

PRUDENTIAL FINANCIAL INC
Form 10-Q
May 04, 2012
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 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 April 30, 2012, 467 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.

Table of Contents**TABLE OF CONTENTS**

	Page Number
PART I FINANCIAL INFORMATION	
Item 1. Financial Statements:	
<u>Unaudited Interim Consolidated Statements of Financial Position as of March 31, 2012 and December 31, 2011</u>	1
<u>Unaudited Interim Consolidated Statements of Operations for the three months ended March 31, 2012 and 2011</u>	2
<u>Unaudited Interim Consolidated Statements of Comprehensive Income for the three months ended March 31, 2012 and 2011</u>	3
<u>Unaudited Interim Consolidated Statements of Equity for the three months ended March 31, 2012 and 2011</u>	4
<u>Unaudited Interim Consolidated Statements of Cash Flows for the three months ended March 31, 2012 and 2011</u>	5
<u>Notes to Unaudited Interim Consolidated Financial Statements</u>	6
Unaudited Interim Supplemental Combining Financial Information:	
<u>Unaudited Interim Supplemental Financial Statements of Financial Position as of March 31, 2012 and December 31, 2011</u>	115
<u>Unaudited Interim Supplemental Financial Statements of Operations for the three months ended March 31, 2012 and 2011</u>	116
<u>Notes to Unaudited Interim Supplemental Combining Financial Information</u>	117
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	119
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	253
Item 4. <u>Controls and Procedures</u>	253
PART II OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	254
Item 1A. <u>Risk Factors</u>	254
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	255
Item 6. <u>Exhibits</u>	255
<u>SIGNATURES</u>	256

Table of Contents

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.

Table of Contents

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**

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

	March 31, 2012	December 31, 2011
ASSETS		
Fixed maturities, available-for-sale, at fair value (amortized cost: 2012-\$238,147; 2011-\$240,424)(1)	\$ 254,591	\$ 254,648
Fixed maturities, held-to-maturity, at amortized cost (fair value: 2012-\$5,006; 2011-\$5,354)(1)	4,775	5,107
Trading account assets supporting insurance liabilities, at fair value(1)	19,679	19,481
Other trading account assets, at fair value	5,181	5,545
Equity securities, available-for-sale, at fair value (cost: 2012-\$6,705; 2011-\$6,922)(1)	8,026	7,535
Commercial mortgage and other loans (includes \$282 and \$603 measured at fair value under the fair value option at March 31, 2012 and December 31, 2011, respectively)(1)	35,623	35,431
Policy loans	11,419	11,559
Other long-term investments (includes \$364 and \$366 measured at fair value under the fair value option at March 31, 2012 and December 31, 2011, respectively)(1)	7,481	7,820
Short-term investments(1)	7,925	9,121
Total investments	354,700	356,247
Cash and cash equivalents(1)	14,201	14,251
Accrued investment income(1)	2,799	2,793
Deferred policy acquisition costs	13,461	12,517
Other assets(1)	16,009	16,056
Separate account assets(1)	236,567	218,380
TOTAL ASSETS	\$ 637,737	\$ 620,244
LIABILITIES AND EQUITY		
LIABILITIES		
Future policy benefits	\$ 168,001	\$ 170,671
Policyholders' account balances	133,505	134,558
Policyholders' dividends	5,811	5,797
Securities sold under agreements to repurchase	7,200	6,218
Cash collateral for loaned securities	2,950	2,973
Income taxes	7,552	6,558
Short-term debt	3,655	2,336
Long-term debt	24,379	24,622

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Other liabilities (includes \$295 and \$282 measured at fair value under the fair value option at March 31, 2012 and December 31, 2012, respectively)(1)	12,579	13,290
Separate account liabilities(1)	236,567	218,380
 Total liabilities	 602,199	 585,403
COMMITMENTS AND CONTINGENT LIABILITIES (See Note 15)		
EQUITY		
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; 660,111,264 and 660,111,264 shares issued at March 31, 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 March 31, 2012 and December 31, 2011, respectively)	0	0
Additional paid-in capital	24,288	24,293
Common Stock held in treasury, at cost (192,076,809 and 192,072,613 shares at March 31, 2012 and December 31, 2011, respectively)	(11,917)	(11,920)
Accumulated other comprehensive income (loss)	7,226	5,418
Retained earnings	15,339	16,456
 Total Prudential Financial, Inc. equity	 34,942	 34,253
Noncontrolling interests	596	588
 Total equity	 35,538	 34,841
TOTAL LIABILITIES AND EQUITY	\$ 637,737	\$ 620,244

(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 Months Ended March 31, 2012 and 2011 (in millions, except per share amounts)**

	Three Months Ended March 31,	
	2012	2011
REVENUES		
Premiums	\$ 6,773	\$ 5,510
Policy charges and fee income	1,049	948
Net investment income	3,320	3,118
Asset management fees and other income	(135)	644
Realized investment gains (losses), net:		
Other-than-temporary impairments on fixed maturity securities	(573)	(575)
Other-than-temporary impairments on fixed maturity securities transferred to Other Comprehensive Income	461	471
Other realized investment gains (losses), net	(1,272)	54
Total realized investment gains (losses), net	(1,384)	(50)
Total revenues	9,623	10,170
BENEFITS AND EXPENSES		
Policyholders' benefits	6,443	5,433
Interest credited to policyholders' account balances	966	823
Dividends to policyholders	442	548
Amortization of deferred policy acquisition costs	(225)	354
General and administrative expenses	2,796	2,384
Total benefits and expenses	10,422	9,542
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES		
	(799)	628
Income tax expense	171	160
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES		
	(970)	468
Equity in earnings of operating joint ventures, net of taxes	7	104
INCOME (LOSS) FROM CONTINUING OPERATIONS		
	(963)	572
Income from discontinued operations, net of taxes	7	14
NET INCOME (LOSS)		
	(956)	586
Less: Income attributable to noncontrolling interests	11	25
NET INCOME (LOSS) ATTRIBUTABLE TO PRUDENTIAL FINANCIAL, INC		
	\$ (967)	\$ 561

**EARNINGS PER SHARE (See Note 8)
Financial Services Businesses**

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Basic:

Income (loss) from continuing operations attributable to Prudential Financial, Inc. per share of Common Stock	\$ (2.10)	\$ 1.09
Income from discontinued operations, net of taxes	0.01	0.03
Net income (loss) attributable to Prudential Financial, Inc. per share of Common Stock	\$ (2.09)	\$ 1.12

Diluted:

Income (loss) from continuing operations attributable to Prudential Financial, Inc. per share of Common Stock	\$ (2.10)	\$ 1.08
Income from discontinued operations, net of taxes	0.01	0.02
Net income (loss) attributable to Prudential Financial, Inc. per share of Common Stock	\$ (2.09)	\$ 1.10

Closed Block Business

Basic and Diluted:

Income from continuing operations attributable to Prudential Financial, Inc. per share of Class B Stock	\$ 6.50	\$ 6.50
Income from discontinued operations, net of taxes	0.00	0.00
Net income attributable to Prudential Financial, Inc. per share of Class B Stock	\$ 6.50	\$ 6.50

See Notes to Unaudited Interim Consolidated Financial Statements

Table of Contents**PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Consolidated Statements of Comprehensive Income****Three Months Ended March 31, 2012 and 2011 (in millions)**

	Three Months Ended March 31,	
	2012	2011
NET INCOME (LOSS)	\$ (956)	\$ 586
Other comprehensive income, before tax:		
Foreign currency translation adjustments	(179)	139
Unrealized investment gains (losses) for the period	2,891	(1,001)
Reclassification adjustment for (gains) losses included in net income	93	98
Net unrealized investment gains (losses)	2,984	(903)
Impact of foreign currency changes and other	15	(3)
Amortization included in net income	40	22
Defined benefit pension and postretirement unrecognized net periodic benefit (cost)	55	19
Other comprehensive income (loss), before tax:	2,860	(745)
Less: Income tax expense (benefit) related to items of other comprehensive income	1,056	(309)
Other comprehensive income (loss), net of taxes:	1,804	(436)
Comprehensive Income	848	150
Comprehensive (income) loss attributable to noncontrolling interests	(7)	(31)
Comprehensive income attributable to Prudential Financial, Inc.	\$ 841	\$ 119

See Notes to Unaudited Interim Consolidated Financial Statements

Table of Contents**PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Consolidated Statements of Equity(1)****Three Months Ended March 31, 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
Balance December 31, 2011	\$ 6	\$ 24,293	\$ 16,456	\$ (11,920)	\$ 5,418	\$ 34,253	\$ 588	\$ 34,841
Common Stock acquired				(250)		(250)		(250)
Contributions from noncontrolling interests							1	1
Stock-based compensation programs		(5)	(150)	253		98		98
Comprehensive income:								
Net income			(967)			(967)	11	(956)
Other comprehensive income (loss), net of tax					1,808	1,808	(4)	1,804
Total comprehensive income (loss)						841	7	848
Balance, March 31, 2012	\$ 6	\$ 24,288	\$ 15,339	\$ (11,917)	\$ 7,226	\$ 34,942	\$ 596	\$ 35,538

