

PRUDENTIAL FINANCIAL INC  
Form 10-Q  
November 08, 2012  
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**UNITED STATES**  
**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 quarterly period ended September 30, 2012

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Transition Period from            to

Commission File Number 001-16707

# Prudential Financial, Inc.

(Exact Name of Registrant as Specified in its Charter)

**New Jersey**  
(State or Other Jurisdiction of

Incorporation or Organization)

**22-3703799**  
(I.R.S. Employer

Identification Number)

**751 Broad Street**

**Newark, New Jersey 07102**

**(973) 802-6000**

(Address and Telephone Number of Registrant's Principal Executive Offices)

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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of the Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of October 31, 2012, 462 million shares of the registrant's Common Stock (par value \$0.01) were outstanding. In addition, 2 million shares of the registrant's Class B Stock, for which there is no established public trading market, were outstanding.



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**Forward-Looking Statements**

Certain of the statements included in this Quarterly Report on Form 10-Q, including but not limited to those in Management's Discussion and Analysis of Financial Condition and Results of Operations, constitute forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. Words such as expects, believes, anticipates, includes, plans, assumes, estimates, projects, should, will, shall or variations of such words are generally part of forward-looking statements. Forward-looking statements are made based on management's current expectations and beliefs concerning future developments and their potential effects upon Prudential Financial, Inc. and its subsidiaries. There can be no assurance that future developments affecting Prudential Financial, Inc. and its subsidiaries will be those anticipated by management. These forward-looking statements are not a guarantee of future performance and involve risks and uncertainties, and there are certain important factors that could cause actual results to differ, possibly materially, from expectations or estimates reflected in such forward-looking statements, including, among others: (1) general economic, market and political conditions, including the performance and fluctuations of fixed income, equity, real estate and other financial markets; (2) the availability and cost of additional debt or equity capital or external financing for our operations; (3) interest rate fluctuations or prolonged periods of low interest rates; (4) the degree to which we choose not to hedge risks, or the potential ineffectiveness or insufficiency of hedging or risk management strategies we do implement, with regard to variable annuity or other product guarantees; (5) any inability to access our credit facilities; (6) reestimates of our reserves for future policy benefits and claims; (7) differences between actual experience regarding mortality, morbidity, persistency, surrender experience, interest rates or market returns and the assumptions we use in pricing our products, establishing liabilities and reserves or for other purposes; (8) changes in our assumptions related to deferred policy acquisition costs, value of business acquired or goodwill; (9) changes in assumptions for retirement expense; (10) changes in our financial strength or credit ratings; (11) statutory reserve requirements associated with term and universal life insurance policies under Regulation XXX and Guideline AXXX; (12) investment losses, defaults and counterparty non-performance; (13) competition in our product lines and for personnel; (14) difficulties in marketing and distributing products through current or future distribution channels; (15) changes in tax law; (16) economic, political, currency and other risks relating to our international operations; (17) fluctuations in foreign currency exchange rates and foreign securities markets; (18) regulatory or legislative changes, including the Dodd-Frank Wall Street Reform and Consumer Protection Act; (19) inability to protect our intellectual property rights or claims of infringement of the intellectual property rights of others; (20) adverse determinations in litigation or regulatory matters and our exposure to contingent liabilities, including in connection with our divestiture or winding down of businesses; (21) domestic or international military actions, natural or man-made disasters including terrorist activities or pandemic disease, or other events resulting in catastrophic loss of life; (22) ineffectiveness of risk management policies and procedures in identifying, monitoring and managing risks; (23) effects of acquisitions, divestitures and restructurings, including possible difficulties in integrating and realizing the projected results of acquisitions, including risks associated with the acquisition of certain insurance operations in Japan; (24) interruption in telecommunication, information technology or other operational systems or failure to maintain the security, confidentiality or privacy of sensitive data on such systems; (25) changes in statutory or U.S. GAAP accounting principles, practices or policies; (26) Prudential Financial, Inc.'s primary reliance, as a holding company, on dividends or distributions from its subsidiaries to meet debt payment obligations and the ability of the subsidiaries to pay such dividends or distributions in light of our ratings objectives and/or applicable regulatory restrictions; and (27) risks due to the lack of legal separation between our Financial Services Businesses and our Closed Block Business. Prudential Financial, Inc. does not intend, and is under no obligation, to update any particular forward-looking statement included in this document. See Risk Factors included in the Annual Report on Form 10-K for the year ended December 31, 2011 for discussion of certain risks relating to our businesses and investment in our securities.

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Throughout this Quarterly Report on Form 10-Q, Prudential Financial and the Registrant refer to Prudential Financial, Inc., the ultimate holding company for all of our companies. Prudential Insurance refers to The Prudential Insurance Company of America, before and after its demutualization on December 18, 2001. Prudential, the Company, we and our refer to our consolidated operations before and after demutualization.

**PART I FINANCIAL INFORMATION****ITEM 1. Financial Statements****PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Consolidated Statements of Financial Position**

September 30, 2012 and December 31, 2011 (in millions, except share amounts)

	September 30, 2012	December 31, 2011
<b>ASSETS</b>		
Fixed maturities, available for sale, at fair value (amortized cost: 2012-\$250,475; 2011-\$240,424)(1)	\$ 273,381	\$ 254,648
Fixed maturities, held-to-maturity, at amortized cost (fair value: 2012-\$5,019; 2011-\$5,354)(1)	4,720	5,107
Trading account assets supporting insurance liabilities, at fair value(1)	20,132	19,481
Other trading account assets, at fair value(1)	5,874	5,545
Equity securities, available-for-sale, at fair value (cost: 2012-\$6,671; 2011- \$6,922)	7,992	7,535
Commercial mortgage and other loans (includes \$248 and \$603 measured at fair value under the fair value option at September 30, 2012 and December 31, 2011, respectively)(1)	36,822	35,431
Policy loans	11,701	11,559
Other long-term investments (includes \$462 and \$366 measured at fair value under the fair value option at September 30, 2012 and December 31, 2011, respectively)(1)	8,155	7,820
Short-term investments	9,295	9,121
Total investments	378,072	356,247
Cash and cash equivalents(1)	13,906	14,251
Accrued investment income(1)	2,870	2,793
Deferred policy acquisition costs	13,666	12,517
Other assets(1)	15,674	16,056
Separate account assets	247,510	218,380
<b>TOTAL ASSETS</b>	<b>\$ 671,698</b>	<b>\$ 620,244</b>
<b>LIABILITIES AND EQUITY</b>		
<b>LIABILITIES</b>		
Future policy benefits	\$ 183,162	\$ 170,671
Policyholders' account balances	135,669	134,558
Policyholders' dividends	7,562	5,797
Securities sold under agreements to repurchase	8,033	6,218
Cash collateral for loaned securities	3,376	2,973
Income taxes	8,896	6,558
Short-term debt	3,013	2,336
Long-term debt	23,845	24,622

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Other liabilities (includes \$394 and \$282 measured at fair value under the fair value option at September 30, 2012 and December 31, 2011, respectively)(1)	11,266	13,290
Separate account liabilities	247,510	218,380
 Total liabilities	 632,332	 585,403
<b>COMMITMENTS AND CONTINGENT LIABILITIES (See Note 15)</b>		
<b>EQUITY</b>		
Preferred Stock (\$.01 par value; 10,000,000 shares authorized; none issued)	0	0
Common Stock (\$.01 par value; 1,500,000,000 shares authorized; 660,111,299 and 660,111,264 shares issued at September 30, 2012 and December 31, 2011, respectively)	6	6
Class B Stock (\$.01 par value; 10,000,000 shares authorized; 2,000,000 shares issued and outstanding at September 30, 2012 and December 31, 2011, respectively)	0	0
Additional paid-in capital	24,348	24,293
Common Stock held in treasury, at cost (198,088,571 and 192,072,613 shares at September 30, 2012 and December 31, 2011, respectively)	(12,225)	(11,920)
Accumulated other comprehensive income	9,650	5,418
Retained earnings	16,896	16,456
 Total Prudential Financial, Inc. equity	 38,675	 34,253
Noncontrolling interests	691	588
 Total equity	 39,366	 34,841
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$ 671,698</b>	<b>\$ 620,244</b>

(1) See Note 5 for details of balances associated with variable interest entities.

*See Notes to Unaudited Interim Consolidated Financial Statements*

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Consolidated Statements of Operations****Three and Nine Months Ended September 30, 2012 and 2011 (in millions, except per share amounts)**

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
<b>REVENUES</b>				
Premiums	\$ 9,027	\$ 6,084	\$ 23,356	\$ 17,864
Policy charges and fee income	1,224	958	3,335	2,911
Net investment income	3,433	3,333	10,111	9,778
Asset management fees and other income	905	2,028	3,167	3,846
Realized investment gains (losses), net:				
Other-than-temporary impairments on fixed maturity securities	(426)	(402)	(1,345)	(1,606)
Other-than-temporary impairments on fixed maturity securities transferred to Other Comprehensive Income	331	286	1,045	1,233
Other realized investment gains (losses), net	(1,350)	2,644	(766)	3,319
Total realized investment gains (losses), net	(1,445)	2,528	(1,066)	2,946
Total revenues	13,144	14,931	38,903	37,345
<b>BENEFITS AND EXPENSES</b>				
Policyholders' benefits	9,576	6,208	23,446	17,676
Interest credited to policyholders' account balances	1,057	1,463	3,270	3,477
Dividends to policyholders	517	679	1,563	1,961
Amortization of deferred policy acquisition costs	182	1,510	1,194	2,375
General and administrative expenses	2,779	2,665	8,264	7,738
Total benefits and expenses	14,111	12,525	37,737	33,227
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES</b>				
	(967)	2,406	1,166	4,118
Income tax expense (benefit)	(331)	860	572	1,312
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES</b>				
	(636)	1,546	594	2,806
Equity in earnings of operating joint ventures, net of taxes	45	67	58	181
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS</b>				
	(591)	1,613	652	2,987
Income (loss) from discontinued operations, net of taxes	(2)	(9)	12	21
<b>NET INCOME (LOSS)</b>				
	(593)	1,604	664	3,008
Less: Income attributable to noncontrolling interests	25	10	51	64
<b>NET INCOME (LOSS) ATTRIBUTABLE TO PRUDENTIAL FINANCIAL, INC</b>	<b>\$ (618)</b>	<b>\$ 1,594</b>	<b>\$ 613</b>	<b>\$ 2,944</b>

**EARNINGS PER SHARE (See Note 8)**



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**Financial Services Businesses**

**Basic:**

Income (loss) from continuing operations attributable to Prudential Financial, Inc. per share of Common Stock	\$ (1.41)	\$ 3.24	\$ 1.19	\$ 5.88
Income (loss) from discontinued operations, net of taxes	0.00	(0.02)	0.03	0.04
Net income (loss) attributable to Prudential Financial, Inc. per share of Common Stock	\$ (1.41)	\$ 3.22	\$ 1.22	\$ 5.92

