21 million shares available for purchase under the current share repurchase program.

For the six months ended June 30, 2005, there were approximately 3.4 million weighted-average shares, compared with 522 thousand shares in 2004, for outstanding stock options that were not included in the calculation of weighted-average shares used in the computation of diluted earnings per share because the exercise price for these options was greater than the average market price during these periods (approximately 3.4 million shares for the three months ended June 30, 2005, and three thousand shares for the same period in 2004).





## 7. SHARE-BASED TRANSACTIONS

Our long-term share-based compensation plans allow for grants of stock options, restricted stock, restricted stock units, and stock appreciation rights. The terms and vesting schedules for share-based awards vary by the type of grant and the employment status of the grantee. Generally, the awards vest based upon time-based conditions or time-and-performance-based conditions. Performance-based vesting conditions generally include the attainment of goals related to Company financial performance. As of June 30, 2005, the only performance-based awards issued and outstanding were restricted stock awards. Upon exercise, share-based compensation awards granted to U.S.-based grantees are settled with authorized but unissued company stock, while share-based compensation awards granted to Japan-based grantees are settled with treasury shares.

We adopted SFAS 123R to account for stock options and other share-based transactions effective January 1, 2005. In accordance with the modified-retrospective application method, we have adjusted previously reported results to reflect the effect of expensing stock options. The cumulative adjustment associated with adoption decreased our tax liability $2 million, increased additional paid-in capital $175 million and decreased retained earnings $173 million as of December 31, 2003.

The following table presents the expense recognized in the following items as a result of applying the provisions of SFAS 123R.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| (In millions, except for per-share amounts) | **2005** | 2004 | **2005** | 2004 |
| Earnings from continuing operations | **$ 8** | $ 7 | **$ 15** | $ 18 |
| Earnings before income taxes | **8** | 7 | **15** | 18 |
| Net earnings | **6** | 7 | **11** | 18 |
| Net earnings per share: | | | | |
| Basic | **$ .01** | $ .01 | **$ .02** | $ .03 |
| Diluted | **.01** | .01 | **.02** | .03 |

We estimate the fair value of each stock option granted using the Black-Scholes-Merton multiple option approach. Expected volatility is based on historical periods generally commensurate with the estimated term of options. Identifiable periods of unusual volatility may be excluded from historical data if they are not considered to be representative of expected future volatility. We use historical data to estimate option exercise and termination patterns within the model. Separate groups of employees that have similar historical exercise patterns are stratified and considered separately for valuation purposes. The expected term of options granted is derived from the output of our option model and represents the weighted-average period of time that options granted are expected to be outstanding. We base the risk-free interest rate on the Treasury note rate with a term comparable to that of the estimated term of options. The weighted-average fair value of options at their grant date was $12.61 for the first half of 2005, compared with $9.98 a year ago. The following table presents the assumptions used in valuing options granted during the six months ended June 30.





| | **2005** | 2004 |
|---|---|---|
| Expected volatility | **28.4%** | 25.0% |
| Expected term (years) | **6.5** | 4.3 |
| Risk-free interest rate | **4.0%** | 4.0% |
| Dividend yield | **1.1%** | .9% |

The following table summarizes stock option activity during the first half of 2005.

| (In thousands of shares) | **Stock Option Shares** | **Weighted-Average Exercise Price Per Share** |
|---|---|---|
| Outstanding at December 31, 2004 | 22,087 | $ 23.86 |
| Granted in first six months of 2005 | 1,233 | 38.81 |
| Canceled in first six months of 2005 | (99) | 33.09 |
| Exercised in first six months of 2005 | (2,205) | 13.76 |
| Outstanding at June 30, 2005 | 21,016 | $ 25.76 |
| Exercisable at June 30, 2005 | 15,268 | $ 22.23 |

As of June 30, 2005, the aggregate intrinsic value of stock options outstanding was $372 million, with a weighted-average remaining term of 5.6 years. The aggregate intrinsic value of stock options exercisable at that same date was $324 million, with a weighted-average remaining term of 4.6 years. The total intrinsic value of stock options exercised during the six months ended June 30, 2005 was $59 million, compared with $47 million for the same period a year ago. We received $28 million and $25 million cash from the exercise of stock options during the six-month periods ended June 30, 2005 and 2004, respectively. The tax benefit realized as a result of stock option exercises was $18 million for the first half of 2005. The tax benefit realized from stock option exercises was immaterial in the first half of 2004.

The following table summarizes restricted stock activity during the first six months of 2005.

| (In thousands of shares) | Shares | Weighted-Average Grant-Date Fair Value |
|---|---|---|
| Restricted stock at December 31, 2004 | 2 | $ 39.98 |
| Granted in first six months of 2005 | 241 | 38.75 |
| Canceled in first six months of 2005 | - | - |
| Vested in first six months of 2005 | - | - |
| Restricted stock at June 30, 2005 | 243 | $ 38.76 |



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As of June 30, 2005, total compensation cost not yet recognized related to restricted stock awards was $8 million. We expect to recognize this cost over a weighted-average period of approximately three years. Grants of restricted stock for the first six months included 150,589 shares that have a performance-based vesting condition. Total compensation cost not yet recognized related to the performance-based awards was $5 million, which we expect to recognize over a period of approximately three years. There are no other contractual terms covering restricted stock awards once vested. No awards of restricted stock were granted during the first six months of 2004.

For additional information on our long-term share-based compensation plans and the types of share-based awards, see Note 8 of the Notes to the Consolidated Financial Statements included in our annual report to shareholders for the year ended December 31, 2004.

## 8. BENEFIT PLANS

Our basic employee defined-benefit pension plans cover substantially all of our full-time employees. The components of retirement expense for the Japanese and U.S. pension plans were as follows for the three- and six-month periods ended June 30:

| | Three Months Ended June 30, | | | | Six Months Ended June 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | **2005** | | 2004 | | **2005** | | 2004 | |
| (In millions) | **Japan** | **U.S.** | Japan | U.S. | **Japan** | **U.S.** | Japan | U.S. |
| Components of net periodic benefit cost: | | | | | | | | |
| Service cost | **$ 1** | **$ 2** | $ 1 | $ 1 | **$ 2** | **$ 4** | $ 2 | $ 2 |
| Interest cost | **-** | **2** | - | 2 | **1** | **4** | 1 | 4 |
| Expected return on plan assets | **-** | **(2)** | - | (1) | **-** | **(3)** | - | (2) |
| Amortization of net actuarial loss | **1** | **1** | 1 | - | **1** | **1** | 2 | - |
| Net periodic benefit cost | **$ 2** | **$ 3** | $ 2 | $ 2 | **$ 4** | **$ 6** | $ 5 | $ 4 |

As of June 30, 2005, approximately $4 million (using the June 30, 2005 exchange rate) had been contributed to the Japanese pension plan for the first six months of 2005. As of June 30, 2005, no contributions had been made to the U.S. pension plan.

For additional information regarding our Japanese and U.S. pension plans, see Note 10 of the Notes to the Consolidated Financial Statement in our annual report to shareholders for the year ended December 31, 2004.



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## 9. COMMITMENTS AND CONTINGENT LIABILITIES

**Commitments**: We have employee benefit plans that provide pension and various post-retirement benefits. For additional information regarding our benefit plans, see Note 10 of the Notes to the Consolidated Financial Statements in our annual report to shareholders for the year ended December 31, 2004.

We lease office space and equipment under various agreements that expire in various years through 2021. For further information regarding lease commitments, see Note 11 of the Notes to the Consolidated Financial Statements in our annual report to shareholders for the year ended December 31, 2004.

**Litigation**: We are a defendant in various lawsuits considered to be in the normal course of business. Some of this litigation is pending in states where large punitive damages bearing little relation to the actual damages sustained by plaintiffs have been awarded against other companies, including insurers, in recent years. Although the final results of any litigation cannot be predicted with certainty, we believe the outcome of pending litigation will not have a material adverse effect on our financial position, results of operations, or cash flows.

## 10. SUBSEQUENT EVENT

On July 20, 2005, the Parent Company issued yen-denominated (Samurai) notes totaling 40 billion yen (approximately $355 million). These bonds pay interest semiannually at .71% and mature July 20, 2010. They are only redeemable prior to maturity upon the occurrence of a tax event as specified in the bond agreement. These securities are not available to U.S. residents or entities. The bonds were issued in Japan under a previously announced 100 billion yen Shelf Registration Statement filed with Japanese regulatory authorities in December 2003. This is the first issuance from the December 2003 Shelf Registration. The proceeds from this issuance will be used for general corporate purposes, including the repayment of 30 billion yen of debt maturing in October 2005.



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## REVIEW BY INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The June 30, 2005, and 2004, financial statements included in this filing have been reviewed by KPMG LLP, an independent registered public accounting firm, in accordance with established professional standards and procedures for such a review.

The report of KPMG LLP commenting upon its review is included on page 21.



