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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Introduction

Management's discussion and analysis of financial condition and results of operations of Nationwide Financial Services, Inc. and its subsidiaries (NFS or collectively the Company) for the three years ended December 31, 1998 follows. This discussion should be read in conjunction with the Company's consolidated financial statements and related notes included elsewhere in this report.

NFS is the holding company for Nationwide Life Insurance Company (NLIC) and other companies that comprise the retirement savings operations of the Nationwide Insurance Enterprise. The Company is a leading provider of long-term savings and retirement products in the United States. The Company develops and sells a diverse range of products including variable annuities, fixed annuities and life insurance as well as investment management services, pension products and administrative services to address an increasing spectrum of customer needs. The Company markets its products through a broad network of wholesale and retail distribution channels, including independent investment dealers, national and regional brokerage firms, financial institutions, pension plan administrators, exclusive retail sales representatives, and Nationwide Insurance Enterprise insurance agents. The Company believes its unique combination of product innovation and strong distributor relationships positions it to compete effectively in the rapidly growing retirement savings market under various economic conditions.

In March 1997, the Company sold 23.6 million newly-issued Class A shares of common stock in an initial public offering (IPO). Prior to and at the time of the IPO certain other transactions were completed to further access the capital markets and to focus the business of NFS on long-term savings and retirement products. These transactions included the sale of $400 million of senior notes and capital securities, the payment of $900 million of dividends to NFS's parent and the dividend of certain companies that do not offer long-term savings products. See note 1 to the Company's consolidated financial statements for a further description of these transactions.

Management's discussion and analysis contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to the results of operations and businesses of the Company. These forward-looking statements involve certain risks and uncertainties. Factors that may cause actual results to differ materially from those contemplated or projected, forecast, estimated or budgeted in such forward looking statements include, among others, the following possibilities: (i) Nationwide Corporation's control of the Company through its beneficial ownership of approximately 97.8% of the combined voting power of all the outstanding common stock and approximately 81.5% of the economic interest in the Company; (ii) the Company's primary reliance, as a holding company, on dividends from its subsidiaries to meet debt payment obligations and the applicable regulatory restrictions on the ability of the Company's subsidiaries to pay such dividends; (iii) the potential impact on the Company's reported net income that could result from the adoption of certain accounting standards issued by the FASB; (iv) tax law changes impacting the tax treatment of life insurance and investment products; (v) heightened competition, including specifically the intensification of price competition, the entry of new competitors and the development of new products by new and existing competitors; (vi) adverse state and federal legislation and regulation, including limitations on premium levels, increases in minimum capital and reserves, and other financial viability requirements; (vii) failure to expand distribution channels in order to obtain new customers or failure to retain existing customers; (viii) inability to carry out marketing and sales plans, including, among others, changes to certain products and acceptance of the revised products in the market; (ix) changes in interest rates and the capital markets causing a reduction of investment income or asset fees, reduction in the value of the Company's investment portfolio or a reduction in the demand for the Company's products; (x) general economic and business conditions which are less favorable than expected; (xi) unanticipated changes in industry trends ratings assigned by nationally recognized statistical rating organizations or A.M. Best Company, Inc.; (xii) inaccuracies in assumptions regarding future persistency, mortality, morbidity and interest rates used in calculating reserve amounts; and (xiii) failure of the Company or its significant business partners and vendors to identify and correct all non-Year 2000 compliant systems, or to develop and execute adequate contingency plans.

Results of Operations

In addition to net income, the Company reports net operating income, which excludes realized investment gains and losses and results of discontinued operations. Net operating income is commonly used in the insurance industry as a measure of on-going earnings performance.

The following table reconciles the Company's reported net income to net operating income for each of the last three years. In addition, net operating income reflecting pro forma adjustments for the IPO, companion senior notes and capital securities public offerings and special dividends as discussed previously is also presented for 1997 and 1996. Note 1 to the Company's consolidated financial statements further describes these transactions. This pro forma information is not necessarily indicative of what the Company's results would have been had the above transactions actually occurred at the beginning of each year presented, or of future results of the Company.

(in millions of dollars, except per share amounts)	**1998**	1997	1996
Net income	**$332.4**	$265.2	$223.6
Realized gains on investments, net of tax	**(11.7)**	(7.9)	(1.0)
Income from discontinued operations, net of tax	—	—	(11.3)
Net operating income	**320.7**	257.3	211.3
Pro forma adjustments, net of tax	—	(2.9)	(26.2)
Pro forma net operating income	**$320.7**	$254.4	$185.1
Basic and diluted pro forma net operating income per share	**$ 2.49**	$ 1.98	$ 1.44

Revenues

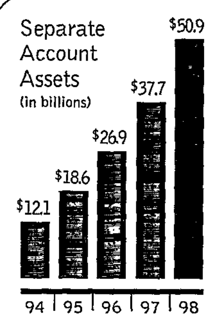
Revenues, excluding realized gains and losses on investments, increased $266.5 million, or 12%, to $2.49 billion in 1998 compared to $2.23 billion in 1997. Revenues in 1997 were up 10% from $2.02 billion reported in 1996. The growth in revenues over the past two years has primarily been driven by increases in policy charges and net investment income. Growth in other income also contributed significantly to revenue growth in 1998.

Policy charges include asset fees, which are primarily earned from separate account assets generated from sales of variable annuities; cost of insurance charges earned on universal life insurance products; administration fees, which include fees charged per contract on a variety of the Company's products and premium loads on universal life insurance products; and surrender fees, which are charged as a percentage of premiums withdrawn during a specified period of annuity and certain life insurance contracts. Policy charges for each of the last three years were as follows:

(in millions of dollars)	**1998**	1997	1996
Asset fees	**$494.7**	$384.8	$275.5
Cost of insurance charges	**88.8**	68.5	53.2
Administrative fees	**73.8**	59.5	50.1
Surrender fees	**41.6**	32.4	22.1
Total policy charges	**$698.9**	$545.2	$400.9

The growth in asset fees reflects increases in total separate account assets of $13.2 billion, or 35%, in 1998 and $10.8 billion, or 40%, in 1997. Record variable annuity sales and strong equity market performance in each of the last three years have resulted in separate account balances increasing 145% from $20.81 billion at the beginning of 1996 to $50.94 billion at the end of 1998.

Cost of insurance charges are assessed as a percentage of the net amount at risk on universal life insurance policies. The net amount at risk is equal to a policy's death benefit minus the related policyholder account value. The increase in cost of insurance charges is due primarily to growth in the net amount at risk related to individual variable universal life insurance reflecting expanded distribution and increased customer demand for variable life products. The net amount at risk related to individual variable universal life insurance grew to $14.95 billion at the end of 1998 compared to $10.44 billion and $7.52 billion at the end of 1997 and 1996, respectively.



The growth in administrative fees is consistent with the increased number of annuity and life insurance contracts in force during 1998 compared to the prior two years. Nearly all of the increase in surrender charges over the past two years is attributable to policyholder withdrawals in the Variable Annuities segment, and is driven by an overall increase in variable annuity policy reserves.