**Diluted:**

Income (loss) from continuing operations attributable to Prudential Financial, Inc. per share of Common Stock	\$ (1.41)	\$ 3.19	\$ 1.18	\$ 5.80
Income (loss) from discontinued operations, net of taxes	0.00	(0.01)	0.03	0.05
Net income (loss) attributable to Prudential Financial, Inc. per share of Common Stock	\$ (1.41)	\$ 3.18	\$ 1.21	\$ 5.85

**Closed Block Business**

**Basic and Diluted:**

Income (loss) from continuing operations attributable to Prudential Financial, Inc. per share of Class B Stock	\$ 20.00	\$ 12.00	\$ 20.50	\$ 19.50
Income (loss) from discontinued operations, net of taxes	(0.50)	0.00	(1.00)	0.00
Net income (loss) attributable to Prudential Financial, Inc. per share of Class B Stock	\$ 19.50	\$ 12.00	\$ 19.50	\$ 19.50

*See Notes to Unaudited Interim Consolidated Financial Statements*

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Consolidated Statements of Comprehensive Income****Three and Nine Months Ended September 30, 2012 and 2011 (in millions)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
<b>NET INCOME (LOSS)</b>	\$ (593)	\$ 1,604	\$ 664	\$ 3,008
Other comprehensive income, before tax:				
Foreign currency translation adjustments:				
Foreign currency translation adjustments for the period	139	212	236	499
Reclassification adjustment for amounts included in net income	0	(44)	0	(44)
Total	139	168	236	455
Net unrealized investment gains:				
Unrealized investment gains for the period	1,740	1,896	5,909	3,197
Reclassification adjustment for (gains) losses included in net income	19	49	168	(122)
Total	1,759	1,945	6,077	3,075
Defined benefit pension and postretirement unrecognized net periodic benefit:				
Impact of foreign currency changes and other	5	(5)	18	(11)
Amortization included in net income	40	24	122	68
Total	45	19	140	57
Other comprehensive income, before tax	1,943	2,132	6,453	3,587
Less: Income tax expense related to:				
Foreign currency translation adjustments	31	92	90	143
Net unrealized investment gains	557	679	2,077	1,052
Defined benefit pension and postretirement unrecognized net periodic benefit	16	8	42	23
Total	604	779	2,209	1,218
Other comprehensive income, net of taxes	1,339	1,353	4,244	2,369
Comprehensive Income	746	2,957	4,908	5,377
Comprehensive income attributable to noncontrolling interests	(4)	(16)	(63)	(93)
<b>Comprehensive income attributable to Prudential Financial, Inc.</b>	\$ 742	\$ 2,941	\$ 4,845	\$ 5,284

*See Notes to Unaudited Interim Consolidated Financial Statements*



**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Consolidated Statements of Equity(1)****Nine Months Ended September 30, 2012 and 2011 (in millions)**

	Prudential Financial, Inc. Equity							
	Common Stock	Additional Paid-in Capital	Retained Earnings	Common Stock Held In Treasury	Accumulated Other Comprehensive Income (Loss)	Total Prudential Financial, Inc. Equity	Noncontrolling Interests	Total Equity
<b>Balance December 31, 2011</b>	\$ 6	\$ 24,293	\$ 16,456	\$ (11,920)	\$ 5,418	\$ 34,253	\$ 588	\$ 34,841
Common Stock acquired				(650)		(650)	0	(650)
Contributions from noncontrolling interests							2	2
Distributions to noncontrolling interests							(78)	(78)
Consolidations/deconsolidations of noncontrolling interests		0				0	116	116
Stock-based compensation programs		55	(173)	345		227		227
Comprehensive income:								
Net income			613			613	51	664
Other comprehensive income, net of tax					4,232	4,232	12	4,244
Total comprehensive income						4,845	63	4,908
<b>Balance, September 30, 2012</b>	\$ 6	\$ 24,348	\$ 16,896	\$ (12,225)	\$ 9,650	\$ 38,675	\$ 691	\$ 39,366

	Prudential Financial, Inc. Equity							
	Common Stock	Additional Paid-in Capital	Retained Earnings	Common Stock Held In Treasury	Accumulated Other Comprehensive Income (Loss)	Total Prudential Financial, Inc. Equity	Noncontrolling Interests	Total Equity
<b>Balance, December 31, 2010</b>	\$ 6	\$ 24,223	\$ 16,381	\$ (11,173)	\$ 2,978	\$ 32,415	\$ 513	\$ 32,928
Common Stock acquired				(750)		(750)		(750)
Cumulative effect of adoption of accounting principle			(2,701)		(179)	(2,880)		(2,880)
Contributions from noncontrolling interests						0	10	10
Distributions to noncontrolling interests						0	(15)	(15)
Consolidations/deconsolidations of noncontrolling interests						0	54	54
Stock-based compensation programs		34	(29)	185		190		190
Comprehensive income:								
Net income			2,944			2,944	64	3,008
Other comprehensive income, net of tax					2,340	2,340	29	2,369
Total comprehensive income						5,284	93	5,377
<b>Balance, September 30, 2011</b>	\$ 6	\$ 24,257	\$ 16,595	\$ (11,738)	\$ 5,139	\$ 34,259	\$ 655	\$ 34,914

(1) Class B Stock is not presented as the amounts are immaterial.

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*See Notes to Unaudited Interim Consolidated Financial Statements*

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Consolidated Statements of Cash Flows****Nine Months Ended September 30, 2012 and 2011 (in millions)**

	<b>2012</b>	<b>2011</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 664	\$ 3,008
Adjustments to reconcile net income to net cash provided by operating activities:		
Realized investment (gains) losses, net	1,066	(2,946)
Policy charges and fee income	(1,080)	(826)
Interest credited to policyholders' account balances	3,269	3,477
Depreciation and amortization	230	202
Gains on trading account assets supporting insurance liabilities, net	(503)	(179)
Change in:		
Deferred policy acquisition costs	(1,438)	75
Future policy benefits and other insurance liabilities	11,336	4,787
Other trading account assets	4	340
Income taxes	879	359
Other, net	(2,678)	2,524
<b>Cash flows from operating activities</b>	<b>11,749</b>	<b>10,821</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from the sale/maturity/prepayment of:		
Fixed maturities, available-for-sale	28,302	31,857
Fixed maturities, held-to-maturity	377	336
Trading account assets supporting insurance liabilities and other trading account assets	10,230	18,883
Equity securities, available-for-sale	3,245	2,823
Commercial mortgage and other loans	3,528	3,138
Policy loans	1,698	1,521
Other long-term investments	1,105	1,556
Short-term investments	20,985	16,799
Payments for the purchase/origination of:		
Fixed maturities, available-for-sale	(38,848)	(38,963)
Fixed maturities, held-to-maturity	(18)	(38)
Trading account assets supporting insurance liabilities and other trading account assets	(10,190)	(20,317)
Equity securities, available-for-sale	(2,897)	(2,335)
Commercial mortgage and other loans	(5,348)	(4,598)
Policy loans	(1,527)	(1,334)
Other long-term investments	(1,316)	(1,252)
Short-term investments	(20,905)	(16,858)
Acquisition of subsidiaries, net of cash acquired.	0	(2,321)
Other, net	167	119
<b>Cash flows used in investing activities</b>	<b>(11,412)</b>	<b>(10,984)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Policyholders' account deposits	17,095	18,632
Policyholders' account withdrawals	(17,935)	(17,047)
Net change in securities sold under agreements to repurchase and cash collateral for loaned securities	2,222	1,356
Cash dividends paid on Common Stock	(53)	(51)
Net change in financing arrangements (maturities 90 days or less)	(74)	207
Common Stock acquired	(650)	(695)
Common Stock reissued for exercise of stock options	117	89
Proceeds from the issuance of debt (maturities longer than 90 days)	2,396	1,229
Repayments of debt (maturities longer than 90 days)	(2,384)	(891)

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Excess tax benefits from share-based payment arrangements	53	13
Change in bank deposits	(1,730)	(114)
Other, net	274	(135)
<b>Cash flows from (used in) financing activities</b>	<b>(669)</b>	<b>2,593</b>
Effect of foreign exchange rate changes on cash balances	(13)	181
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>(345)</b>	<b>2,611</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<b>14,251</b>	<b>12,915</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$ 13,906</b>	<b>\$ 15,526</b>
<b>NON-CASH TRANSACTIONS DURING THE PERIOD</b>		
Treasury Stock shares issued for stock-based compensation programs	\$ 209	\$ 73

*See Notes to Unaudited Interim Consolidated Financial Statements*

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**PRUDENTIAL FINANCIAL, INC.**

**Notes to Unaudited Interim Consolidated Financial Statements**

**1. BUSINESS AND BASIS OF PRESENTATION**

Prudential Financial, Inc. ( Prudential Financial ) and its subsidiaries (collectively, Prudential or the Company ) provide a wide range of insurance, investment management, and other financial products and services to both individual and institutional customers throughout the United States and in many other countries. Principal products and services provided include life insurance, annuities, retirement-related services, mutual funds, and investment management. The Company has organized its principal operations into the Financial Services Businesses and the Closed Block Business. The Financial Services Businesses operate through three operating divisions: U.S. Retirement Solutions and Investment Management, U.S. Individual Life and Group Insurance, and International Insurance. The Company's businesses that are not sufficiently material to warrant separate disclosure and divested businesses, are included in Corporate and Other operations within the Financial Services Businesses. The Closed Block Business, which includes the Closed Block (see Note 6), is managed separately from the Financial Services Businesses. The Closed Block Business was established on the date of demutualization and includes the Company's in force participating insurance and annuity products and assets that are used for the payment of benefits and policyholders' dividends on these products, as well as other assets and equity that support these products and related liabilities. In connection with the demutualization, the Company ceased offering these participating products.

***Basis of Presentation***

The Unaudited Interim Consolidated Financial Statements include the accounts of Prudential Financial, entities over which the Company exercises control, including majority-owned subsidiaries and minority-owned entities such as limited partnerships in which the Company is the general partner, and variable interest entities in which the Company is considered the primary beneficiary. See Note 5 for more information on the Company's consolidated variable interest entities. The Unaudited Interim Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America ( U.S. GAAP ) on a basis consistent with reporting interim financial information in accordance with instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission ( SEC ). Intercompany balances and transactions have been eliminated.

In the opinion of management, all adjustments necessary for a fair statement of the financial position and results of operations have been made. All such adjustments are of a normal, recurring nature, except for the adjustments described below under Out of Period Adjustments. Interim results are not necessarily indicative of the results that may be expected for the full year. These financial statements should be read in conjunction with the Company's Audited Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

The Company's Gibraltar Life Insurance Company, Ltd. ( Gibraltar Life ) consolidated operations, including the previously-acquired AIG Star Life Insurance Co., Ltd., AIG Edison Life Insurance Company, AIG Financial Assurance Japan K.K., and AIG Edison Service Co., Ltd. use a November 30 fiscal year end for purposes of inclusion in the Company's Consolidated Financial Statements. Therefore, the Unaudited Interim Consolidated Financial Statements as of September 30, 2012, include the assets and liabilities of Gibraltar Life as of August 31, 2012 and the results of operations for Gibraltar Life for the three and nine months ended August 31, 2012.