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## Report of Independent Registered Public Accounting Firm

The shareholders and board of directors of Aflac Incorporated:

We have reviewed the consolidated balance sheet of Aflac Incorporated and subsidiaries as of June 30, 2005, and the related consolidated statements of earnings and comprehensive income for the three-month and six-month periods ended June 30, 2005, and 2004, and the consolidated statements of shareholders' equity and cash flows for the six-month periods ended June 30, 2005, and 2004. These consolidated financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the accompanying consolidated balance sheet of Aflac Incorporated and subsidiaries as of December 31, 2004, and the related consolidated statements of earnings, shareholders' equity, cash flows and comprehensive income for the year then ended (not presented herein); and in our report dated March 4, 2005, we expressed an unqualified opinion on those consolidated financial statements.

As discussed in Notes 1 and 7 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, to account for stock options and other share-based transactions, effective January 1, 2005.

Atlanta, GA
August 5, 2005



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## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

**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 included in the forward-looking statements. 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 herein, 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," "will," "assumes," "potential," "target," 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 and customer response to new products and new marketing initiatives
- 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 investment yield rates
- fluctuations in foreign currency exchange rates
- deviations in actual experience from pricing and reserving assumptions including, but not limited to, morbidity, mortality, persistency, expenses, and investment yields
- 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
- ineffectiveness of hedging strategies used to minimize the exposure of our shareholders' equity to foreign currency translation fluctuations
- events resulting in catastrophic loss of life or injury
- general economic conditions in the United States and Japan



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## Company Overview

Aflac Incorporated (the Parent Company) and its subsidiaries (the Company) primarily sell supplemental health and life insurance in the United States and Japan. The Company's insurance business is marketed and administered through American Family Life Assurance Company of Columbus (Aflac), which operates in the United States (Aflac U.S.) and as a branch in Japan (Aflac Japan). Most of Aflac's policies are individually underwritten and marketed through independent agents. Our insurance operations in the United States and our branch in Japan service the two markets for our insurance business.

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 period from December 31, 2004, to June 30, 2005. As a result, the following discussion should be read in conjunction with the consolidated financial statements and notes that are included in our annual report to shareholders for the year ended December 31, 2004. Prior year results have been adjusted in this quarterly report to reflect adoption of Statement of Financial Accounting Standards No. 123 (revised), Share-Based Payment, on January 1, 2005. For additional information, see Note 7 of the Notes to the Consolidated Financial Statements.

This MD&A is divided into four primary sections. In the first section, we discuss our critical accounting estimates. We then follow with a discussion of the results of our operations on a consolidated basis and by segment. The third section presents an analysis of our financial condition as well as a discussion of market risks of financial instruments. We then conclude by addressing the availability of capital and the sources and uses of cash in the Capital Resources and Liquidity section.

## Critical Accounting Estimates

We prepare our financial statements in accordance with U.S. generally accepted accounting principles (GAAP). The preparation of financial statements in conformity with GAAP requires us to make estimates based on currently available information when recording transactions resulting from business operations. The estimates that we deem to be most critical to an understanding of Aflac's results of operations and financial condition are those related to investments, deferred policy acquisition costs and policy liabilities. The preparation and evaluation of these critical accounting estimates involve the use of various assumptions developed from management's analyses and judgments. The application of these critical accounting estimates determines the values at which 95% of our assets and 83% 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 produce significantly different results. There have been no changes in the items that we have identified as critical accounting estimates during the six months ended June 30, 2005. For additional information, see the Critical Accounting Estimates section of MD&A included in our annual report to shareholders for the year ended December 31, 2004.



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### New Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards

(SFAS) No. 123 (revised), Share-Based Payment (SFAS 123R). This standard amends SFAS No. 123, Accounting for Stock-Based Compensation, and supercedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and its related implementation guidance. SFAS 123R focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions, such as granting stock options. It requires that companies use a fair value method to value stock options and other forms of share-based payments and recognize the related compensation expense in net earnings. We adopted SFAS 123R effective January 1, 2005, using the modified-retrospective application method. As a result, 2004 results have been adjusted to reflect the expensing of stock options. See Note 7 of the Notes to the Consolidated Financial Statements for additional information.

For additional information on new accounting pronouncements and the impact, if any, on our financial position or results of operations, see Note 1 of the Notes to the Consolidated Financial Statements included in our annual report to shareholders for the year ended December 31, 2004.

## RESULTS OF OPERATIONS

The following table is a presentation of items impacting net earnings and net earnings per diluted share for the periods ended June 30.

### Items Impacting Net Earnings

| | Three Months Ended June 30, | | | | Six Months Ended June 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 | **2005** | 2004 | **2005** | 2004 |
| | In millions | | Per Diluted Share | | In millions | | Per Diluted Share | |
| Net earnings | **$336** | $258 | **$ .66** | $ .50 | **$664** | $563 | **$ 1.30** | $ 1.09 |
| **Items impacting net earnings, net of tax:** | | | | | | | | |
| Realized investment gains (losses) | **7** | (3) | **.01** | (.01) | **9** | 3 | **.01** | - |
| Impact from SFAS 133 | **3** | (23) | **.01** | (.04) | **(6)** | (12) | **(.01)** | (.02) |
| Japanese pension obligation transfer | **-** | - | **-** | - | **-** | 3 | **-** | .01 |
| Foreign currency translation* | **3** | 11 | **.01** | .02 | **8** | 26 | **.02** | .05 |

**Translation effect on Aflac Japan segment and Parent Company yen-denominated interest expense*



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### Realized Investment Gains and Losses

Our investment strategy is to invest in fixed-income securities in order to provide a reliable stream of investment income, which is one of the drivers of the company's profitability. We do not purchase securities with the intent of generating capital gains or losses. However, investment gains and losses may be realized as a result of changes in the financial markets and the creditworthiness of specific issuers. The realization of investment gains and losses is independent of the underwriting and administration of our insurance products, which are the principal drivers of our profitability. Realized investment gains during the first six months of 2005 and 2004 primarily resulted from sales transactions in the normal course of business.

### Impact from SFAS 133

We entered into cross-currency swap agreements to effectively convert our dollar-denominated senior debt obligation, which matures in 2009, into a yen-denominated obligation (see Notes 4 and 5 of the Notes to the Consolidated Financial Statements). The effect of issuing fixed-rate, dollar-denominated debt and swapping it into fixed-rate, yen-denominated debt has the same economic impact on Aflac as if we had issued straight yen-denominated debt of a like amount. However, the accounting treatment for cross-currency swaps is different from issuing yen-denominated (Samurai) notes. SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended (SFAS 133), requires that the change in the fair value of the interest rate component of the cross-currency swap, which does not qualify for hedge accounting, be reflected in net earnings (other income). This change in fair value is determined by relative dollar and yen interest rates and has no cash impact on our results of operations. At maturity, the swaps' fair value and their initial contract fair value will be equal, and the cumulative impact of gains and losses from the changes in fair value of the interest component will be zero. We have the ability to retain the cross-currency swaps until their maturity. The impact from SFAS 133 includes the change in fair value of the interest rate component of the cross-currency swaps, which does not qualify for hedge accounting.

We have also issued yen-denominated debt (Samurai notes). We have designated these notes as a hedge of our investment in Aflac Japan. If the value of these yen-denominated notes exceeds our investment in Aflac Japan, we would be required to recognize the foreign currency effect on the excess, or ineffective portion, in net earnings (other income). The ineffective portion would be included in the impact from SFAS 133. These hedges were effective during the six-month period ended June 30, 2005; therefore, there was no impact on net earnings. See Note 4 of the Notes to the Consolidated Financial Statements and Note 1 of the Notes to the Consolidated Financial Statements in our annual report to shareholders for the year ended December 31, 2004, for additional information.





## Nonrecurring Items

During the first quarter of 2004, we concluded the process of returning the substitutional portion of Aflac Japan's pension plan to the Japanese government as allowed by the Japan Pension Insurance Law. We recognized a one-time gain (other income) as the result of this transfer to the Japanese government in the amount of $6 million (after-tax, $3 million, or $.01 per diluted share). For additional information on the transfer, see Note 10 of the Notes to the Consolidated Financial Statements in our annual report to shareholders for the year ended December 31, 2004.

## Foreign Currency Translation

Aflac Japan's premiums and most of its investment income are received in yen. Claims and expenses are paid in yen, and we primarily purchase yen-denominated assets to support yen-denominated policy liabilities. These and other yen-denominated financial statement items are translated into dollars for financial reporting purposes. We translate Aflac Japan's yen-denominated income statement from yen into dollars using an average exchange rate for the reporting period, and we translate its yen-denominated balance sheet using the exchange rate at the end of the period. However, it is important to distinguish between translating and converting foreign currency. Except for a limited number of transactions, we do not actually convert yen into dollars.

Due to the relative size of Aflac Japan, where our functional currency is the Japanese yen, fluctuations in the yen/dollar exchange rate can have a significant effect on our reported results. In periods 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. Consequently, yen weakening has the effect of suppressing current period results in relation to the comparable prior period, while yen strengthening has the effect of magnifying current period results in relation to the comparable prior period. As a result, we view foreign currency translation as a financial reporting issue for Aflac and not an economic event to our company or shareholders. Because changes in exchange rates distort the growth rates of our operations, management evaluates Aflac's financial performance excluding the impact of foreign currency translation.

## Income Taxes

Our combined U.S. and Japanese effective income tax rate on net earnings was 35.1% for the six-month period ended June 30, 2005, compared with 36.1% for the same period in 2004.

