10-Q 1 q900edg.txt 3RD QUARTER FORM 10-Q SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 FORM 10-Q QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT of 1934 For the quarter ended September 30, 2000 Commission File No. 1-7434 AFLAC INCORPORATED -- GEORGIA 58-1167100 ------------------------------- ------------------- (State or other jurisdiction of (I.R.S. Employer incorporation or organization) Identification No.) 1932 WYNNTON ROAD, COLUMBUS, GEORGIA 31999 -- -- (Address of principal executive offices and zip code) Registrant's telephone number, including area code (706) 323-3431 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 the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. Class November 1, 2000 ---------------------------- ------------------ Common Stock, $.10 Par Value 265,232,935 shares AFLAC INCORPORATED AND SUBSIDIARIES INDEX Page No. ---- Items other than those listed above are omitted because they are not required or are not applicable. i Part I. Financial Information AFLAC INCORPORATED AND SUBSIDIARIES Consolidated Balance Sheets (In millions) September 30, December 31, 2000 1999 (Unaudited) ------------ ------------ ASSETS: Investments and cash: Securities available for sale, at fair value: Fixed maturities (amortized cost, $20,589 in 2000 and $18,896 in 1999) $ 22,094 $ 20,859 Perpetual debentures (amortized cost, $2,473 in 2000 and $2,564 in 1999) 2,062 2,024 Equity securities (cost, $161 in 2000 and $137 in 1999) 237 215 Securities held to maturity, at amortized cost: Fixed maturities (fair value, $3,895 in 2000 and $4,280 in 1999) 3,909 4,389 Perpetual debentures (fair value, $3,502 in 2000 and $3,732 in 1999) 3,668 3,903 Other investments 19 18 Cash and cash equivalents 808 616 -------- -------- Total investments and cash 32,797 32,024 Receivables, primarily premiums 313 270 Accrued investment income 341 369 Deferred policy acquisition costs 3,758 3,692 Property and equipment, at cost less accumulated depreciation 491 509 Other 204 177 -------- -------- Total assets $ 37,904 $ 37,041 ======== ======== See the accompanying Notes to Consolidated Financial Statements. (continued) 1 AFLAC INCORPORATED AND SUBSIDIARIES Consolidated Balance Sheets (continued) (In millions, except for share and per-share amounts) September 30, December 31, 2000 1999 (Unaudited) ------------ ------------ Liabilities and Shareholders' Equity: Liabilities: Policy liabilities: Future policy benefits $ 27,442 $ 27,310 Unpaid policy claims 1,780 1,618 Unearned premiums 361 361 Other policyholders' funds 371 315 -------- -------- Total policy liabilities 29,954 29,604 Notes payable 914 1,111 Income taxes 1,660 1,511 Payables for return of cash collateral on loaned securities 397 - Other 875 947 -------- -------- Total liabilities 33,800 33,173 -------- -------- Shareholders' equity: Common stock of $.10 par value. In thousands: authorized 1,000,000 shares; issued 322,276 shares in 2000 and 320,349 shares in 1999 32 32 Additional paid-in capital 329 310 Retained earnings 3,812 3,356 Accumulated other comprehensive income: Unrealized foreign currency translation gains 184 232 Unrealized gains on investment securities 985 1,032 Treasury stock, at average cost (1,238) (1,094) -------- -------- Total shareholders' equity 4,104 3,868 -------- -------- Total liabilities and shareholders' equity $ 37,904 $ 37,041 ======== ======== Shareholders' equity per share $ 15.48 $ 14.56 ======== ======== See the accompanying Notes to Consolidated Financial Statements. 2 AFLAC INCORPORATED AND SUBSIDIARIES Consolidated Statements of Earnings (In millions, except for share and per-share amounts - Unaudited)

Three Months Ended September 30, Nine Months Ended September 30, --------- ------------ --------- --- ------------ ------------ - 2000 1999 2000 1999 - ------- ----- --- -------- --------

~~Revenues: Premiums, principally supplemental health insurance $ 2,081 $ 1,847 $ 6,154 $ 5,281 Net investment income 392 347 1,153 992 Realized investment gains (losses) (6) (3) (100) (12) Other income 8 5 25 14 ------ - ------- ---~~

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~~Total revenues 2,475 2,196 7,232 6,275 ------- ------- ------- -------~~

~~Benefits and expenses: Benefits and claims 1,676 1,498 4,946 4,277 Acquisition and operating expenses: Amortization of deferred policy acquisition costs 76 62 222 183 Insurance commissions 266 235 780 680 Insurance expenses 183 160 565 453 Interest expense 5 5 14 13 Release of retirement liability - - (101) - Other operating expenses 17 16 51 50 ------- ------- ------- ------- Total acquisition and operating expenses 547 478 1,531 1,379 ------- ------- ------- ------- Total benefits and expenses 2,223 1,976 6,477 5,656 ------- ------- ------- -------~~

~~Earnings before income taxes 252 220 755 619 ------- ------- ------- ------- Income tax expense (benefit): Operations 89 76 234~~

~~217 Deferred tax benefit from Japanese tax rate reduction - - - (67) ------- ------- ------- ------- Total income taxes 89 76 234 150 ------- ------- ------- ------- Net earnings $ 163 $ 144 $ 521 $ 469 ======= ======= ======= =======~~

~~(continued on next page) 3~~

AFLAC INCORPORATED AND SUBSIDIARIES Consolidated Statements of Earnings (continued) (In millions, except for share and per-share amounts - Unaudited)

Three Months Ended September 30, Nine Months Ended September 30, ---------- -------------- ------- ------ -------------- ---------- 2000 1999 2000 1999 -- ------ ------- - -------- ---- ---- ~~Net earnings per share: Basic $ .61 $ .54 $ 1.96 $ 1.77 Diluted .60 .52 1.91 1.70~~ ═══════ ═══════ ═══════ ═══════ ~~Shares used in computing earnings per share (In thousands): Basic 265,090 265,540 265,419 265,822 Diluted 272,196 274,497 272,295 275,743~~ ═══════ ═══════ ═══════ ═══════ ~~Cash dividends per share $ .085 $ .075 $ .245 $ .215~~ ═══════ ═══════ ═══════ ═══════ ~~See the accompanying Notes to Consolidated Financial Statements. 4~~