*Use of Estimates*

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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**PRUDENTIAL FINANCIAL, INC.**

**Notes to Unaudited Interim Consolidated Financial Statements (Continued)**

The most significant estimates include those used in determining deferred policy acquisition costs and related amortization; value of business acquired and its amortization; amortization of sales inducements; measurement of goodwill and any related impairment; valuation of investments including derivatives and the recognition of other-than-temporary impairments; future policy benefits including guarantees; pension and other postretirement benefits; provision for income taxes and valuation of deferred tax assets; and reserves for contingent liabilities, including reserves for losses in connection with unresolved legal matters.

***Reclassifications***

Certain amounts in prior periods have been reclassified to conform to the current period presentation.

***Out of Period Adjustments***

In the second quarter of 2012, the Company recorded two out of period adjustments resulting in a decrease of \$122 million to Income from continuing operations before income taxes and equity in earnings of operating joint ventures for the nine months ended September 30, 2012.

The first adjustment related to a decline in the value of a real estate-related investment. Based on a review of the underlying collateral and a related guarantee, the Company determined that impairments of \$75 million should be recognized, of which \$61 million should have been recorded in prior years. The second adjustment consisted of an increase of \$61 million in reserves for estimated payments arising from use of new Social Security Master Death File matching criteria to identify deceased policy and contract holders. During the initial calculation of the reserve in the third quarter of 2011, the Company excluded certain life policies in extended term status from the analysis used to identify potential claims.

The adjustments resulted in a decrease in adjusted operating income, the Company's measure of segment performance, of \$106 million for the nine months ended September 30, 2012, including a reduction of \$61 million to the Asset Management segment and a reduction of \$45 million to the Corporate and Other operations of the Financial Services Businesses. In addition, the adjustments resulted in a reduction of \$16 million to the Closed Block Business. The adjustments are not material to any previously reported quarterly or annual financial statements.

In addition to the two out of period adjustments discussed above, in the first quarter of 2011, the Company recorded an out of period adjustment that decreased Income from continuing operations before income taxes and equity in earnings of operating joint ventures by \$95 million. This adjustment had no impact on adjusted operating income, the Company's measure of segment performance, and was not material to any previously reported quarterly or annual financial statements. For additional information regarding this out of period adjustment, see Note 1 to the Company's Consolidated Financial Statements included in its 2011 Annual Report on Form 10-K.

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For further information on the presentation of segment results and a definition of adjusted operating income, see Note 11.

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**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)****2. SIGNIFICANT ACCOUNTING POLICIES AND PRONOUNCEMENTS***Investments in Debt and Equity Securities and Commercial Mortgage and Other Loans*

The Company's investments in debt and equity securities include fixed maturities; equity securities; and short-term investments. The accounting policies related to these, as well as commercial mortgage and other loans, are as follows:

Fixed maturities are comprised of bonds, notes and redeemable preferred stock. Fixed maturities classified as available-for-sale are carried at fair value. See Note 13 for additional information regarding the determination of fair value. Fixed maturities for which the Company has asserted the positive intent and ability to hold to maturity are carried at amortized cost and classified as held-to-maturity. The amortized cost of fixed maturities is adjusted for amortization of premiums and accretion of discounts to maturity. Interest income, as well as the related amortization of premium and accretion of discount, is included in Net investment income under the effective yield method. For mortgage-backed and asset-backed securities, the effective yield is based on estimated cash flows, including interest rate and prepayment assumptions based on data from widely accepted third-party data sources or internal estimates. In addition to interest rate and prepayment assumptions, cash flow estimates also vary based on other assumptions regarding the underlying collateral, including default rates and changes in value. These assumptions can significantly impact income recognition and the amount of other-than-temporary impairments recognized in earnings and other comprehensive income. For high credit quality mortgage-backed and asset-backed securities (those rated AA or above), cash flows are updated quarterly, and the amortized cost and effective yield of the security are adjusted as necessary to reflect historical prepayment experience and changes in estimated future prepayments. The adjustments to amortized cost are recorded as a charge or credit to net investment income in accordance with the retrospective method. For mortgage-backed and asset-backed securities rated below AA or those for which an other than temporary impairment has been recorded, the effective yield is adjusted prospectively for any changes in estimated cash flows. See the discussion below on realized investment gains and losses for a description of the accounting for impairments. Unrealized gains and losses on fixed maturities classified as available-for-sale, net of tax, and the effect on deferred policy acquisition costs, value of business acquired, unearned revenue reserves, deferred sales inducements, future policy benefits and policyholders' dividends that would result from the realization of unrealized gains and losses, are included in Accumulated other comprehensive income (loss).

Trading account assets supporting insurance liabilities, at fair value includes invested assets that support certain products included in the Retirement segment, as well as certain products included in the International Insurance segment, which are experience rated, meaning that the investment results associated with these products are expected to ultimately accrue to contractholders. Realized and unrealized gains and losses for these investments are reported in Asset management fees and other income. Interest and dividend income from these investments is reported in Net investment income.

Other trading account assets, at fair value consist primarily of fixed maturities, equity securities, including certain perpetual preferred stock, and certain derivatives, including those used by the Company in its capacity as a broker-dealer and derivative hedging positions used in a non-broker-dealer capacity primarily to hedge the risks related to certain products. These instruments are carried at fair value. Realized and unrealized gains and losses on these investments and on derivatives used by the Company in its capacity as a broker-dealer are reported in Asset management fees and other income and, for those related to the Company's former global commodities group, in Income from discontinued operations, net of taxes. Interest and dividend income from these investments is reported in Net investment income and, for those related to the

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Company's former global commodities group, in Income from discontinued operations, net of taxes.

Equity securities available-for-sale are comprised of common stock, mutual fund shares, non-redeemable preferred stock, and certain perpetual preferred stock, and are carried at fair value. The associated unrealized

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**PRUDENTIAL FINANCIAL, INC.**

**Notes to Unaudited Interim Consolidated Financial Statements (Continued)**

gains and losses, net of tax, and the effect on deferred policy acquisition costs, value of business acquired, unearned revenue reserves, deferred sales inducements, future policy benefits and policyholders' dividends that would result from the realization of unrealized gains and losses, are included in Accumulated other comprehensive income (loss). The cost of equity securities is written down to fair value when a decline in value is considered to be other-than-temporary. See the discussion below on realized investment gains and losses for a description of the accounting for impairments. Dividends from these investments are recognized in Net investment income when earned.

Commercial mortgage and other loans consist of commercial mortgage loans, agricultural loans, loans backed by residential properties, as well as certain other collateralized and uncollateralized loans. Commercial mortgage loans are broken down by class which is based on property type (industrial properties, retail, office, multi-family/apartment, hospitality, and other). Loans backed by residential properties primarily include recourse loans held by the Company's international insurance businesses. Other collateralized loans primarily include senior loans made by the Company's international insurance businesses and loans made to the Company's former real estate franchisees. Uncollateralized loans primarily represent reverse dual currency loans and corporate loans held by the Company's international insurance businesses.

Commercial mortgage and other loans originated and held for investment are generally carried at unpaid principal balance, net of unamortized deferred loan origination fees and expenses and net of an allowance for losses. Commercial mortgage loans originated within the Company's commercial mortgage operations include loans held for sale which are reported at the lower of cost or fair value; loans held for investment which are reported at amortized cost net of unamortized deferred loan origination fees and expenses and net of an allowance for losses; and loans reported at fair value under the fair value option. Commercial mortgage and other loans acquired, including those related to the acquisition of a business, are recorded at fair value when purchased, reflecting any premiums or discounts to unpaid principal balances.

Interest income, as well as prepayment fees and the amortization of the related premiums or discounts, related to commercial mortgage and other loans, are included in Net investment income.

Impaired loans include those loans for which it is probable that amounts due will not be collected according to the contractual terms of the loan agreement. The Company defines "past due" as principal or interest not collected at least 30 days past the scheduled contractual due date. Interest received on loans that are past due, including impaired and non-impaired loans as well as loans that were previously modified in a troubled debt restructuring, is either applied against the principal or reported as net investment income based on the Company's assessment as to the collectability of the principal. See Note 4 for additional information about the Company's past due loans.

The Company discontinues accruing interest on loans after the loans become 90 days delinquent as to principal or interest payments, or earlier when the Company has doubts about collectability. When the Company discontinues accruing interest on a loan, any accrued but uncollectible interest on the loan and other loans backed by the same collateral, if any, is charged to interest income in the same period. Generally, a loan is restored to accrual status only after all delinquent interest and principal are brought current and, in the case of loans where the payment of interest has been interrupted for a substantial period, or the loan has been modified, a regular payment performance has been established.

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The Company reviews the performance and credit quality of the commercial mortgage and other loan portfolio on an on-going basis. Loans are placed on watch list status based on a predefined set of criteria and are assigned one of three categories. Loans are placed on "early warning" status in cases where, based on the Company's analysis of the loan's collateral, the financial situation of the borrower or tenants or other market

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**PRUDENTIAL FINANCIAL, INC.**

**Notes to Unaudited Interim Consolidated Financial Statements (Continued)**

factors, it is believed a loss of principal or interest could occur. Loans are classified as *closely monitored* when it is determined that there is a collateral deficiency or other credit events that may lead to a potential loss of principal or interest. Loans *not in good standing* are those loans where the Company has concluded that there is a high probability of loss of principal, such as when the loan is delinquent or in the process of foreclosure. As described below, in determining the allowance for losses, the Company evaluates each loan on the watch list to determine if it is probable that amounts due will not be collected according to the contractual terms of the loan agreement.

Loan-to-value and debt service coverage ratios are measures commonly used to assess the quality of commercial mortgage loans. The loan-to-value ratio compares the amount of the loan to the fair value of the underlying property collateralizing the loan, and is commonly expressed as a percentage. Loan-to-value ratios greater than 100% indicate that the loan amount exceeds the collateral value. A smaller loan-to-value ratio indicates a greater excess of collateral value over the loan amount. The debt service coverage ratio compares a property's net operating income to its debt service payments. Debt service coverage ratios less than 1.0 times indicate that property operations do not generate enough income to cover the loan's current debt payments. A larger debt service coverage ratio indicates a greater excess of net operating income over the debt service payments. The values utilized in calculating these ratios are developed as part of the Company's periodic review of the commercial mortgage loan and agricultural loan portfolio, which includes an internal appraisal of the underlying collateral value. The Company's periodic review also includes a quality re-rating process, whereby the internal quality rating originally assigned at underwriting is updated based on current loan, property and market information using a proprietary quality rating system. The loan-to-value ratio is the most significant of several inputs used to establish the internal credit rating of a loan which in turn drives the allowance for losses. Other key factors considered in determining the internal credit rating include debt service coverage ratios, amortization, loan term, estimated market value growth rate and volatility for the property type and region. See Note 4 for additional information related to the loan-to-value ratios and debt service coverage ratios related to the Company's commercial mortgage and agricultural loan portfolios.