## Earnings Projections

We communicate earnings guidance in this report based on the growth in net earnings per diluted share. However, certain items that cannot be predicted or that are outside of management's control may have a significant impact on actual results. Therefore, our projections of net earnings include certain assumptions to reflect the limitations that are inherent in projections of net earnings.

In the context of a forward-looking discussion, the impact of foreign currency translation on our results of operations is inherently unpredictable. Therefore, our projections of net earnings assume no impact from foreign currency translation for a given period in relation to the comparable prior period.

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Furthermore, as discussed previously, we do not purchase securities with the intent of generating capital gains or losses. Therefore, we do not attempt to predict realized investment gains and losses, which include impairment charges, as their ultimate realization will be the result of market conditions that may or may not be predictable. As a result, our projections of net earnings assume no realized investment gains or losses in future periods.

Net earnings are also affected by the impact from SFAS 133, which is based on relative dollar and yen interest rates. Similar to foreign currency exchange rates, yen and dollar interest rates are also inherently unpredictable. Consequently, our projections of net earnings assume no impact from SFAS 133.

Finally, because nonrecurring items represent the financial impact of items that have not occurred within the past two years and are not expected to occur within the next two years, we do not attempt to predict their occurrence in future periods.

Subject to the assumptions set forth above and reflecting adoption of SFAS 123R, our objective for 2005 is to achieve net earnings per diluted share of at least $2.56, an increase of 14.8% over 2004. If we achieve this objective, the following table shows the likely results for 2005 net earnings per diluted share, including the impact of foreign currency translation using various yen/dollar exchange rate scenarios.

**2005 Net Earnings Per Share (EPS) Scenarios***

| Weighted-Average Yen/Dollar Exchange Rate | Net Earnings Per Share | % Growth Over 2004 | Yen Impact on EPS |
|---|---|---|---|
| 95.00 | $ 2.75 | 23.3 % | $ .19 |
| 100.00 | 2.67 | 19.7 | .11 |
| 105.00 | 2.60 | 16.6 | .04 |
| 108.26 ** | 2.56 | 14.8 | - |
| 110.00 | 2.54 | 13.9 | (.02 ) |
| 115.00 | 2.49 | 11.7 | (.07 ) |

**Assumes: No realized investment gains/losses, no impact from SFAS 133, and no nonrecurring items in 2005 and 2004*

*** Actual 2004 weighted-average exchange rate*

Our objective for 2006 is to increase net earnings per diluted share by 15% on the basis described above. Our objective for 2007 is to increase net earnings per diluted share by 13% to 16% on the basis described above.



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## INSURANCE OPERATIONS

Aflac's insurance business consists of two segments: Aflac Japan and Aflac U.S. GAAP financial reporting requires that an enterprise report financial and descriptive information about operating segments in its annual financial statements. Furthermore, these requirements direct a public business enterprise to report a measure of segment profit or loss, certain revenue and expense items, and segment assets. We measure and evaluate our insurance segments' financial performance using operating earnings on a pretax basis. We define segment operating earnings as the profits we derive from our operations before realized investment gains and losses, the impact from SFAS 133, and nonrecurring items. We believe that an analysis of segment pretax operating earnings is vitally important to an understanding of the underlying profitability drivers and trends of our insurance business. Furthermore, because a significant portion of our business is conducted in Japan, we believe it is equally important to understand the impact of translating Japanese yen into U.S. dollars.

We evaluate our sales efforts using new annualized premium sales, an industry operating measure. Total new annualized premium sales, which include new sales and the incremental increase in premiums due to conversions, represent the premiums that we would collect over a 12-month period, assuming the policies remain in force. Premium income, or earned premiums, is a financial performance measure that reflects collected or due premiums that have been earned ratably on policies in force during the reporting period.

## Aflac Japan

Aflac Japan, which operates as a branch of Aflac, is the principal contributor to consolidated earnings. Based on financial results determined in accordance with Japan's Financial Services Agency (FSA) requirements for the Japanese fiscal year ended March 31, 2005, Aflac Japan ranked first in terms of individual insurance policies in force and 10th in terms of assets among all life insurance companies operating in Japan.



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### Aflac Japan Pretax Operating Earnings

Changes in Aflac Japan's pretax operating earnings and profit margins are primarily affected by morbidity, mortality, expenses, persistency and investment yields. The following table presents a summary of operating results for Aflac Japan.

**Aflac Japan Summary of Operating Results**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| (In millions) | **2005** | 2004 | **2005** | 2004 |
| Premium income | **$ 2,217** | $ 2,042 | **$ 4,471** | $ 4,105 |
| Net investment income | **412** | 385 | **822** | 761 |
| Other income | **7** | 3 | **15** | 7 |
| Total operating revenues | **2,636** | 2,430 | **5,308** | 4,873 |
| Benefits and claims | **1,735** | 1,622 | **3,522** | 3,265 |
| Operating expenses: | | | | |
| Amortization of deferred policy acquisition costs | **72** | 66 | **144** | 137 |
| Insurance commissions | **233** | 217 | **467** | 437 |
| Insurance and other expenses | **209** | 186 | **388** | 355 |
| Total operating expenses | **514** | 469 | **999** | 929 |
| Total benefits and expenses | **2,249** | 2,091 | **4,521** | 4,194 |
| Pretax operating earnings* | **$ 387** | $ 339 | **$ 787** | $ 679 |
| Weighted-average yen/dollar exchange rates | **107.63** | 109.73 | **106.04** | 108.52 |

| | In Dollars | | | | In Yen | | | |
|---|---|---|---|---|---|---|---|---|
| **Percentage changes over previous period:** | Three Months Ended June 30, | | Six Months Ended June 30, | | Three Months Ended June 30, | | Six Months Ended June 30, | |
| | **2005** | 2004 | **2005** | 2004 | **2005** | 2004 | **2005** | 2004 |
| Premium income | **8.6%** | 15.3% | **8.9%** | 16.7% | **6.6%** | 6.8% | **6.5%** | 6.6% |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Net investment income | **7.0** | 10.6 | **8.1** | 10.4 | **5.0** | 2.4 | **5.7** | .9 |
| Total operating revenues | **8.5** | 14.5 | **8.9** | 15.5 | **6.5** | 6.0 | **6.5** | 5.6 |
| Pretax operating earnings* | **14.1** | 22.7 | **15.9** | 22.1 | **11.9** | 13.6 | **13.2** | 11.5 |

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| **Ratios to total revenues, in dollars:** | **2005** | 2004 | **2005** | 2004 |
| Benefits and claims | **65.8%** | 66.8% | **66.3%** | 67.0% |
| Operating expenses: | | | | |
| Amortization of deferred policy acquisition costs | **2.7** | 2.7 | **2.7** | 2.8 |
| Insurance commissions | **8.8** | 8.9 | **8.8** | 9.0 |
| Insurance and other expenses | **8.0** | 7.6 | **7.4** | 7.3 |
| Total operating expenses | **19.5** | 19.2 | **18.9** | 19.1 |
| Pretax operating earnings* | **14.7** | 14.0 | **14.8** | 13.9 |

**See page 28 for our definition of segment operating earnings.*



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The percentage increases in premium income reflect the growth of premiums in force. Annualized premiums in force in yen increased 6.9% to 992.6 billion yen in the first six months of 2005, compared with 928.5 billion yen a year ago, and reflect the high persistency of Aflac Japan's business and the sales of new policies. Annualized premiums in force, translated into dollars at respective period-end exchange rates, were $9.0 billion in 2005 and $8.6 billion in 2004.

The benefit ratio has declined over the past several years, reflecting the impact of new products with lower benefit ratios. We have also experienced favorable claim trends in our cancer product line and better-than-expected claim experience in our Rider MAX product line. We expect the benefit ratio to continue to decline in future years primarily reflecting the shift to newer products and riders. As a part of our information technology strategy, we have identified ways to improve and simplify our computing infrastructure, including for example, consolidation of processing from two mainframe systems to one. As a result, we determined it was appropriate to write off two billion yen, or $18 million before taxes, of costs related to software that will no longer be used. Despite the write-off, the expense ratio declined in the first six months of 2005, reflecting lower amortization of deferred acquisition costs and lower stock option expense, compared with a year ago. However, we expect the operating expense ratio to be relatively stable in the future. Due to improvement in the benefit and operating expense ratios, the pretax operating profit margin expanded from 13.9% to 14.8%.

Aflac Japan maintains a portfolio of dollar-denominated and reverse-dual currency securities (yen-denominated debt securities with dollar coupon payments). Dollar-denominated investment income from these assets accounted for approximately 30% of Aflac Japan's investment income in the first six months of both 2005 and 2004. In periods when the yen strengthens in relation to the dollar, translating Aflac Japan's dollar-denominated investment income into yen lowers comparative growth rates for net investment income, total operating revenues, and pretax operating earnings in yen terms. In periods when the yen weakens, translating dollar-denominated investment income into yen magnifies comparative growth rates for net investment income, total operating revenues, and pretax operating earnings in yen terms. The following table illustrates the effect of translating Aflac Japan's dollar-denominated investment income and related items by comparing certain segment results with those that would have been reported had yen/dollar exchange rates remained unchanged from the comparable period in the prior year.