AFLAC INCORPORATED AND SUBSIDIARIES Consolidated Statements of Shareholders' Equity (In millions, except for per-share amounts - Unaudited) Nine Months Ended September 30, ------------------------------ 2000 1999 ------ ------ Common Stock: Balance at beginning and end of period $ 32 $ 32 ------ ------ Additional paid-in capital: Balance at beginning of year 310 235 Exercise of stock options, including income tax benefits 15 12 Gain on treasury stock reissued 4 53 ------ ------ Balance at end of period 329 300 ------ ------ Retained earnings: Balance at beginning of year 3,356 2,862 Net earnings 521 469 Dividends to shareholders ($.245 per share in 2000 and $.215 in 1999) (65) (57) ------ ------ Balance at end of period 3,812 3,274 ------ ------ Accumulated other comprehensive income: Balance at beginning of year 1,264 1,551 Change in unrealized foreign currency translation gains (losses) during period, net of income taxes (48) 6 Change in unrealized gains (losses) on investment securities during period, net of income taxes (47) (329) ------ ------ Balance at end of period 1,169 1,228 ------ ------ Treasury stock: Balance at beginning of year (1,094) (910) Purchases of treasury stock (176) (181) Cost of shares issued 32 29 ------ ------ Balance at end of period (1,238) (1,062) ------ ------ Total shareholders' equity $ 4,104 $ 3,772 ══════ ══════ See the accompanying Notes to Consolidated Financial Statements. 5 AFLAC INCORPORATED AND SUBSIDIARIES Consolidated Statements of Cash Flows (In millions - Unaudited) Nine Months Ended September 30, 2000 1999 ------ ------ Cash flows from operating activities: Net earnings $ 521 $ 469 Adjustments to reconcile net earnings to net cash provided by operating activities: Increase in policy liabilities 2,055 1,900 Deferred income taxes 86 (1) Change in income taxes payable 229 (224) Increase in deferred policy acquisition costs (215) (215) Change in receivables and advance premiums (24) (10) Realized investment losses 100 12 Release of retirement liability (101) - Other, net (38) 262 ------ ------ Net cash provided by operating activities 2,613 2,193 ------ ------ Cash flows from investing activities: Proceeds from investments sold or matured: Securities available for sale: Fixed-maturity securities sold 572 985 Fixed-maturity securities matured 301 177 Equity securities 30 67 Securities held to maturity: Fixed-maturity securities matured - 18 Other investments, net (3) - Costs of investments acquired: Securities available for sale: Fixed-maturity securities (3,234) (2,587) Perpetual debentures (26) (819) Equity securities (54) (61) Securities held to maturity: Fixed-maturity securities - (42) Investment in new subsidiary (9) - Cash received as collateral on loaned securities 397 44 Additions to property and equipment, net (14) (15) ------ ------ Net cash used by investing activities $(2,040) $(2,233) ------ ------ (continued) 6 AFLAC INCORPORATED AND SUBSIDIARIES Consolidated Statements of Cash Flows (continued) (In millions - Unaudited) Nine Months Ended September 30, 2000 1999 ------ ------ Cash flows from financing activities: Proceeds from borrowings $ 15 $ 446 Principal payments under debt obligations (169) (78) Dividends paid to shareholders (61) (53) Purchases of treasury stock (176) (181) Treasury stock reissued 27 30 Other, net 14 10 ------ ------ Net cash provided (used) by financing activities (350) 174 ------ ------ Effect of exchange rate changes on cash and cash equivalents (31) 26 ------ ------ Net change in cash and cash equivalents 192 160 Cash and cash equivalents, beginning of year 616 374 ------ ------ Cash and cash equivalents, end of period $ 808 $ 534 ====== ====== Supplemental disclosures of cash flow information: Cash payments during the period for: Interest on debt obligations $ 14 $ 9 Income taxes 97 261 Non-cash financing activities: Capital lease obligations 15 4 Treasury shares issued for: Dividends to shareholders 4 4 Associates stock bonus plan 5 50 See the accompanying Notes to Consolidated Financial Statements. 7 AFLAC INCORPORATED AND SUBSIDIARIES Consolidated Statements of Comprehensive Income (In millions - Unaudited)

Three Months Ended Nine Months Ended September 30, September 30, --------------------------- - --------------------------- 2000 1999 2000 1999 -------- -------- -------- -------- ~~Net earnings $ 163 $ 144 $ 521 $ 469 -------- -------- -------- --------~~

~~Other comprehensive income, before income taxes: Foreign currency translation adjustments: Change in unrealized foreign currency translation gains (losses) during the period 17 (104) 45 (87) Unrealized gains (losses) on investment securities: Unrealized holding gains (losses) arising during the period (306) 36 (209) (418) Reclassification adjustment for realized (gains) losses included in net earnings 7 3 100 13 -------- -------- -------- --------~~

~~Total other comprehensive income, before income taxes (282) (65) (64) (492) Income tax expense (benefit)~~

~~(benefit) related to items of other comprehensive income (114) (45) 31 (169) ------- ------- ------- ------- Other comprehensive income (loss), net of income taxes (168) (20) (95) (323) ------- ------- ------- ------- Total comprehensive income (loss) $ (5) $ 124 $ 426 $ 146 ======= ======= ======= ======= See the accompanying Notes to Consolidated Financial Statements. 8~~

AFLAC INCORPORATED AND SUBSIDIARIES Notes to Consolidated Financial Statements 1. Basis of Presentation In the opinion of management, the accompanying unaudited consolidated financial statements of AFLAC Incorporated and subsidiaries (the "Company") contain all adjustments necessary to fairly present the consolidated balance sheet as of September 30, 2000, and the consolidated statements of earnings and comprehensive income for the three and nine month periods ended September 30, 2000 and 1999, and the consolidated statements of cash flows and shareholders' equity for the nine months ended September 30, 2000 and 1999. Results of operations for interim periods are not necessarily indicative of results for the entire year. We prepare our financial statements in accordance with 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: deferred policy acquisition costs and liabilities for future policy benefits and unpaid policy claims. 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 financial statements should be read in conjunction with the financial statements included in our annual report to shareholders for the year ended December 31, 1999. 2. Accounting Pronouncements Statement of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities, was issued in June 1998. This Statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in investment securities and other contracts, and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the balance sheet and measure those instruments at fair value. The accounting for changes in the fair value of a derivative will be included in either earnings or other comprehensive income depending on the intended use of the derivative instrument. According to SFAS No. 133, we will be required to recognize in net earnings the unrealized gains/losses on the interest rate components of our cross currency swaps (see Note 5). If we had adopted SFAS No. 133 on January 1, 2000, we would have recorded a pretax gain of $14 million for the nine months ended September 30, 2000 related to the change in fair value of the interest rate components of these cross currency swaps. We are continuing our review of SFAS No. 133 in anticipation of additional guidance and interpretation of this standard which we will adopt effective January 1, 2001. 9 3. Segment Information Information regarding components of operations is as follows: (In millions) Three Months Ended Nine Months Ended September 30, September 30, 2000 1999 2000 1999 -------- -------- -------- -------- Revenues: AFLAC Japan: Earned premiums $ 1,685 $ 1,501 $ 5,008 $ 4,271 Net investment income 320 280 940 804 Other income 1 2 7 3 ------- ------- ------- ------- Total AFLAC Japan revenues 2,006 1,783 5,955 5,078 ------- ------- ------- ------- AFLAC U.S.: Earned premiums 395 346 1,146 1,010 Net investment income 70 62 205 179 Other income 2 1 4 2 ------- ------- ------- ------- Total AFLAC U.S. revenues 467 409 1,355 1,191 ------- ------- ------- ------- Other business segments 7 5 20 16 ------- ------- ------- ------- Total business segments 2,480 2,197 7,330 6,285 Realized investment gains (losses) (6) (3) (100) (12) Corporate 7 11 24 28 Intercompany eliminations (6) (9) (22) (26) ------- ------- ------- ------- Total revenues $ 2,475 $ 2,196 $ 7,232 $ 6,275 ======= ======= ======= ======= Earnings before income taxes: AFLAC Japan $ 195 $ 171 $ 574 $ 481 AFLAC U.S. 75 65 216 191 Other business segments - (2) (2) (2) ------- ------- ------- ------- Total business segments 270 234 788 670 Realized investment gains (losses) (6) (3) (100) (12) Release of retirement liability - - 101 - Interest expense, non-insurance operations (4) (4) (12) (10) Corporate (8) (7) (22) (29) ------- ------- ------- ------- Total earnings before income taxes $ 252 $ 220 $ 755 $ 619 ======= ======= ======= ======= 10 Assets were as follows: September 30, December 31, (In millions) 2000 1999 ------------ ----------- Assets: AFLAC Japan $ 32,917 $ 32,274 AFLAC U.S. 4,806 4,448 Other business segments 38 34 -------- -------- Total business segments 37,761 36,756 Corporate 5,209 5,213 Intercompany eliminations (5,066) (4,928) -------- -------- Total assets $ 37,904 $ 37,041 ======== ======== 4. Japanese Income Taxes At the end of March 1999, the Japanese government reduced the Japanese corporate income tax rate from 41.7% to 36.2%, which increased net earnings for the first nine months of 1999 by $67 million ($.25 per basic share, $.24 per diluted share) from the reduction of our consolidated deferred income tax liability as of March 31, 1999. This was the net effect of recalculating Japanese deferred income taxes at the new 36.2% rate on the temporary differences between the financial reporting basis of AFLAC Japan's assets and liabilities, reduced by the limitations in the U.S. foreign tax credit provisions. This tax rate reduction was effective April 1, 1999 for AFLAC Japan, for purposes of calculating income tax expense on operating earnings. 5. Notes Payable A summary of notes payable is as follows: September 30, December 31, (In millions) 2000 1999 ------------ ----------- 1.67% yen-denominated senior notes due April 2009 $ 513 $ 541 Unsecured, yen-denominated notes payable to banks: Reducing, revolving credit agreement, due annually through July 2001: 2.29% fixed interest rate 105 222 Variable interest rate (.55% at September 30, 2000) 15 31 Revolving credit agreement due November 2002: 1.24% fixed interest rate 72 114 Variable interest rate (.50% at September 30, 2000) 167 138 Short term (.50% at December 31, 1999) - 45 6.89% unsecured short-term dollar-denominated note payable to bank (paid in October 2000) 15 - Obligations under capitalized leases, due monthly through 2005, secured by computer equipment in Japan 27 20 ------ ------ Total notes payable $ 914 $ 1,111 ====== ====== 11 In September 2000, we filed a shelf registration statement with the Japanese regulatory authorities to issue up to 100 billion yen of yen- denominated Samurai notes. These securities are not for sale in the United States. On October 25, 2000, we issued in Japan 30 billion yen ($278 million) of Samurai notes with a 1.55% coupon payable semiannually, due October 25, 2005. These notes are redeemable at our option and at any time with a redemption price equal to the principal amount of the notes being redeemed plus a premium. We received net proceeds of 29.9 billion yen ($277 million) after issue costs. We temporarily invested the proceeds in short- duration dollar-denominated securities and they will be used to purchase shares of our common stock. In April 1999, we issued