Loans backed by residential properties, other collateralized loans, and uncollateralized loans are also reviewed periodically. Each loan is assigned an internal or external credit rating. Internal credit ratings take into consideration various factors including financial ratios and qualitative assessments based on non-financial information. In cases where there are personal or third party guarantors, the credit quality of the guarantor is also reviewed. These factors are used in developing the allowance for losses. Based on the diversity of the loans in these categories and their immateriality, the Company has not disclosed the credit quality indicators related to these loans in Note 4.

For those loans not reported at fair value, the allowance for losses includes a loan specific reserve for each impaired loan that has a specifically identified loss and a portfolio reserve for probable incurred but not specifically identified losses. For impaired commercial mortgage and other loans the allowances for losses are determined based on the present value of expected future cash flows discounted at the loan's effective interest rate, or based upon the fair value of the collateral if the loan is collateral dependent. The portfolio reserves for probable incurred but not specifically identified losses in the commercial mortgage and agricultural loan portfolio segments considers the current credit composition of the portfolio based on an internal quality rating, (as described above). The portfolio reserves are determined using past loan experience, including historical credit migration, loss probability and loss severity factors by property type. These factors are reviewed each quarter and updated as appropriate.

The allowance for losses on commercial mortgage and other loans can increase or decrease from period to period based on the factors noted above. Realized investment gains (losses), net includes changes in the allowance for losses and changes in value for loans accounted for under the fair value option. Realized investment gains (losses), net also includes gains and losses on sales, certain restructurings, and foreclosures.





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**PRUDENTIAL FINANCIAL, INC.**

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When a commercial mortgage or other loan is deemed to be uncollectible, any specific valuation allowance associated with the loan is reversed and a direct write down to the carrying amount of the loan is made. The carrying amount of the loan is not adjusted for subsequent recoveries in value.

Commercial mortgage and other loans are occasionally restructured in a troubled debt restructuring. These restructurings generally include one or more of the following: full or partial payoffs outside of the original contract terms; changes to interest rates; extensions of maturity; or additions or modifications to covenants. Additionally, the Company may accept assets in full or partial satisfaction of the debt as part of a troubled debt restructuring. When restructurings occur, they are evaluated individually to determine whether the restructuring or modification constitutes a troubled debt restructuring as defined by authoritative accounting guidance. If the borrower is experiencing financial difficulty and the Company has granted a concession, the restructuring, including those that involve a partial payoff or the receipt of assets in full satisfaction of the debt is deemed to be a troubled debt restructuring. Based on the Company's credit review process described above, these loans generally would have been deemed impaired prior to the troubled debt restructuring, and specific allowances for losses would have been established prior to the determination that a troubled debt restructuring has occurred.

In a troubled debt restructuring where the Company receives assets in full satisfaction of the debt, any specific valuation allowance is reversed and a direct write down of the loan is recorded for the amount of the allowance, and any additional loss, net of recoveries, or any gain is recorded for the difference between the fair value of the assets received and the recorded investment in the loan. When assets are received in partial settlement, the same process is followed, and the remaining loan is evaluated prospectively for impairment based on the credit review process noted above. When a loan is restructured in a troubled debt restructuring, the impairment of the loan is remeasured using the modified terms and the loan's original effective yield, and the allowance for loss is adjusted accordingly. Subsequent to the modification, income is recognized prospectively based on the modified terms of the loans in accordance with the income recognition policy noted above. Additionally, the loan continues to be subject to the credit review process noted above.

In situations where a loan has been restructured in a troubled debt restructuring and the loan has subsequently defaulted, this factor is considered when evaluating the loan for a specific allowance for losses in accordance with the credit review process noted above.

See Note 4 for additional information about commercial mortgage and other loans that have been restructured in a troubled debt restructuring.

Short-term investments primarily consist of highly liquid debt instruments with a maturity of greater than three months and less than twelve months when purchased, other than those debt instruments meeting this definition that are included in Trading account assets supporting insurance liabilities, at fair value. These investments are generally carried at fair value and include certain money market investments, short-term debt securities issued by government sponsored entities and other highly liquid debt instruments. Short-term investments held in the Company's former broker-dealer operations were marked-to-market through Income from discontinued operations, net of taxes.

Realized investment gains (losses) are computed using the specific identification method with the exception of some of the Company's International Insurance businesses portfolios, where the average cost method is used. Realized investment gains and losses are generated from

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numerous sources, including the sale of fixed maturity securities, equity securities, investments in joint ventures and limited partnerships and other types of investments, as well as adjustments to the cost basis of investments for net other-than-temporary impairments recognized in earnings. Realized investment gains and losses are also generated from prepayment premiums received on private fixed maturity securities, allowance for losses on commercial mortgage and other loans, fair value

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**PRUDENTIAL FINANCIAL, INC.**

**Notes to Unaudited Interim Consolidated Financial Statements (Continued)**

changes on commercial mortgage loans carried at fair value, and fair value changes on embedded derivatives and free-standing derivatives that do not qualify for hedge accounting treatment, except those derivatives used in the Company's capacity as a broker or dealer.

The Company's available-for-sale and held-to-maturity securities with unrealized losses are reviewed quarterly to identify other-than-temporary impairments in value. In evaluating whether a decline in value is other-than-temporary, the Company considers several factors including, but not limited to the following: (1) the extent and the duration of the decline; (2) the reasons for the decline in value (credit event, currency or interest-rate related, including general credit spread widening); and (3) the financial condition of and near-term prospects of the issuer. With regard to available-for-sale equity securities, the Company also considers the ability and intent to hold the investment for a period of time to allow for a recovery of value. When it is determined that a decline in value of an equity security is other-than-temporary, the carrying value of the equity security is reduced to its fair value, with a corresponding charge to earnings.

Under the authoritative guidance for the recognition and presentation of other-than-temporary impairments for debt securities, an other-than-temporary impairment must be recognized in earnings for a debt security in an unrealized loss position when an entity either (a) has the intent to sell the debt security or (b) more likely than not will be required to sell the debt security before its anticipated recovery. For all debt securities in unrealized loss positions that do not meet either of these two criteria, the guidance requires that the Company analyze its ability to recover the amortized cost by comparing the net present value of projected future cash flows with the amortized cost of the security. The net present value is calculated by discounting the Company's best estimate of projected future cash flows at the effective interest rate implicit in the debt security prior to impairment. The Company may use the estimated fair value of collateral as a proxy for the net present value if it believes that the security is dependent on the liquidation of collateral for recovery of its investment. If the net present value is less than the amortized cost of the investment, an other-than-temporary impairment is recognized. In addition to the above mentioned circumstances, the Company also recognizes an other-than-temporary impairment in earnings when a non-functional currency denominated security in an unrealized loss position due to currency exchange rates approaches maturity.

Under the authoritative guidance for the recognition and presentation of other-than-temporary impairments, when an other-than-temporary impairment of a debt security has occurred, the amount of the other-than-temporary impairment recognized in earnings depends on whether the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis. If the debt security meets either of these two criteria or the foreign currency translation loss is not expected to be recovered before maturity, the other-than-temporary impairment recognized in earnings is equal to the entire difference between the security's amortized cost basis and its fair value at the impairment measurement date. For other-than-temporary impairments of debt securities that do not meet these criteria, the net amount recognized in earnings is equal to the difference between the amortized cost of the debt security and its net present value calculated as described above. Any difference between the fair value and the net present value of the debt security at the impairment measurement date is recorded in Other comprehensive income (loss). Unrealized gains or losses on securities for which an other-than-temporary impairment has been recognized in earnings is tracked as a separate component of Accumulated other comprehensive income (loss).

For debt securities, the split between the amount of an other-than-temporary impairment recognized in other comprehensive income and the net amount recognized in earnings is driven principally by assumptions regarding the amount and timing of projected cash flows. For mortgage-backed and asset-backed securities, cash flow estimates consider the payment terms of the underlying assets backing a particular security, including interest rate and prepayment assumptions, based on data from widely accepted third-party data sources or internal estimates. In addition to interest rate and prepayment assumptions, cash flow estimates also include other



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**PRUDENTIAL FINANCIAL, INC.**

**Notes to Unaudited Interim Consolidated Financial Statements (Continued)**

assumptions regarding the underlying collateral including default rates and recoveries, which vary based on the asset type and geographic location, as well as the vintage year of the security. For structured securities, the payment priority within the tranche structure is also considered. For all other debt securities, cash flow estimates are driven by assumptions regarding probability of default and estimates regarding timing and amount of recoveries associated with a default. The Company has developed these estimates using information based on its historical experience as well as using market observable data, such as industry analyst reports and forecasts, sector credit ratings and other data relevant to the collectability of a security, such as the general payment terms of the security and the security's position within the capital structure of the issuer.

The new cost basis of an impaired security is not adjusted for subsequent increases in estimated fair value. In periods subsequent to the recognition of an other-than-temporary impairment, the impaired security is accounted for as if it had been purchased on the measurement date of the impairment. For debt securities, the discount (or reduced premium) based on the new cost basis may be accreted into net investment income in future periods, including increases in cash flow on a prospective basis. In certain cases where there are decreased cash flow expectations, the security is reviewed for further cash flow impairments.

***Derivative Financial Instruments***

Derivatives are financial instruments whose values are derived from interest rates, foreign exchange rates, financial indices, values of securities or commodities, credit spreads, market volatility, expected returns, and liquidity. Values can also be affected by changes in estimates and assumptions, including those related to counterparty behavior and non-performance risk used in valuation models. Derivative financial instruments generally used by the Company include swaps, futures, forwards and options and may be exchange-traded or contracted in the over-the-counter market. Derivative positions are carried at fair value, generally by obtaining quoted market prices or through the use of valuation models.

Derivatives are used in a non-broker-dealer capacity to manage the interest rate and currency characteristics of assets or liabilities and to mitigate volatility of expected non-U.S. earnings and net investments in foreign operations resulting from changes in currency exchange rates. Additionally, derivatives may be used to seek to reduce exposure to interest rate, credit, foreign currency and equity risks associated with assets held or expected to be purchased or sold, and liabilities incurred or expected to be incurred. As discussed in detail below and in Note 14, all realized and unrealized changes in fair value of non-broker-dealer related derivatives are recorded in current earnings, with the exception of the effective portion of cash flow hedges and effective hedges of net investments in foreign operations. Cash flows from derivatives are reported in the operating, investing, or financing activities sections in the Unaudited Interim Consolidated Statements of Cash Flows based on the nature and purpose of the derivative.