Net investment income includes the gross investment income earned on investments supporting fixed annuities and certain life insurance products as well as the yield on the Company's general account invested assets which are not allocated to product segments. Net investment income grew from $1.36 billion and $1.41 billion in 1996 and 1997, respectively, to $1.49 billion in 1998 primarily due to increased invested assets to support growth in fixed annuity and life insurance policy reserves. Fixed annuity policy reserves, which include the fixed option of the Company's variable annuity products, increased $682.4 million in 1997 and $704.7 million in 1998 and were $14.90 billion as of year end 1998. The growth in life insurance reserves was led by corporate-owned life insurance products, where fixed reserves increased $201.1 million in 1997 and $596.7 million in 1998. The increase in net investment income due to growth in invested assets was partially offset by declining investment yields in 1998 and 1997 due to lower market interest rates.

Realized gains and losses on investments are not considered by the Company to be recurring components of earnings. The Company makes decisions concerning the sale of invested assets based on a variety of market, business, tax and other factors.

Other income includes fees earned by the Company's investment management subsidiaries as well as commissions and other income earned by other subsidiaries of the Company that provide marketing, distribution and administration services. During 1998, NFS acquired three companies for a total purchase price of

$61.1 million in an effort to expand the Company's investment management and large case pension plan administration services. All three acquisitions were accounted for using the purchase method, and the related revenues and expenses have only been included in the Company's consolidated results since the date of acquisition. Other income included in the Company's current year results earned by companies that were acquired in 1998 totaled $20.5 million. The remaining $24.8 million increase in other income during 1998 is primarily attributable to growth in the Company's mutual fund operations that were in place during all the years presented. Other income in 1997 compared to 1996 was relatively unchanged.

Benefits and Expenses

Interest credited to policyholder account balances totaled $1.07 billion in 1998 compared to $1.02 billion in 1997 and $982.3 million in 1996 and principally relates to fixed annuity and corporate-owned life insurance products. The growth in interest credited reflects the increase in policy reserves previously discussed partially offset by reduced average crediting rates. The average crediting rate on fixed annuity policy reserves was 5.95% in 1998 compared to 6.12% and 6.30% in 1997 and 1996, respectively.

Amortization of deferred policy acquisition costs (DAC) increased $47.4 million in 1998 and $33.8 million in 1997 principally due to the Variable Annuities segment, which accounted for $36.1 and $30.4 million of the increases as a result of strong sales growth in each of the last two years.

Operating expenses were $472.1 million in 1998, a 17% increase from 1997 operating expenses of $402.7 million. Operating expenses were $353.5 million in 1996. The increase reflects the growth in the number of annuity and life insurance contracts in-force and the related increase in administrative processing costs as well as the effect of acquisitions and start-up companies. In addition to the three acquisitions discussed previously, two subsidiaries, Nationwide Trust Company, F.S.B. and Nationwide Financial Services (Bermuda), Ltd., began operations in 1998. Excluding the effects of the 1998 acquisitions and start-up companies, operating expenses increased 11% in 1998, down from the 14% increase reported in 1997.

The increase in interest expense reflects the senior notes and capital securities issued at the IPO in March 1997 being outstanding for the entire year in 1998 as well as the interest expense on $200 million of preferred securities issued through a subsidiary trust in October 1998.

Federal income tax expense was $173.1 million representing an effective tax rate of 34.2% for 1998. Federal income tax expense in 1997 and 1996 was $141.8 million and $115.8 million, respectively, representing effective rates of 34.8% and 35.3%.

Year 2000

The Company has developed and implemented a plan to address issues related to the Year 2000. The problem relates to many existing computer systems using only two digits to identify a year in a date field. These systems were designed and developed without considering the impact of the upcoming change in the century. If not corrected, many computer systems could fail or create erroneous results when processing information dated after December 31, 1999. Like many organizations, the Company is required to renovate or replace many computer systems so that the systems will function properly after December 31, 1999.

The Company has completed an inventory and assessment of all computer systems and has implemented a plan to renovate or replace all applications that were identified as not Year 2000 compliant. The Company has renovated all applications that required renovation. Testing of the renovated programs included running each application in a Year 2000 environment and was completed as planned during 1998. For applications being replaced, the Company had all replacement systems in place and functioning as planned by year-end 1998. Conversions of existing traditional life policies will continue through second quarter, 1999. In addition, the shareholder services system that support mutual fund products will be fully deployed in the first quarter of 1999.

The Company has completed an inventory and assessment of all vendor products and has tested and certified that each vendor product is Year 2000 compliant. Any vendor products that could not be certified as Year 2000 compliant were replaced or eliminated in 1998.

The Company has also addressed issues associated with the exchange of electronic data with external organizations. The Company has completed an inventory and assessment of all business partners including electronic interfaces. Processes have been put in place and programs initiated to process data irrespective of the format by converting non-compliant data into a Year 2000 compliant format.

Systems supporting the Company's infrastructure such as telecommunications, voice and networks will be compliant by March 1999. The Company's assessment of Year 2000 issues has also included non-information technology systems with embedded computer chips. The Company's building systems such as fire, security, and elevators and escalators supporting facilities in Columbus, Ohio have been tested and are Year 2000 compliant.

In addition to resolving internal Year 2000 readiness issues, the Company is surveying significant external organizations (business partners) to assess if they will be Year 2000 compliant and be in a position to do business in the Year 2000 and beyond. Specifically, the Company has contacted mutual fund organizations that provide funds for our variable annuity and life products. The same action will continue during the first quarter of 1999 with wholesale producers. The Company continues its efforts to identify external risk factors and is planning to develop contingency plans as part of its ongoing risk management strategy.

The preceding Year 2000 discussion excludes the three companies acquired in 1998. The Company has reviewed the acquired companies' systems, applications, and business partners, and work plans have been developed for the acquired companies to become Year 2000 compliant during the second and third quarters of 1999.

Operating expenses in 1998 and 1997 include approximately $44.7 million and $45.4 million, respectively, for technology projects, including costs related to Year 2000. The company anticipates spending approximately $5 million on Year 2000 activities in 1999. Management does not anticipate that the completion of Year 2000 renovation and replacement activities will result in a reduction in operating expenses. Rather, personnel and resources currently allocated to Year 2000 issues will be assigned to other technology-related projects.

Recently Issued Accounting Standards

In June 1998, the FASB issued *Statement of Financial Accounting Standards (SFAS) No. 133 — Accounting for Derivative Instruments and Hedging Activities.* SFAS 133 establishes accounting and reporting standards for derivative instruments and for hedging activities. Contracts that contain embedded derivatives, such as certain insurance contracts, are also addressed by the Statement. SFAS 133 requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. The Statement is effective for fiscal years beginning after June 15, 1999. It may be implemented earlier provided adoption occurs as of the beginning of any fiscal quarter after issuance. The Company plans to adopt this Statement in first quarter 2000 and is currently evaluating the impact on results of operations and financial condition.

In March 1998, The American Institute of Certified Public Accountant's Accounting Standards Executive Committee issued *Statement of Position 98-1 — Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* (SOP 98-1). SOP 98-1 provides guidance intended to standardize accounting practices for costs incurred to develop or obtain computer software for internal use. Specifically, SOP 98-1 provides guidance for determining whether computer software is for internal use and when costs incurred for internal use software are to be capitalized. SOP 98-1 is effective for financial statements for fiscal years beginning after December 15, 1998. The Company does not expect the adoption of SOP 98-1, which occurred on January 1, 1999, to have a material impact on the Company's financial statements.