$450 million of senior notes with a 6.50% coupon, payable semiannually, due April 15, 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 amount. We have entered into cross currency swaps that have the effect of converting the dollar-denominated principal and interest into yen-denominated obligations. At September 30, 2000, the outstanding principal was 55.6 billion yen ($515 million using the September 30, 2000 exchange rate), less loan discount of $2 million, for a net payable of $513 million at an interest rate of 1.67%. We have a reducing, revolving credit agreement that provides for bank borrowings through July 2001 in either U.S. dollars or Japanese yen. Under the terms of the agreement, the borrowing limit reduced to $125 million on July 17, 2000. At September 30, 2000, 11.3 billion yen ($105 million) was outstanding at a fixed interest rate and 1.6 billion yen ($15 million) was outstanding at a variable interest rate under this agreement. We also have an unsecured revolving credit agreement that provides for bank borrowings through November 2002 with a borrowing limit of $250 million, payable in either U.S. dollars or Japanese yen. At September 30, 2000, 7.8 billion yen ($72 million) was outstanding at a fixed interest rate and 18.0 billion yen ($167 million) was outstanding at a variable interest rate under this agreement. Since these loans are denominated in yen, the principal amount of the loans as stated in dollar terms at any date will fluctuate due to changes in the yen/dollar exchange rate. We have outstanding interest rate swaps on a portion of our variable interest rate yen-denominated borrowings (19.1 billion yen). These swaps reduce the impact of changes in interest rates on our borrowing costs and effectively change our interest rate from variable to fixed on a portion of these loans. Under these agreements, we make fixed rate payments at 2.29% on one loan and 1.24% on another loan and receive floating rate payments (.54% at September 30, 2000, plus loan costs of 25 or 20 basis points, respectively) based on three-month Japanese yen LIBOR. We have designated our yen-denominated borrowings as a hedge of our net investment in AFLAC Japan. Foreign currency translation gains/losses are included in accumulated other comprehensive income. Outstanding principal and related accrued interest payable on the yen-denominated borrowings were translated into dollars at end-of-period exchange rates. Interest expense was translated at average exchange rates for the period the interest expense was incurred. 12 6. Investment Securities Net unrealized gains and losses on investment securities, less amounts applicable to policy liabilities and deferred income taxes, are reported in accumulated other comprehensive income. The portion of unrealized gains credited to policy liabilities represents gains that would not inure to the benefit of shareholders if such gains were actually realized. These amounts relate to policy reserve interest requirements and reflect the difference between market investment yields and estimated minimum required interest rates. The net effect on shareholders' equity of unrealized gains and losses from investment securities at the following dates was: (In millions) September 30, December 31, 2000 1999 ------------ ------------ Unrealized gains on securities available for sale $ 1,170 $ 1,501 Unamortized unrealized gains on securities transferred to held to maturity 1,092 1,258 Less: Policy liabilities 452 840 Deferred income taxes 825 887 --------- --------- Shareholders' equity, net unrealized gains on investment securities $ 985 $ 1,032 ========= ========= The issuers of two debt securities held in our portfolio experienced significant credit rating downgrades during the first half of 2000. During the second quarter of 2000, we sold one security carried in available-for- sale at a realized loss of $34 million. We recorded an impairment loss of $57 million on the other security, which was carried in the held-to-maturity category. We have reclassified this security to the available-for-sale category. These losses decreased net earnings by $58 million ($.22 per basic share and $.21 per diluted share) for the nine months ended September 30, 2000. 7. Security Lending AFLAC Japan uses short-term security lending arrangements to increase investment income with minimal risk. At September 30, 2000, and December 31, 1999, we had security loans outstanding in the amounts of $386 million and $2.4 billion at fair value, respectively. We receive cash or other securities as collateral for such loans. At September 30, 2000, we held cash collateral of $397 million for loaned securities in the amount of $386 million. Also at December 31, 1999, we held Japanese government bonds as collateral for loaned securities in the amount of $2.4 billion at fair value. Our security lending policy requires that the fair value of the securities received as collateral and cash received as collateral be 102% and 100% or more, respectively, of the fair value of the loaned securities as of the date the securities are loaned and not less than 100% thereafter. 13 For loans involving unrestricted cash collateral, the collateral is recorded as an asset with a corresponding liability for the return of the collateral. For loans involving securities as collateral, the collateral is not recorded as an asset or liability. 8. Common Stock The following is a reconciliation of the number of shares of our common stock for the nine months ended September 30: 2000 1999 (In thousands of shares) ---------- ---------- Common stock - issued: Balance at beginning of year 320,349 317,971 Exercise of stock options 1,927 1,789 -------- -------- Balance at end of period 322,276 319,760 -------- -------- Treasury stock: Balance at beginning of year 54,608 52,287 Purchases of treasury stock: Open market 3,892 3,394 Other 134 183 Shares issued to sales associates stock bonus plan and AFL Stock Plan (468) (609) Exercise of stock options (1,048) (1,006) -------- -------- Balance at end of period 57,118 54,249 -------- -------- Shares outstanding at end of period 265,158 265,511 ======== ======== 9. Litigation We are a defendant in various litigation considered to be in the normal course of business. Some of this litigation is pending in Alabama, 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. Release of Retirement Liability The surviving spouse of the Company's former chairman of the board, John B. Amos, had been receiving lifetime spousal retirement benefits under a shareholder approved employment contract. The benefits were payable at .5% of the Company's pretax earnings, for the previous year, as defined in the agreement. In May 2000, the former chairman's spouse unexpectedly passed away. The Company had accrued an unfunded liability for projected retirement payments based on a normal life expectancy. The release of the remaining accrued liability increased net earnings by $99 million ($.37 per basic share, $.36 per diluted share) for the nine months ended September 30, 2000. 14 REVIEW BY INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS The September 30, 2000, and 1999, financial statements included in this filing have been reviewed by KPMG LLP, independent certified public accountants, in accordance with established professional standards and procedures for such a review. The report of KPMG LLP commenting upon their review is included on page 16. 15 KPMG LLP Certified Public Accountants 303 Peachtree Street, N.E. Telephone: (404) 222-3000 Suite 2000 Telefax: (404) 222-3050 Atlanta, GA 30308 INDEPENDENT AUDITORS' REVIEW REPORT The Shareholders and Board of Directors AFLAC Incorporated: We have reviewed the consolidated balance sheet of AFLAC Incorporated and subsidiaries as of September 30, 2000, and the related consolidated statements of earnings and comprehensive income for the three-month and nine-month periods ended September 30, 2000, and 1999, and the consolidated statements of shareholders' equity and cash flows for the nine-month periods ended September 30, 2000 and 1999. These consolidated financial statements are the responsibility of the Company's management. We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, 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 review, 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 accounting principles generally accepted in the United States of America. We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the accompanying consolidated balance sheet of AFLAC Incorporated and subsidiaries as of December 31, 1999, 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 January 27, 2000, we expressed an unqualified opinion on those financial statements. KPMG LLP Atlanta, GA November 9, 2000 16 ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS AFLAC Incorporated is the parent company of American Family Life Assurance Company of Columbus, AFLAC. Our principal business is supplemental health insurance, which is marketed and administered through AFLAC. Most of AFLAC's policies are individually underwritten, and marketed at worksites through independent agents, with premiums paid by the employee. Our operations in Japan (AFLAC Japan) and the United States (AFLAC U.S.) service the two markets for our insurance business. RESULTS OF OPERATIONS Several significant non-operating items affected our net earnings during 2000 and 1999. In the second quarter of 2000, a release of an accrued unfunded liability for projected retirement payments increased net earnings by $99 million ($.37 per basic share, $.36 per diluted share) for the nine months ended September 30, 2000. (See Note 10 of the Notes to the Consolidated Financial Statements.) Also during the second quarter of 2000, we recorded investment losses on two debt securities associated with significant credit downgrades, which decreased net earnings by $58 million ($.22 per basic share, $.21 per diluted share) for the nine months ended September 30, 2000. (See Note 6 of the Notes to the Consolidated Financial Statements.) Due to a corporate income tax rate reduction in Japan during 1999, the statutory tax rate for AFLAC Japan declined from 41.7% to 36.2%. This tax rate decline resulted in a reduction in our deferred income tax liability as of March 31, 1999, which increased net earnings by $67 million ($.25 per basic share and $.24 per diluted share) for the nine months ended September 30, 1999. 17 The following table sets forth the results of operations by business segment for the periods shown.