Derivatives were also used in a derivative broker-dealer capacity in the Company's former global commodities group to meet the needs of clients by structuring transactions that allow clients to manage their exposure to interest rates, foreign exchange rates, indices and prices of securities and commodities. The Company's global commodities group was sold on July 1, 2011. See Note 3 for further details. Realized and unrealized changes in fair value of derivatives used in these dealer-related operations are included in Income from discontinued operations, net of taxes in the periods in which the changes occur. Cash flows from such derivatives are reported in the operating activities section of the Unaudited Interim Consolidated Statements of Cash Flows.

Derivatives are recorded either as assets, within Other trading account assets, at fair value or Other long-term investments, or as liabilities, within Other liabilities, except for embedded derivatives which are recorded with the associated host contract. The Company nets the fair value of all derivative financial instruments with counterparties for which a master netting arrangement has been executed.

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**Notes to Unaudited Interim Consolidated Financial Statements (Continued)**

The Company designates derivatives as either (1) a hedge of the fair value of a recognized asset or liability or unrecognized firm commitment ( fair value hedge); (2) a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability ( cash flow hedge); (3) a foreign-currency fair value or cash flow hedge ( foreign currency hedge); (4) a hedge of a net investment in a foreign operation; or (5) a derivative that does not qualify for hedge accounting.

To qualify for hedge accounting treatment, a derivative must be highly effective in mitigating the designated risk of the hedged item. Effectiveness of the hedge is formally assessed at inception and throughout the life of the hedging relationship. Even if a derivative qualifies for hedge accounting treatment, there may be an element of ineffectiveness of the hedge. Under such circumstances, the ineffective portion is recorded in Realized investment gains (losses), net.

The Company formally documents at inception all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives designated as fair value, cash flow, or foreign currency hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. Hedges of a net investment in a foreign operation are linked to the specific foreign operation.

When a derivative is designated as a fair value hedge and is determined to be highly effective, changes in its fair value, along with changes in the fair value of the hedged asset or liability (including losses or gains on firm commitments), are reported on a net basis in the income statement, generally in Realized investment gains (losses), net. When swaps are used in hedge accounting relationships, periodic settlements are recorded in the same income statement line as the related settlements of the hedged items.

When a derivative is designated as a cash flow hedge and is determined to be highly effective, changes in its fair value are recorded in Accumulated other comprehensive income (loss), to the extent they are effective, until earnings are affected by the variability of cash flows being hedged (e.g., when periodic settlements on a variable-rate asset or liability are recorded in earnings). At that time, the related portion of deferred gains or losses on the derivative instrument is reclassified and reported in the income statement line item associated with the hedged item.

When a derivative is designated as a foreign currency hedge and is determined to be highly effective, changes in its fair value are recorded either in current period earnings if the hedge transaction is a fair value hedge (e.g., a hedge of a recognized foreign currency asset or liability) or in Accumulated other comprehensive income (loss) if the hedge transaction is a cash flow hedge (e.g., a foreign currency denominated forecasted transaction). When a derivative is used as a hedge of a net investment in a foreign operation, its change in fair value, to the extent effective as a hedge, is recorded in the cumulative translation adjustment account within Accumulated other comprehensive income (loss).

If it is determined that a derivative no longer qualifies as an effective fair value or cash flow hedge or management removes the hedge designation, the derivative will continue to be carried on the balance sheet at its fair value, with changes in fair value recognized currently in Realized investment gains (losses), net. In this scenario, the hedged asset or liability under a fair value hedge will no longer be adjusted for changes in fair value and the existing basis adjustment is amortized to the income statement line associated with the asset or liability. The



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component of Accumulated other comprehensive income (loss) related to discontinued cash flow hedges is reclassified to the income statement line associated with the hedged cash flows consistent with the earnings impact of the original hedged cash flows.

When hedge accounting is discontinued because the hedged item no longer meets the definition of a firm commitment, or because it is probable that the forecasted transaction will not occur by the end of the specified

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**PRUDENTIAL FINANCIAL, INC.**

**Notes to Unaudited Interim Consolidated Financial Statements (Continued)**

time period, the derivative will continue to be carried on the balance sheet at its fair value, with changes in fair value recognized currently in Realized investment gains (losses), net. Any asset or liability that was recorded pursuant to recognition of the firm commitment is removed from the balance sheet and recognized currently in Realized investment gains (losses), net. Gains and losses that were in Accumulated other comprehensive income (loss) pursuant to the hedge of a forecasted transaction are recognized immediately in Realized investment gains (losses), net.

If a derivative does not qualify for hedge accounting, all changes in its fair value, including net receipts and payments, are included in Realized investment gains (losses), net without considering changes in the fair value of the economically associated assets or liabilities.

The Company is a party to financial instruments that contain derivative instruments that are embedded in the financial instruments. At inception, the Company assesses whether the economic characteristics of the embedded instrument are clearly and closely related to the economic characteristics of the remaining component of the financial instrument (i.e., the host contract) and whether a separate instrument with the same terms as the embedded instrument would meet the definition of a derivative instrument. When it is determined that (1) the embedded instrument possesses economic characteristics that are not clearly and closely related to the economic characteristics of the host contract, and (2) a separate instrument with the same terms would qualify as a derivative instrument, the embedded instrument qualifies as an embedded derivative that is separated from the host contract, carried at fair value, and changes in its fair value are included in Realized investment gains (losses), net. For certain financial instruments that contain an embedded derivative that otherwise would need to be bifurcated and reported at fair value, the Company may elect to classify the entire instrument as a trading account asset and report it within Other trading account assets, at fair value.

***Adoption of New Accounting Pronouncements***

Effective January 1, 2012, the Company adopted, retrospectively, updated guidance regarding the presentation of comprehensive income. The updated guidance eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. Under the updated guidance, an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The updated guidance does not change the items that are reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The Company opted to present the total of comprehensive income, the components of net income, and the components of other comprehensive income in two separate but consecutive statements. The Unaudited Interim Consolidated Financial Statements included herein reflect the adoption of this updated guidance.

Effective January 1, 2012, the Company adopted, prospectively, updated guidance regarding the fair value measurements and disclosure requirements. The updated guidance clarifies existing guidance related to the application of fair value measurement methods and requires expanded disclosures. The expanded disclosures required by this guidance are included in Note 13. Adoption of this guidance did not have a material effect on the Company's consolidated financial position or results of operations.

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Effective January 1, 2012, the Company adopted, prospectively, updated guidance regarding the assessment of effective control for repurchase agreements. The Company's adoption of this guidance did not have a material effect on the Company's consolidated financial position, results of operations, and financial statement disclosures.

Effective January 1, 2012, the Company adopted, retrospectively, new authoritative guidance to address diversity in practice regarding the interpretation of which costs relating to the acquisition of new or renewal

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insurance contracts qualify for deferral. Under the amended guidance, acquisition costs are to include only those costs that are directly related to the acquisition or renewal of insurance contracts by applying a model similar to the accounting for loan origination costs. An entity may defer incremental direct costs of contract acquisition with independent third parties or employees that are essential to the contract transaction, as well as the portion of employee compensation, including payroll fringe benefits and other costs directly related to underwriting, policy issuance and processing, medical inspection, and contract selling for successfully negotiated contracts. Prior period financial information presented in these financial statements has been adjusted to reflect the retrospective adoption of the amended guidance. The lower level of costs now qualifying for deferral will be only partially offset by a lower level of amortization of Deferred policy acquisition costs, and, as such, will initially result in lower earnings in future periods, primarily within the International Insurance and Individual Annuities segments. The impact to the International Insurance segment largely reflects lower deferrals of allocated costs of its proprietary distribution system, while the impact to the Individual Annuities segment mainly reflects lower deferrals of its wholesaler costs. While the adoption of this amended guidance changes the timing of when certain costs are reflected in the Company's results of operations, it has no effect on the total acquisition costs to be recognized over time and has no impact on the Company's cash flows.

The following tables present amounts as previously reported in 2011, the effect on those amounts of the change due to the retrospective adoption of the amended guidance related to the deferral of acquisition costs as described above, and the adjusted amounts that are reflected in the Unaudited Interim Consolidated Financial Statements, included herein.

**Unaudited Interim Consolidated Statement of Financial Position:**

	December 31, 2011		
	As Previously Reported	Effect of Change (in millions)	As Currently Reported
Deferred policy acquisition costs	\$ 16,790	\$ (4,273)	\$ 12,517
Other assets	16,060	(4)	16,056
<b>TOTAL ASSETS</b>	<b>624,521</b>	<b>(4,277)</b>	<b>620,244</b>
Future policy benefits	170,459	212	170,671
Policyholders' account balances	134,552	6	134,558
Income taxes	8,083	(1,525)	6,558
Total liabilities	586,710	(1,307)	585,403
Accumulated other comprehensive income (loss)	5,563	(145)	5,418
Retained earnings	19,281	(2,825)	16,456
Total Prudential Financial, Inc. equity	37,223	(2,970)	34,253
Total equity	37,811	(2,970)	34,841
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$ 624,521</b>	<b>\$ (4,277)</b>	<b>\$ 620,244</b>

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)****Unaudited Interim Consolidated Statement of Operations:**

	<b>Three Months Ended September 30, 2011</b>		
	<b>As Previously Reported</b>	<b>Effect of Change (in millions)</b>	<b>As Currently Reported</b>
<b>REVENUES</b>			
Premiums	\$ 6,092	\$ (8)	\$ 6,084
Asset management fees and other income	2,006	22	2,028
Total revenues	14,917	14	14,931
<b>BENEFITS AND EXPENSES</b>			
Amortization of deferred policy acquisition costs	1,786	(276)	1,510
General and administrative expenses	2,447	218	2,665
Total benefits and expenses	12,583	(58)	12,525
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES</b>			
	2,334	72	2,406
Income tax expense	848	12	860
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES</b>			
	1,486	60	1,546
Equity in earnings of operating joint ventures, net of tax	67	0	67
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS</b>			
	1,553	60	1,613
<b>NET INCOME (LOSS)</b>			
	1,544	60	1,604
<b>NET INCOME (LOSS) ATTRIBUTABLE TO PRUDENTIAL FINANCIAL, INC.</b>			
	\$ 1,534	\$ 60	\$ 1,594
<b>EARNINGS PER SHARE</b>			
<b>Financial Services Businesses</b>			
<b>Basic:</b>			
Income from continuing operations attributable to Prudential Financial, Inc. per share of Common Stock	\$ 3.12	\$ 0.12	\$ 3.24
Net income attributable to Prudential Financial, Inc. per share of Common Stock	\$ 3.10	\$ 0.12	\$ 3.22
<b>Diluted:</b>			
Income from continuing operations attributable to Prudential Financial, Inc. per share of Common Stock	\$ 3.08	\$ 0.11	\$ 3.19
Net income attributable to Prudential Financial, Inc. per share of Common Stock	\$ 3.06	\$ 0.12	\$ 3.18
<b>Closed Block Business</b>			
<b>Basic and Diluted:</b>			
Income from continuing operations attributable to Prudential Financial, Inc. per share of Class B Stock	\$ 10.50	\$ 1.50	\$ 12.00
Net income attributable to Prudential Financial, Inc. per share of Class B stock	\$ 10.50	\$ 1.50	\$ 12.00