Statutory Premiums and Deposits

The Company sells its products through a broad distribution network comprised of wholesale and retail distribution channels. Wholesale distributors are unaffiliated entities that sell the Company's products to their own customer base and include independent broker/dealers, national and regional brokerage firms, pension plan administrators and financial institutions. Retail distributors are representatives of the Company who market products directly to a customer base identified by the Company and include exclusive sales representatives and Nationwide Insurance Enterprise insurance agents. Statutory premiums and deposits by distribution channel for each of the last three years are summarized as follows:

(in millions of dollars)	**1998**	1997	1996
Wholesale channels			
Independent broker/dealers	**$ 3,682.0**	$ 3,699.1	$ 3,607.8
National and regional brokerage firms (1)	**337.4**	—	—
Financial institutions	**2,036.0**	1,653.2	947.2
Pension plan administrators	**2,854.6**	2,325.0	1,911.6
Life specialists	**645.7**	195.0	20.0
Total wholesale channels	**9,555.7**	7,872.3	6,486.6
Retail channels			
Exclusive retail sales representatives	**2,327.9**	1,862.1	1,528.0
Nationwide agents	**935.5**	602.7	525.5
Total retail channels	**3,263.4**	2,464.8	2,053.5
Total external premiums and deposits	**12,819.1**	10,337.1	8,540.1
Nationwide Insurance Enterprise employee and agent benefit plans	**323.3**	174.9	502.5
Total statutory premiums and deposits	**$13,142.4**	$10,512.0	$ 9,042.6

(1) Prior to 1998, national and regional brokerage firm sales were included in independent broker/dealer sales.

Excluding Nationwide Insurance Enterprise benefit plan sales, the Company achieved annual sales growth of 24%, 21%, and 29% in 1998, 1997 and 1996, respectively.

The Company's flagship products are marketed under The BEST of AMERICA® brand, and include individual and group variable annuities and variable life insurance. The BEST of AMERICA® products allow customers to choose from among investment options managed by premier mutual fund managers. The Company has also developed private label variable and fixed annuity products in conjunction with other financial services providers which allow those providers to sell products to their own customer bases under their own brand name.

The Company also markets group deferred compensation retirement plans to employees of state and local governments for use under Internal Revenue Code (IRC) Section 457. The Company utilizes its sponsorship by the National Association of Counties and The United States Conference of Mayors when marketing IRC Section 457 products. In addition, the Company utilizes an exclusive arrangement with the National Education Association (NEA) to market tax-qualified annuities under IRC 403(b) to NEA members. Variable annuities developed for the NEA members are sold under the NEA Valuebuilder brand.

External statutory premiums and deposits by product for each of the last three years are as follows:

(in millions of dollars)	**1998**	1997	1996
The BEST of AMERICA® products:			
Individual variable annuities	**$ 4,661.1**	$ 4,269.6	$3,801.5
Group variable annuities	**2,760.0**	2,220.5	1,807.1
Variable universal life	**315.9**	220.0	165.4
Private label annuities	**1,093.3**	1,006.4	625.9
IRC Section 457 annuities	**2,155.3**	1,716.5	1,425.8
The NEA Valuebuilder annuities	**172.6**	145.6	102.2
Traditional/Universal life	**246.0**	248.4	253.9
Corporate owned life insurance	**645.8**	195.0	20.0
Other	**769.1**	315.1	338.3
	$12,819.1	$10,337.1	$8,540.1

Business Segments

The Company has three product segments: Variable Annuities, Fixed Annuities and Life Insurance. In addition, the Company reports certain other revenues and expenses in a Corporate and Other segment. All information set forth below relating to the Company's Variable Annuities segment excludes the fixed option under the Company's variable annuity contracts. Such information is included in the Company's Fixed Annuities segment.

The following table summarizes operating income (loss) before federal income tax expense for the Company's business segments for each of the last three years.

(in millions of dollars)	1998	1997	1996
Variable annuities	**$218.4**	$150.9	$ 90.3
Fixed annuities	**175.3**	169.5	135.4
Life insurance	**94.8**	70.9	67.2
Corporate and other	**(0.9)**	4.6	35.4
	$487.6	$395.9	$328.3

Variable Annuities

The Variable Annuities segment consists of annuity contracts that provide the customer with the opportunity to invest in mutual funds managed by independent investment managers and the Company, with investment returns accumulating on a tax-deferred basis. The Company's variable annuity products consist almost entirely of flexible premium deferred variable annuity contracts.

The following table summarizes certain selected financial data for the Company's Variable Annuities segment for the years indicated.

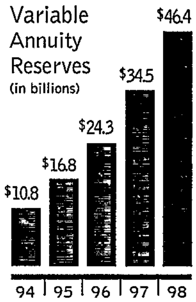
(in millions of dollars)	1998	1997	1996
Income Statement Data			
Revenues	**$ 529.5**	$ 404.0	$ 284.6
Benefits and expenses	**311.1**	253.1	194.3
Operating income before federal income tax expense	**$ 218.4**	$ 150.9	$ 90.3
Other Data			
Statutory premiums and deposits (1)	**$ 9,543.3**	$ 7,535.8	$ 6,500.3
Policy reserves as of year end	**$46,420.8**	$34,486.7	$24,278.1
Pre-tax operating income to average policy reserves	**0.54%**	0.51%	0.44%

(1) Statutory data have been derived from the Annual Statements of the Company's life insurance subsidiaries, as filed with insurance regulatory authorities and prepared in accordance with statutory accounting practices.

Variable Annuities segment revenues reflect a significant increase in policy charges, primarily asset fees, consistent with the growth in variable annuity policy reserves. Asset fees were $479.1 million in 1998 up 29% from $370.2 million in 1997 and totaled $261.8 million in 1996. Asset fees are charged as a percentage of policy reserves which have increased substantially in the past three years as a result of steady premium growth and through market appreciation on investments underlying reserves. Variable annuity policy reserves grew $11.93 billion during 1998 reaching $46.42 billion as of year end 1998 compared to growth in 1997 of $10.21 billion and year end 1997 reserves of $34.49 billion. During 1996, policy reserves increased $7.52 billion.

The Company has continued to achieve high sales growth through deeper penetration of existing distribution channels and the addition of new sales outlets. In addition, growing consumer acceptance of equity-based retirement savings products, a robust United States stock market and low interest rates have all combined to provide a very favorable environment for variable annuity sales. The Company's broad network of strong distribution relationships coupled with product innovation allowed the Company to maintain its ranking as the third largest seller of individual variable annuities in the United States during 1998. Company sales of all variable annuities increased 27% during 1998 to a record $9.54 billion compared to $7.54 billion in 1997. Variable annuity sales in 1997 represented a 16% increase over 1996 sales of $6.50 billion.

An example of the Company's ability to develop innovative products and to leverage its strong distributor relationships to maintain its competitive position is America's FUTURE Annuity. This individual variable annuity product was developed in late 1997 in association with mutual fund partners and distributors and offers the customer greater flexibility and investment choice with insurance charges lower than comparable products sold through the financial planning community. Sales of this product reached $2.4 billion during 1998, its first full year of availability.