	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
Balance, December 31, 2010	\$ 6	\$ 24,223	\$ 16,381	\$ (11,173)	\$ 2,978	\$ 32,415	\$ 513	\$ 32,928
Cumulative effect of adoption of accounting principle			(2,701)		(179)	(2,880)		(2,880)
Contributions from noncontrolling interests							6	6
Stock-based compensation programs		(13)	(11)	111		87		87
Comprehensive income:								
Net income			561			561	25	586
Other comprehensive income (loss), net of tax					(442)	(442)	6	(436)
Total comprehensive income (loss)						119	31	150
Balance, March 31, 2011	\$ 6	\$ 24,210	\$ 14,230	\$ (11,062)	\$ 2,357	\$ 29,741	\$ 550	\$ 30,291

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

See Notes to Unaudited Interim Consolidated Financial Statements

Table of Contents**PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Consolidated Statements of Cash Flows****Three Months Ended March 31, 2012 and 2011 (in millions)**

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ (956)	\$ 586
Adjustments to reconcile net income to net cash provided by operating activities:		
Realized investment (gains) losses, net	1,384	50
Policy charges and fee income	(326)	(298)
Interest credited to policyholders' account balances	966	823
Depreciation and amortization	105	(19)
Gains on trading account assets supporting insurance liabilities, net	(234)	21
Change in:		
Deferred policy acquisition costs	(1,047)	(389)
Future policy benefits and other insurance liabilities	2,689	1,710
Other trading account assets	(48)	60
Income taxes	272	166
Other, net	(2,038)	(479)
Cash flows from operating activities	767	2,231
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from the sale/maturity/prepayment of:		
Fixed maturities, available-for-sale	10,967	6,902
Fixed maturities, held-to-maturity	123	139
Trading account assets supporting insurance liabilities and other trading account assets	4,512	4,420
Equity securities, available-for-sale	1,088	424
Commercial mortgage and other loans	784	944
Policy loans	577	465
Other long-term investments	554	368
Short-term investments	7,399	3,925
Payments for the purchase/origination of:		
Fixed maturities, available-for-sale	(13,573)	(8,048)
Fixed maturities, held-to-maturity	0	(12)
Trading account assets supporting insurance liabilities and other trading account assets	(4,360)	(4,523)
Equity securities, available-for-sale	(941)	(438)
Commercial mortgage and other loans	(1,380)	(1,260)
Policy loans	(451)	(405)
Other long-term investments	(277)	(174)
Short-term investments	(7,262)	(4,056)
Acquisition of subsidiaries, net of cash acquired	0	(2,321)
Other, net	16	(282)
Cash flows used in investing activities	(2,224)	(3,932)
CASH FLOWS FROM FINANCING ACTIVITIES		
Policyholders' account deposits	5,404	5,544
Policyholders' account withdrawals	(6,074)	(5,580)
Net change in securities sold under agreements to repurchase and cash collateral for loaned securities	970	(6)
Cash dividends paid on Common Stock	(44)	(41)
Net change in financing arrangements (maturities 90 days or less)	145	537
Common Stock acquired	(225)	0
Common Stock reissued for exercise of stock options	63	47
Proceeds from the issuance of debt (maturities longer than 90 days)	1,130	144
Repayments of debt (maturities longer than 90 days)	(191)	(334)

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Excess tax benefits from share-based payment arrangements	44	6
Other, net	297	(488)
Cash flows from (used in) financing activities	1,519	(171)
Effect of foreign exchange rate changes on cash balances	(112)	(48)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(50)	(1,920)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	14,251	12,915
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 14,201	\$ 10,995
NON-CASH TRANSACTIONS DURING THE PERIOD		
Treasury Stock shares issued for stock-based compensation programs	\$ 205	\$ 56

See Notes to Unaudited Interim Consolidated Financial Statements

Table of Contents

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 adjustment described below under Out of Period Adjustment. 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 March 31, 2012, include the assets and liabilities of Gibraltar Life as of February 29, 2012 and the results of operations for Gibraltar Life for the three months ended February 29, 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.

Table of Contents

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 Adjustment

For the three months ended March 31, 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. The adjustment related to the amortization of unrealized losses associated with U.S. dollar-denominated collateralized mortgage-backed securities held by the Gibraltar Life Insurance Company, Ltd. consolidated operations (Gibraltar Life operations) that were reclassified from available-for-sale to held-to-maturity in December 2008. The adjustment, which had no impact on the carrying value of these securities, resulted from using the contractual maturities of the securities rather than the expected effective duration of the securities as the basis for the amortization of the unrealized losses that existed when the securities were reclassified. The adjustment had no impact on adjusted operating income, the Company's measure of segment performance, and is not material to any previously reported quarterly or annual financial statements. For further information on the presentation of segment results and a definition of adjusted operating income, see Note 11.

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 that the Company has both the positive

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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 provided 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 asset-backed and

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

mortgage-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, 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 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 gains and losses, net of tax, and the effect on deferred policy acquisition costs, value of business acquired, 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.

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

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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 according to the contractual terms of the loan agreement will not all be collected. 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.

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 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 according to the contractual terms of the loan agreement will not be collected.

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,

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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.

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.

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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 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 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

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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 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

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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.

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

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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.

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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) 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 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 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

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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.

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 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 impact of the retrospective adoption of this guidance on previously reported December 31, 2011 balances was a reduction in Deferred policy acquisition costs of \$4.3 billion, an increase in Future policy benefits of \$0.2 billion, and a reduction in Total equity of \$3.0 billion. The impact of the retrospective adoption of this guidance on previously reported income from continuing operations before income taxes for the three months ended March 31, 2011 was a decrease of \$76 million. 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

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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

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

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
TOTAL ASSETS	624,521	(4,277)	620,244
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
TOTAL LIABILITIES AND EQUITY	\$ 624,521	\$ (4,277)	\$ 620,244

Unaudited Interim Consolidated Statement of Operations:

	Three Months Ended March 31, 2011		
	As Previously Reported	Effect of Change (in millions)	As Currently Reported
REVENUES			
Premiums	\$ 5,521	\$ (11)	\$ 5,510
Asset management fees and other income	649	(5)	644
Total revenues	10,186	(16)	10,170
BENEFITS AND EXPENSES			
Amortization of deferred policy acquisition costs	459	(105)	354
General and administrative expenses	2,219	165	2,384

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Total benefits and expenses	9,482	60	9,542
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES	704	(76)	628
Income tax expense	190	(30)	160
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES	514	(46)	468
Equity in earnings of operating joint ventures, net of taxes	105	(1)	104
INCOME (LOSS) FROM CONTINUING OPERATIONS	619	(47)	572
NET INCOME (LOSS)	633	(47)	586
NET INCOME (LOSS) ATTRIBUTABLE TO PRUDENTIAL FINANCIAL, INC.	\$ 608	\$ (47)	\$ 561

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

	Three Months Ended March 31, 2011		
	As Previously Reported	Effect of Change (in millions)	As Currently Reported
EARNINGS PER SHARE			
Financial Services Businesses			
Basic:			
Income (loss) from continuing operations attributable to Prudential Financial, Inc. per share of Common Stock	\$ 1.19	\$ (0.10)	\$ 1.09
Net income (loss) attributable to Prudential Financial, Inc. per share of Common Stock	\$ 1.22	\$ (0.10)	\$ 1.12
Diluted:			
Income (loss) from continuing operations attributable to Prudential Financial, Inc. per share of Common Stock	\$ 1.17	\$ (0.09)	\$ 1.08
Net income (loss) attributable to Prudential Financial, Inc. per share of Common Stock	\$ 1.20	\$ (0.10)	\$ 1.10
Closed Block Business			
Basic and Diluted:			
Income from continuing operations attributable to Prudential Financial, Inc. per share of Class B Stock	\$ 5.00	\$ 1.50	\$ 6.50
Net income attributable to Prudential Financial, Inc. per share of Class B Stock	\$ 5.00	\$ 1.50	\$ 6.50

Unaudited Interim Consolidated Statement of Cash Flows:

	Three Months Ended March 31, 2011		
	As Previously Reported	Effect of Change (in millions)	As Currently Reported
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	\$ 633	\$ (47)	\$ 586
Change in:			
Deferred policy acquisition costs	(449)	60	(389)
Future policy benefits and other insurance liabilities	1,699	11	1,710
Other, net	(455)	(24)	(479)
Cash flows from operating activities	\$ 2,231	\$ 0	\$ 2,231

3. ACQUISITIONS AND DISPOSITIONS*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

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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, the Star and Edison Businesses were merged into the Gibraltar Life Insurance Company, Ltd.

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

The Star and Edison Businesses primarily distribute 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.

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):

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

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

- (1) Total invested assets, at fair value, include \$55 million of related party assets. Other assets include \$86 million of related party assets.
- (2) Reflects revisions to prior period presentation for correction of treatment of certain acquired policies and refinements to certain data.
- (3) Reflects reclassifications to prior period presentation for correction of classification of certain acquired policies.
- (4) 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 will be amortized over the expected life of the contracts in proportion to either gross premiums or gross profits, depending on the type of contract. Total gross profits will include both actual experience as it arises and estimates of gross profits for future periods. The Company will regularly evaluate and adjust the

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

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 associated with this acquisition are as follows: 48% related to accident and health insurance products, 45% related to individual life insurance, and 7% related to fixed annuities.

The following table provides estimated future amortization of VOBA, net of interest, assuming March 31, 2012 end of period foreign currency exchange rates remain constant, relating to the Star and Edison Businesses for the periods indicated.