**Aflac Japan Percentage Changes Over Previous Period**

For the Periods Ended June 30,

(Yen Operating Results)

| | Including Foreign Currency Changes | | | | Excluding Foreign Currency Changes** | | | |
|---|---|---|---|---|---|---|---|---|
| | Three-Month Operating Results | | Six-Month Operating Results | | Three-Month Operating Results | | Six-Month Operating Results | |
| | **2005** | 2004 | **2005** | 2004 | **2005** | 2004 | **2005** | 2004 |
| Net investment income | **5.0%** | 2.4% | **5.7%** | .9% | **5.6%** | 4.9% | **6.4%** | 3.7% |
| Total operating revenues | **6.5** | 6.0 | **6.5** | 5.6 | **6.6** | 6.4 | **6.6** | 6.1 |
| Pretax operating earnings* | **11.9** | 13.6 | **13.2** | 11.5 | **12.5** | 14.3 | **13.9** | 12.4 |

**See page 28 for our definition of segment operating earnings.*

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

### Aflac Japan Sales

Aflac Japan's total new annualized premium sales were consistent with our expectations for the quarter. Total new sales rose 1.2% in the second quarter and were restrained by significant declines in Rider MAX sales and conversions. Sales of our supplemental medical products were very strong, increasing 29.4% over last year. Sales through Dai-ichi Mutual Life dramatically improved, rising 19.2% over the second quarter of 2004. The following table presents Aflac Japan's total new annualized premium sales for the periods ended June 30.

| | In Dollars | | | | In Yen | | | |
|---|---|---|---|---|---|---|---|---|
| (In millions of dollars and | Three Months | | Six Months | | Three Months | | Six Months | |
| billions of yen) | **2005** | 2004 | **2005** | 2004 | **2005** | 2004 | **2005** | 2004 |
| Total new annualized premium sales | **$302** | $294 | **$587** | $557 | **32.6** | 32.2 | **62.4** | 60.5 |
| Increase over comparable period in prior year | **2.9%** | 5.5% | **5.4%** | 10.2% | **1.2%** | (2.3)% | **3.1%** | .9% |

Our objective for 2005 is to increase total new annualized premium sales in yen by 5% to 10%.





Aflac Japan's sales mix has been shifting during the last few years. The following table details the contributions to total new annualized premium sales by major product for the periods ended June 30.

| | Three Months | | Six Months | |
|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 |
| Medical policies | **38%** | 30% | **39%** | 31% |
| Rider MAX | **12** | 23 | **12** | 22 |
| Cancer life | **24** | 23 | **23** | 24 |
| Ordinary life | **19** | 19 | **19** | 18 |
| Other | **7** | 5 | **7** | 5 |
| Total | **100%** | 100% | **100%** | 100% |

Sales of EVER, a whole-life fixed-benefit medical product, now exceed sales of Rider MAX. We believe consumer response to our EVER product line, which includes EVER Half and EVER Bonus, has been favorably impacted by health care legislation effective in April 2003 that increased out-of-pocket costs for most Japanese consumers. We continue to believe that the medical category will be an important part of our product portfolio.

As we have disclosed previously, we expect that the effect of Rider MAX conversions on total new annualized sales will continue to decline in future periods. Sales of Rider MAX to both new and existing cancer policyholders have also declined. However, we have seen a steady increase in the percentage of customers who are purchasing both our cancer product and EVER, compared with cancer plus Rider MAX. We believe this could be due to a consumer preference for the greater flexibility that comes with owning two stand-alone policies. We believe it also reflects the visibility and popularity of EVER as Japan's number one medical product.

Sales through Dai-ichi Life dramatically improved, rising 19.2% over the second quarter of 2004, and accounted for 7% of total new annualized premium sales, compared with 6% a year ago. We continue to be very pleased with our alliance with Dai-ichi Life and for the full year, we expect sales through Dai-ichi to exceed its 2004 results.

We continued to focus on the growth of our distribution system in Japan. In the second quarter of 2005, we recruited more than 1,100 agencies, bringing the total number of recruited agencies to more than 2,200 as of June 30, 2005. Based on first half results, we believe we are on track to meet our annual goal of 4,400 agencies. During the first half of 2005, the number of licensed sales associates rose to approximately 76,500, compared with 71,400 at December 31, 2004. The growth of licensed sales associates primarily resulted from individual agency recruitment. 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. Furthermore, we believe that these new agencies and associates will enable us to further expand our reach in the Japanese market.





**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. 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 investment grade at the time of purchase. These securities are generally issued with standard documentation for medium-term note programs and have appropriate covenants.

Investment yields in Japan declined slightly in the second quarter from levels in the first three months of the year. For example, the yield of a composite index of 20-year Japanese government bonds averaged 1.93% in the second quarter, compared with 2.03% in first quarter of 2005. As of July 22, 2005, we had invested, or committed to invest, approximately 74% of our expected 2005 cash flow at an average yield of 3.03%. The following table compares the results of Aflac Japan's investment activities during and for the periods ended June 30.

| | Three Months | | Six Months | |
|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 |

| | | | | |
|---|---|---|---|---|
| New money yield - yen only | **2.70%** | 3.51% | **2.79%** | 3.07% |
| New money yield - blended | **2.85** | 3.63 | **2.98** | 3.21 |
| Return on average invested assets, net of investment expenses | **4.11** | 4.29 | **4.11** | 4.27 |
| Portfolio yield, including dollar-denominated investments, end of period | | | **4.28%** | 4.42% |

See Investments and Cash on page 38 for additional information.

### Japanese Economy

After a period of prolonged weakness in its economy, Japan has shown signs of economic improvement. While recent events continue to indicate that Japan's economy has begun to recover, the time required for a full economic recovery remains uncertain. For additional information, see the Japanese Economy section of MD&A in our annual report to shareholders for the year ended December 31, 2004.

## Aflac U.S.

### Aflac U.S. Pretax Operating Earnings

Changes in Aflac U.S. pretax operating earnings and profit margins are primarily affected by morbidity, mortality, expenses, persistency and investment yields. The following table presents a summary of operating results for Aflac U.S.





**Aflac U.S. Summary of Operating Results**

| (In millions) | Three Months Ended June 30, **2005** | Three Months Ended June 30, 2004 | Six Months Ended June 30, **2005** | Six Months Ended June 30, 2004 |
|---|---|---|---|---|
| Premium income | **$ 803** | $ 726 | **$ 1,590** | $ 1,437 |
| Net investment income | **104** | 98 | **206** | 195 |
| Other income | **3** | 3 | **5** | 5 |
| Total operating revenues | **910** | 827 | **1,801** | 1,637 |
| Benefits and claims | **494** | 446 | **973** | 881 |
| Operating expenses: | | | | |
| Amortization of deferred policy acquisition costs | **62** | 61 | **126** | 120 |
| Insurance commissions | **101** | 91 | **201** | 181 |
| Insurance and other expenses | **123** | 109 | **238** | 214 |
| Total operating expenses | **286** | 261 | **565** | 515 |
| Total benefits and expenses | **780** | 707 | **1,538** | 1,396 |
| Pretax operating earnings* | **$ 130** | $ 120 | **$ 263** | $ 241 |

| | | | | |
|---|---|---|---|---|
| **Percentage changes over previous period:** | | | | |
| Premium income | **10.6%** | 14.0% | **10.7%** | 13.9% |
| Net investment income | **6.2** | 12.7 | **5.7** | 11.7 |
| Total operating revenues | **10.0** | 13.8 | **10.1** | 13.6 |
| Pretax operating earnings* | **8.3** | 17.2 | **9.0** | 15.9 |
| **Ratios to total revenues:** | | | | |
| Benefits and claims | **54.2%** | 53.9% | **54.0%** | 53.8% |
| Operating expenses | | | | |
| Amortization of deferred policy acquisition costs | **6.8** | 7.4 | **7.0** | 7.3 |
| Insurance commissions | **11.1** | 11.0 | **11.1** | 11.1 |
| Insurance and other expenses | **13.6** | 13.2 | **13.3** | 13.1 |
| Total operating expenses | **31.5** | 31.6 | **31.4** | 31.5 |
| Pretax operating earnings* | **14.3** | 14.5 | **14.6** | 14.7 |

**See page 28 for our definition of segment operating earnings.*

The percentage increases in premium income reflect the growth of premiums in force. The increases in annualized premiums in force of 9.9% in the first six months of 2005 and 13.2% for the same period of 2004 were favorably affected by sales at the worksite primarily through cafeteria plans and a slight improvement in the persistency of several products. Annualized premiums in force at June 30, 2005 were $3.5 billion, compared with $3.2 billion a year ago.

The benefit ratio has increased slightly over the past several years, primarily due to the impact of declining investment yields on the growth of our investment income and the slowdown in U.S. sales in 2004 and 2003. As a percentage of premium income, the benefit ratio has been fairly stable at 61.2% in the first six months of 2005, compared with 61.3% in the first half of 2004. In 2005 we expect the benefit ratio; the operating expense ratio, excluding discretionary promotional expenses; and the pretax operating profit margin to remain relatively stable.