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)**

	<b>Nine Months Ended September 30, 2011</b>		
	<b>As Previously Reported</b>	<b>Effect of Change (in millions)</b>	<b>As Currently Reported</b>
<b>REVENUES</b>			
Premiums	\$ 17,892	\$ (28)	\$ 17,864
Asset management fees and other income	3,823	23	3,846
Total revenues	37,350	(5)	37,345
<b>BENEFITS AND EXPENSES</b>			
Amortization of deferred policy acquisition costs	2,888	(513)	2,375
General and administrative expenses	7,138	600	7,738
Total benefits and expenses	33,140	87	33,227
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES</b>			
	4,210	(92)	4,118
Income tax expense	1,370	(58)	1,312
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES</b>			
	2,840	(34)	2,806
Equity in earnings of operating joint ventures, net of tax	183	(2)	181
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS</b>			
	3,023	(36)	2,987
<b>NET INCOME (LOSS)</b>			
	3,044	(36)	3,008
<b>NET INCOME (LOSS) ATTRIBUTABLE TO PRUDENTIAL FINANCIAL, INC.</b>			
	\$ 2,980	\$ (36)	\$ 2,944
<b>EARNINGS PER SHARE</b>			
<b>Financial Services Businesses</b>			
<b>Basic:</b>			
Income (loss) from continuing operations attributable to Prudential Financial, Inc. per share of Common Stock	\$ 5.97	\$ (0.09)	\$ 5.88
Net income (loss) attributable to Prudential Financial, Inc. per share of Common Stock	\$ 6.01	\$ (0.09)	\$ 5.92
<b>Diluted:</b>			
Income (loss) from continuing operations attributable to Prudential Financial, Inc. per share of Common Stock	\$ 5.89	\$ (0.09)	\$ 5.80
Net income (loss) attributable to Prudential Financial, Inc. per share of Common Stock	\$ 5.93	\$ (0.08)	\$ 5.85
<b>Closed Block Business</b>			
<b>Basic and Diluted:</b>			
Income from continuing operations attributable to Prudential Financial, Inc. per share of Class B Stock	\$ 15.00	\$ 4.50	\$ 19.50
Net income attributable to Prudential Financial, Inc. per share of Class B Stock	\$ 15.00	\$ 4.50	\$ 19.50

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)****Unaudited Interim Consolidated Statement of Cash Flows:**

	Nine Months Ended September 30, 2011		
	As Previously Reported	Effect of Change (in millions)	As Currently Reported
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income	\$ 3,044	\$ (36)	\$ 3,008
Change in:			
Deferred policy acquisition costs	(12)	87	75
Future policy benefits and other insurance liabilities	4,759	28	4,787
Other, net	2,603	(79)	2,524
<b>Cash flows from operating activities</b>	<b>\$ 10,821</b>	<b>\$ 0</b>	<b>\$ 10,821</b>

**3. ACQUISITIONS AND DISPOSITIONS*****Acquisition of The Hartford's Individual Life Insurance Business***

On September 27, 2012, the Company announced that Prudential Insurance entered into an agreement to acquire The Hartford's Individual Life Insurance Business through a reinsurance transaction. The Company will pay The Hartford cash consideration of \$615 million, primarily in the form of a ceding commission to provide reinsurance for approximately 700,000 life insurance policies with net retained face amount in force of approximately \$135 billion. The transaction is expected to close in early 2013, subject to regulatory approvals and customary closing conditions.

***Acquisition of AIG Star Life Insurance Co., Ltd., AIG Edison Life Insurance Company and Related Entities from AIG***

On February 1, 2011, Prudential Financial completed the acquisition from American International Group, Inc. (AIG) of AIG Star Life Insurance Co., Ltd. (Star), AIG Edison Life Insurance Company (Edison), AIG Financial Assurance Japan K.K., and AIG Edison Service Co., Ltd. (collectively, the Star and Edison Businesses) pursuant to the stock purchase agreement dated September 30, 2010 between Prudential Financial and AIG. The total purchase price was \$4,709 million, comprised of \$4,213 million in cash and \$496 million in assumed third party debt, substantially all of which is expected to be repaid, over time, with excess capital of the acquired entities. The acquisition of these businesses included the purchase by the Company of all of the shares of these entities, which became indirect wholly-owned subsidiaries of the Company. All acquired entities are Japanese corporations and their businesses are in Japan. On January 1, 2012, Star and Edison were merged into the Gibraltar Life Insurance Company, Ltd.

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The Star and Edison Businesses primarily distributed individual life insurance, fixed annuities and certain accident and health products with fixed benefits through captive agents, independent agents, and banks. The addition of these operations to the Company's existing businesses increases its scale in the Japanese insurance market and provides complementary distribution opportunities.

Prudential Financial made a Section 338(g) election under the Internal Revenue Code with respect to the acquisition resulting in the acquired entities being treated for U.S. tax purposes as newly-incorporated companies. Under such election, the U.S. tax basis of the assets acquired and liabilities assumed of the Star and Edison Businesses were adjusted as of February 1, 2011 to reflect the consequences of the Section 338(g) election.



**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)**

Although the acquisition of the Star and Edison Businesses included the acquisition of multiple entities, the Company views this as a single acquisition and reports it as such in the following disclosures.

*Net Assets Acquired*

The following table presents an allocation of the purchase price to assets acquired and liabilities assumed at February 1, 2011 (the Acquisition Date ):

	<b>(in millions)</b>
Total invested assets at fair value(1)	\$ 43,103
Cash and cash equivalents	1,813
Accrued investment income	348
Value of business acquired	3,769
Goodwill	173
Other assets(1)	880
<b>Total assets acquired</b>	<b>50,086</b>
Future policy benefits	22,202
Policyholders' account balances(2)	22,785
Long-term debt	496
Other liabilities	390
<b>Total liabilities assumed</b>	<b>45,873</b>
<b>Net assets acquired</b>	<b>\$ 4,213</b>

(1) Total invested assets, at fair value, include \$55 million of related party assets. Other assets include \$86 million of related party assets.

(2) Includes investment contracts reported at fair value, which exceeded the account value by \$646 million.

*Value of Business Acquired*

Value of business acquired ( VOBA ), which is established in accordance with purchase accounting guidance, is an intangible asset associated with the acquired in force insurance contracts representing the difference between the fair value and carrying value of the liabilities, determined as of the acquisition date. The fair value of the liabilities, and hence VOBA, reflects the cost of the capital attributable to the acquired insurance contracts. VOBA is amortized over the expected life of the contracts in proportion to either gross premiums or gross profits, depending on the

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type of contract. Total gross profits include both actual experience as it arises and estimates of gross profits for future periods. The Company regularly evaluates and adjusts the VOBA balance with a corresponding charge or credit to earnings for the effects of actual gross profits and changes in assumptions regarding estimated future gross profits. VOBA is reported as a component of Other assets and the amortization of VOBA is reported in General and administrative expenses. The proportion of the VOBA balance attributable to each of the product groups, as of the acquisition date, was as follows: 48% related to accident and health insurance products, 45% related to individual life insurance, and 7% related to fixed annuities.

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)**

The following table provides estimated future amortization of VOBA, net of interest, assuming September 30, 2012 end of period foreign currency exchange rates remain constant, relating to the Star and Edison Businesses for the periods indicated.

	<b>(in millions)</b>
Remainder of 2012	\$ 97
2013	\$ 354
2014	\$ 309
2015	\$ 267
2016	\$ 235
2017 and thereafter	\$ 1,849

Information regarding the change in VOBA is as follows:

	<b>(in millions)</b>
Balance as of January 1, 2012	\$ 3,490
Amortization	(378)
Interest	32
Foreign currency translation	(33)
Balance as of September 30, 2012	\$ 3,111

*Goodwill*

As a result of the acquisition of the Star and Edison Businesses, the Company recognized an asset for goodwill representing the excess of the acquisition cost over the net fair value of the assets acquired and liabilities assumed. Goodwill resulting from the acquisition of the Star and Edison Businesses amounted to \$173 million. Based on the Company's final calculation of the 338(g) election the Company determined that none of the goodwill is tax deductible. In accordance with U.S. GAAP, goodwill is not amortized but rather is tested at least annually for impairment. The test is performed at the reporting unit level which for this acquisition is the International Insurance segment's Gibraltar Life and Other operations.

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)***Supplemental Unaudited Pro Forma Information*

The following supplemental information presents selected unaudited pro forma information for the Company assuming the acquisition had occurred as of January 1, 2010. This pro forma information does not purport to represent what the Company's actual results of operations would have been if the acquisition had occurred as of the date indicated or what such results would be for any future periods. The pro forma information does not reflect the impact of future events that may occur, including but not limited to, expense efficiencies arising from the acquisition and also does not give effect to certain one-time charges that the Company expects to incur, such as restructuring and integration costs.

	<b>Nine Months Ended September 30, 2011 (in millions, except per share amounts)</b>
Total revenues	\$ 38,665
Income from continuing operations	3,152
Net income attributable to Prudential Financial, Inc.	3,109
<b>Earnings per share Financial Services Businesses</b>	
<b>Basic:</b>	
Income from continuing operations attributable to Prudential Financial, Inc. per share of Common Stock	\$ 6.22
Net income attributable to Prudential Financial, Inc. per share of Common Stock	6.26
<b>Diluted:</b>	
Income from continuing operations attributable to Prudential Financial, Inc. per share of Common Stock	\$ 6.14
Net income attributable to Prudential Financial, Inc. per share of Common Stock	6.18
<b>Earnings per share Closed Block Business</b>	
<b>Basic and Diluted:</b>	
Income from continuing operations attributable to Prudential Financial, Inc. per share of Class B Stock	\$ 19.50
Net income attributable to Prudential Financial, Inc. per share of Class B Stock	19.50

*Discontinued Operations*

Income (loss) from discontinued businesses, including charges upon disposition, are as follows:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
	<b>(in millions)</b>			
Real estate investments sold or held for sale	\$ (3)	\$ 3	\$ 19	\$ 21

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Global commodities business	0	(2)	0	16
Other	0	0	0	0
Income (loss) from discontinued operations before income taxes	(3)	1	19	37
Income tax expense (benefit)	(1)	10	7	16
Income (loss) from discontinued operations, net of taxes	\$ (2)	\$ (9)	\$ 12	\$ 21

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)**

On April 6, 2011, the Company entered into a stock and asset purchase agreement with Jefferies Group, Inc. ( Jefferies ), pursuant to which the Company agreed to sell to Jefferies all of the issued and outstanding shares of capital stock of the Company's subsidiaries that conducted its global commodities business (the Global Commodities Business) and certain assets that were primarily used in connection with the Global Commodities Business. Subsidiaries included in the sale were Prudential Bache Commodities, LLC, Prudential Bache Securities, LLC, Bache Commodities Limited, and Bache Commodities (Hong Kong) Ltd. On July 1, 2011, the Company completed the sale and received cash proceeds of \$422 million. In addition to the earnings for this business, included in the table above for the three and nine months ended September 30, 2011, are after-tax losses of \$10 million and \$17 million, respectively, recorded in connection with the sale of this business. This consisted of pre-tax losses of \$6 million and \$18 million and income tax expense of \$4 million and income tax benefit of \$1 million, for the three and nine months ended September 30, 2011, respectively.