	(in millions)
Remainder of 2012	\$ 290
2013	\$ 344
2014	\$ 299
2015	\$ 259
2016	\$ 227
2017 and thereafter	\$ 1,805

Information regarding the change in VOBA is as follows:

	(in millions)
Balance as of January 1, 2012	\$ 3,490
Amortization	(142)
Interest	11
Foreign currency translation	(135)
Balance as of March 31, 2012	\$ 3,224

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 will not be amortized but rather will be tested at least annually for impairment. The test will be 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.

	Three Months Ended March 31, 2011 (in millions except per share amount)	
Total revenues	\$	11,490
Income from continuing operations		737
Net income attributable to Prudential Financial, Inc.		726
Earnings per share Financial Services Businesses		
Basic:		
Income from continuing operations attributable to Prudential Financial, Inc. per share of Common Stock	\$	1.43
Net income attributable to Prudential Financial, Inc. per share of Common Stock		1.46
Diluted:		
Income from continuing operations attributable to Prudential Financial, Inc. per share of Common Stock	\$	1.41
Net income attributable to Prudential Financial, Inc. per share of Common Stock		1.44
Earnings per share Closed Block Business		
Basic and Diluted:		
Income from continuing operations attributable to Prudential Financial, Inc. per share of Class B Stock	\$	6.50
Net income attributable to Prudential Financial, Inc. per share of Class B Stock		6.50

Discontinued Operations

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

	Three Months Ended March 31, 2012 2011 (in millions)	
Global commodities business	\$ 0	\$ 15
Real estate investments sold or held for sale	10	14

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Other	0	1
Income from discontinued operations before income taxes	10	30
Income tax expense	3	16
Income from discontinued operations, net of taxes	\$ 7	\$ 14

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.

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:

	March 31, 2012	December 31, 2011
	(in millions)	
Total assets	\$ 75	\$ 464
Total liabilities	\$ 4	\$ 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:

	March 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (in millions)	Fair Value
				Other-than- temporary Impairments in AOCI(3)

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Fixed maturities, available-for-sale					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ 11,763	\$ 2,411	\$ 45	\$ 14,129	\$ 0
Obligations of U.S. states and their political subdivisions	2,617	438	1	3,054	0
Foreign government bonds	71,292	5,109	67	76,334	0
Corporate securities	119,639	10,517	1,687	128,469	(13)
Asset-backed securities(1)	12,296	177	1,569	10,904	(1,147)
Commercial mortgage-backed securities	11,551	742	50	12,243	10
Residential mortgage-backed securities(2)	8,989	519	50	9,458	(12)
Total fixed maturities, available-for-sale	\$ 238,147	\$ 19,913	\$ 3,469	\$ 254,591	\$ (1,162)
Equity securities, available-for-sale	\$ 6,705	\$ 1,416	\$ 95	\$ 8,026	

- (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 \$368 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)**

	March 31, 2012				Other-than-temporary Impairments in AOCI(4)
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (in millions)	Fair Value	
Fixed maturities, held-to-maturity					
Foreign government bonds	\$ 1,176	\$ 113	\$ 0	\$ 1,289	\$ 0
Corporate securities(1)	1,104	17	86	1,035	0
Asset-backed securities(2)	1,132	61	1	1,192	0
Commercial mortgage-backed securities	400	66	0	466	0
Residential mortgage-backed securities(3)	963	61	0	1,024	0
Total fixed maturities, held-to-maturity(1)	\$ 4,775	\$ 318	\$ 87	\$ 5,006	\$ 0

(1) Excludes notes with amortized cost of \$500 million (fair value, \$546 million) which have been offset with the associated payables under a netting agreement.

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

(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.

	December 31, 2011				Other-than-temporary Impairments in AOCI(3)
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (in millions)	Fair Value	
Fixed maturities, available-for-sale					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ 12,249	\$ 2,873	\$ 18	\$ 15,104	\$ 0
Obligations of U.S. states and their political subdivisions	2,664	393	2	3,055	0
Foreign government bonds	72,442	4,754	209	76,987	0
Corporate securities	119,800	10,088	3,015	126,873	(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)
Total fixed maturities, available-for-sale	\$ 240,424	\$ 19,480	\$ 5,256	\$ 254,648	\$ (1,226)
Equity securities, available-for-sale	\$ 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) 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	
Fixed maturities, held-to-maturity					
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
Total fixed maturities, held-to-maturity(1)	\$ 5,107	\$ 345	\$ 98	\$ 5,354	\$ 0

- (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 collateralized by auto loans, credit cards, education loans, and other asset types.
(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 March 31, 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	\$ 15,209	\$ 15,601	\$ 0	\$ 0
Due after one year through five years	44,948	46,971	64	66
Due after five years through ten years	50,974	55,022	391	396
Due after ten years(1)	94,180	104,392	1,825	1,862
Asset-backed securities	12,296	10,904	1,132	1,192
Commercial mortgage-backed securities	11,551	12,243	400	466
Residential mortgage-backed securities	8,989	9,458	963	1,024
Total(1)	\$ 238,147	\$ 254,591	\$ 4,775	\$ 5,006

- (1) Excludes notes with amortized cost of \$500 million (fair value, \$546 million) which have been offset with the associated payables under a netting agreement.

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 March 31,	
	2012	2011
(in millions)		
Fixed maturities, available-for-sale		
Proceeds from sales	\$ 5,663	\$ 3,141
Proceeds from maturities/repayments	4,989	3,931
Gross investment gains from sales, prepayments, and maturities	127	197
Gross investment losses from sales and maturities	(78)	(68)
Fixed maturities, held-to-maturity		
Gross investment gains from prepayments	\$ 0	\$ 0
Proceeds from maturities/repayments	123	139
Equity securities, available-for-sale		
Proceeds from sales	\$ 1,082	\$ 480
Gross investment gains from sales	122	97
Gross investment losses from sales	(86)	(13)
Fixed maturity and equity security impairments		
Net writedowns for other-than-temporary impairment losses on fixed maturities recognized in earnings(1)	\$ (112)	\$ (104)
Writedowns for impairments on equity securities	(49)	(22)

(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 table sets 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**

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
Balance, beginning of period	\$ 1,475	\$ 1,493
Credit loss impairments previously recognized on securities which matured, paid down, prepaid or were sold during the period	(18)	(168)
Credit loss impairments previously recognized on securities impaired to fair value during the period(1)	(59)	(1)
Credit loss impairment recognized in the current period on securities not previously impaired	24	17
Additional credit loss impairments recognized in the current period on securities previously impaired	37	46
Increases due to the passage of time on previously recorded credit losses	13	14
Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected	(7)	(9)
Balance, end of period	\$ 1,465	\$ 1,392

(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.

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:

	March 31, 2012		December 31, 2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(in millions)			
Short-term investments and cash equivalents	\$ 567	\$ 567	\$ 951	\$ 951
Fixed maturities:				
Corporate securities	10,890	11,676	10,297	11,036
Commercial mortgage-backed securities	2,038	2,147	2,157	2,247
Residential mortgage-backed securities(1)	1,821	1,876	1,786	1,844
Asset-backed securities(2)	1,423	1,308	1,504	1,367
Foreign government bonds	637	657	644	655
U.S. government authorities and agencies and obligations of U.S. states	411	449	440	470

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Total fixed maturities	17,220	18,113	16,828	17,619
Equity securities	977	999	1,050	911
Total trading account assets supporting insurance liabilities	\$ 18,764	\$ 19,679	\$ 18,829	\$ 19,481

- (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.

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

The net change in unrealized gains (losses) from trading account assets supporting insurance liabilities still held at period end, recorded within Asset management fees and other income, was \$263 million and \$(44) million during the three months ended March 31, 2012 and 2011, respectively.

Other Trading Account Assets

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

	March 31, 2012		December 31, 2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(in millions)			
Short-term investments and cash equivalents	\$ 3	\$ 3	\$ 4	\$ 3
Fixed maturities:				
Asset-backed securities	494	457	698	652
Residential mortgage-backed securities	175	100	186	96
Corporate securities	560	576	557	555
Commercial mortgage-backed securities	143	108	155	110
U.S. government authorities and agencies and obligations of U.S. states	151	141	41	31
Foreign government bonds	45	45	47	47
Total fixed maturities	1,568	1,427	1,684	1,491
Other	17	21	15	19
Equity securities	1,611	1,634	1,682	1,621
Subtotal	3,199	3,085	3,385	3,134
Derivative instruments		2,096		2,411
Total other trading account assets	\$ 3,199	\$ 5,181	\$ 3,385	\$ 5,545

The net change in unrealized gains (losses) from other trading account assets, excluding derivatives instruments, still held at period end, recorded within Asset management fees and other income, was \$137 million and \$51 million during the three months ended March 31, 2012 and 2011, respectively.

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.

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

As of both March 31, 2012 and December 31, 2011, the Company was not exposed to any concentrations of credit risk of any single issuer greater than 10% of the Company's stockholders' equity, other than 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.