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### Aflac U.S. Sales

Aflac U.S. produced strong sales growth in the second quarter. Several products contributed to our solid results including our accident/disability product line, hospital indemnity and dental products. The following table presents Aflac's U.S. total new annualized premium sales for the periods ended June 30.

| | Three Months | | Six Months | |
|---|---|---|---|---|
| (In millions) | **2005** | 2004 | **2005** | 2004 |
| Total new annualized premium sales | **$ 307** | $ 281 | **$ 593** | $ 573 |
| Increase over comparable period in prior year | **9.2%** | 6.4% | **3.5%** | 10.0% |

Our objective for 2005 is to increase total new annualized premium sales by 3% to 8%.

One aspect of our growth strategy is the continued enhancement of our product line. Based on consumer feedback, we revised our dental product in November 2004. We also developed a vision care product in 2004 for introduction in mid-2005, and we are optimistic that the introduction of this product will benefit sales in the second half of the year. The following table details the contributions to total new annualized premium sales by major product category for the periods ended June 30.

| | Three Months | | Six Months | |
|---|---|---|---|---|
| | **2005** | 2004 | **2005** | 2004 |
| Accident/disability coverage | **53%** | 52% | **52%** | 52% |
| Cancer expense insurance | **18** | 19 | **18** | 20 |
| Hospital indemnity products | **11** | 11 | **11** | 11 |
| Fixed-benefit dental coverage | **8** | 7 | **8** | 7 |
| Other | **10** | 11 | **11** | 10 |
| Total | **100%** | 100% | **100%** | 100% |

We were very pleased that new agent recruitment continued to improve. During the second quarter, we recruited more than 6,700 new sales associates, which was 11.5% above the second quarter of 2004. During the first six months, we recruited nearly 13,200 new sales associates or 10.9% more than the first six months of 2004. At the end of the second quarter, Aflac U.S. was represented by more than 61,000 licensed sales associates, or 4.4% higher than a year ago. We believe we will see improved sales momentum as the year progresses due in part to the continued expansion of our sales force. We also believe we can improve retention and productivity of sales associates as we continue to focus on recently adopted training initiatives and introduce new training programs. Ultimately, we believe these actions will lead to better recruiting and faster sales growth in the United States.



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**Aflac U.S. Investments**

For the quarter ended June 30, 2005, available cash flow was invested at an average yield of 6.06%, compared with 6.74% in 2004. For the six months ended June 30, 2005, available cash flow was invested at an average yield of 6.05%, compared with 6.34% for the same period in 2004. The overall return on average invested assets, net of investment expenses, was 6.85% for the second quarter of 2005, compared with 6.98% in 2004. For the six-month periods ended June 30, the overall return on average invested assets, net of investment expenses, was 6.24% in 2005 and 7.05% in 2004. The yield on Aflac's U.S. portfolio was 7.30% at June 30, 2005, compared with a yield of 7.48% at June 30, 2004. See Investments and Cash on page 38 for additional information.

## Analysis of Financial Condition

Our financial condition has remained strong in the functional currencies of our operations during the last two years. 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 June 30, 2005, was 110.62 yen to one U.S. dollar, or 5.8% weaker than the December 31, 2004, exchange rate of 104.21. The weaker yen decreased reported investments and cash by $2.5 billion, total assets by $2.8 billion, and total liabilities by $2.7 billion, compared with the amounts that would have been reported for the second quarter of 2005 if the exchange rate had remained unchanged from December 31, 2004.

**Market Risks of Financial Instruments**

Because we invest in fixed-income securities, our financial instruments are exposed primarily to two types of market risks - currency risk and interest rate 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 dollar-denominated 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, reported amounts are affected by foreign currency fluctuations. We report unrealized foreign currency translation gains and losses in accumulated other comprehensive income.



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On a consolidated basis, we attempt 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, by the Parent Company's issuance of yen-denominated debt and by the use of cross-currency swaps (see Hedging Activities on page 47 for additional information). As a result, the effect of currency fluctuations on our net assets is mitigated. At June 30, 2005, consolidated yen-denominated net assets subject to foreign currency fluctuation were $1.3 billion. At June 30, 2005, Aflac Japan's yen-denominated net assets were $2.7 billion and Aflac Incorporated's yen-denominated net liabilities were $1.4 billion. The following table demonstrates the effect of foreign currency fluctuations by presenting the dollar values of our yen-denominated assets and liabilities and our consolidated yen-denominated net asset exposure at selected exchange rates.

**Dollar Value of Yen-Denominated Assets and Liabilities**
**At Selected Exchange Rates**
**June 30, 2005**

(In millions)

| **Yen/dollar exchange rates** | **95.62** | **110.62*** | **125.62** |
|---|---|---|---|
| **Yen-denominated financial instruments:** | | | |
| Assets: | | | |
| Securities available for sale: | | | |
| Fixed maturities | $ 23,191 | $ 20,046 | $ 17,652 |
| Perpetual debentures | 4,140 | 3,578 | 3,151 |
| Equity securities | 56 | 49 | 43 |
| Securities held to maturity: | | | |
| Fixed maturities | 12,867 | 11,122 | 9,794 |
| Perpetual debentures | 5,169 | 4,468 | 3,935 |
| Cash and cash equivalents | 754 | 652 | 574 |
| Subtotal | 46,177 | 39,915 | 35,149 |
| Liabilities: | | | |
| Notes payable | 1,063 | 919 | 809 |
| Cross-currency swaps | 581 | 502 | 442 |
| Japanese policyholder protection fund | 265 | 229 | 202 |
| Other financial instruments | 28 | 24 | 21 |
| Subtotal | 1,937 | 1,674 | 1,474 |
| Net yen-denominated financial instruments | 44,240 | 38,241 | 33,675 |
| Other yen-denominated assets | 5,663 | 4,895 | 4,311 |
| Other yen-denominated liabilities | (48,390) | (41,828) | (36,834) |
| Consolidated yen-denominated net assets subject to foreign currency fluctuation | $ 1,513 | $ 1,308 | $ 1,152 |

**Actual June 30, 2005 exchange rate*

We are exposed to economic currency risk only when yen funds are actually converted into dollars. This primarily occurs when we transfer funds from Aflac Japan to Aflac U.S., which is done annually. The exchange rates prevailing at the time of transfer will differ from the exchange rates prevailing at the time the yen profits were earned. These repatriations have not been greater than 80% of Aflac Japan's prior year FSA-based earnings. A portion of the repatriation may be used to service Aflac Incorporated's yen-denominated notes payable with the remainder converted into dollars.



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### Interest Rate Risk

Our primary interest rate exposure is to 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 fair values to interest rate changes on debt securities we own. 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.

At June 30, 2005, we had $4.9 billion of net unrealized gains on total debt securities. We estimate that the reduction in the fair value of debt securities we own resulting from a 100 basis point increase in market interest rates would be approximately $4.8 billion, based on our portfolio as of June 30, 2005. The effect on yen-denominated debt securities is approximately $3.9 billion and the effect on dollar-denominated debt securities is approximately $829 million.

Changes in the interest rate environment have contributed to the unrealized gains on debt securities we own. However, we do not expect to realize a majority of these unrealized gains because we have the ability to hold these securities to maturity. Should significant amounts of unrealized losses occur because of increases in market yields, we likewise would not expect to realize these 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. Currently, when debt securities we own 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. Also, our strategy of developing and marketing riders to our older policies has helped offset the negative investment spread. And despite 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 experience from mortality, morbidity and expenses.

### 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 diversified portfolio of fixed-income investments that reflects the characteristics of the liabilities it supports.



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Aflac invests primarily within the debt securities markets. Our investment activities expose us to credit risk, which is a consequence of extending credit and/or carrying investment positions. However, we continue to adhere to prudent standards for credit quality. We accomplish this by considering our product needs and the overall corporate objectives, in addition to credit risk. Our investment policy requires that all securities be rated investment grade at the time of purchase. In evaluating the initial rating, we look at the overall senior issuer rating, the explicit rating for the actual issue or the rating for the security class, and, where applicable, the appropriate designation from the Securities Valuation Office (SVO) of the National Association of Insurance Commissioners (NAIC). In addition, we perform extensive internal credit reviews to ensure that we are consistent in applying rating criteria for all of our securities. The following table details investment securities by segment.

**Investment Securities by Segment**

| | Aflac Japan | Aflac U.S. |
|---|---|---|

| (In millions) | **June 30, 2005** | December 31, 2004 | **June 30, 2005** | December 31, 2004 |
|---|---|---|---|---|
| Securities available for sale, at fair value: | | | | |
| Fixed maturities | **$ 23,007** | $ 23,485 | **$ 6,133** | $ 5,681 |
| Perpetual debentures | **3,791** | 3,580 | **454** | 439 |
| Equity securities | **49** | 47 | **30** | 30 |
| Total available for sale | **26,847** | 27,112 | **6,617** | 6,150 |
| Securities held to maturity, at amortized cost: | | | | |
| Fixed maturities | **11,123** | 10,064 | **17** | 16 |
| Perpetual debentures | **4,468** | 4,759 | **-** | - |
| Total held to maturity | **15,591** | 14,823 | **17** | 16 |
| Total investment securities | **$ 42,438** | $ 41,935 | **$ 6,634** | $ 6,166 |

The increase in investments during the first six months of 2005 reflected the substantial cash flows in the functional currencies of our operations, partially offset by a weaker yen/dollar exchange rate. See Capital Resources and Liquidity on page 47 for additional information.