Real estate investments sold or held for sale reflects the income or loss from discontinued real estate investments.

Charges recorded in connection with the disposals of businesses include estimates that are subject to subsequent adjustment.

The Company's Unaudited Interim Consolidated Statements of Financial Position include total assets and total liabilities related to discontinued businesses as follows:

	September 30, 2012	December 31, 2011
	(in millions)	
Total assets	\$ 23	\$ 464
Total liabilities	\$ 0	\$ 7

**4. INVESTMENTS***Fixed Maturities and Equity Securities*

The following tables provide information relating to fixed maturities and equity securities (excluding investments classified as trading) as of the dates indicated:

	Amortized Cost	Gross Unrealized	September 30, 2012 Gross Unrealized	Fair Value	Other-than- temporary
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		Gains	Losses		Impairments in AOCI(3)
		(in millions)			
<b>Fixed maturities, available-for-sale</b>					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ 12,175	\$ 3,472	\$ 14	\$ 15,633	\$ 0
Obligations of U.S. states and their political subdivisions	2,618	494	2	3,110	0
Foreign government bonds	79,795	7,035	90	86,740	1
Corporate securities	124,005	13,249	1,659	135,595	(1)
Asset-backed securities(1)	12,012	200	1,032	11,180	(1,083)
Commercial mortgage-backed securities	11,364	791	39	12,116	5
Residential mortgage-backed securities(2)	8,506	545	44	9,007	(12)
<b>Total fixed maturities, available-for-sale</b>	<b>\$ 250,475</b>	<b>\$ 25,786</b>	<b>\$ 2,880</b>	<b>\$ 273,381</b>	<b>\$ (1,090)</b>
<b>Equity securities, available-for-sale</b>	<b>\$ 6,671</b>	<b>\$ 1,460</b>	<b>\$ 139</b>	<b>\$ 7,992</b>	

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)**

- (1) Includes credit tranching securities collateralized by sub-prime mortgages, auto loans, credit cards, education loans, and other asset types.  
(2) Includes publicly-traded agency pass-through securities and collateralized mortgage obligations.  
(3) Represents the amount of other-than-temporary impairment losses in Accumulated other comprehensive income (loss), or AOCI, which were not included in earnings. Amount excludes \$649 million of net unrealized gains on impaired securities relating to changes in the value of such securities subsequent to the impairment measurement date.

	September 30, 2012				Other-than-temporary Impairments in AOCI(4)
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (in millions)	Fair Value	
<b>Fixed maturities, held-to-maturity</b>					
Foreign government bonds	\$ 1,268	\$ 144	\$ 0	\$ 1,412	\$ 0
Corporate securities(1)	1,143	36	70	1,109	0
Asset-backed securities(2)	1,115	72	0	1,187	0
Commercial mortgage-backed securities	336	57	0	393	0
Residential mortgage-backed securities(3)	858	60	0	918	0
<b>Total fixed maturities, held-to-maturity(1)</b>	<b>\$ 4,720</b>	<b>\$ 369</b>	<b>\$ 70</b>	<b>\$ 5,019</b>	<b>\$ 0</b>

- (1) Excludes notes with amortized cost of \$1,000 million (fair value, \$1,052 million) which have been offset with the associated payables under a netting agreement.  
(2) Includes credit tranching securities primarily collateralized by non-sub-prime mortgages.  
(3) Includes publicly-traded agency pass-through securities and collateralized mortgage obligations.  
(4) Represents the amount of other-than-temporary impairment losses in AOCI, which were not included in earnings. Amount excludes \$1 million of net unrealized losses on impaired securities relating to changes in the value of such securities subsequent to the impairment measurement date.

	December 31, 2011(3)				Other-than-temporary Impairments in AOCI(4)
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (in millions)	Fair Value	
<b>Fixed maturities, available-for-sale</b>					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ 12,270	\$ 2,880	\$ 18	\$ 15,132	\$ 0
Obligations of U.S. states and their political subdivisions	2,410	332	2	2,740	0
Foreign government bonds	72,508	4,696	169	77,035	0
Corporate securities	119,967	10,200	3,055	127,112	(22)
Asset-backed securities(1)	12,346	172	1,825	10,693	(1,199)
Commercial mortgage-backed securities	11,519	669	108	12,080	8
Residential mortgage-backed securities(2)	9,404	531	79	9,856	(13)



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Total fixed maturities, available-for-sale	\$ 240,424	\$ 19,480	\$ 5,256	\$ 254,648	\$ (1,226)
<b>Equity securities, available-for-sale</b>	\$ 6,922	\$ 1,061	\$ 448	\$ 7,535	

- (1) Includes credit tranching securities collateralized by sub-prime mortgages, auto loans, credit cards, education loans, and other asset types.
- (2) Includes publicly-traded agency pass-through securities and collateralized mortgage obligations.
- (3) Prior period amounts are presented on a basis consistent with the current period presentation.
- (4) Represents the amount of other-than-temporary impairment losses in AOCI, which were not included in earnings. Amount excludes \$223 million of net unrealized gains on impaired securities relating to changes in the value of such securities subsequent to the impairment measurement date.

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)**

	December 31, 2011				Other-than-temporary Impairments in AOCI(4)
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (in millions)	Fair Value	
<b>Fixed maturities, held-to-maturity</b>					
Foreign government bonds	\$ 1,260	\$ 128	\$ 0	\$ 1,388	\$ 0
Corporate securities(1)	1,157	21	98	1,080	0
Asset-backed securities(2)	1,213	62	0	1,275	0
Commercial mortgage-backed securities	428	69	0	497	0
Residential mortgage-backed securities(3)	1,049	65	0	1,114	0
<b>Total fixed maturities, held-to-maturity(1)</b>	<b>\$ 5,107</b>	<b>\$ 345</b>	<b>\$ 98</b>	<b>\$ 5,354</b>	<b>\$ 0</b>

- (1) Excludes notes with amortized cost of \$500 million (fair value, \$519 million) which have been offset with the associated payables under a netting agreement.  
(2) Includes credit tranching securities primarily collateralized by non-sub-prime mortgages.  
(3) Includes publicly-traded agency pass-through securities and collateralized mortgage obligations.  
(4) Represents the amount of other-than-temporary impairment losses in AOCI, which were not included in earnings.

The amortized cost and fair value of fixed maturities by contractual maturities at September 30, 2012, are as follows:

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value (in millions)	Amortized Cost	Fair Value
Due in one year or less	\$ 13,704	\$ 13,843	\$ 0	\$ 0
Due after one year through five years	44,625	46,376	74	77
Due after five years through ten years	54,970	60,226	421	431
Due after ten years(1)	105,294	120,633	1,916	2,013
Asset-backed securities	12,012	11,180	1,115	1,187
Commercial mortgage-backed securities	11,364	12,116	336	393
Residential mortgage-backed securities	8,506	9,007	858	918
<b>Total(1)</b>	<b>\$ 250,475</b>	<b>\$ 273,381</b>	<b>\$ 4,720</b>	<b>\$ 5,019</b>

- (1) Excludes notes with amortized cost of \$1,000 million (fair value, \$1,052 million) which have been offset with the associated payables under a netting agreement.

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Actual maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Asset-backed, commercial mortgage-backed and residential mortgage-backed securities are shown separately in the table above, as they are not due at a single maturity date.

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)**

The following table depicts the sources of fixed maturity proceeds and related investment gains (losses), as well as losses on impairments of both fixed maturities and equity securities:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(in millions)			
<b>Fixed maturities, available-for-sale</b>				
Proceeds from sales	\$ 2,682	\$ 8,333	\$ 12,140	\$ 19,262
Proceeds from maturities/repayments	5,509	3,804	15,794	13,062
Gross investment gains from sales, prepayments, and maturities	129	188	397	630
Gross investment losses from sales and maturities	(87)	(74)	(245)	(255)
<b>Fixed maturities, held-to-maturity</b>				
Gross investment gains from prepayments	\$ 0	\$ 0	\$ 0	\$ 0
Proceeds from maturities/repayments	132	68	379	338
<b>Equity securities, available-for-sale</b>				
Proceeds from sales	\$ 1,101	\$ 1,168	\$ 3,251	\$ 2,854
Gross investment gains from sales	125	94	339	403
Gross investment losses from sales	(61)	(106)	(222)	(176)
<b>Fixed maturity and equity security impairments</b>				
Net writedowns for other-than-temporary impairment losses on fixed maturities recognized in earnings(1)	\$ (95)	\$ (116)	\$ (300)	\$ (373)
Writedowns for impairments on equity securities	(24)	(42)	(114)	(101)

(1) Excludes the portion of other-than-temporary impairments recorded in Other comprehensive income (loss), representing any difference between the fair value of the impaired debt security and the net present value of its projected future cash flows at the time of impairment.

As discussed in Note 2, a portion of certain other-than-temporary impairment ( OTTI ) losses on fixed maturity securities are recognized in Other comprehensive income (loss) ( OCI ). For these securities, the net amount recognized in earnings ( credit loss impairments ) represents the difference between the amortized cost of the security and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security prior to impairment. Any remaining difference between the fair value and amortized cost is recognized in OCI. The following tables set forth the amount of pre-tax credit loss impairments on fixed maturity securities held by the Company as of the dates indicated, for which a portion of the OTTI loss was recognized in OCI, and the corresponding changes in such amounts.

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)****Credit losses recognized in earnings on fixed maturity securities held by the Company for which a portion of the OTTI loss was recognized in OCI**

	<b>Three Months Ended September 30, 2012</b>	<b>Nine Months Ended September 30, 2012</b>
	<b>(in millions)</b>	
Balance, beginning of period	\$ 1,433	\$ 1,475
Credit loss impairments previously recognized on securities which matured, paid down, prepaid or were sold during the period	(48)	(133)
Credit loss impairments previously recognized on securities impaired to fair value during the period(1)	(10)	(69)
Credit loss impairment recognized in the current period on securities not previously impaired	1	31
Additional credit loss impairments recognized in the current period on securities previously impaired	22	80
Increases due to the passage of time on previously recorded credit losses	16	45
Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected	(8)	(23)
Balance, end of period	\$ 1,406	\$ 1,406

	<b>Three Months Ended September 30, 2011</b>	<b>Nine Months Ended September 30, 2011</b>
	<b>(in millions)</b>	
Balance, beginning of period	\$ 1,419	\$ 1,493
Credit loss impairments previously recognized on securities which matured, paid down, prepaid or were sold during the period	(57)	(294)
Credit loss impairments previously recognized on securities impaired to fair value during the period(1)	0	(31)
Credit loss impairment recognized in the current period on securities not previously impaired	8	34
Additional credit loss impairments recognized in the current period on securities previously impaired	34	192
Increases due to the passage of time on previously recorded credit losses	16	43
Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected	(7)	(24)
Balance, end of period	\$ 1,413	\$ 1,413

(1) Represents circumstances where the Company determined in the current period that it intends to sell the security or it is more likely than not that it will be required to sell the security before recovery of the security's amortized cost.