	March 31, 2012		December 31, 2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
(in millions)				
Investments in Japanese government and government agency securities:				
Fixed maturities, available-for-sale	\$ 58,790	\$ 62,442	\$ 60,323	\$ 63,846
Fixed maturities, held-to-maturity	1,176	1,289	1,260	1,388
Trading account assets supporting insurance liabilities	468	480	471	483
Other trading account assets	39	39	40	40
Short-term investments	0	0	0	0
Cash equivalents	803	803	0	0
Total	\$ 61,276	\$ 65,053	\$ 62,094	\$ 65,757

	March 31, 2012		December 31, 2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
(in millions)				
Investments in South Korean government and government agency securities:				
Fixed maturities, available-for-sale	\$ 4,946	\$ 5,501	\$ 4,678	\$ 5,240
Fixed maturities, held-to-maturity	0	0	0	0
Trading account assets supporting insurance liabilities	17	18	17	18
Other trading account assets	2	2	2	2
Short-term investments	0	0	0	0
Cash equivalents	0	0	0	0
Total	\$ 4,965	\$ 5,521	\$ 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:

	March 31, 2012		December 31, 2011	
	Amount (in millions)	% of Total	Amount (in millions)	% of Total
Commercial and agricultural mortgage loans by property type:				
Office	\$ 6,507	19.9%	\$ 6,391	19.8%
Retail	7,707	23.5	7,309	22.7
Apartments/Multi-Family	5,033	15.4	5,277	16.4
Industrial	7,045	21.5	7,049	21.8
Hospitality	1,584	4.8	1,486	4.6
Other	2,711	8.3	2,707	8.4
Total commercial mortgage loans	30,587	93.4	30,219	93.7
Agricultural property loans	2,156	6.6	2,046	6.3
Total commercial and agricultural mortgage loans by property type	32,743	100.0%	32,265	100.0%
Valuation allowance	(298)		(313)	
Total net commercial and agricultural mortgage loans by property type	32,445		31,952	
Other loans				
Uncollateralized loans	2,130		2,323	
Residential property loans	935		1,034	
Other collateralized loans	166		176	
Total other loans	3,231		3,533	
Valuation allowance	(53)		(54)	
Total net other loans	3,178		3,479	
Total commercial mortgage and other loans(1)	\$ 35,623		\$ 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 (27%), New York (11%), and Texas (7%) at March 31, 2012.

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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	Residential Property Loans	March 31, 2012 Other Collateralized Loans	Uncollateralized Loans	Total
	(in millions)					
Allowance for losses, beginning of year	\$ 294	\$ 19	\$ 16	\$ 18	\$ 20	\$ 367
Addition to / (release of) allowance of losses	(8)	0	(1)	(2)	4	(7)
Charge-offs, net of recoveries	(7)	0	0	0	0	(7)
Change in foreign exchange	0	0	(1)	0	(1)	(2)
Total ending balance	\$ 279	\$ 19	\$ 14	\$ 16	\$ 23	\$ 351

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

	December 31, 2011					Total
	Commercial Mortgage Loans	Agricultural Property Loans	Residential Property Loans	Other Collateralized Loans	Uncollateralized Loans	
	(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
Total ending balance	\$ 294	\$ 19	\$ 16	\$ 18	\$ 20	\$ 367

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:

	March 31, 2012					Total
	Commercial Mortgage Loans	Agricultural Property Loans	Residential Property Loans	Other Collateralized Loans	Uncollateralized Loans	
	(in millions)					
Allowance for Credit Losses:						
Ending balance: individually evaluated for impairment	\$ 111	\$ 12	\$ 0	\$ 16	\$ 1	\$ 140
Ending balance: collectively evaluated for impairment	168	7	14	0	22	211
Ending balance: loans acquired with deteriorated credit quality	0	0	0	0	0	0
Total ending balance	\$ 279	\$ 19	\$ 14	\$ 16	\$ 23	\$ 351

Recorded Investment:(1)

Ending balance gross of reserves: individually evaluated for impairment	\$ 1,547	\$ 43	\$ 0	\$ 107	\$ 94	\$ 1,791
Ending balance gross of reserves: collectively evaluated for impairment	29,040	2,113	935	59	2,036	34,183
Ending balance gross of reserves: loans acquired with deteriorated credit quality	0	0	0	0	0	0
Total ending balance, gross of reserves	\$ 30,587	\$ 2,156	\$ 935	\$ 166	\$ 2,130	\$ 35,974

(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)**

	December 31, 2011						
	Commercial Mortgage Loans	Agricultural Property Loans	Residential Property Loans	Other Collateralized Loans	Uncollateralized Loans		Total
	(in millions)						
Allowance for Credit Losses:							
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
Total ending balance	\$ 294	\$ 19	\$ 16	\$ 18	\$ 20		\$ 367

Recorded Investment:(1)

Ending balance gross of reserves: individually evaluated for impairment	\$ 1,903	\$ 45	\$ 0	\$ 110	\$ 92		\$ 2,150
Ending balance gross of reserves: collectively evaluated for impairment	28,316	2,001	1,034	66	2,231		33,648
Ending balance gross of reserves: loans acquired with deteriorated credit quality	0	0	0	0	0		0
Total ending balance, gross of reserves	\$ 30,219	\$ 2,046	\$ 1,034	\$ 176	\$ 2,323		\$ 35,798

(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)**

Impaired loans include those loans for which it is probable that amounts due according to the contractual terms of the loan agreement will not all be collected. Impaired commercial mortgage and other loans identified in management's specific review of probable loan losses, and the related allowance for losses, as of the dates indicated are as follows:

	March 31, 2012				
	Recorded Investment(1)	Unpaid Principal Balance	Related Allowance (in millions)	Average Recorded Investment Before Allowance(2)	Interest Income Recognized(3)
With no related allowance recorded:					
Commercial mortgage loans:					
Industrial	\$ 19	\$ 19	\$ 0	\$ 9	\$ 0
Retail	0	0	0	0	0
Office	15	94	0	9	1
Apartments/Multi-Family	22	22	0	11	0
Hospitality	63	125	0	31	1
Other	17	17	0	17	0
Total commercial mortgage loans	136	277	0	77	2
Agricultural property loans	0	0	0	0	0
Residential property loans	0	0	0	0	0
Other collateralized loans	0	0	0	0	0
Uncollateralized loans	6	12	0	6	0
Total with no related allowance	\$ 142	\$ 289	\$ 0	\$ 83	\$ 2
With an allowance recorded:					
Commercial mortgage loans:					
Industrial	\$ 28	\$ 28	\$ 19	\$ 41	\$ 0
Retail	46	46	7	67	1
Office	22	22	0	35	0
Apartments/Multi-Family	101	101	16	101	1
Hospitality	91	91	55	110	0
Other	129	133	20	111	2
Total commercial mortgage loans	417	421	117	465	4
Agricultural property loans	9	9	6	14	0
Residential property loans	0	0	0	0	0
Other collateralized loans	21	21	15	21	0
Uncollateralized loans	0	0	1	0	0

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Total with related allowance	\$ 447	\$ 451	\$ 139	\$ 500	\$ 4
Total:					
Commercial mortgage loans	\$ 553	\$ 698	\$ 117	\$ 542	\$ 6
Agricultural property loans	9	9	6	14	0
Residential property loans	0	0	0	0	0
Other collateralized loans	21	21	15	21	0
Uncollateralized loans	6	12	1	6	0
Total	\$ 589	\$ 740	\$ 139	\$ 583	\$ 6

- (1) Recorded investment reflects the balance sheet carrying value gross of related allowance.
- (2) Average recorded investment represents the average of the beginning-of-period and end-of-period balances.
- (3) The interest income recognized is for the year-to-date of income regardless of when the impairments occurred.

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

	December 31, 2011				
	Recorded Investment(1)	Unpaid Principal Balance	Related Allowance (in millions)	Average Recorded Investment Before Allowance(2)	Interest Income Recognized(3)
With no related allowance recorded:					
Commercial mortgage loans:					
Industrial	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Retail	0	0	0	0	0
Office	2	84	0	1	0
Apartments/Multi-Family	0	0	0	0	0
Hospitality	0	0	0	23	0
Other	17	17	0	11	1
Total commercial mortgage loans	19	101	0	35	1
Agricultural property loans	0	0	0	1	0
Residential property loans	0	0	0	0	0
Other collateralized loans	0	0	0	0	0
Uncollateralized loans	6	13	0	6	0
Total with no related allowance	\$ 25	\$ 114	\$ 0	\$ 42	\$ 1
With an allowance recorded:					
Commercial mortgage loans:					
Industrial	\$ 54	\$ 54	\$ 19	\$ 36	\$ 1
Retail	89	89	11	114	3
Office	47	47	3	49	0
Apartments/Multi-Family	102	102	19	197	4
Hospitality	129	129	55	178	0
Other	92	92	13	100	2
Total commercial mortgage loans	513	513	120	674	10
Agricultural property loans	19	19	11	14	0
Residential property loans	0	0	0	5	0
Other collateralized loans	21	21	18	31	2
Uncollateralized loans	0	0	0	13	0
Total with related allowance	\$ 553	\$ 553	\$ 149	\$ 737	\$ 12
Total:					
Commercial mortgage loans	\$ 532	\$ 614	\$ 120	\$ 709	\$ 11

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Agricultural property loans	19	19	11	15	0
Residential property loans	0	0	0	5	0
Other collateralized loans	21	21	18	31	2
Uncollateralized loans	6	13	0	19	0
Total	\$ 578	\$ 667	\$ 149	\$ 779	\$ 13

- (1) Recorded investment reflects the balance sheet carrying value gross of related allowance.
- (2) Average recorded investment represents the average of the beginning-of-period and all subsequent quarterly end-of-period balances.
- (3) The interest income recognized is for the year-to-date of income regardless of when the impairments occurred.