Although the equity markets were more volatile in 1998 than in the previous two years, equity market conditions over each of the past three years have contributed significantly to the growth in variable annuity policy reserves. Variable annuity policy reserves reflect market appreciation of $6.80 billion, $5.21 billion and $2.72 billion in 1998, 1997 and 1996, respectively.

Increased variable annuity revenues were partially offset by increased amortization of DAC in 1998 compared to 1997 and 1996 due to overall growth in the variable annuity business and by increased operating expenses.

Operating expenses increased 15% during 1998 and 20% during 1997; however, the growth in expenses was far outpaced by the 31% and 42% increases in revenues over those same periods. As a result, operating income as a percentage of reserves has improved to 0.54% in 1998 up 3 basis points from 1997 and up 10 basis points from 1996. The Company has controlled operating expense growth by increasing productivity through investments in technology and economies of scale.

Fixed Annuities

The Fixed Annuities segment consists of annuity contracts that generate a return for the customer at a specified interest rate, fixed for a prescribed period, with returns accumulating on a tax-deferred basis. Such contracts consist of single premium deferred annuities, flexible premium deferred annuities and single premium immediate annuities. The Fixed Annuities segment includes the fixed option under the Company's variable annuity contracts.

The following table summarizes certain selected financial data for the Company's Fixed Annuities segment for the years indicated.

(in millions of dollars)	**1998**	1997	1996
Income Statement Data			
Revenues:			
Net investment income	**$ 1,116.6**	$ 1,098.2	$ 1,050.6
Other	**35.7**	43.2	42.0
	1,152.3	1,141.4	1,092.6
Benefits and expenses:			
Interest credited to policyholder account balances	**828.6**	823.4	805.0
Other benefits and expenses	**148.4**	148.5	152.2
	977.0	971.9	957.2
Operating income before federal income tax expense	**$ 175.3**	$ 169.5	$ 135.4
Other Data			
Statutory premiums and deposits (1)	**$ 2,068.0**	$ 2,137.9	$ 1,600.5
Policy reserves as of year end	**$14,898.9**	$14,194.2	$13,511.8
Pre-tax operating income to average policy reserves	**1.21%**	1.22%	1.03%

(1) Statutory data have been derived from the Annual Statements of the Company's life insurance subsidiaries, as filed with insurance regulatory authorities and prepared in accordance with statutory accounting practices.

Fixed Annuities segment results reflect an increase in interest spread income attributable to growth in fixed annuity policy reserves and wider interest margins. Interest spread is the differential between net investment income and interest credited to policyholder account balances. Interest spreads vary depending on crediting rates offered by competitors, performance of the investment portfolio, changes in market interest rates and other factors.

The following table depicts the interest margins on general account policy reserves in the Fixed Annuities segment for each of the last three years.

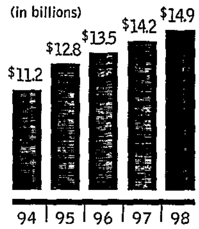
	1998	1997	1996
Net investment income	**8.02%**	8.16%	8.22%
Interest credited	**5.95**	6.12	6.30
	2.07%	2.04%	1.92%

The declining interest rate environment has put pressure on interest margins as fixed income investments have matured or prepaid and have been reinvested at lower rates; however, mortgage loan and bond prepayment income actually increased interest margins in 1998. Prepayment income added 8 additional basis points to the 1998 interest margin compared to 1997. The Company expects 1999 interest margins excluding prepayment income to return to historically normal levels of 190 to 195 basis points.

The Company is able to mitigate the effects of lower investment yields by periodically resetting the rates credited on fixed annuity contracts. As of December 31, 1998, $7.17 billion, or 48% of fixed annuity policy reserves, were in contracts where the guaranteed interest rate is reestablished each quarter. Fixed annuity policy reserves of $5.29 billion are in contracts that adjust the crediting rate on an annual basis with portions resetting in each calendar quarter. The Company also has $1.36 billion of fixed annuity policy reserves that call for the crediting rate to be reset annually on each January 1. The remaining $1.08 billion of fixed annuity policy reserves are in payout status where the Company has guaranteed periodic, typically monthly, payments.

Fixed annuity policy reserves increased to $14.90 billion as of year-end compared to $14.19 billion a year ago and $13.51 billion as of the end of 1996. Fixed annuity sales during 1998 were $2.07 billion, essentially even with 1997 sales of $2.14 billion, reflecting the low interest rate environment and customer preference for equity-linked products. Sales in 1996 were $1.60 billion. The increase in sales in 1998 and 1997 over 1996 reflects the impact of first year bonus crediting rate programs for certain of the Company's variable annuity products. Such programs initially attract sales to the Fixed Annuities segment. Over the subsequent twelve months, the funds are then systematically transferred to variable investments. Most of the Company's fixed annuity sales are premiums allocated to the guaranteed fixed option of variable annuity contracts. Fixed annuity sales for 1998 include $1.68 billion in premiums allocated to the fixed option under a variable annuity contract, compared to $1.67 billion in 1997 and $1.24 billion in 1996.

Fixed Annuity Reserves (in billions)



Results in 1996 were adversely impacted by a $13.0 million charge related to reserve strengthening for the immediate annuity line.

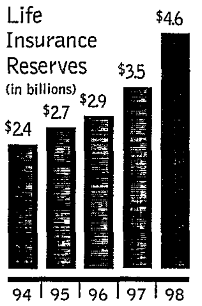
Life Insurance

The Life Insurance segment consists of insurance products, including variable universal life insurance and corporate-owned life insurance products, that provide a death benefit and also allow the customer to build cash value on a tax-deferred basis.

The following table summarizes certain selected financial data for the Company's Life Insurance segment for the years indicated.

(in millions of dollars)	**1998**	1997	1996
Income Statement Data			
Revenues	**$ 551.2**	$ 473.1	$ 435.6
Benefits and expenses	**456.4**	402.2	368.4
Operating income before federal income tax expense	**$ 94.8**	$ 70.9	$ 67.2
Other Data			
Statutory premiums (1):			
Traditional and universal life	**$ 246.0**	$ 248.4	$ 253.9
Variable universal life	**316.0**	220.0	165.4
Corporate-owned life	**645.8**	195.0	20.0
Policy reserves as of year end:			
Traditional and universal life	**2,439.7**	2,369.5	2,295.5
Variable universal life	**1,270.1**	895.6	622.6
Corporate-owned life	**903.6**	221.9	20.8

(1) Statutory data have been derived from the Annual Statements of the Company's life insurance subsidiaries, as filed with insurance regulatory authorities and prepared in accordance with statutory accounting practices.



The increase in Life Insurance segment earnings is attributable to strong growth in investment life insurance products, which include individual variable universal life insurance and corporate-owned life insurance, where the Company has aggressively expanded its distribution capabilities. Investment life premiums and deposits increased from $185.4 million in 1996 to $415.0 million in 1997 to $961.8 million in 1998. As a result of the sales growth and high persistency, revenues from investment life products increased to $150.4 million in 1998 from $71.9 million in 1997 and $45.5 million in 1996. The Company believes there are growth opportunities for investment life products and in 1999 will be introducing new products and expanding distribution to new outlets to better penetrate these markets.