We have investments in both publicly issued and privately issued securities. However, the status of issuance should not be viewed as an indicator of liquidity or as a limitation on the determination of fair value. The outstanding amount of a particular issuance, as well as the level of activity in a particular issuance and the state of the market, including credit events and the interest rate environment, affect liquidity regardless of type of issuance. We routinely assess the fair value of all of our investments. This process includes evaluating quotations provided by outside securities pricing sources and/or compiled using data provided by external debt and equity market sources, as described more fully in Note 3 of the Notes to the Consolidated Financial Statements included in our annual report to shareholders for the year ended December 31, 2004. The following table details investment securities by type of issuance.





**Investment Securities by Type of Issuance**

| | **June 30, 2005** | | December 31, 2004 | |
|---|---|---|---|---|
| (In millions) | **Amortized Cost** | **Fair Value** | Amortized Cost | Fair Value |
| Publicly issued securities: | | | | |
| Fixed maturities | **$ 15,414** | **$ 17,994** | $ 15,737 | $ 18,122 |
| Perpetual debentures | **102** | **119** | 109 | 120 |
| Equity securities | **14** | **53** | 15 | 54 |
| Total publicly issued | **15,530** | **18,166** | 15,861 | 18,296 |
| Privately issued securities: | | | | |
| Fixed maturities | **21,180** | **23,000** | 20,481 | 21,566 |

| | | | | |
|---|---|---|---|---|
| Perpetual debentures | **8,362** | **8,875** | 8,602 | 8,823 |
| Equity securities | **18** | **26** | 19 | 23 |
| Total privately issued | **29,560** | **31,901** | 29,102 | 30,412 |
| Total investment securities | **$ 45,090** | **$ 50,067** | $ 44,963 | $ 48,708 |

Total privately issued securities accounted for 65.6%, at amortized cost, of total debt securities as of June 30, 2005, compared with 64.7% at December 31, 2004. Privately issued securities held by Aflac Japan at amortized cost accounted for $27.4 billion, or 60.8%, of total debt securities at June 30, 2005 and $27.0 billion, or 60.1%, of total debt securities at December 31, 2004. Reverse-dual currency debt securities accounted for $7.8 billion, or 26.4%, of total privately issued securities as of June 30, 2005, compared with $7.8 billion, or 26.8%, of total privately issued securities as of December 31, 2004. Aflac Japan has invested in privately issued securities to secure higher yields than those available from Japanese government bonds. Aflac Japan's investments in yen-denominated privately issued securities consist primarily of non-Japanese issuers and have longer maturities, thereby allowing us to improve our asset/liability matching and our overall investment returns. Most of our privately issued securities were issued under medium-term note programs and have standard documentation commensurate with credit ratings, except when internal credit analysis indicates that additional protective and/or event-risk covenants are required.

We use specific criteria to judge the credit quality of both existing and prospective investments. Furthermore, we use several methods to monitor these criteria, including credit rating services and internal credit analysis. All of our securities have ratings from either a nationally recognized security rating organization or the SVO of the NAIC. The percentage distribution by credit rating of our purchases of debt securities, based on acquisition cost, was as follows:

| | **Six Months Ended June 30, 2005** | Twelve Months Ended December 31, 2004 | Six Months Ended June 30, 2004 |
|---|---|---|---|
| AAA | **7.1%** | 9.1% | 12.2% |
| AA | **27.0** | 41.2 | 29.6 |
| A | **54.0** | 36.7 | 37.0 |
| BBB | **11.9** | 13.0 | 21.2 |
| | **100.0%** | 100.0% | 100.0% |





The percentage distribution, at amortized cost and fair value, by credit rating of debt securities we own was as follows:

| | **June 30, 2005** | | December 31, 2004 | |
|---|---|---|---|---|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| AAA | **3.6%** | **3.6%** | 3.5% | 3.5% |
| AA | **33.0** | **34.4** | 32.7 | 34.3 |
| A | **37.1** | **37.1** | 36.2 | 36.1 |

| | | | | |
|---|---|---|---|---|
| BBB | **24.5** | **23.5** | 25.8 | 24.6 |
| BB or lower | **1.8** | **1.4** | 1.8 | 1.5 |
| Total | **100.0%** | **100.0%** | 100.0% | 100.0% |

The overall credit quality of our portfolio remained high in part because our investment policy prohibits us from purchasing below-investment-grade securities. In the event of a credit rating downgrade to below-investment-grade status, we do not automatically liquidate our position. However, if the security is in the held-to-maturity portfolio, we immediately transfer it to the available-for-sale portfolio so that the security's fair value and its unrealized gain/loss are reflected on the balance sheet.

Once we designate a security as below investment grade, we begin a more intensive monitoring of the issuer. We do not automatically recognize an impairment for the difference between fair value and carrying value. Our investment management starts by reviewing its credit analysis. Included in this process are an evaluation of the issuer, its current credit posture and an assessment of the future prospects for the company. We then obtain fair value information from at least three independent pricing sources. Upon determining the fair value, we move our focus to an analysis of whether or not the decline in fair value, if any, is other than temporary. For securities with a carrying value in excess of fair value, investment management then reviews the issue based on our impairment policy to determine if the investment should be impaired and/or liquidated. The assessment of whether a decline is other than temporary requires significant management judgment and is discussed more fully in the Critical Accounting Estimates section of MD&A in our annual report to shareholders for the year ended December 31, 2004. Securities classified as below investment grade were as follows:



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**Below-Investment-Grade Securities**

| | **June 30, 2005** | | December 31, 2004 | |
|---|---|---|---|---|
| (In millions) | **Amortized Cost** | **Fair Value** | Amortized Cost | Fair Value |
| Ahold Finance | **$ 320** | **$ 260** | $ 338 | $ 300 |
| KLM Royal Dutch Airlines | **271** | **242** | 288 | 239 |
| Toys R Us Japan | **90** | **96** | 96 | 108 |
| LeGrand | **46** | **53** | 46 | 51 |
| General Motors | **32** | **26** | - | - |
| Tennessee Gas Pipeline | **31** | **34** | 31 | 33 |
| Ikon Inc.* | **-** | **-** | 8 | 9 |
| Total | **$ 790** | **$ 711** | $ 807 | $ 740 |

**Security sold during 2005*

Occasionally a debt security will be split-rated. This occurs when one rating agency rates the security as investment grade while another rating agency rates the same security as below investment grade. Our policy is to review each issue on a case-by-case basis to determine if a split-rated security should be classified as investment grade or below investment grade. Our review includes evaluating the SVO designation as well as current market pricing and other factors, such as the issuer's or security's inclusion on a credit rating downgrade watch list. Split-rated securities as of June 30, 2005, represented 1.0% of total debt securities at amortized cost and were as follows:

**Split-Rated Securities**

| (In millions) | Amortized Cost | Moody's Rating | S&P Rating | SVO Class | Investment Grade Status |
|---|---|---|---|---|---|
| Ford Motor Credit | $ 272 | Baa2 | BB+ | 2/2FE | Investment Grade |
| Ford | 123 | Baa3 | BB+ | 2FE | Investment Grade |
| Tyco Electronics AMP (AMP Japan) | 54 | Ba1 | BBB | 2 | Investment Grade |
| Union Carbide Corp. | 15 | B1 | BBB- | 2FE | Investment Grade |

The following table provides details on amortized cost, fair value and unrealized gains and losses for our investments in debt securities by investment-grade status as of June 30, 2005.

| (In millions) | Total Amortized Cost | Total Fair Value | Percent of Fair Value | Gross Unrealized Gains | Gross Unrealized Losses |
|---|---|---|---|---|---|
| Available-for-sale securities: | | | | | |
| Investment-grade securities | $ 28,661 | $ 32,673 | 65.4 % | $ 4,150 | $ 138 |
| Below-investment-grade securities | 790 | 711 | 1.4 | 17 | 96 |
| Held-to-maturity securities: | | | | | |
| Investment-grade securities | 15,608 | 16,604 | 33.2 | 1,196 | 200 |
| Total | $ 45,059 | $ 49,988 | 100.0 % | $ 5,363 | $ 434 |



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The following table presents an aging of securities in an unrealized loss position as of June 30, 2005.

**Aging of Unrealized Losses**

| | Total | Total | Less than six months | | Six months to 12 months | | Over 12 months | |
|---|---|---|---|---|---|---|---|---|
| (In millions) | Amortized Cost | Unrealized Loss | Amortized Cost | Unrealized Loss | Amortized Cost | Unrealized Loss | Amortized Cost | Unrealized Loss |
| Available-for-sale securities: | | | | | | | | |
| Investment-grade securities | $ 2,532 | $ 137 | $ 839 | $ 48 | $ 274 | $ 11 | $ 1,419 | $ 78 |
| Below-investment- | | | | | | | | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| grade securities | 592 | 97 | 10 | 2 | 22 | 4 | 560 | 91 |
| Held-to-maturity securities: | | | | | | | | |
| Investment-grade securities | 3,783 | 200 | 1,447 | 55 | 343 | 22 | 1,993 | 123 |
| Total | $ 6,907 | $ 434 | $ 2,296 | $ 105 | $ 639 | $ 37 | $ 3,972 | $ 292 |

The following table presents a distribution of unrealized losses by magnitude as of June 30, 2005.