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

The net carrying value of commercial and other loans held for sale by the Company as of March 31, 2012 and December 31, 2011, was \$203 million and \$514 million, respectively. In all these transactions, the Company pre-arranges that it will sell the loan to an investor. As of both March 31, 2012 and December 31, 2011, all of the Company's commercial and other loans held for sale were collateralized, with collateral primarily consisting of office buildings, retail properties, apartment complexes and industrial buildings.

The following tables set forth the credit quality indicators as of March 31, 2012, based upon the recorded investment gross of allowance for credit losses.

Commercial mortgage loans Industrial

	Debt Service Coverage Ratio March 31, 2012						Total
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X (in millions)	1.0X to <1.2X	Less than 1.0X	
Loan-to-Value Ratio							
0%-49.99%	\$ 582	\$ 390	\$ 199	\$ 250	\$ 20	\$ 39	\$ 1,480
50%-59.99%	298	25	391	234	87	45	1,080
60%-69.99%	1,024	107	435	655	244	16	2,481
70%-79.99%	172	154	163	359	285	93	1,226
80%-89.99%	19	0	0	106	103	241	469
90%-100%	0	0	0	0	111	55	166
Greater than 100%	0	0	16	6	2	119	143
Total Industrial	\$ 2,095	\$ 676	\$ 1,204	\$ 1,610	\$ 852	\$ 608	\$ 7,045

Commercial mortgage loans Retail

	Debt Service Coverage Ratio March 31, 2012						Total
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X (in millions)	1.0X to <1.2X	Less than 1.0X	
Loan-to-Value Ratio							
0%-49.99%	\$ 1,198	\$ 287	\$ 409	\$ 100	\$ 85	\$ 1	\$ 2,080
50%-59.99%	581	680	611	80	73	3	2,028
60%-69.99%	557	534	824	393	96	17	2,421
70%-79.99%	0	92	377	453	27	11	960
80%-89.99%	0	0	0	0	31	19	50
90%-100%	0	0	5	58	5	33	101

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Greater than 100%	0	0	0	13	54	0	67
Total Retail	\$ 2,336	\$ 1,593	\$ 2,226	\$ 1,097	\$ 371	\$ 84	\$ 7,707

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

	Debt Service Coverage Ratio March 31, 2012						Total
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X (in millions)	1.0X to <1.2X	Less than 1.0X	
Loan-to-Value Ratio							
0%-49.99%	\$ 1,855	\$ 364	\$ 262	\$ 87	\$ 22	\$ 30	\$ 2,620
50%-59.99%	588	106	194	155	134	20	1,197
60%-69.99%	614	352	264	207	7	94	1,538
70%-79.99%	0	0	0	122	606	2	730
80%-89.99%	0	0	33	190	52	55	330
90%-100%	0	0	0	15	0	17	32
Greater than 100%	0	0	0	17	34	9	60
Total Office	\$ 3,057	\$ 822	\$ 753	\$ 793	\$ 855	\$ 227	\$ 6,507

Commercial mortgage loans Apartments/Multi-Family

	Debt Service Coverage Ratio March 31, 2012						Total
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X (in millions)	1.0X to <1.2X	Less than 1.0X	
Loan-to-Value Ratio							
0%-49.99%	\$ 694	\$ 209	\$ 239	\$ 157	\$ 206	\$ 60	\$ 1,565
50%-59.99%	112	71	178	183	69	40	653
60%-69.99%	426	28	311	388	67	30	1,250
70%-79.99%	165	21	225	472	291	0	1,174
80%-89.99%	0	0	0	23	26	58	107
90%-100%	0	0	8	16	2	70	96
Greater than 100%	0	0	36	15	0	137	188
Total Apartments/Multi-Family	\$ 1,397	\$ 329	\$ 997	\$ 1,254	\$ 661	\$ 395	\$ 5,033

Commercial mortgage loans Hospitality

	Debt Service Coverage Ratio March 31, 2012						Total
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X	1.0X to <1.2X	Less than 1.0X	

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

(in millions)

Loan-to-Value Ratio							
0%-49.99%	\$ 248	\$ 91	\$ 137	\$ 57	\$ 21	\$ 0	\$ 554
50%-59.99%	175	15	0	0	0	0	190
60%-69.99%	91	0	63	243	11	0	408
70%-79.99%	0	0	6	117	47	0	170
80%-89.99%	0	0	5	68	29	34	136
90%-100%	0	0	0	0	2	19	21
Greater than 100%	0	0	0	0	12	93	105
Total Hospitality	\$ 514	\$ 106	\$ 211	\$ 485	\$ 122	\$ 146	\$ 1,584

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

	Debt Service Coverage Ratio March 31, 2012						Total
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X (in millions)	1.0X to <1.2X	Less than 1.0X	
Loan-to-Value Ratio							
0%-49.99%	\$ 235	\$ 18	\$ 57	\$ 22	\$ 0	\$ 0	\$ 332
50%-59.99%	319	99	13	7	10	0	448
60%-69.99%	244	28	530	205	110	0	1,117
70%-79.99%	338	0	71	180	14	0	603
80%-89.99%	0	0	72	9	0	6	87
90%-100%	0	0	0	0	16	0	16
Greater than 100%	0	0	19	0	2	87	108
Total Other	\$ 1,136	\$ 145	\$ 762	\$ 423	\$ 152	\$ 93	\$ 2,711

Commercial mortgage loans Agricultural Properties

	Debt Service Coverage Ratio March 31, 2012						Total
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X (in millions)	1.0X to <1.2X	Less than 1.0X	
Loan-to-Value Ratio							
0%-49.99%	\$ 528	\$ 120	\$ 340	\$ 411	\$ 151	\$ 2	\$ 1,552
50%-59.99%	67	116	6	37	0	0	226
60%-69.99%	155	5	180	0	0	0	340
70%-79.99%	0	0	0	0	0	0	0
80%-89.99%	0	0	0	0	0	0	0
90%-100%	0	0	0	0	0	38	38
Greater than 100%	0	0	0	0	0	0	0
Total Agricultural	\$ 750	\$ 241	\$ 526	\$ 448	\$ 151	\$ 40	\$ 2,156

Commercial mortgage and agricultural loans

	Debt Service Coverage Ratio March 31, 2012				Total
	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X	1.0X to <1.2X	

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Loan-to-Value Ratio	Greater than 2.0X				Less than 1.0X			
	(in millions)							
0%-49.99%	\$ 5,340	\$ 1,479	\$ 1,643	\$ 1,084	\$ 505	\$ 132	\$ 10,183	
50%-59.99%	2,140	1,112	1,393	696	373	108	5,822	
60%-69.99%	3,111	1,054	2,607	2,091	535	157	9,555	
70%-79.99%	675	267	842	1,703	1,270	106	4,863	
80%-89.99%	19	0	110	396	241	413	1,179	
90%-100%	0	0	13	89	136	232	470	
Greater than 100%	0	0	71	51	104	445	671	
Total Commercial Mortgage and Agricultural	\$ 11,285	\$ 3,912	\$ 6,679	\$ 6,110	\$ 3,164	\$ 1,593	\$ 32,743	

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

The following tables set forth the credit quality indicators as of December 31, 2011, based upon the recorded investment gross of allowance for credit losses.

Commercial mortgage loans Industrial

	Debt Service Coverage Ratio December 31, 2011						Total
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X (in millions)	1.0X to <1.2X	Less than 1.0X	
Loan-to-Value Ratio							
0%-49.99%	\$ 627	\$ 311	\$ 211	\$ 254	\$ 19	\$ 48	\$ 1,470
50%-59.99%	299	86	315	246	73	46	1,065
60%-69.99%	922	287	380	308	373	105	2,375
70%-79.99%	175	86	136	448	402	95	1,342
80%-89.99%	0	0	0	106	114	236	456
90%-100%	19	0	0	0	0	162	181
Greater than 100%	16	0	0	0	19	125	160
Total Industrial	\$ 2,058	\$ 770	\$ 1,042	\$ 1,362	\$ 1,000	\$ 817	\$ 7,049

Commercial mortgage loans Retail

	Debt Service Coverage Ratio December 31, 2011						Total
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X (in millions)	1.0X to <1.2X	Less than 1.0X	
Loan-to-Value Ratio							
0%-49.99%	\$ 1,188	\$ 251	\$ 523	\$ 87	\$ 18	\$ 3	\$ 2,070
50%-59.99%	627	507	590	54	48	3	1,829
60%-69.99%	351	539	739	485	82	17	2,213
70%-79.99%	0	47	289	608	18	0	962
80%-89.99%	0	31	0	9	17	23	80
90%-100%	0	0	18	14	16	40	88
Greater than 100%	0	0	0	21	46	0	67
Total Retail	\$ 2,166	\$ 1,375	\$ 2,159	\$ 1,278	\$ 245	\$ 86	\$ 7,309