The increase in benefits and expenses is composed primarily of increased interest credited to policyholders and increased operating expenses. Death claims and other policyholder benefits reflected modest growth during 1997 and 1998. Interest credited to policyholders increased $36.9 million in 1998 reaching $115.4 million compared to $78.5 million a year ago. Interest credited to policyholders totaled $70.2 million in 1996. The increased corporate-owned life insurance business discussed previously accounted for most of the increases. Operating expenses grew to $101.7 million in 1998 compared to $94.5 million and $78.9 million in 1997 and 1996, respectively, reflecting the increased number of policies in-force as well as technology related expenditures.

Corporate and Other

The following table summarizes certain selected financial data for the Company's Corporate and Other segment for the years indicated.

(in millions of dollars)	**1998**	1997	1996
Income Statement Data			
Revenues	**$260.8**	$208.8	$204.0
Benefits and expenses	**261.7**	204.2	168.6
Operating income before federal income tax expense (1)	**$ (0.9)**	$ 4.6	$ 35.4

(1) Excludes realized gains (losses) on investments and discontinued operations.

Revenues in the Corporate and Other segment consist of net investment income on invested assets not allocated to the three product segments, investment management fees and other revenues earned from investment management services (other than the portion allocated to the Variable Annuities and Life Insurance segments), commissions and other income earned by the marketing and distribution subsidiaries of the Company and net investment income and policy charges from group annuity contracts issued to Nationwide Insurance Enterprise employee and agent benefit plans.

The decrease in operating income in 1998 and 1997 compared to 1996 primarily relates to interest expense on the notes and capital securities issued in March 1997 concurrent with the IPO and on the preferred securities issued in October 1998. Interest expense totaled $35.1 million and $26.1 million in 1998 and 1997, respectively.

Investments

General

The Company's assets are divided between separate account and general account assets. As of December 31, 1998, $50.94 billion (or 68%) of the Company's total assets were held in separate accounts and $23.73 billion (or 32%) were held in the Company's general account, including $20.94 billion of general account investments. Separate account assets consist primarily of deposits from the Company's variable annuity business. Most separate account assets are invested in various mutual funds. All of the investment risk in the Company's separate account assets is borne by the Company's customers, with the exception of $743.9 million of policy reserves as of December 31, 1998 ($365.5 million as of December 31, 1997) for which the Company bears the investment risk. In addition to the information presented herein, see note 3 to the consolidated financial statements for further information regarding the Company's investments.

The following table summarizes the Company's consolidated general account invested assets by asset category.

	December 31, 1998		December 31, 1997	
(in millions of dollars)	**Carrying Value**	**% of Total**	**Carrying Value**	**% of Total**
Fixed maturity securities	**$14,247.9**	**68.0%**	$13,210.1	67.2%
Mortgage loans, net	**5,328.4**	**25.5**	5,181.6	26.3
Real estate, net	**243.6**	**1.2**	311.4	1.6
Policy loans	**464.3**	**2.2**	415.3	2.1
Equity securities	**134.0**	**0.6**	80.4	0.4
Other long-term investments	**44.0**	**0.2**	25.2	0.1
Short-term investments	**478.3**	**2.3**	449.2	2.3
Total	**$20,940.5**	**100.0%**	$19,673.2	100.0%

Fixed Maturity Securities

The following table summarizes the composition of the Company's general account fixed maturity securities by category.

	December 31, 1998		December 31, 1997	
(in millions of dollars)	**Carrying Value**	**% of Total**	**Carrying Value**	**% of Total**
U.S. government/agencies	**$ 269.0**	**1.9%**	$ 319.7	2.4%
Foreign governments	**111.0**	**0.8**	95.8	0.7
State and political subdivisions	**1.6**	**—**	1.6	—
Mortgage-backed securities:				
U.S. government/agencies	**3,562.2**	**25.0**	3,750.3	28.4
Non-government/agencies	**—**	**—**	—	—
Corporate:				
Public	**5,194.3**	**36.4**	4,597.3	34.8
Private	**5,109.8**	**35.9**	4,445.4	33.7
Total	**$14,247.9**	**100.0%**	$13,210.1	100.0%

The average duration and average maturity of the Company's general account fixed maturity securities as of December 31, 1998 were approximately 3.24 and 7.45 years, respectively. As a result, the market value of the Company's general account investments may fluctuate significantly in response to changes in interest rates. In addition, the Company may also be likely to experience investment losses to the extent its liquidity needs require the disposition of general account fixed maturity securities in unfavorable interest rate environments.

The National Association of Insurance Commissioners (NAIC) assigns securities quality ratings and uniform valuations called "NAIC Designations" which are used by insurers when preparing their annual statements. The NAIC assigns designations to publicly traded as well as privately placed securities. The designations assigned by the NAIC range from class 1 to class 6, with a designation in class 1 being of the highest quality. Of the Company's general account fixed maturity securities, 97% were in the highest two NAIC Designations as of December 31, 1998.

The following table sets forth an analysis of credit quality, as determined by NAIC Designation, of the Company's general account fixed maturity securities portfolio.

(in millions of dollars)		**December 31, 1998**		December 31, 1997	
NAIC Designation(1)	**Rating Agency Equivalent Designation(2)**	**Carrying Value**	**% of Total**	**Carrying Value**	**% of Total**
1	Aaa/Aa/A	**$ 9,166.1**	**64.3%**	$ 8,815.3	66.7%
2	Baa	**4,715.1**	**33.1**	4,116.6	31.2
3	Ba	**347.2**	**2.5**	220.9	1.7
4	B	**5.6**	**—**	53.7	0.4
5	Caa and lower	**13.9**	**0.1**	3.6	—
6	In or near default	**—**	**—**	—	—
		$14,247.9	**100.0%**	$13,210.1	100.0%

(1) NAIC Designations are assigned no less frequently than annually. Some designations for securities shown have been assigned to securities not yet assigned an NAIC Designation in a manner approximating equivalent public rating categories.

(2) Comparison's between NAIC and Moody's designations are published by the NAIC. In the event no Moody's rating is available, the Company has assigned internal ratings corresponding to the public rating.

The Company's general account mortgage-backed security (MBS) investments include residential MBSs and multi-family mortgage pass-through certificates. As of December 31, 1998, MBSs were $3.56 billion (or 25%) of the carrying value of the general account fixed maturity securities available-for-sale, all of which were guaranteed by the U.S. government or an agency of the U.S. government.

The Company believes that general account MBS investments add diversification, liquidity, credit quality and additional yield to its general account fixed maturity securities portfolio. The objective of the Company's general account MBS investments is to provide reasonable cash flow stability and increased yield. General account MBS investments include collateralized mortgage obligations (CMOs), Real Estate Mortgage Investment Conduits (REMICs) and mortgage-backed pass-through securities. The Company's general account MBS investments do not include interest-only securities or principal-only securities or other MBSs which may exhibit extreme market volatility.