SUMMARY OF OPERATING RESULTS BY BUSINESS SEGMENT (In millions, except for per-share amounts) Three Months Ended September 30, Nine Months Ended September 30, -- -- Percentage Change 2000 1999 Percentage Change 2000 1999 ----------------- ---------------- ----------------- ------------------ ~~Operating earnings: AFLAC Japan. . . . . 13.9% $ 195 $ 171 19.4% $ 574 $ 481 AFLAC U.S. . . . . 15.4 75 65 13.1 216 191 All other business segments. . . . - (2) (2) (2) ----- ----- ----- ----- Total business segments. . . . . 15.2 270 234 17.6 788 670 Interest expense, non-insurance operations . . . . 1.0 (4) (4) (13.7) (12) (10) Corporate and eliminations . . . . 6.8 (7) (7) 20.9 (22) (28) ----- ----- ----- ----- Pretax operating earnings. . . . 16.2 259 223 19.4 754 632 Income taxes . . . . 12.6 90 80 17.2 265 227 ----- ----- ----- ----- Operating earnings . . . . 18.2 169 143 20.6 489 405 Non-operating items: Realized investment gains (losses), net of tax . . . . . . (6) 1 (67) (3) Release of retirement liability, net of tax . . . . - - 99 - Deferred tax benefit from Japanese tax rate reduction . . . . - - - 67 -- --- ----- ----- ----- Net earnings . . . . 13.5% $ 163 $ 144 11.0% $ 521 $ 469~~ ===== ===== ===== ===== ~~Operating earnings per basic share . 18.5% $ .64 $ .54 21.1% $ 1.84 $ 1.52 Operating earnings per diluted share 19.2 .62 .52 21.8 1.79 1.47~~ ===== ===== ===== ===== ~~Net earnings per basic share . . . . 13.0% $ .61 $ .54 10.7% $ 1.96 $ 1.77 Net earnings per diluted share . . . 15.4 .60 .52 12.4 1.91 1.70~~ ===== ===== ===== =====