Commercial mortgage loans Office

	Debt Service Coverage Ratio December 31, 2011						Total
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X (in millions)	1.0X to <1.2X	Less than 1.0X	
Loan-to-Value Ratio							
0%-49.99%	\$ 1,756	\$ 365	\$ 181	\$ 132	\$ 23	\$ 31	\$ 2,488
50%-59.99%	572	106	210	198	16	9	1,111
60%-69.99%	612	412	79	460	61	38	1,662
70%-79.99%	65	0	31	15	618	15	744
80%-89.99%	0	0	0	138	52	54	244
90%-100%	0	0	16	0	0	18	34
Greater than 100%	0	0	17	71	8	12	108
Total Office	\$ 3,005	\$ 883	\$ 534	\$ 1,014	\$ 778	\$ 177	\$ 6,391

Table of Contents**PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)****Commercial mortgage loans Apartments/Multi-Family**

	Debt Service Coverage Ratio December 31, 2011						Total
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X (in millions)	1.0X to <1.2X	Less than 1.0X	
Loan-to-Value Ratio							
0%-49.99%	\$ 726	\$ 176	\$ 272	\$ 172	\$ 215	\$ 61	\$ 1,622
50%-59.99%	95	16	257	156	59	31	614
60%-69.99%	425	18	341	356	76	88	1,304
70%-79.99%	107	99	146	729	130	47	1,258
80%-89.99%	0	15	0	107	0	52	174
90%-100%	0	0	13	16	2	77	108
Greater than 100%	0	0	0	36	21	140	197
Total Apartments/Multi-Family	\$ 1,353	\$ 324	\$ 1,029	\$ 1,572	\$ 503	\$ 496	\$ 5,277

Commercial mortgage loans Hospitality

	Debt Service Coverage Ratio December 31, 2011						Total
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X (in millions)	1.0X to <1.2X	Less than 1.0X	
Loan-to-Value Ratio							
0%-49.99%	\$ 143	\$ 158	\$ 0	\$ 115	\$ 22	\$ 0	\$ 438
50%-59.99%	51	0	0	9	57	0	117
60%-69.99%	0	6	45	350	11	0	412
70%-79.99%	6	0	0	0	117	61	184
80%-89.99%	0	0	77	49	37	36	199
90%-100%	0	0	19	0	21	15	55
Greater than 100%	0	0	0	0	2	79	81
Total Hospitality	\$ 200	\$ 164	\$ 141	\$ 523	\$ 267	\$ 191	\$ 1,486

Commercial mortgage loans Other

	Debt Service Coverage Ratio December 31, 2011						Total
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X	1.0X to <1.2X	Less than 1.0X	

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

(in millions)

Loan-to-Value Ratio								
0%-49.99%	\$ 333	\$ 31	\$ 6	\$ 74	\$ 1	\$ 1	\$ 446	
50%-59.99%	50	185	20	7	0	0	262	
60%-69.99%	111	173	280	295	118	7	984	
70%-79.99%	286	0	202	286	13	0	787	
80%-89.99%	0	0	61	21	15	5	102	
90%-100%	0	19	0	0	16	15	50	
Greater than 100%	0	0	0	0	2	74	76	
Total Other	\$ 780	\$ 408	\$ 569	\$ 683	\$ 165	\$ 102	\$ 2,707	

Table of Contents**PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)****Commercial mortgage loans Agricultural Properties**

	Debt Service Coverage Ratio December 31, 2011						Total
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X (in millions)	1.0X to <1.2X	Less than 1.0X	
Loan-to-Value Ratio							
0%-49.99%	\$ 383	\$ 123	\$ 340	\$ 427	\$ 154	\$ 0	\$ 1,427
50%-59.99%	70	120	8	39	0	3	240
60%-69.99%	155	5	181	0	0	0	341
70%-79.99%	0	0	0	0	0	0	0
80%-89.99%	0	0	0	0	0	0	0
90%-100%	0	0	0	0	0	38	38
Greater than 100%	0	0	0	0	0	0	0
Total Agricultural	\$ 608	\$ 248	\$ 529	\$ 466	\$ 154	\$ 41	\$ 2,046

Commercial mortgage and agricultural loans

	Debt Service Coverage Ratio December 31, 2011						Total
	Greater than 2.0X	1.8X to 2.0X	1.5X to <1.8X	1.2X to <1.5X (in millions)	1.0X to <1.2X	Less than 1.0X	
Loan-to-Value Ratio							
0%-49.99%	\$ 5,156	\$ 1,415	\$ 1,533	\$ 1,261	\$ 452	\$ 144	\$ 9,961
50%-59.99%	1,764	1,020	1,400	709	253	92	5,238
60%-69.99%	2,576	1,440	2,045	2,254	721	255	9,291
70%-79.99%	639	232	804	2,086	1,298	218	5,277
80%-89.99%	0	46	138	430	235	406	1,255
90%-100%	19	19	66	30	55	365	554
Greater than 100%	16	0	17	128	98	430	689
Total Commercial Mortgage and Agricultural	\$ 10,170	\$ 4,172	\$ 6,003	\$ 6,898	\$ 3,112	\$ 1,910	\$ 32,265

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

The following tables provide an aging of past due commercial mortgage and other loans as of the dates indicated, based upon the recorded investment gross of allowance for credit losses.

	Current	March 31, 2012				Total Past Due	Total Commercial Mortgage and Other Loans
		30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days - Accruing (in millions)	Greater Than 90 Days - Not Accruing		
Commercial mortgage loans:							
Industrial	\$ 7,045	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 7,045
Retail	7,702	0	0	0	5	5	7,707
Office	6,502	5	0	0	0	5	6,507
Apartments/Multi-Family	4,991	0	0	0	42	42	5,033
Hospitality	1,584	0	0	0	0	0	1,584
Other	2,700	5	0	0	6	11	2,711
Total commercial mortgage loans	30,524	10	0	0	53	63	30,587
Agricultural property loans	2,117	0	0	0	39	39	2,156
Residential property loans	897	16	6	0	16	38	935
Other collateralized loans	164	0	0	0	2	2	166
Uncollateralized loans	2,130	0	0	0	0	0	2,130
Total	\$ 35,832	\$ 26	\$ 6	\$ 0	\$ 110	\$ 142	\$ 35,974

	Current	December 31, 2011				Total Past Due	Total Commercial Mortgage and Other Loans
		30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days - Accruing (in millions)	Greater Than 90 Days - Not Accruing		
Commercial mortgage loans:							
Industrial	\$ 7,047	\$ 0	\$ 2	\$ 0	\$ 0	\$ 2	\$ 7,049
Retail	7,294	0	0	0	15	15	7,309
Office	6,369	5	0	0	17	22	6,391
Apartments/Multi-Family	5,207	0	0	0	70	70	5,277
Hospitality	1,486	0	0	0	0	0	1,486
Other	2,657	13	10	0	27	50	2,707
Total commercial mortgage loans	30,060	18	12	0	129	159	30,219
Agricultural property loans	2,005	0	1	1	39	41	2,046

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Residential property loans	988	22	6	0	18	46	1,034
Other collateralized loans	174	0	0	0	2	2	176
Uncollateralized loans	2,323	0	0	0	0	0	2,323
Total	\$ 35,550	\$ 40	\$ 19	\$ 1	\$ 188	\$ 248	\$ 35,798

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

See Note 2 for further discussion regarding nonaccrual status loans. The following table sets forth commercial mortgage and other loans on nonaccrual status as of the dates indicated, based upon the recorded investment gross of allowance for credit losses:

	March 31, 2012	December 31, 2011 (in millions)
Commercial mortgage loans:		
Industrial	\$ 42	\$ 54
Retail	62	72
Office	38	58
Apartments/Multi-Family	127	129
Hospitality	110	169
Other	142	144
Total commercial mortgage loans	521	626
Agricultural property loans	43	44
Residential property loans	16	18
Other collateralized loans	21	15
Uncollateralized loans	8	8
Total	\$ 609	\$ 711

For the three months ended March 31, 2012, there were no commercial mortgage and other loans sold or acquired.

The following tables provide information about commercial mortgage and other loans involved in a troubled debt restructuring during the periods indicated. The pre-modification outstanding recorded investment has been adjusted for any partial payoffs, and the table excludes troubled debt restructurings where the Company has received assets, other than loans, in full satisfaction of the loan. See Note 2 for additional information relating to the accounting for troubled debt restructurings.

	Three Months Ended March 31, 2012 Adjusted		Three Months Ended March 31, 2011 Adjusted	
	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial mortgage loans:				
Industrial	\$ 0	\$ 0	\$ 0	\$ 0
Retail	0	0	23	23
Office	5	5	5	5
Apartments/Multi-Family	0	0	36	36

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Hospitality	0	0	0	0
Other	0	0	6	5
Total commercial mortgage loans	5	5	70	69
Agricultural property loans	0	0	0	0
Residential property loans	0	0	0	0
Other collateralized loans	0	0	3	2
Uncollateralized loans	0	0	0	0
Total	\$ 5	\$ 5	\$ 73	\$ 71

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

The amount of payment defaults during the period on commercial mortgage and other loans that were modified as a troubled debt restructuring within the last 12 months was less than \$1 million as of March 31, 2012.

As of March 31, 2012, the Company committed to fund \$6 million to borrowers that have been involved in a troubled debt restructuring.