Prepayment risk is an inherent risk of holding MBSs. However, the degree of prepayment risk is particular to the type of MBS held. The Company limits its exposure to prepayments by purchasing less volatile types of MBSs. As of December 31, 1998, $2.43 billion (or 68%) of the carrying value of the general account MBS portfolio was invested in planned amortization class CMOs/REMICs (PACs). PACs are securities whose cash flows are designed to remain constant over a variety of mortgage prepayment environments. Other classes in the CMO/REMIC security are structured to accept the volatility of mortgage prepayment changes, thereby insulating the PAC class.

The following table sets forth the distribution by investment type of the Company's general account MBS portfolio.

	December 31, 1998		December 31, 1997	
(in millions of dollars)	**Carrying Value**	**% of Total**	**Carrying Value**	**% of Total**
Accrual	**$ 77.3**	**2.2%**	$ 48.5	1.3%
Planned Amortization Class	**2,433.4**	**68.3**	2,645.3	70.5
Sequential	**45.6**	**1.3**	19.8	0.5
Scheduled	**143.8**	**4.0**	160.6	4.3
Targeted Amortization Class	**92.0**	**2.6**	90.8	2.4
Very Accurately Defined Maturity	**477.8**	**13.4**	550.1	14.7
Multi-family Mortgage Pass-through Certificates	**251.0**	**7.0**	235.2	6.3
Other	**41.3**	**1.2**	—	—
	$3,562.2	**100.0%**	$3,750.3	100.0%

The Company invests in private fixed maturity securities because of the (i) generally higher nominal yield available compared to comparably rated public fixed maturity securities, (ii) more restrictive financial and business covenants available in private fixed maturity security loan agreements and (iii) stronger prepayment protection. Although private fixed maturity securities are not registered with the Securities and Exchange Commission and generally are less liquid than public fixed maturity securities, restrictive financial and business covenants included in private fixed maturity security loan agreements generally are designed to compensate for the impact of increased liquidity risk. A significant majority of the private fixed maturity securities that the Company holds are participations in issues that are also owned by other investors. In addition, some of the private fixed maturity securities are rated by nationally recognized rating agencies and substantially all have been assigned a rating designation by the NAIC.

Mortgage Loans

As of December 31, 1998, general account mortgage loans were $5.33 billion (or 25%) of the carrying value of consolidated general account invested assets. As of such date, commercial mortgage loans constituted substantially all (99.9%) of total general account mortgage loans. Commitments to fund mortgage loans of $156.0 million extending into 1999 were outstanding as of December 31, 1998.

In June 1997, the Company exchanged $359.7 million of multi-family mortgage loans with the Federal Home Loan Mortgage Corporation (FHLMC) for FHLMC multi-family mortgage pass-through certificates supported by the exchanged loans. The transaction resulted in the reclassification of the exchanged amount from mortgage loans on real estate to fixed maturity securities available-for-sale on the consolidated balance sheet. No gain or loss was recognized as a result of the exchange.

The summary below depicts loans by remaining principal balance as of December 31, 1998:

(in millions of dollars)	Office	Warehouse	Retail	Apartment & other	Total
East North Central	$116.6	$ 163.8	$ 607.6	$ 180.8	$1,068.8
East South Central	32.4	28.1	126.4	90.3	277.2
Mountain	32.5	19.6	101.7	105.1	258.9
Middle Atlantic	145.4	98.3	167.6	58.4	469.7
New England	29.6	45.8	123.4	—	198.8
Pacific	216.9	345.2	440.8	123.9	1,126.8
South Atlantic	115.9	152.6	484.5	444.1	1,197.1
West North Central	127.9	8.5	55.9	61.6	253.9
West South Central	124.9	91.7	144.3	160.3	521.2
	$942.1	$ 953.6	$2,252.2	$1,224.5	5,372.4
Less valuation allowances and unamortized discount					44.0
Total mortgage loans on real estate, net					$5,328.4

As of December 31, 1998, the Company's largest exposure to any single borrowing group was $101.4 million, or 2% of the Company's general account mortgage portfolio.

As of December 31, 1998 none of the Company's mortgage loans were classified as delinquent compared to 0.19% a year ago. Foreclosed and restructured loans totaled only 0.64% and 1.84% of the Company's mortgage loans as of December 31, 1998 and 1997, respectively.

Liquidity and Capital Resources

Liquidity and capital resources demonstrate the overall financial strength of the Company and its ability to generate strong cash flows from its operations and borrow funds at competitive rates to meet operating and growth needs. The Company's capital structure consists of debt, capital and preferred securities of subsidiary trusts and equity, summarized in the following table.

	December 31,		
(in millions of dollars)	**1998**	1997	1996 Pro forma (1)
Long-term debt	**$ 298.4**	$ 298.4	$ 298.4
Capital and preferred securities of subsidiary trusts	**300.0**	100.0	100.0
Total long-term debt and capital and preferred securities	**598.4**	398.4	398.4
Shareholders' equity, excluding accumulated other comprehensive income	**2,201.6**	1,877.1	1,632.3
Accumulated other comprehensive income	**275.9**	247.1	173.6
Total shareholders' equity	**2,447.5**	2,124.2	1,805.9
Total capital	**$3,045.9**	$2,522.6	$ 2,204.3

(1) Adjusts 1996 shareholders' equity for the net proceeds of the IPO and for the special dividends paid in anticipation of the IPO.

NFS is a holding company whose principal asset is the common stock of NLIC. The principal sources of funds for NFS to pay interest, dividends and operating expenses are existing cash and investments, and dividends from NLIC and other subsidiaries.

State insurance laws generally restrict the ability of insurance companies to pay cash dividends in excess of certain prescribed limitations without prior approval. The ability of NLIC to pay dividends is subject to restrictions set forth in the insurance laws and regulations of Ohio, its domiciliary state. The Ohio insurance laws require life insurance companies to seek prior regulatory approval to pay a dividend if the fair market value of the dividend, together with that of other dividends made within the preceding 12 months, exceeds the greater of (i) 10% of statutory-basis policyholders' surplus as of the prior December 31 or (ii) the statutory-basis net income of the insurer for the prior year. NLIC's statutory-basis policyholders' surplus as of December 31, 1998 was $1.32 billion and statutory-basis net income for 1998 was $171.0 million. Total dividends paid in the twelve months preceding December 31, 1998 were $100.0 million. The payment of dividends by NLIC may also be subject to restrictions set forth in the insurance laws of New York that limit the amount of statutory profits on NLIC's participating policies (measured before dividends to policyholders) that can inure to the benefit of NFS and its stockholders. NFS currently does not expect such regulatory requirements to impair its ability to pay interest, dividends, operating expenses, and principal in the future.

Also available as a source of funds to the Company is a $600.0 million revolving credit facility entered into by NLIC and Nationwide Mutual Insurance Company in August 1996 with a five year term with a group of national financial institutions. In September 1997, the credit agreement was amended to include NFS as a party to and borrower under the agreement. The facility provides for several and not joint liability with respect to any amount drawn by any party. To date, no amounts have been drawn down on the facility. The facility provides covenants, including, but not limited to, requirements that the Company maintain consolidated tangible net worth, as defined, in excess of $1.23 billion and NLIC maintain statutory surplus in excess of $875 million. The Company had no amounts outstanding under this agreement as of December 31, 1998.