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The following discussion of earnings comparisons focuses on operating earnings and excludes realized investment gains/losses, the gain from the release of the retirement accrual in 2000, and the deferred income tax benefit from the Japanese tax rate reduction in 1999. Operating earnings per share amounts referenced in the following discussion are based on the diluted number of average outstanding shares. FOREIGN CURRENCY TRANSLATION Due to the relative size of AFLAC Japan, fluctuations in the yen/dollar exchange rate can have a significant effect on our reported results. In years when the yen weakens, translating yen into dollars causes fewer dollars to be reported. When the yen strengthens, translating yen into dollars causes more dollars to be reported. The following table illustrates the effect of foreign currency translation on our reported results by comparing those results as if foreign currency rates had remained unchanged from the comparable period in the prior year. AFLAC Incorporated and Subsidiaries Selected Percentage Changes for Supplemental Consolidated Data (For the periods ended September 30, 2000) Three Months Nine Months Operating Results Operating Results -------------------- -------------------- Including Excluding Including Excluding Currency Currency Currency Currency Changes Changes* Changes Changes* --------- --------- --------- --------- Premium income 12.7% 7.7% 16.5% 8.5% Net investment income 12.9 9.2 16.2 10.4 Operating revenues 12.9 8.1 16.6 8.9 Total benefits and expenses 12.5 7.5 16.3 8.2 Operating earnings 18.2 15.8 20.6 16.4 Operating earnings per diluted share 19.2 17.3 21.8 17.7 --- *Amounts excluding foreign currency changes were determined using the same yen/dollar exchange rate for the current period as the comparable period in the prior year. === The yen began to strengthen in relation to the dollar at the end of 1998 after several years of weakening. The average yen-to-dollar exchange rates were 107.65 and 113.68 for the three months ended September 30, 2000 and 1999, and 107.16 and 117.09 for the nine months ended September 30, 2000 and 1999, respectively. The strengthening of the yen in 2000 increased operating earnings by approximately $.01 per share for the three months ended September 30, 2000, and $.06 per share for the nine months ended September 30, 2000. Operating earnings per share increased 19.2% to $.62 for the three-month period ended September 30, 2000, compared with the same period in 1999 and increased 21.8% to $1.79 for the nine-month period ended September 30, 2000, compared with the same period in 1999. Operating earnings per share, excluding the effect of foreign currency translation, increased 17.3% for the quarter and 17.7% for the nine months ended September 30, 2000. 19 Our primary financial objective is the growth of operating earnings per share excluding the effect of foreign currency fluctuations. Our objective for 2000 through 2002 is to increase operating earnings per share growth by 15% to 17%, excluding the impact of currency translation. If we achieve a 17% increase, the following table shows the likely results for operating earnings per share for the year 2000 when the estimated impact from various foreign currency translations are included. 2000 Operating EPS Scenarios --------------------------- Annual Average Yen Annual Operating % Growth Yen Impact Exchange Rate Diluted EPS Over 1999 on EPS ------------- ---------------- --------- ---------- 100.00 $ 2.48 24.0% $ .14 105.00 2.42 21.0 .08 110.00 2.38 19.0 .04 113.96* 2.34 17.0 - 115.00 2.33 16.5 (.01) 120.00 2.29 14.5 (.05) 125.00 2.25 12.5 (.09) *Actual exchange rate for the year ended December 31, 1999. We believe we will achieve the high end of our earnings objective for the fourth quarter. If we reach that target and the yen averages 107 to 110 to the dollar for the fourth quarter, we would expect operating earnings for the full year to be approximately $2.40 per share. SHARE REPURCHASE PROGRAM During the third quarter, we acquired approximately 787,000 shares of our stock, bringing the total number of shares purchased in the first nine months to 3.9 million. At the end of September 2000, we had available approximately 9.2 million shares authorized by the board of directors for repurchase. INCOME TAXES Our combined U.S. and Japanese effective income tax rates on operating earnings for the nine months ended September 30, 2000 and 1999 were 35.2% and 35.9%, respectively. Income tax expense for 1999 included approximately $2 million of additional taxes from an income tax audit in Japan. Excluding that amount, the effective income tax rate on operating earnings for 1999 was 35.4%. The 1999 reduction in the statutory tax rate in Japan did not significantly change our combined U.S./Japan effective tax rate as it shifted a portion of our income tax expense from Japan operations to U.S. operations as a result of the U.S. foreign tax credit provisions. 20 INSURANCE OPERATIONS, AFLAC JAPAN AFLAC Japan, a branch of AFLAC and the principal contributor to our earnings, ranks number one in terms of premium income and profits among all foreign life and non-life insurance companies operating in Japan. Among all life insurance companies operating in Japan, AFLAC Japan ranked second in terms of individual policies in force and 14th in terms of assets according to Financial Services Agency (FSA) data as of March 31, 2000. The following table presents a summary of AFLAC Japan's operating results. AFLAC JAPAN SUMMARY OF OPERATING RESULTS Three Months Ended Nine Months Ended September 30, September 30, (In millions) 2000 1999 2000 1999 ------------------ ------------------ Premium income. . . . . $ 1,685 $ 1,501 $ 5,008 $ 4,271 Investment income . . . . 320 280 940 804 Other income. . . . . 1 2 7 3 ------ ------ ------ ------ Total revenues. . . . . 2,006 1,783 5,955 5,078 ------ ------ ------ ------ Benefits and claims . . . . . . 1,428 1,280 4,226 3,648 Operating expenses. . . . . . . 383 332 1,155 949 ------ ------ ------ ------ Total benefits and expenses . 1,811 1,612 5,381 4,597 ------ ------ ------ ------ Pretax operating earnings . $ 195 $ 171 $ 574 $ 481 ====== ====== ====== ====== --- Percentage changes in dollars over previous period: Premium income. . . . . 12.3% 34.6% 17.3% 24.7% Investment income . . . . . . 14.0 28.3 17.0 20.8 Total revenues. . . . . 12.6 33.6 17.3 24.1 Pretax operating earnings . . 13.9 40.4 19.4 31.5 --- Percentage changes in yen over previous period: Premium income. . . . . 6.1% 9.4% 7.3% 8.5% Investment income . . . . . 8.6 3.7 7.3 4.9 Total revenues. . . . . 6.5 8.5 7.4 7.9 Pretax operating earnings . . 9.0 13.1 9.6 13.9 --- Ratios to total revenues: Benefits and claims . . . . . 71.2% 71.8% 71.0% 71.8% Operating expenses. . . . . . 19.1 18.6 19.4 18.7 Pretax operating earnings . . 9.7 9.6 9.6 9.5 === 21 AFLAC JAPAN SALES AFLAC Japan's new annualized premium sales in the third quarter rose 21.5% to 24.6 billion yen, or $241 million. Sales were led by Rider MAX, the popular rider to our cancer life coverage. Rider MAX sales were at record levels during the third quarter and accounted for approximately 46% of total sales. Ordinary life insurance sales also showed solid gains, representing 9.8% of sales during the quarter. For the first nine months of 2000, new sales increased 14.1% to 72.3 billion yen, or $682 million. In addition to strong sales, we are also seeing continued growth of our distribution system in Japan. During the third quarter, we recruited 500 new agencies, bringing the total number of agencies representing AFLAC to approximately 9,000 at the end of September. We believe that new agencies will continue to be attracted to AFLAC Japan's high commissions and its superior products, customer service and brand image. In 2001, Japan's insurance market will further deregulate. As a result, we expect competition to increase. We also expect increased opportunities for AFLAC Japan. In preparation for deregulation, AFLAC Japan and Dai-ichi Mutual Life Insurance Company (Dai-ichi Life) agreed to a major marketing alliance that anticipates the sale of each company's products through their respective distribution systems. The initial focus will be the sale of AFLAC Japan's supplemental insurance products through Dai-ichi Life's sales force of 50,000 people. These sales are expected to commence in the first half of 2001, pending approval by regulatory authorities. In addition, the companies will use their expertise to develop new products and sales methods. The alliance will also explore the opportunities for shared know- how in the areas of information technology and customer service. To further prepare for deregulation, we will continue building on our competitive strengths. To that end, we plan on improving the products we offer and introducing new ones. We will continue to expand our distribution system through the addition of new agencies as well as alternative sales channels like the Internet. And we will also invest in new technologies to maintain our cost and service advantages and aggressively promote our brand through advertising. In July 2000, we began offering a new optional commission contract which pays a higher first year commission, but limits renewal commissions to nine years rather than the life of the contract. Other changes we have made to our business recently, including our laptop computer sales aid, new products and aggressive recruiting, are all part of our plan for competing in a deregulated environment. We recognize that we will face more competition in the future, and we continue to look for ways to improve. At the same time, companies will find it difficult to compete with us because of our low-cost structure. Although Japan's economy remains weak, we continue to believe it is one of the best insurance markets in the world and one of great opportunities for growth. Our objective is for AFLAC Japan's sales to increase approximately 15% for the years 2000 and 2001. 22 AFLAC JAPAN INVESTMENTS Despite a modest rise in Japanese interest rates in August, investment yields remained at very low levels during the third quarter. For example, the yield of a composite index of 20-year Japanese government bonds averaged 2.28% during the third quarter, up from an average of 2.11% in the second quarter. AFLAC Japan invested in sectors other than government bonds and thereby purchased yen-denominated securities at an average yield of 3.38% in the quarter. Including dollar-denominated investments, the blended new money yield was 3.75% for the quarter. At the end of the third quarter, the yield on AFLAC Japan's fixed-maturity portfolio was 5.06%, compared with 5.21% a year ago. The return on average invested assets, net of investment expenses, was 4.83% for the nine months, compared with 5.02% a year ago. AFLAC JAPAN OTHER The operating expense ratio has increased slightly due to expenditures for additional marketing programs, including advertising and direct response efforts. The benefit ratio has declined due to the mix of business shifting to newer products that have a lower loss ratio than the traditional cancer life insurance. In July 2000, we initiated an internal compliance review to determine the extent to which inappropriate premium discounts, if any, may have been given to customers, and to put in place any corrective measures necessary to ensure full regulatory compliance in the future. We also informed the FSA at the time the review was initiated. At this time the review has not been completed and we cannot speculate about any actions the FSA might take. However, we believe the outcome of our voluntary review and response by the FSA will not have an adverse material impact on our operations or financial condition. 