Net Investment Income

Net investment income for the three months ended March 31, 2012 and 2011, was from the following sources:

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
Fixed maturities, available-for-sale	\$ 2,401	\$ 2,183
Fixed maturities, held-to-maturity	34	37
Equity securities, available-for-sale	76	73
Trading account assets	231	211
Commercial mortgage and other loans	487	476
Policy loans	148	144
Broker-dealer related receivables	0	0
Short-term investments and cash equivalents	12	13
Other long-term investments	40	79
Gross investment income	3,429	3,216
Less: investment expenses	(109)	(98)
Net investment income	\$ 3,320	\$ 3,118

Realized Investment Gains (Losses), Net

Realized investment gains (losses), net, for the three months ended March 31, 2012 and 2011, were from the following sources:

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
Fixed maturities	\$ (63)	\$ 25
Equity securities	(13)	62
Commercial mortgage and other loans	11	11
Investment real estate	3	(3)
Joint ventures and limited partnerships	(4)	(1)
Derivatives(1)	(1,319)	(161)
Other	1	17
Realized investment gains (losses), net	\$ (1,384)	\$ (50)

(1) Includes the offset of hedged items in qualifying effective hedge relationships prior to maturity or termination.

Table of Contents**PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)***Net Unrealized Investment Gains (Losses)*

Net unrealized investment gains and losses on securities classified as available-for-sale and certain other long-term investments and other assets are included in the Company's Unaudited Interim Consolidated Statements of Financial Position as a component of AOCI. Changes in these amounts include reclassification adjustments to exclude from Other comprehensive income (loss) those items that are included as part of Net income for a period that had been part of Other comprehensive income (loss) in earlier periods. The amounts for the periods indicated below, split between amounts related to fixed maturity securities on which an OTTI loss has been recognized, and all other net unrealized investment gains and losses, are as follows:

Net Unrealized Investment Gains and Losses on Fixed Maturity Securities on which an OTTI loss has been recognized

	Net Unrealized Gains (Losses) on Investments	Deferred Policy Acquisition Costs, Deferred Sales Inducements, and Value of Business Acquired	Future Policy Benefits	Policyholders Dividends	Deferred Income Tax (Liability) Benefit	Accumulated Other Comprehensive Income (Loss) Related To Net Unrealized Investment Gains (Losses)
	(in millions)					
Balance, December 31, 2011	\$ (1,003)	\$ 16	\$ 14	\$ 466	\$ 269	\$ (238)
Net investment gains (losses) on investments arising during the period	131				(46)	85
Reclassification adjustment for (gains) losses included in net income	155				(54)	101
Reclassification adjustment for OTTI losses excluded from net income(1)	(77)				27	(50)
Impact of net unrealized investment (gains) losses on deferred policy acquisition costs, deferred sales inducements and value of business acquired		(5)			2	(3)
Impact of net unrealized investment (gains) losses on future policy benefits			0		0	0
Impact of net unrealized investment (gains) losses on policyholders' dividends				(155)	54	(101)
Balance, March 31, 2012	\$ (794)	\$ 11	\$ 14	\$ 311	\$ 252	\$ (206)

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

- (1) Represents transfers in related to the portion of OTTI losses recognized during the period that were not recognized in earnings for securities with no prior OTTI loss.

Table of Contents**PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)***All Other Net Unrealized Investment Gains and Losses in AOCI*

	Net Unrealized Gains (Losses) on Investments(1)	Deferred Policy Acquisition Costs, Deferred Sales Inducements, and Value of Business Acquired	Future Policy Benefits	Policyholders Dividends	Deferred Income Tax (Liability) Benefit	Accumulated Other Comprehensive Income (Loss) Related To Net Unrealized Investment Gains (Losses)
	(in millions)					
Balance, December 31, 2011	\$ 15,748	\$ (1,182)	\$ (1,269)	\$ (4,319)	\$ (2,935)	\$ 6,043
Net investment gains (losses) on investments arising during the period	2,628				(943)	1,685
Reclassification adjustment for (gains) losses included in net income	(62)				19	(43)
Reclassification adjustment for OTTI losses excluded from net income(2)	77				(30)	47
Impact of net unrealized investment (gains) losses on deferred policy acquisition costs, deferred sales inducements and value of business acquired		78			(30)	48
Impact of net unrealized investment (gains) losses on future policy benefits			138		(54)	84
Impact of net unrealized investment (gains) losses on policyholders dividends				76	(28)	48
Balance, March 31, 2012	\$ 18,391	\$ (1,104)	\$ (1,131)	\$ (4,243)	\$ (4,001)	\$ 7,912

(1) Includes cash flow hedges. See Note 14 for information on cash flow hedges.

(2) Represents transfers out related to the portion of OTTI losses recognized during the period that were not recognized in earnings for securities with no prior OTTI loss.

The table below presents net unrealized gains (losses) on investments by asset class as of the dates indicated:

	March 31, 2012	December 31, 2011
	(in millions)	
Fixed maturity securities on which an OTTI loss has been recognized	\$ (794)	\$ (1,003)
Fixed maturity securities, available-for-sale all other	17,238	15,227

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Equity securities, available-for-sale	1,321	613
Derivatives designated as cash flow hedges(1)	(196)	(86)
Other investments(2)	28	(6)
Net unrealized gains (losses) on investments	\$ 17,597	\$ 14,745

(1) See Note 14 for more information on cash flow hedges.

(2) Includes \$90 million of net unrealized losses on held-to-maturity securities that were transferred from available-for-sale as of March 31, 2012. Also includes net unrealized gains on certain joint ventures that are strategic in nature and are included in Other assets.

Table of Contents**PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)*****Duration of Gross Unrealized Loss Positions for Fixed Maturities***

The following table shows the fair value and gross unrealized losses aggregated by investment category and length of time that individual fixed maturity securities have been in a continuous unrealized loss position, as of the dates indicated:

	Less than twelve months		March 31, 2012 Twelve months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
			(in millions)			
Fixed maturities(1)						
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ 1,260	\$ 39	\$ 55	\$ 6	\$ 1,315	\$ 45
Obligations of U.S. states and their political subdivisions	33	0	8	1	41	1
Foreign government bonds	1,785	50	157	17	1,942	67
Corporate securities	10,190	378	9,891	1,396	20,081	1,774
Commercial mortgage-backed securities	978	15	266	35	1,244	50
Asset-backed securities	1,649	243	3,830	1,326	5,479	1,569
Residential mortgage-backed securities	381	7	396	43	777	50
Total	\$ 16,276	\$ 732	\$ 14,603	\$ 2,824	\$ 30,879	\$ 3,556

(1) Includes \$670 million of fair value and \$87 million of gross unrealized losses at March 31, 2012, on securities classified as held-to-maturity, a portion of which are not reflected in Accumulated other comprehensive income (loss).

	Less than twelve months		December 31, 2011 Twelve months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
			(in millions)			
Fixed maturities(1)						
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ 870	\$ 8	\$ 130	\$ 10	\$ 1,000	\$ 18
Obligations of U.S. states and their political subdivisions	7	0	46	2	53	2
Foreign government bonds	4,017	182	306	27	4,323	209
Corporate securities	21,419	1,144	9,691	1,969	31,110	3,113
Commercial mortgage-backed securities	917	61	362	47	1,279	108
Asset-backed securities	2,746	40	4,134	1,785	6,880	1,825
Residential mortgage-backed securities	422	19	378	60	800	79

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Total	\$ 30,398	\$ 1,454	\$ 15,047	\$ 3,900	\$ 45,445	\$ 5,354
-------	-----------	----------	-----------	----------	-----------	----------

- (1) Includes \$706 million of fair value and \$98 million of gross unrealized losses at December 31, 2011, on securities classified as held-to-maturity, a portion of which are not reflected in Accumulated other comprehensive income (loss).

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

The gross unrealized losses at March 31, 2012 and December 31, 2011, are composed of \$2,292 million and \$3,535 million related to high or highest quality securities based on NAIC or equivalent rating and \$1,264 million and \$1,819 million, related to other than high or highest quality securities based on NAIC or equivalent rating, respectively. At March 31, 2012, \$2,278 million of the gross unrealized losses represented declines in value of greater than 20%, \$256 million of which had been in that position for less than six months, as compared to \$3,478 million at December 31, 2011, that represented declines in value of greater than 20%, \$871 million of which had been in that position for less than six months. At March 31, 2012, the \$2,824 million of gross unrealized losses of twelve months or more were concentrated in asset-backed securities, and in the manufacturing, finance, and public utilities sectors of the Company's corporate securities. At December 31, 2011, the \$3,900 million of gross unrealized losses of twelve months or more were concentrated in asset-backed securities, and in the manufacturing, finance, and services sectors of the Company's corporate securities. In accordance with its policy described in Note 2, the Company concluded that an adjustment to earnings for other-than-temporary impairments for these securities was not warranted at March 31, 2012 or December 31, 2011. These conclusions are based on a detailed analysis of the underlying credit and cash flows on each security. The gross unrealized losses are primarily attributable to foreign currency exchange rate movements, general credit spread widening and increased liquidity discounts. At March 31, 2012, the Company does not intend to sell the securities and it is not more likely than not that the Company will be required to sell the securities before the anticipated recovery of its remaining amortized cost basis.