**Percentage Decline from Amortized Cost**

| | | | Percentage of Decline | | | |
|---|---|---|---|---|---|---|
| | Total | Total | Less than 20% | | 20% to 35% | |
| (In millions) | Amortized Cost | Unrealized Loss | Amortized Cost | Unrealized Loss | Amortized Cost | Unrealized Loss |
| Available-for-sale securities: | | | | | | |
| Investment-grade securities | $ 2,532 | $ 137 | $ 2,532 | $ 137 | $ - | $ - |
| Below-investment-grade securities | 592 | 97 | 303 | 35 | 289 | 62 |
| Held-to-maturity securities: | | | | | | |
| Investment-grade securities | 3,783 | 200 | 3,783 | 200 | - | - |
| Total | $ 6,907 | $ 434 | $ 6,618 | $ 372 | $ 289 | $ 62 |



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The following table presents the 10 largest unrealized loss positions in our portfolio as of June 30, 2005.

| (In millions) | Credit Ratings | Amortized Cost | Fair Value | Unrealized Loss |
|---|---|---|---|---|
| Ahold Finance | BB | $ 320 | $ 260 | $ 60 |
| Ford Motor | BBB | 395 | 362 | 33 |
| KLM Royal Dutch Airlines | B | 271 | 242 | 29 |
| KBC Groupe SA | A | 245 | 219 | 26 |
| BAWAG | BBB | 126 | 109 | 17 |
| CSAV | BBB | 217 | 201 | 16 |
| Hypo-Vorarlberger Bank | A | 99 | 83 | 16 |
| National Bank of Greece (NBG Finance) | A | 271 | 258 | 13 |

| | | | | |
|---|---|---|---|---|
| EFG Eurobank Ergasias | A | 271 | 259 | 12 |
| United Mexican States | BBB | 405 | 394 | 11 |

The fair value of our investments in debt securities can fluctuate greatly as a result of changes in interest rates and foreign currency exchange rates. We believe that the declines in fair value noted above primarily resulted from changes in the interest rate and foreign currency environments rather than credit issues. Therefore, we believe that it would be inappropriate to recognize impairment charges for changes in fair value that we believe are temporary.

Based on our evaluation and analysis of specific issuers in accordance with our impairment policy, impairment charges recognized during the six-month periods ended June 30, 2005, and 2004, were immaterial.

Realized losses on debt securities by investment-grade status were as follows for the three- and six-month periods ended June 30, 2005. There were no disposals of below-investment-grade securities which resulted in losses during the first six months of 2005.

**Realized Losses on Debt Securities**

| | **Three Months Ended June 30, 2005** | | **Six Months Ended June 30, 2005** | |
|---|---|---|---|---|
| (In millions) | **Proceeds** | **Realized Loss** | **Proceeds** | **Realized Loss** |
| Investment-grade securities, length of consecutive unrealized loss: | | | | |
| Less than six months | $ 72 | $ - | $ 104 | $ 1 |
| Six months to 12 months | - | - | 16 | 1 |
| Over 12 months | 71 | 3 | 113 | 5 |
| Total | $ 143 | $ 3 | $ 233 | 7 |

As part of our investment activities, we have investments in variable interest entities (VIEs) and special purpose entities (SPEs). See Note 3 of the Notes to the Consolidated Financial Statements for additional information.





Cash, cash equivalents, and short-term investments totaled $1.4 billion, or 2.8% of total investments and cash, as of June 30, 2005, compared with $3.8 billion, or 7.3% at December 31, 2004. The decrease in cash, compared with December 31, 2004, was due to the return of cash collateral ($2.6 billion) attributed to a higher level of loaned securities at year-end. Mortgage loans on real estate and other long-term investments remained immaterial at both June 30, 2005, and December 31, 2004.

**Deferred Policy Acquisition Costs**

The following table presents deferred policy acquisition costs by segment.

| (In millions) | **June 30, 2005** | December 31, 2004 |
|---|---|---|
| Aflac Japan | **$ 3,722** | $ 3,812 |
| Aflac U.S. | **1,864** | 1,783 |

Aflac Japan's deferred policy acquisition costs decreased $90 million, or 2.4% (3.6% increase in yen) for the six months ended June 30, 2005. Deferred policy acquisition costs of Aflac U.S. increased $81 million, or 4.5% during the first six months of 2005. The weaker yen at June 30, 2005, decreased reported deferred policy acquisition costs by $229 million. The decrease in total deferred policy acquisition costs was the result of a weaker yen, partially offset by deferred costs associated with new annualized premium sales.

### Policy Liabilities

The following table presents policy liabilities by segment.

[redacted]

| (In millions) | **June 30, 2005** | December 31, 2004 |
|---|---|---|
| [redacted] | | |
| Aflac Japan | **$ 38,572** | $ 39,356 |
| Aflac U.S. | **4,496** | 4,198 |
| [redacted] | | |
| | | |
| [redacted] | | |

Aflac Japan's policy liabilities decreased $784 million, or 2.0% (4.0% increase in yen) for the six months ended June 30, 2005. Policy liabilities of Aflac U.S. increased $298 million, or 7.1% for the six months ended June 30, 2005. The weaker yen at June 30, 2005, decreased reported policy liabilities by $2.4 billion. The decrease in total policy liabilities reflected a weaker yen, partially offset by the growth and aging of our in-force business.



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### Notes Payable

Notes payable totaled $1.4 billion at both June 30, 2005, and December 31, 2004. The ratio of debt to total capitalization (debt plus shareholders' equity, excluding the unrealized gains and losses on investment securities) was 19.9% as of June 30, 2005, compared with 21.7% as of December 31, 2004. In July 2005, we issued 40 billion yen of yen-denominated Samurai notes. If these notes had been outstanding at June 30, 2005, our debt to total capitalization ratio would have been 23.9%. In October 2005, we will use 30 billion yen of the July 2005 Samurai proceeds to pay off the maturing 1.55% Samurai notes and expect the debt to capitalization ratio to decrease as a result. See Note 5 of the Notes to the Consolidated Financial Statements for additional information on notes payable at June 30, 2005.

### Off-Balance Sheet Arrangements

As of June 30, 2005, 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

We use 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.

### Benefit Plans

Aflac U.S. and Aflac Japan have various benefit plans. For additional information on our U.S. and Japanese plans, see Note 8 of the Notes to the Consolidated Financial Statements and Note 10 of the Notes to the Consolidated Financial Statements in our annual report to shareholders for the year ended December 31, 2004.

### State Guaranty Associations and Policyholder Protection Fund

The U.S. and Japanese insurance industries each have policyholder protection systems that provide funds for the policyholders of insolvent insurers. See the State Guaranty Associations and Policyholder Protection Fund section of MD&A in our annual report to shareholders for the year ended December 31, 2004, for additional information.



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### Hedging Activities

Aflac has limited hedging activities. Our primary exposure to be hedged is our investment in Aflac Japan, which is affected by changes in the yen/dollar exchange rate. In order to mitigate this exposure, we have taken the following courses of action. First, Aflac Japan owns dollar-denominated securities, which serve as an economic currency hedge of a portion of our investment in Aflac Japan. Second, we have designated the Parent Company's yen-denominated liabilities (Samurai notes payable and cross-currency swaps) as a hedge of our investment in Aflac Japan. If the total of these yen-denominated liabilities is equal to or less than our net investment in Aflac Japan, the hedge is deemed to be effective and the related exchange effect is reported in the unrealized foreign currency component of other comprehensive income. Should these yen-denominated liabilities exceed our investment in Aflac Japan, the portion of the hedge that exceeds our investment in Aflac Japan would be deemed ineffective. As required by SFAS 133, we would then recognize the foreign exchange effect on the ineffective portion in net earnings (other income). We estimate that if the ineffective portion was $100 million, we would report a foreign exchange gain/loss of approximately $1 million for every one yen weakening/strengthening in the end-of-period yen/dollar exchange rate. At June 30, 2005, and December 31, 2004, our hedge was effective with yen-denominated assets exceeding yen-denominated liabilities by 144.6 billion yen and 76.6 billion yen, respectively. The increase in our yen-denominated net asset position is primarily a result of an increased net asset position that we chose not to hedge.

## Capital Resources and Liquidity

Aflac provides the primary sources of liquidity to the Parent Company through dividends and management fees. Aflac declared dividends to the Parent Company in the amount of $356 million in the first half of 2005, compared with $297 million for the same period in 2004. During the first six months of 2005, Aflac Japan paid $15 million to the Parent Company for management fees, compared with $12 million for the same period of 2004. The primary uses of cash by the Parent Company are shareholder dividends and our share repurchase program. The Parent Company's sources and uses of cash are reasonably predictable and are not expected to change materially in the future.

The Parent Company also accesses debt security markets to provide additional sources of capital. Capital is primarily used to fund business expansion, capital expenditures and our share repurchase program. In 2003, we filed a Shelf Registration Statement with Japanese regulatory authorities to issue up to 100 billion yen (approximately $904 million using the June 30, 2005 exchange rate) of Samurai notes in Japan. In July 2005, we issued 40 billion yen of these securities with a coupon of .71% and a five-year maturity. These securities are not available to U.S. persons or entities. If issued, the remaining 60 billion yen of the 2003 Shelf Registration will not be available to U.S. persons or entities. For additional information, see Notes 5 and 10 of the Notes to the Consolidated Financial Statements. We believe outside sources for additional debt and equity capital, if needed, will continue to be available.