23 INSURANCE OPERATIONS, AFLAC U.S. The following table presents a summary of AFLAC U.S. operating results. AFLAC U.S. SUMMARY OF OPERATING RESULTS Three Months Ended Nine Months Ended September 30, September 30, (In millions) 2000 1999 2000 1999 ----------------- ------------------ Premium income. . . . . $ 395 $ 346 $1,146 $1,010 Investment income . . . . 70 62 205 179 Other income. . . . . 2 1 4 2 ----- ----- ----- ----- Total revenues. . . . . 467 409 1,355 1,191 ----- ----- ----- ----- Benefits and claims . . . . . . 248 218 719 630 Operating expenses. . . . . . . 144 126 420 370 ----- ----- ----- ----- Total benefits and expenses . 392 344 1,139 1,000 ----- ----- ----- ----- Pretax operating earnings . $ 75 $ 65 $ 216 $ 191 ===== ===== ===== ===== --- Percentage increases over previous period: Premium income. . . . . 14.2% 13.7% 13.5% 13.9% Investment income . . . . . . 13.5 12.6 14.4 12.2 Total revenues. . . . . 14.3 13.4 13.8 13.4 Pretax operating earnings . . 15.4 10.6 13.1 11.9 --- Ratios to total revenues: Benefits and claims . . . . . 53.1% 53.2% 53.1% 52.9% Operating expenses. . . . . . 30.9 30.9 31.0 31.1 Pretax operating earnings . . 16.0 15.9 15.9 16.0 === AFLAC U.S. SALES New annualized premium sales rose 30.4% in the third quarter to a record $174 million. For the nine months, new sales were up 26.5% to $492 million. Accident/disability insurance again led our sales for the quarter, accounting for more than 54% of total sales. However, we also produced strong results for other products including our founding product, cancer expense insurance. AFLAC's payroll life products continued to sell well, accounting for more than 5% of sales for the first nine months of the year. We are also pleased with the initial reception to recently introduced products such as dental insurance and specified event coverage. We believe AFLAC U.S. will achieve or exceed our upwardly revised sales objective of 20% growth in new sales for the full year 2000. AFLAC U.S. continued to rapidly expand its sales force. During the third quarter, the number of producing sales associates on a monthly average basis increased 24.7%, compared with the three months ended September 30, 1999, to more than 11,000 agents. We believe the expansion of our distribution system has benefited from our current advertising campaign, which has dramatically increased awareness of AFLAC and its products. 24 Technology continues to play an important role at AFLAC U.S. In addition to the continued success of our electronic sales system, SmartApp, we are also pursuing additional technological initiatives. We have claims forms available for download from our Web site for each product we offer in every state. The combination of downloadable claims forms and facsimile claims submission greatly enhances service to our customers and efficiency of our administration. Savings from new electronic work processes have allowed us to invest heavily in national advertising, which has benefited our name recognition, recruiting and sales results. AFLAC U.S. INVESTMENTS During the first nine months of 2000, available cash flow was invested at an average yield-to-maturity of 8.31% compared with 7.88% during the first nine months of 1999. The overall return on average invested assets, net of investment expenses, was 7.60% for the first nine months of 2000 compared with 7.50% for the first nine months of 1999. AFLAC U.S. OTHER Management expects the operating expense ratio, including discretionary television advertising expenses, to remain approximately level in the future. By improving administrative systems and controlling other costs, we have been able to redirect funds to national television advertising programs without significantly affecting the operating expense ratio. The aggregate benefit ratio has remained relatively stable. The mix of business has shifted toward accident and hospital indemnity policies, which have lower benefit ratios than other products. We expect future benefit ratios for some of our supplemental products to increase slightly due to our ongoing efforts to improve policy persistency and enhance policyholder benefits. Management expects the pretax operating profit margin to be approximately 16% for the full year 2000. FINANCIAL ACCOUNTING STANDARDS BOARD STATEMENTS SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, was issued in June 1998. This Statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in investment securities and other contracts, and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the balance sheet and measure those instruments at fair value. The accounting for changes in the fair value of a derivative will be included in either earnings or other comprehensive income depending on the intended use of the derivative instruments. According to SFAS No. 133, we will be required to recognize in net earnings the unrealized gains/losses on the interest rate components of our cross currency swaps (see Note 5). However, we will exclude gains and losses on derivative instruments, as well as realized investment gains and losses from operating earnings. If we had adopted SFAS No. 133 on January 1, 2000, we would have recorded a pretax gain of $14 million for the nine months ended September 30, 2000 related to the change in fair value of the interest rate components of these cross currency swaps. We are continuing our review of SFAS No. 133 in anticipation of additional guidance and interpretation of this standard which we will adopt effective January 1, 2001. 25 ANALYSIS OF FINANCIAL CONDITION Since December 31, 1999, our financial condition has remained strong in the functional currencies of our operations. The investment portfolios of AFLAC Japan and AFLAC U.S. have continued to grow and primarily consist of investment grade securities. Due to the substantial amounts of yen-denominated items in the balance sheet, changes in the yen/dollar exchange rate can have a significant effect on our financial statements. 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 September 30, 2000, was 108.00 yen to one U.S. dollar, 5.2% weaker than the exchange rate of 102.40 as of December 31, 1999. Management estimates that the weaker yen rate decreased reported investments and cash by $1.5 billion, total assets by $1.7 billion, and total liabilities by $1.7 billion compared with the amounts that would have been reported for 2000 if the exchange rate had remained unchanged from year-end 1999. INVESTMENTS AND CASH The continued growth in investments and cash reflects the substantial cash flows in the functional currencies of our operations. Net unrealized gains of $991 million on investment securities at September 30, 2000, consisted of $2.5 billion in gross unrealized gains and $1.5 billion in gross unrealized losses. AFLAC invests primarily within the Japanese, U.S. and Euroyen debt securities markets. We require that all securities have an initial rating of Class 1 or 2 as determined by the Securities Valuation Office of the National Association of Insurance Commissioners (NAIC). We use specific criteria to judge the credit quality and liquidity of our investments and use a variety of credit rating services to monitor these criteria. Applying those various credit ratings to a standardized rating system based on the categories of a nationally recognized rating service, the percentages of our debt securities, at amortized cost, were as follows: September 30, December 31, 2000 1999 ------------ ------------ AAA 25.6% 28.0% AA 22.8 24.6 A 36.0 33.5 BBB 15.2 12.1 BB .4 1.8 ----- ----- 100.0% 100.0% ===== ===== The issuers of two debt securities experienced significant credit rating downgrades during the first half of 2000. During the second quarter of 2000, we sold one security carried in available-for-sale at a realized loss of $34 million. We recorded an impairment loss of $57 million on the other security, which was carried in the held-to-maturity category. We have reclassified this security to the available-for-sale category. These losses decreased net earnings by $58 million ($.22 per basic share and $.21 per diluted share) for the nine months ended September 30, 2000. 26 Private placement investments accounted for 51.1% and 49.0% of our total debt securities at amortized cost as of September 30, 2000 and December 31, 1999, respectively. AFLAC Japan has made investments in the private placement market to secure higher yields than those available from Japanese government bonds. Most of AFLAC's private placements are issued under medium-term note programs and have standard covenants commensurate with credit rankings, except when internal credit analysis indicates that additional protective and/or event-risk covenants are required. The following table shows an analysis of investment securities (at cost or amortized cost): AFLAC Japan AFLAC U.S. ------------------------- ------------------------- September 30, December 31, September 30, December 31, (In millions) 2000 1999 2000 1999 ------------------------- ------------------------- Available for sale: Fixed-maturity securities $17,184 $15,491 $ 3,405* $ 3,405* Perpetual debentures 2,299 2,411 174 153 Equity securities 60 45 101 92 ------ ------ ------ ------ Total available for sale 19,543 17,947 3,680 3,650 ------ ------ ------ ------ Held to maturity: Fixed-maturity securities 3,909 4,389 - - Perpetual debentures 3,668 3,903 - - ------ ------ ------ ------ Total held to maturity 7,577 8,292 - - ------ ------ ------ ------ Total $27,120 $26,239 $ 3,680 $ 3,650 ====== ====== ====== ====== *Includes securities held by the parent company of $69 at September 30, 2000, and $240 at December 31, 1999 POLICY LIABILITIES Policy liabilities increased $350 million, or 1.2%, during the first nine months of 2000. AFLAC Japan increased $166 million, or .6% (6.1% increase in yen), and AFLAC U.S. increased $184 million, or 8.0%. Changes in policy liabilities were primarily due to the addition of new business, the aging of policies in force, the weaker yen and the effect of the market value adjustment for securities available for sale (see Note 6 of the Notes to the Consolidated Financial Statements). The weaker yen at September 30, 2000, compared with December 31, 1999, decreased reported policy liabilities by $1.5 billion. 27 DEBT In September 2000, we filed a shelf registration statement with the Japanese regulatory authorities to issue up to 100 billion yen of yen- denominated Samurai notes. These securities are not for sale in the United States. On October 25, 2000, we issued in Japan 30 billion yen ($278 million) of Samurai notes with a 1.55% coupon payable semiannually, due October 25, 2005.