**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)****Trading Account Assets Supporting Insurance Liabilities**

The following table sets forth the composition of Trading account assets supporting insurance liabilities as of the dates indicated:

	September 30, 2012		December 31, 2011(3)	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
(in millions)				
Short-term investments and cash equivalents	\$ 640	\$ 640	\$ 951	\$ 951
Fixed maturities:				
Corporate securities	11,122	12,153	10,369	11,113
Commercial mortgage-backed securities	1,951	2,095	2,157	2,247
Residential mortgage-backed securities(1)	1,799	1,880	1,786	1,844
Asset-backed securities(2)	1,227	1,150	1,504	1,367
Foreign government bonds	736	756	599	608
U.S. government authorities and agencies and obligations of U.S. states	408	455	413	440
<b>Total fixed maturities</b>	<b>17,243</b>	<b>18,489</b>	<b>16,828</b>	<b>17,619</b>
Equity securities	1,029	1,003	1,050	911
<b>Total trading account assets supporting insurance liabilities</b>	<b>\$ 18,912</b>	<b>\$ 20,132</b>	<b>\$ 18,829</b>	<b>\$ 19,481</b>

(1) Includes publicly-traded agency pass-through securities and collateralized mortgage obligations.

(2) Includes credit tranching securities collateralized by sub-prime mortgages, auto loans, credit cards, education loans and other asset types.

(3) Prior period amounts are presented on a basis consistent with the current period presentation.

The net change in unrealized gains and losses from trading account assets supporting insurance liabilities still held at period end, recorded within Asset management fees and other income included \$288 million and \$12 million of gains during the three months ended September 30, 2012 and 2011, respectively, and \$568 million and \$120 million of gains during the nine months ended September 30, 2012 and 2011, respectively.

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)*****Other Trading Account Assets***

The following table sets forth the composition of the Other trading account assets as of the dates indicated:

	September 30, 2012		December 31, 2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(in millions)			
Short-term investments and cash equivalents	\$ 83	\$ 85	\$ 4	\$ 3
Fixed maturities:				
Asset-backed securities	416	314	698	652
Residential mortgage-backed securities	0	0	186	96
Corporate securities	670	675	557	555
Commercial mortgage-backed securities	121	91	155	110
U.S. government authorities and agencies and obligations of U.S. states	34	21	41	31
Foreign government bonds	52	52	47	47
<b>Total fixed maturities</b>	<b>1,293</b>	<b>1,153</b>	<b>1,684</b>	<b>1,491</b>
Other	1	4	15	19
Equity securities	1,524	1,557	1,682	1,621
<b>Subtotal</b>	<b>\$ 2,901</b>	<b>\$ 2,799</b>	<b>\$ 3,385</b>	<b>\$ 3,134</b>
Derivative instruments		3,075		2,411
<b>Total other trading account assets</b>	<b>\$ 2,901</b>	<b>\$ 5,874</b>	<b>\$ 3,385</b>	<b>\$ 5,545</b>

The net change in unrealized gains and losses from other trading account assets, excluding derivative instruments, still held at period end, recorded within Asset management fees and other income included \$62 million of gains and \$126 million of losses during the three months ended September 30, 2012 and 2011, respectively, and \$149 million of gains and \$23 million of losses during the nine months ended September 30, 2012 and 2011, respectively.



**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)****Concentrations of Financial Instruments**

The Company monitors its concentrations of financial instruments on an on-going basis, and mitigates credit risk by maintaining a diversified investment portfolio which limits exposure to any one issuer.

As of September 30, 2012 and December 31, 2011, the Company's exposure to concentrations of credit risk of single issuers greater than 10% of the Company's stockholders' equity included securities of the U.S. government, certain U.S. government agencies and certain securities guaranteed by the U.S. government, as well as the securities disclosed below.

	September 30, 2012		December 31, 2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(in millions)			
<b>Investments in Japanese government and government agency securities:</b>				
Fixed maturities, available-for-sale	\$ 65,817	\$ 70,647	\$ 60,323	\$ 63,846
Fixed maturities, held-to-maturity	1,242	1,382	1,260	1,388
Trading account assets supporting insurance liabilities	552	569	471	483
Other trading account assets	41	41	40	40
Short-term investments	0	0	0	0
Cash equivalents	2,316	2,316	0	0
Total	\$ 69,968	\$ 74,955	\$ 62,094	\$ 65,757

	September 30, 2012		December 31, 2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(in millions)			
<b>Investments in South Korean government and government agency securities:</b>				
Fixed maturities, available-for-sale	\$ 5,405	\$ 6,618	\$ 4,678	\$ 5,240
Fixed maturities, held-to-maturity	0	0	0	0
Trading account assets supporting insurance liabilities	0	0	17	18
Other trading account assets	2	2	2	2
Short-term investments	0	0	0	0
Cash equivalents	0	0	0	0
Total	\$ 5,407	\$ 6,620	\$ 4,697	\$ 5,260

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)****Commercial Mortgage and Other Loans**

The Company's commercial mortgage and other loans are comprised as follows, as of the dates indicated:

	September 30, 2012		December 31, 2011	
	Amount	% of	Amount	% of
	(in millions)	Total	(in millions)	Total
<b>Commercial and agricultural mortgage loans by property type:</b>				
Office	\$ 6,655	19.5%	\$ 6,391	19.8%
Retail	8,182	24.0	7,309	22.7
Apartments/Multi-Family	5,312	15.5	5,277	16.4
Industrial	7,493	21.9	7,049	21.8
Hospitality	1,509	4.4	1,486	4.6
Other	2,827	8.3	2,707	8.4
Total commercial mortgage loans	31,978	93.6	30,219	93.7
Agricultural property loans	2,169	6.4	2,046	6.3
Total commercial and agricultural mortgage loans by property type	34,147	100.0%	32,265	100.0%
Valuation allowance	(274)		(313)	
Total net commercial and agricultural mortgage loans by property type	33,873		31,952	
<b>Other loans</b>				
Uncollateralized loans	1,939		2,323	
Residential property loans	901		1,034	
Other collateralized loans	151		176	
Total other loans	2,991		3,533	
Valuation allowance	(42)		(54)	
Total net other loans	2,949		3,479	
Total commercial mortgage and other loans(1)	\$ 36,822		\$ 35,431	

(1) Includes loans held at fair value.

The commercial mortgage and agricultural property loans are geographically dispersed throughout the United States, Canada and Asia with the largest concentrations in California (26%), New York (11%) and Texas (8%) at September 30, 2012.

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Activity in the allowance for losses for all commercial mortgage and other loans, as of the dates indicated, is as follows:

	Commercial Mortgage Loans	Agricultural Property Loans	September 30, 2012		Uncollateralized Loans	Total
			Residential Property Loans	Other Collateralized Loans		
(in millions)						
Allowance for losses, beginning of year	\$ 294	\$ 19	\$ 16	\$ 18	\$ 20	\$ 367
Addition to / (release of) allowance of losses	(8)	1	(4)	(6)	(1)	(18)
Charge-offs, net of recoveries	(32)	0	0	0	0	(32)
Change in foreign exchange	0	0	0	0	(1)	(1)
<b>Total Ending Balance</b>	<b>\$ 254</b>	<b>\$ 20</b>	<b>\$ 12</b>	<b>\$ 12</b>	<b>\$ 18</b>	<b>\$ 316</b>

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)**

	December 31, 2011					
	Commercial Mortgage Loans	Agricultural Property Loans	Residential Property Loans	Other Collateralized Loans	Uncollateralized Loans	Total
	(in millions)					
Allowance for losses, beginning of year	\$ 497	\$ 8	\$ 17	\$ 20	\$ 33	\$ 575
Addition to / (release of) allowance of losses	(94)	11	(2)	13	1	(71)
Charge-offs, net of recoveries	(109)	0	0	(15)	(15)	(139)
Change in foreign exchange	0	0	1	0	1	2
<b>Total Ending Balance</b>	<b>\$ 294</b>	<b>\$ 19</b>	<b>\$ 16</b>	<b>\$ 18</b>	<b>\$ 20</b>	<b>\$ 367</b>

The following tables set forth the allowance for credit losses and the recorded investment in commercial mortgage and other loans as of the dates indicated:

	September 30, 2012					
	Commercial Mortgage Loans	Agricultural Property Loans	Residential Property Loans	Other Collateralized Loans	Uncollateralized Loans	Total
	(in millions)					
<b>Allowance for Credit Losses:</b>						
Ending balance: individually evaluated for impairment	\$ 89	\$ 12	\$ 0	\$ 12	\$ 0	\$ 113
Ending balance: collectively evaluated for impairment	165	8	12	0	18	203
Ending balance: loans acquired with deteriorated credit quality	0	0	0	0	0	0
<b>Total ending balance</b>	<b>\$ 254</b>	<b>\$ 20</b>	<b>\$ 12</b>	<b>\$ 12</b>	<b>\$ 18</b>	<b>\$ 316</b>

**Recorded Investment:(1)**

Ending balance gross of reserves: individually evaluated for impairment	\$ 1,260	\$ 49	\$ 0	\$ 98	\$ 8	\$ 1,415
Ending balance gross of reserves: collectively evaluated for impairment	30,718	2,120	901	53	1,931	35,723
Ending balance gross of reserves: loans acquired with deteriorated credit quality	0	0	0	0	0	0
<b>Total ending balance, gross of reserves</b>	<b>\$ 31,978</b>	<b>\$ 2,169</b>	<b>\$ 901</b>	<b>\$ 151</b>	<b>\$ 1,939</b>	<b>\$ 37,138</b>

(1) Recorded investment reflects the balance sheet carrying value gross of related allowance.



**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)**

	<b>Commercial Mortgage Loans</b>	<b>Agricultural Property Loans</b>	<b>December 31, 2011 Residential Property Loans</b>	<b>December 31, 2011 Other Collateralized Loans</b>	<b>Uncollateralized Loans</b>	<b>Total</b>
	(in millions)					
<b>Allowance for Credit Losses:</b>						
Ending balance: individually evaluated for impairment	\$ 120	\$ 11	\$ 0	\$ 18	\$ 0	\$ 149
Ending balance: collectively evaluated for impairment	174	8	16	0	20	218
Ending balance: loans acquired with deteriorated credit quality	0	0	0	0	0	0
<b>Total ending balance</b>	<b>\$ 294</b>	<b>\$ 19</b>	<b>\$ 16</b>	<b>\$ 18</b>		