A primary liquidity concern with respect to annuity and life insurance products is the risk of early policyholder withdrawal. The Company mitigates this risk by offering variable products where the investment risk is transferred to the policyholder, charging surrender fees at the time of withdrawal for certain products, applying a market value adjustment to withdrawals for certain products in the Company's general account, and monitoring and matching anticipated cash inflows and outflows.

For individual annuity products ($34.2 billion of reserves as of December 31, 1998) the surrender charge is calculated as a percentage of the lesser of deposits made or the amount surrendered and is assessed at declining rates during the first seven years after a deposit is made.

For group annuity products ($26.0 billion of reserves as of December 31, 1998), the surrender charge amounts and periods can vary significantly, depending on the terms of each contract and the compensation structure for the producer. Generally, surrender charge percentages for group products are less than individual products because the Company incurs lower expenses at contract origination for group products. In addition, over ninety percent of the general account group annuity reserves are subject to a market value adjustment at withdrawal.

Life insurance policies are also subject to withdrawal. However, they are less susceptible to withdrawal than are annuity products because policyholders generally must undergo a new underwriting process and may incur a surrender fee in order to obtain a new insurance policy.

The short-term and long-term liquidity requirements of the Company are monitored regularly to match cash inflows with cash requirements. The Company periodically reviews its short-term and long-term projected sources and uses of funds and the asset/liability, investment and cash flow assumptions underlying these projections. Adjustments are made periodically with respect to the Company's investment policies to reflect changes in the Company's short-term and long-term cash needs and changing business and economic conditions.

Given the Company's historic cash flow and current financial results, management of the Company believes that the cash flow from the operating activities of the Company over the next year will provide sufficient liquidity for the operations of the Company, as well as provide sufficient funds to enable the Company to make dividend and interest payments.

Market Risk Sensitive Financial Instruments

The Company is subject to potential fluctuations in earnings and the fair value of certain of its assets and liabilities, as well as variations in expected cash flows due to changes in market interest rates and equity prices. The following discussion focuses on specific exposures the Company has to interest rate and equity price risk and describes strategies used to manage these risks. The discussion is limited to financial instruments subject to market risks and is not intended to be a complete discussion of all of the risks the Company is exposed to.

Interest Rate Risk

Fluctuations in interest rates can potentially impact the Company's earnings and cash flows, and the fair value of its assets and liabilities. Generally, in a declining interest rate environment, the Company may be required to reinvest the proceeds from matured and prepaid investments at rates lower than the overall yield of the portfolio, which could reduce interest spread income. In addition, minimum guaranteed crediting rates (typically 3% or 3.5%) on certain annuity contracts could result in a reduction of the Company's interest spread income in the event of a significant and prolonged decline in interest rates from market rates at the end of 1998. The average crediting rate of annuity products during 1998 was 5.95%, well in excess of the guaranteed rates. The Company mitigates this risk by investing in assets with maturities and durations that match the expected characteristics of the liabilities and by investing in mortgage backed securities with limited prepayment exposure.

Conversely, a rising interest rate environment could result in a reduction of interest spread income or an increase in policyholder surrenders. Investments supporting annuity liabilities have a weighted average maturity of seven years when purchased and therefore, the change in yield of the portfolio will lag changes in market interest rates. This lag is increased if the rate of prepayments of mortgage-backed securities slows. To the extent the Company sets renewal rates based on current market rates, this will result in reduced interest spreads. Alternatively, if the Company sets renewal crediting rates while attempting to maintain a desired spread from the portfolio yield, the rates offered by the Company may be less than new money rates offered by competitors. This difference could result in an increase in surrender activity by policyholders. If the Company could not fund the surrenders with its cash flow from operations, the Company may be required to sell investments, which likely would have declined in value due to the increase in interest rates. The Company mitigates this risk by offering products that assess surrender charges or market value adjustments at the time of surrender, by investing in assets with maturities and durations that match the expected characteristics of the liabilities, and by investing in mortgage backed securities with limited prepayment exposure.

Asset/Liability Management Strategies to Manage Interest Rate Risk

The Company employs an asset/liability management approach tailored to the specific requirements of each of its products. The Company's general account investments are primarily managed in a number of pools that are segregated by weighted average maturity of the assets acquired by the pools. For fixed maturity securities and mortgages, the weighted average maturity is based on repayments which are scheduled to occur under the terms of the asset. For mortgage backed securities, repayments are determined using the current rate of repayment of the underlying mortgages and the terms of the securities. Each product line has an investment strategy based on its specific characteristics. The strategy establishes asset duration, quality and other guidelines. The Company determines the amount of new investments needed for each line to arrive at the amount of new investments needed for each pool by month. The investments acquired for each pool are shared on a proportional basis by each of the lines requesting investments in the pool based on their actual investment needs.

For all business having future benefits which cannot be changed at the option of the policyholder, the underlying assets are managed in a separate pool. The duration of assets and liabilities in this pool are kept as close together as possible. For assets, the repayment cash flows, plus anticipated coupon payments, are used in calculating asset duration. Future benefits and expenses are used for liabilities. On December 31, 1998, the average duration of assets in this pool was 7.5 years and the average duration of the liabilities was 7.8 years. Policy reserves on this business were $1.1 billion as of December 31, 1998.

Because the timing of the payment of future benefits on the majority of the Company's business can be changed by the policyholder, the Company employs cash flow testing techniques in its asset/liability management process. Annually, the Company's annuity and insurance business is analyzed to determine the adequacy of the reserves supporting such business. This analysis is accomplished by projecting under a number of possible future interest rate scenarios the anticipated cash flows from such business and the assets required to support such business. The first seven of these scenarios are required by the state insurance laws. Projections are also made using 13 additional scenarios which involve more extreme fluctuations in future interest rates. Finally, to get a statistical analysis of possible results and to minimize any bias in the 20 predetermined scenarios, additional projections are made using 50 randomly generated interest rate scenarios. For the Company's 1998 cash flow testing process, interest rates for 90-day treasury bills ranged from 0.7% to 9.5% under the 20 predetermined scenarios and 1.2% to 21.9% under the 50 random scenarios. Interest rates for longer maturity treasury securities had comparable ranges. The values produced by each projection are used to determine future gains or losses from the Company's annuity and insurance business, which, in turn, are used to quantify the adequacy of the Company's reserves over the entire projection period. The results of the Company's cash flow testing indicated that the Company's reserves were adequate as of December 31, 1998.

Characteristics of Interest Rate Sensitive Financial Instruments

The following table provides information about the Company's financial instruments that are sensitive to changes in interest rates. Insurance contracts that subject the Company to significant mortality risk, including life insurance contracts and life-contingent immediate annuities, do not meet the definition of a financial instrument and are not included in the table.