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 the Parent Company for management fees and dividends. Both the sources and uses of cash are reasonably predictable.

When making an investment decision, our first consideration is based on product needs. Our investment objectives provide for liquidity through the purchase of investment-grade debt securities. These objectives also take into account duration matching, and because of the long-term nature of our business, we have adequate time to react to changing cash flow needs.

In general, our insurance products provide fixed-benefit amounts that are not subject to medical-cost inflation. Furthermore, our business is widely dispersed in both the United States and Japan. This geographic dispersion and the nature of our benefit structure mitigate the risk of a significant unexpected increase in claims payments due to epidemics and events of a catastrophic nature. Additionally, our insurance policies generally are not interest-sensitive and therefore are not subject to unexpected policyholder redemptions due to investment yield changes. As a result of policyholder aging, claims payments are expected to gradually increase over the life of a policy. Therefore, future policy benefit reserves are accumulated in the early years of a policy and are designed to help fund future claims payments. We expect our future cash flows from premiums and our investment portfolio to be sufficient to meet our cash needs for benefits and expenses.

### Consolidated Cash Flows

We translate 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 six months ended June 30.

**Consolidated Cash Flows by Activity**

| (In millions) | **2005** | 2004 |
|---|---|---|
| Operating activities | **$ 2,356** | $ 2,249 |
| Investing activities | **(4,543)** | (2,083) |
| Financing activities | **(154)** | (132) |
| Exchange effect on cash and cash equivalents | **(44)** | (14) |
| Net change in cash and cash equivalents | **$ (2,385)** | $ 20 |

### Operating Activities

In the first half of 2005, consolidated cash flow from operations increased 4.8%. Net cash flow from operations other than Japan increased 2.8% in the six-month period ended June 30, 2005, to $457 million, compared with $444 million for the six months ended June 30, 2004. For the six months ended June 30, 2005, net cash flow from operations for Aflac Japan increased 5.3% (3.6% increase in yen) to $1.9 billion, compared with $1.8 billion for the six months ended June 30, 2004.





### Investing Activities

Operating cash flow is primarily used to purchase debt securities to meet future policy obligations. As a result of the return of the cash collateral from securities lending activities of Aflac U.S. at the end of 2004 (approximately $2.6 billion), consolidated cash flow used by investing activities was $4.5 billion in the first half of 2005, compared with $2.1 billion in the first half of 2004. Aflac Japan had cash outflows from investing activities of $1.7 billion in the first half of 2005, compared with cash outflows of $1.9 billion for the same period of 2004. Aflac U.S. had net cash outflows of $2.8 billion in the first half of 2005, compared with net outflows of $173 million a year ago.

Prudent portfolio management dictates that 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. Currently, when debt securities we own mature, the proceeds may be reinvested at a yield below that required for the accretion of policy benefit liabilities on policies issued in earlier years. However, the long-term nature of our business and our strong cash flows provides us with the ability to minimize the effect of mismatched durations and/or yields identified by various asset adequacy analyses. When market opportunities arise, we dispose of selected debt securities that are available for sale to improve the duration matching of our assets and liabilities and/or improve future investment yields. As a result, dispositions before maturity can vary significantly from year to year. Dispositions before maturity were approximately 2% of the year-to-date average investment portfolio of debt securities available for sale during the six-month periods ended June 30, 2005 and 2004.

### Financing Activities

The following table presents a summary of treasury stock activity during the six-month periods ended June 30.

| (In millions of dollars and thousands of shares) | **2005** | 2004 |
|---|---|---|
| Treasury stock purchases | **$ 225** | $ 178 |
| Shares purchased | **5,650** | 4,447 |
| Stock issued from treasury | **$ 27** | $ 25 |
| Shares issued | **2,482** | 1,763 |

Dividends to shareholders in the first half of 2005 of $.22 per share increased 15.8% over the same period of 2004. The following table presents the sources of dividends paid to shareholders for the six-month periods ended June 30.

| (In millions) | **2005** | 2004 |
|---|---|---|
| Dividends paid in cash | **$ 105** | $ 92 |
| Dividends through issuance of treasury shares | **5** | 5 |
| Total dividends to shareholders | **$ 110** | $ 97 |



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### Regulatory Restrictions

Aflac is domiciled in Nebraska and is subject to its regulations. In addition to limitations and restrictions imposed by U.S. insurance regulators, Japan's 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.

Payments are made from Aflac Japan to the Parent Company for management fees and to Aflac U.S. for allocated expenses and remittances of earnings. Expenses allocated to Aflac Japan were $14 million for the six-month period ended June 30, 2005, compared with $13 million a year ago. During the first six months of 2005, Aflac Japan remitted profits of $184 million (20.0 billion yen) to Aflac U.S. No amounts were remitted during the first half of 2004. For additional information on regulatory restrictions on dividends, profit transfers and other remittances, see Note 9 of the Notes to the Consolidated Financial Statements and the Regulatory Restrictions section of MD&A, both in our annual report to shareholders for the year ended December 31, 2004.

### Rating Agencies

Aflac is rated AA by both Standard & Poor's and Fitch Ratings and Aa2 (Excellent) by Moody's for financial strength. A.M. Best assigned Aflac an A+ (Superior) rating for financial strength and operating performance. Aflac Incorporated's senior debt is rated A by Standard & Poor's, A+ by Fitch Ratings, and A2 by Moody's.

### Other

In July 2005, the board of directors declared the third quarter cash dividend of $.11 per share. The dividend is payable on September 1, 2005, to shareholders of record at the close of business on August 19, 2005. In 2004, the board of directors authorized the purchase of up to 30 million shares of our common stock. As of June 30, 2005, approximately 21 million shares were available for purchase under our share repurchase program.

For information regarding commitments and contingent liabilities, see Note 9 of the Notes to the Consolidated Financial Statements.

## Item 3. Quantitative and Qualitative Disclosures about Market Risk.

The information required by Item 3 is incorporated by reference from the Market Risks of Financial Instruments section of MD&A in Part I, Item 2 of this report.



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## Item 4. Controls and Procedures.

**Disclosure Controls and Procedures**

The Company's Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this quarterly report (the "Evaluation Date"). Based on such evaluation, such officers have concluded that, as of the Evaluation Date, the Company's disclosure controls and procedures are effective.

**Internal Control Over Financial Reporting**

(c) Changes in Internal Control Over Financial Reporting.

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the second fiscal quarter of 2005 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.





## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings.

We are a defendant in various lawsuits considered to be in the normal course of business. Some of this litigation is pending in states where large punitive damages bearing little relation to the actual damages sustained by plaintiffs have been awarded against other companies, including insurers, in recent years. Although the final results of any litigation cannot be predicted with certainty, we believe the outcome of pending litigation will not have a material adverse effect on our financial position, results of operations, or cash flows.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

During the second quarter of 2005, we repurchased shares of Aflac stock as follows:

**Issuer Purchases of Equity Securities**

| Period | (a) Total Number of Shares Purchased | (b) Average Price Paid Per Share | (c) Total Number of Shares Purchased as Part of Announced Plans or Programs | (d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|---|---|---|---|---|
| April 1 - April 30 | 668,900 | $ 39.64 | 668,900 | 23,298,263 |
| May 1 - May 31 | 664,400 | 41.41 | 664,400 | 22,633,863 |
| June 1 - June 30 | 1,306,400 | 42.22 | 1,306,400 | 21,327,463 |
| Total | 2,639,700 | $ 41.36 | 2,639,700 | 21,327,463 |

*The remaining 21,327,463 shares relate to a repurchase authorization approved by the board and announced in February 2004.*

## Item 6. Exhibits.

**(a) Exhibits:**

| | |
|---|---|
| 11.0 - | Statement regarding the computation of per-share earnings for the Registrant. |
| 12.0 - | Statement regarding the computation of ratio of earnings to fixed charges for the Registrant. |
| 15.0 - | Letter from KPMG LLP regarding unaudited interim financial information. |
| 31.1 - | Certification of CEO dated August 5, 2005, required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934. |
| 31.2 - | Certification of CFO dated August 5, 2005, required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934. |
| 32.0 - | Certification of CEO and CFO dated August 5, 2005, Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |





## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**Aflac Incorporated**

| | | |
|---|---|---|
| August 5, 2005 | President, Treasurer and Chief Financial Officer | /s/ ***Kriss Cloninger III*** <br> (Kriss Cloninger III) |
| August 5, 2005 | Senior Vice President, Financial Services; Chief Accounting Officer | /s/ ***Ralph A. Rogers Jr.*** <br> (Ralph A. Rogers Jr.) |





## Exhibit Index

11.0 - Statement regarding the computation of per-share earnings for the Registrant.

12.0 - Statement regarding the computation of ratio of earnings to fixed charges for the Registrant.

15.0 - Letter from KPMG LLP regarding unaudited interim financial information.

31.1 - Certification of CEO dated August 5, 2005, required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.

31.2 - Certification of CFO dated August 5, 2005, required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.

32.0 - Certification of CEO and CFO dated August 5, 2005, Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.