These notes are redeemable at our option and at any time with a redemption price equal to the principal amount of the notes being redeemed plus a premium. We received net proceeds of 29.9 billion yen ($277 million) after issue costs. We temporarily invested the proceeds in short- duration dollar-denominated securities and they will be used to purchase shares of our common stock. In April 1999, we issued $450 million of senior notes with a 6.50% coupon, paid semiannually, due April 15, 2009. The notes are redeemable at our option and at any time at a redemption price equal to the principal amount of the notes being redeemed plus a make-whole amount. We received net proceeds of $446 million after discount and issue costs. These proceeds have been temporarily invested in short-duration securities and are being used primarily to purchase shares of our common stock. The net proceeds may also be used to repay indebtedness or for general corporate purposes. We entered into cross-currency swaps that had the effect of converting the dollar-denominated principal and interest into yen-denominated obligations. At September 30, 2000, the outstanding principal was 55.6 billion yen ($515 million) at an interest rate of 1.67% after the effect of the cross-currency swaps. See Note 5 of the Notes to the Consolidated Financial Statements for information on other debt outstanding at September 30, 2000. Our ratio of debt to total capitalization (debt plus shareholders' equity, excluding the unrealized gains on investment securities) was 22.7% and 28.1% as of September 30, 2000 and December 31, 1999, respectively. If we include the Samurai debt issued in October 2000, the ratio would have been 27.6% at September 30, 2000. SECURITY LENDING AFLAC Japan uses short-term security lending arrangements to increase investment income with minimal risk. For further information regarding such arrangements, see Note 7 of the Notes to the Consolidated Financial Statements. POLICYHOLDER GUARANTY FUNDS Under insurance guaranty fund laws in most U.S. states, insurance companies doing business in those states can be assessed for policyholder losses up to prescribed limits that are incurred by insolvent companies with similar lines of business. Such assessments have not been material to us in the past. We believe that future assessments relating to companies in the U.S. currently involved in insolvency proceedings will not materially impact the consolidated financial statements. 28 The Life Insurance Association of Japan, an industry organization, implemented a voluntary policyholder protection fund in 1996 to provide capital support to insolvent life insurers. AFLAC Japan pledged investment securities to the Life Insurance Association of Japan under this program. A separate, mandatory policyholder protection system was enacted by the Japanese government during 1998. The life insurance industry is making contributions to these funds over a 10-year period. Our obligation to the mandated policyholder protection system was increased in 1999 due to the insolvency of Toho Mutual Life Insurance Company. We have recorded a liability for our share of these obligations. For further information regarding policyholder protection funds, see Note 2 of the Notes to the Consolidated Financial Statements in our annual report to shareholders for the year ended December 31, 1999. In October 2000, two Japanese life insurance companies, Chiyoda Mutual Life Insurance Company and Kyoei Life Insurance Company, filed an application with the court for protection under a special reorganization law for financial institutions. At this time, we do not expect additional assessments from the policyholder protection fund. SHAREHOLDERS' EQUITY Our insurance operations continue to provide the primary sources of liquidity. Capital needs are also supplemented by borrowed funds. The principal sources of cash from insurance operations are premiums and investment income. Primary uses of cash in the insurance operations are policy claims, commissions, operating expenses, income taxes and payments to AFLAC Incorporated for management fees and dividends. Both the sources and uses of cash are reasonably predictable. Our investment objectives provide for liquidity through the ownership of high-quality investment securities. AFLAC insurance policies are generally not interest-sensitive and therefore are not subject to unexpected policyholder redemptions due to investment yield changes. Also, the majority of our policies provide indemnity benefits rather than reimbursement for actual medical costs and thus are not subject to the risks of medical-cost inflation. The achievement of continued long-term growth will require growth in AFLAC's statutory capital and surplus. We may secure additional statutory capital through various sources, such as internally generated statutory earnings or equity contributions by AFLAC Incorporated from funds generated through debt or equity offerings. In October 2000, we received $277 million from the issuance of Samurai notes in Japan. We believe outside sources for additional debt and equity capital, if needed, will continue to be available for capital expenditures, business expansion and the funding of our share repurchase program. AFLAC Incorporated capital resources are largely dependent upon the ability of AFLAC to pay management fees and dividends. The Georgia Insurance Department imposes certain limitations and restrictions on payments of dividends, management fees, loans and advances by AFLAC to AFLAC Incorporated. The Georgia Insurance Statutes require prior approval for dividend distributions that exceed the greater of statutory earnings for the previous year or 10% of statutory capital and surplus as of the previous year-end. In addition, the Georgia Insurance Department must approve service arrangements and other transactions within the affiliated group. These regulatory limitations are not expected to affect the level of 29 management fees or dividends paid by AFLAC to AFLAC Incorporated. A life insurance company's statutory capital and surplus is computed according to rules prescribed by the National Association of Insurance Commissioners (NAIC), as modified by the insurance department in the insurance company's state of domicile. Statutory accounting rules are different from generally accepted accounting principles and are intended to emphasize policyholder protection and company solvency. Currently, prescribed or permitted statutory accounting principles (SAP) used by insurers for financial reporting to state insurance regulators may vary among states and among companies. The NAIC has recodified SAP to promote standardization throughout the industry. The NAIC has scheduled these new accounting principles to become effective January 1, 2001. They must also be adopted by the individual state insurance departments. In addition to restrictions by U.S. insurance regulators, the Japanese Financial Services Agency (FSA) may impose restrictions on transfers of funds from AFLAC Japan. Payments are made from AFLAC Japan to AFLAC Incorporated for management fees, and to AFLAC U.S. for allocated expenses and remittances of earnings. Total funds received from AFLAC Japan were $189 million in the first nine months of 2000 and $272 million for the same period in 1999. AFLAC Japan repatriated profits in the amount of 17 billion yen ($157 million) to AFLAC U.S. in July 2000. The FSA may not allow transfers of funds if the payment would cause AFLAC Japan to lack sufficient financial strength for the protection of policyholders. The FSA maintains its own solvency standards, a version of risk-based capital requirements. AFLAC Japan's solvency margin significantly exceeds regulatory minimums. For additional information on regulatory restrictions on dividends, profit transfers and other remittances, see Note 9 of the Notes to the Consolidated Financial Statements in our annual report to shareholders for the year ended December 31, 1999. OTHER The board of directors approved a quarterly cash dividend of $.085 per share. The dividend is payable on December 1, 2000, to shareholders of record at the close of business on November 16, 2000. Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK Our financial instruments are exposed to primarily three types of market risks. These are interest rate, equity price, and foreign currency exchange rate risk. INTEREST RATE RISK Our primary interest rate exposure is a result of the effect of changes in interest rates on the fair value of our investments in debt securities. We use modified duration analysis, which provides a measure of price percentage volatility, to estimate the amount of sensitivity to interest rate changes in our debt securities. We attempt to match the duration of our assets with the duration of our liabilities. For AFLAC Japan, the duration of policy benefit liabilities is 30 longer than that of the related invested assets due to the unavailability of acceptable long-duration yen-denominated securities. Currently, when our debt securities mature, the proceeds are reinvested at a yield below that of the interest required for the accretion of policy benefit liabilities on policies issued in earlier years. However, the investment yield on new investments exceeds interest requirements on policies issued in recent years. At September 30, 2000, we had $915 million of net unrealized gains on debt securities. The hypothetical reduction in the fair value of our debt securities resulting from a 100 basis point increase in market interest rates is estimated to be $2.8 billion based on our portfolio as of September 30, 2000. The effect on yen-denominated debt securities is approximately $2.4 billion and the effect on dollar-denominated debt securities is approximately $396 million. We have outstanding interest rate swaps on 19.1 billion yen ($177 million) of our variable-interest-rate yen-denominated borrowings. These swaps reduce the impact of fluctuations in interest rates on our borrowing costs and effectively change our interest rates from variable to fixed. Therefore, movements in market interest rates should have no material effect on earnings. At September 30, 2000, we also had yen-denominated bank borrowings in the amount of 19.6 billion yen ($182 million) with a variable interest rate of .50%. The effect on net earnings in 2000 due to changes in market interest rates was immaterial. For further information on our notes payable, see Note 5 of the Notes to the Consolidated Financial Statements. EQUITY PRICE RISK Equity securities at September 30, 2000, totaled $237 million, or .7% of total investments and cash on a consolidated basis. We use beta analysis to measure the sensitivity of our equity securities portfolio to fluctuations in the broad market. The beta of our equity securities portfolio is .99. For example, if the overall stock market value changed by 10%, the value of AFLAC's equity securities would be expected to change by approximately 9.9%, or $23 million. CURRENCY RISK Most of AFLAC Japan's investments and cash are denominated in yen. When yen-denominated financial instruments mature or are sold, the proceeds are generally reinvested in yen-denominated securities and are held to fund yen-denominated policy obligations rather than converted into dollars. In addition to the yen-denominated financial instruments held by AFLAC Japan, AFLAC Incorporated has yen-denominated bank borrowings and notes payable that have been designated as a hedge of our investment in AFLAC Japan. The unrealized foreign currency translation gains and losses related to these borrowings are reported in accumulated other comprehensive income. AFLAC Incorporated has cross currency swaps on its $450 million senior notes. We have entered into cross currency swaps to convert the dollar- denominated principal and interest into yen-denominated obligations. These 31 swaps have been designated as a hedge of our investment in AFLAC Japan. The unrealized foreign currency translation gains and losses related to these swaps are reported in accumulated other comprehensive income. For information regarding future changes, see Financial Accounting Standards Board Statements on page 25. We attempt to match yen-denominated assets to yen-denominated liabilities on a consolidated basis in order to minimize the exposure of our shareholders' equity to foreign currency translation fluctuations. The table below compares the U.S. dollar values of our yen-denominated assets and liabilities at various exchange rates. Dollar Value of Yen-Denominated Assets and Liabilities At Selected Exchange Rates (September 30, 2000) 93.00 108.00* 123.00 (In millions) Yen Yen Yen -- Yen-denominated financial instruments: Assets: Securities available for sale: Fixed maturities $ 19,961 $ 17,188 $ 15,092 Perpetual debentures 2,010 1,731 1,520 Equity securities 79 68 60 Securities held to maturity: Fixed maturities 4,539 3,909 3,432 Perpetual debentures 4,260 3,668 3,221 Cash and cash equivalents 837 721 633 Other financial instruments 7 6 5 ------- ------- ------- Total 31,693 27,291 23,963 ------- ------- ------- Liabilities - notes payable 1,044 899 789 ------- ------- ------- Net yen-denominated financial instruments 30,649 26,392 23,174 Other yen-denominated assets 4,324 3,723 3,269 Other yen-denominated liabilities (34,530) (29,733) (26,108) ------- ------- ------- Consolidated yen-denominated net assets subject to foreign currency fluctuation $ 443 $ 382 $ 335 ======= ======= ======= *Actual September 30, 2000 exchange rate For information regarding the effect of foreign currency translation on operating earnings per share, see Foreign Currency Translation beginning on page 19. 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 32 discussed. We desire to take advantage of these provisions. This report contains cautionary statements identifying important factors that could cause actual results to differ materially from those projected in this discussion and analysis, and in any other statements made by company officials in oral discussions with the financial community and contained in documents filed with the Securities and Exchange Commission (SEC). Forward- looking statements are not based on historical information and relate to future operations, strategies, financial results or other developments. In particular, statements containing words such as "expect," "anticipate," "believe," "goal," "objective" 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: regulatory developments, assessments for insurance company insolvencies, competitive conditions, new products, ability to repatriate profits from Japan, general economic conditions in the United States and Japan, changes in U.S. and/or Japanese tax laws or accounting requirements, adequacy of reserves, credit and other risks associated with AFLAC's investment activities, significant changes in interest rates, and fluctuations in foreign currency exchange rates. PART II. OTHER INFORMATION Item 1. LEGAL PROCEEDINGS We are a defendant in various litigation considered to be in the normal course of business. Some of this litigation is pending in Alabama, 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 6. EXHIBITS AND REPORTS ON FORM 8-K (a) Exhibits: 4.0 - There are no long-term debt instruments in which the total amount of securities authorized exceeds 10% of the total assets of AFLAC Incorporated and its subsidiaries on a consolidated basis. We agree to furnish a copy of any long-term debt instruments to the Securities and Exchange Commission upon request. 12.0 - Statement regarding the computation of ratio of earnings to fixed charges 27.0 - Financial Data Schedule (for SEC use only) (b) Reports on Form 8-K: We filed a Form 8-K on September 19, 2000 regarding our issuance of Samurai notes in Japan. Items other than those listed above are omitted because they are not required or are not applicable. 33 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 Date November 9, 2000 /s/ KRISS CLONINGER, III ----------------------- -------------------------- KRISS CLONINGER,III Executive Vice President; Treasurer and Chief Financial Officer Date November 9, 2000 /s/ NORMAN P. FOSTER ----------------------- -------------------------- NORMAN P. FOSTER Executive Vice President, Corporate Finance EXHIBITS FILED WITH CURRENT FORM 10-Q: 12.0 - Statement regarding the computation of ratio of earnings to fixed charges 27.0 - Financial Data Schedule (for SEC use only). 35