(in millions of dollars)	1999	2000	2001	2002	2003	There-after	Total	Fair Value
Assets								
Fixed maturity securities:								
Corporate bonds:								
Principal	$1,092.7	$1,049.2	$1,667.6	$1,386.3	$ 882.7	$2,866.7	$ 8,945.2	$ 9,366.9
Average interest rate	8.0%	7.5%	7.3%	7.2%	7.0%	7.6%		
Mortgage and other asset-backed securities:								
Principal	$ 905.3	$ 964.3	$ 870.7	$ 588.9	$ 367.3	$ 718.3	$ 4,414.8	$ 4,499.4
Average interest rate	7.3%	7.4%	7.2%	7.4%	7.4%	7.0%		
Other fixed maturity securities:								
Principal	$ 7.8	$ 72.0	$ 54.6	$ 103.3	$ 60.6	$ 65.8	$ 364.1	$ 381.6
Average interest rate	8.5%	6.4%	7.0%	6.6%	6.9%	6.8%		
Mortgage loans on real estate:								
Principal	$ 185.9	$ 373.9	$ 313.1	$ 339.5	$ 408.8	$3,751.2	$ 5,372.4	$ 5,527.6
Average interest rate	9.2%	9.3%	7.0%	8.5%	7.6%	7.1%		
Liabilities								
Deferred fixed annuities:								
Principal	$1,639.6	$1,548.3	$1,733.7	$1,232.5	$1,169.6	$8,270.7	$15,594.4	$15,282.0
Average credited rate	5.2%	4.8%	4.5%	4.3%	4.1%	4.1%		
Immediate annuities:								
Principal	$ 20.6	$ 20.7	$ 22.3	$ 25.2	$ 29.9	$ 53.1	$ 171.8	$ 201.6
Average credited rate	7.3%	7.3%	7.3%	7.3%	7.4%	7.4%		
Long-term debt:								
Principal	—	—	—	—	—	$ 300.0	$ 300.0	$ 339.9
Average interest rate	—	—	—	—	—	8.0%		
Capital and preferred securities of subsidiary trusts:								
Principal	—	—	—	—	—	$ 300.0	$ 300.0	$ 314.5
Average interest rate	—	—	—	—	—	7.6%		

Additional information about the characteristics of the financial instruments and assumptions underlying the data presented in the table above are as follows:

Mortgage and other asset-backed securities (MBSs): The maturity year is determined based on the terms of the securities and the current rate of prepayment of the underlying pools of mortgages. The Company limits its exposure to prepayments by purchasing less volatile types of MBSs (see "Management's Discussion and Analysis of Financial Condition and Results of Operations — Investments — Fixed Maturity Securities").

Other Fixed Maturity Securities and Mortgage Loans on Real Estate: The maturity year is determined based on the maturity date of the security or loan.

Deferred Fixed Annuities: The maturity year is based on the expected date of policyholder withdrawal, taking into account actual experience, current interest rates, and contract terms. Included are group annuity contracts ($10.30 billion) which are generally subject to market value adjustment upon surrender and may also be subject to surrender charges. Of the total group annuity liabilities, $7.17 billion was in contracts where the crediting rate is reset quarterly. For the remaining $3.13 billion of group annuity reserves, the crediting rate is reset annually on January 1. Also included are $5.29 billion of individual annuity liabilities where the crediting rate is reset annually, with portions resetting in each calendar quarter. Such individual annuity contracts are also subject to surrender charges calculated as a percentage of the lesser of deposits made or the amount surrendered and assessed at declining rates during the first seven years after a deposit is made. The average crediting rate is calculated as the difference between the projected yield of the assets backing the liabilities and a targeted interest spread.

Immediate Annuities: Included are non-life contingent contracts in payout status where the Company has guaranteed periodic, typically monthly, payments. The maturity year is based on the terms of the contract.

Long-term Debt and Capital and Preferred Securities of Subsidiary Trusts: The maturity year is the stated maturity date of the obligation. While each obligation is callable, either at a premium or with a make-whole provision, the Company currently has no plans to call the obligations prior to the stated maturity date.

Equity Market Risk

Asset fees calculated as a percentage of the separate account assets are a significant source of revenue to the Company. At December 31, 1998, 86% of separate account assets were invested in equity mutual funds. Gains and losses in the equity markets will result in corresponding increases and decreases in the Company's separate account assets and the reported asset fee revenue. In addition, a decrease in separate account assets may decrease the Company's expectations of future profit margins which may require the Company to accelerate the amortization of deferred policy acquisition costs.

Inflation

The rate of inflation did not have a material effect on the revenues or operating results of the Company during 1998, 1997 or 1996.

FIVE-YEAR SUMMARY

(in millions of dollars, except per share amounts)	1998	1997	1996	1995	1994
	Years ended December 31,				
Results of operations (1)					
Policy charges	**$ 698.9**	$ 545.2	$ 400.9	$ 286.6	$ 217.2
Life insurance premiums	**200.0**	205.4	198.6	199.1	176.7
Net investment income	**1,486.8**	1,413.9	1,357.8	1,294.0	1,210.8
Realized gains (losses) on investments	**17.9**	11.1	(0.2)	(1.7)	(16.5)
Other	**108.1**	62.8	59.5	59.0	45.9
Total revenues	**2,511.7**	2,238.4	2,016.6	1,837.0	1,634.1
Interest credited and other benefits	**1,284.4**	1,235.4	1,201.6	1,155.4	1,031.5
Interest expense on debt and capital and preferred securities	**35.1**	26.1	—	—	—
Other operating expenses	**686.7**	569.9	486.9	400.4	362.2
Total benefits and expenses	**2,006.2**	1,831.4	1,688.5	1,555.8	1,393.7
Income from continuing operations before federal income tax expense	**505.5**	407.0	328.1	281.2	240.4
Federal income tax expense	**173.1**	141.8	115.8	96.3	82.5
Income from continuing operations	**$ 332.4**	$ 265.2	$ 212.3	$ 184.9	$ 157.9
Net income	**$ 332.4**	$ 265.2	$ 223.6	$ 209.6	$ 178.4
Basic and diluted net income per common share (2)	**$ 2.58**	$ 2.14			
Cash dividends declared	**$ 0.30**	$ 0.18			
Diluted average shares outstanding (in millions)	**128.6**	124.1			
Reconciliation of net income to net operating income (1)					
Net income	**$ 332.4**	$ 265.2	$ 223.6	$ 209.6	$ 178.4
Less: Realized (gains) losses on investments, net of tax	**(11.7)**	(7.9)	(1.0)	(0.1)	10.3
Less: Income from discontinued operations, net of tax	**—**	—	(11.3)	(24.7)	(20.5)
Net operating income	**320.7**	257.3	211.3	184.8	$ 168.2
Pro forma adjustments	**—**	(2.9)	(26.2)	(26.2)	
Pro forma net operating income	**$ 320.7**	$ 254.4	$ 185.1	$ 158.6	
Pro forma net operating income per common share	**$ 2.49**	$ 1.98	$ 1.44	$ 1.24	

(1) Comparisons between 1998 results of operations and those of prior years are affected by the Company's initial public offering in March 1997 and companion offerings of senior notes and capital securities as well as the payment of certain special dividends. Pro forma amounts adjust for these transactions. See note 1 to the consolidated financial statements for further description of these transactions and the related pro forma adjustments.

(2) Actual earnings and book value per common share amounts have not been presented for periods prior to 1997, because such amounts are not meaningful due to the effects of initial public offering and the $900.0 million of dividends paid prior to the initial public offering as described in note 1 to the consolidated financial statements.