Duration of Gross Unrealized Loss Positions for Equity Securities

The following table shows the fair value and gross unrealized losses aggregated by length of time that individual equity securities have been in a continuous unrealized loss position, as of the following dates:

	Less than twelve months		March 31, 2012 Twelve months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Equity securities, available-for-sale	\$ 1,165	\$ 95	\$ 0	\$ 0	\$ 1,165	\$ 95

(in millions)

	Less than twelve months		December 31, 2011 Twelve months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Equity securities, available-for-sale	\$ 2,602	\$ 448	\$ 0	\$ 0	\$ 2,602	\$ 448

(in millions)

At March 31, 2012, \$24 million of the gross unrealized losses represented declines in value of greater than 20%, \$14 million of which had been in that position for less than six months. At December 31, 2011, \$236 million of the gross unrealized losses represented declines in value of greater than 20%, \$225 million of which had been in that position for less than six months. In accordance with its policy described in Note 2, the

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Company concluded that an adjustment for other-than-temporary impairments for these equity securities was not warranted at March 31, 2012 or December 31, 2011.

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

5. VARIABLE INTEREST ENTITIES

In the normal course of its activities, the Company enters into relationships with various special purpose entities and other entities that are deemed to be variable interest entities ("VIEs"). A VIE is an entity that either (1) has equity investors that lack certain essential characteristics of a controlling financial interest (including the ability to control activities of the entity, the obligation to absorb the entity's expected losses and the right to receive the entity's expected residual returns) or (2) lacks sufficient equity to finance its own activities without financial support provided by other entities, which in turn would be expected to absorb at least some of the expected losses of the VIE.

If the Company determines that it is the VIE's primary beneficiary, it consolidates the VIE. There are currently two models for determining whether or not the Company is the primary beneficiary of a VIE. The first relates to those VIEs that have the characteristics of an investment company and for which certain other conditions are true. These conditions are that (1) the Company does not have the implicit or explicit obligation to fund losses of the VIE and (2) the VIE is not a securitization entity, asset-backed financing entity or an entity that was formerly considered a qualified special-purpose entity. In this model the Company is the primary beneficiary if it stands to absorb a majority of the VIE's expected losses or to receive a majority of the VIE's expected residual returns and would be required to consolidate the VIE.

For all other VIEs, the Company is the primary beneficiary if the Company has (1) the power to direct the activities of the VIE that most significantly impact the economic performance of the entity and (2) the obligation to absorb losses of the entity that could be potentially significant to the VIE or the right to receive benefits from the entity that could be potentially significant. If both conditions are present the Company would be required to consolidate the VIE.

Consolidated Variable Interest Entities for which the Company is the Investment Manager

The Company is the investment manager of certain asset-backed investment vehicles (commonly referred to as collateralized debt obligations, or CDOs) and certain other vehicles for which the Company earns fee income for investment management services, including certain investment structures which the Company's asset management business invests with other co-investors in investment funds referred to as feeder funds. The Company sells or syndicates investments through these vehicles, principally as part of the strategic investing activity of the Company's asset management businesses. Additionally, the Company may invest in debt or equity securities issued by these vehicles. CDOs raise capital by issuing debt securities, and use the proceeds to purchase investments, typically interest-bearing financial instruments. The Company analyzes these relationships to determine whether it has (1) the power to direct the activities of the VIE that most significantly impact the economic performance of the entity and (2) the obligation to absorb losses of the entity that could be potentially significant to the VIE or the right to receive benefits from the entity that could be potentially significant and thus is the primary beneficiary. This analysis includes a review of (1) the Company's rights and responsibilities as investment manager, (2) fees received by the Company and (3) other interests (if any) held by the Company. The Company is not required to provide, and has not provided, material financial or other support to any VIE for which it is the investment manager.

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

The Company has determined that it is the primary beneficiary of certain VIEs for which it is the asset manager, including certain CDOs and other investment structures, as it meets both conditions listed above. The table below reflects the carrying amount and balance sheet caption in which the assets and liabilities of consolidated VIEs for which the Company is the investment manager are reported. The assets of these VIEs are restricted and must be used first to settle liabilities of the VIE. The creditors of these VIEs do not have recourse to the Company in excess of the assets contained within the VIE.

	March 31, 2012	December 31, 2011
	(in millions)	
Fixed maturities, available-for-sale	\$ 85	\$ 83
Other trading account assets	300	271
Commercial mortgage and other loans	133	154
Other long-term investments	21	19
Cash and cash equivalents	79	275
Accrued investment income	1	1
Other assets	38	17
 Total assets of consolidated VIEs	 \$ 657	 \$ 820
 Other liabilities	 \$ 531	 \$ 723
 Total liabilities of consolidated VIEs	 \$ 531	 \$ 723

The Company also consolidates a VIE whose beneficial interests are wholly-owned by consolidated subsidiaries. This VIE is not included in the table above and the Company does not currently intend to sell these beneficial interests to third parties.

Other Consolidated Variable Interest Entities

The Company is the primary beneficiary of certain VIEs in which the Company has invested, as part of its investment activities. Included among these structured investments are structured investments issued by a VIE that manages yen-denominated investments coupled with cross-currency coupon swap agreements thereby creating synthetic dual currency investments. The Company's involvement in the structuring of these investments combined with its economic interest indicates that the Company is the primary beneficiary. The Company has not provided material financial or other support that was not contractually required to these VIEs. The table below reflects the carrying amount and balance sheet caption in which the assets and liabilities of consolidated VIEs for which the Company is not the investment manager are reported. These liabilities primarily comprise obligations under debt instruments issued by the VIEs that are non-recourse to the Company. The creditors of each consolidated VIE have recourse only to the assets of that VIE.

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

	March 31, 2012	December 31, 2011
	(in millions)	
Fixed maturities, available-for-sale	\$ 120	\$ 129
Fixed maturities, held-to-maturity	1,113	1,191
Trading account assets supporting insurance liabilities	8	8
Other long-term investments	138	141
Accrued investment income	4	5
Total assets of consolidated VIEs	\$ 1,383	\$ 1,474
Total liabilities of consolidated VIEs	\$ 0	\$ 0

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

In addition, not reflected in the table above, the Company has created a trust that is a VIE, to facilitate Prudential Insurance's Funding Agreement Notes Issuance Program (FANIP). The trust issues medium-term notes secured by funding agreements issued to the trust by Prudential Insurance with the proceeds of such notes. The trust is the beneficiary of an indemnity agreement with the Company that provides that the Company is responsible for costs related to the notes issued with limited exception. As a result, the Company has determined that it is the primary beneficiary of the trust, which is therefore consolidated.

The funding agreements represent an intercompany transaction that is eliminated upon consolidation. However, in recognition of the security interest in such funding agreements, the trust's medium-term note liability of \$2,984 million and \$3,197 million at March 31, 2012 and December 31, 2011, respectively, is classified within Policyholders' account balances. Creditors of the trust have recourse to Prudential Insurance if the trust fails to make contractual payments on the medium-term notes. The Company has not provided material financial or other support that was not contractually required to the trust.

Unconsolidated Variable Interest Entities

The Company has determined that it is not the primary beneficiary of certain VIEs for which it is the investment manager, including certain CDOs and other investment structures, as it does not have both (1) the power to direct the activities of the VIE that most significantly impact the economic performance of the entity and (2) the obligation to absorb losses of the entity that could be potentially significant to the VIE or the right to receive benefits from the entity that could be potentially significant. The Company's maximum exposure to loss resulting from its relationship with unconsolidated VIEs for which it is the investment manager is limited to its investment in the VIEs, which was \$554 million and \$534 million at March 31, 2012 and December 31, 2011. These investments are reflected in Fixed maturities, available-for-sale, Other trading account assets, at fair value and Other long-term investments. The fair value of assets held within these unconsolidated VIEs was \$7,816 million and \$7,720 million as of March 31, 2012 and December 31, 2011, respectively. There are no liabilities associated with these unconsolidated VIEs on the Company's balance sheet.

In the normal course of its activities, the Company will invest in joint ventures and limited partnerships. These ventures include hedge funds, private equity funds and real estate-related funds and may or may not be VIEs. The Company's maximum exposure to loss on these investments, both VIEs and non-VIEs, is limited to the amount of its investment. The Company has determined that it is not required to consolidate these entities because either (1) it does not control them or (2) it does not have the obligation to absorb losses of the entities that could be potentially significant to the entities or the right to receive benefits from the entities that could be potentially significant. The Company classifies these investments as Other long-term investments and its maximum exposure to loss associated with these entities was \$4,579 million and \$4,486 million as of March 31, 2012 and December 31, 2011, respectively.

In addition, in the normal course of its activities, the Company will invest in structured investments including VIEs for which it is not the investment manager. These structured investments typically invest in fixed income investments and are managed by third parties and include asset-backed securities, commercial mortgage-backed securities and residential mortgage-backed securities. The Company's maximum exposure to loss on these structured investments, both VIEs and non-VIEs, is limited to the amount of its investment. See Note 4 for details regarding the carrying amounts and classification of these assets. The Company has not provided material financial or other support that was not contractually required to these structures. The Company has determined that it is not the primary beneficiary of these structures due to the fact that it does not

control these entities.

Included among these structured investments are asset-backed securities issued by VIEs that manage investments in the European market. In addition to a stated coupon, each investment provides a return based on

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

the VIE's portfolio of assets and related investment activity. The market value of these VIEs was approximately \$2.6 billion as of both March 31, 2012 and December 31, 2011 and these VIEs were financed primarily through the issuance of notes similar to those purchased by the Company. The Company generally accounts for these investments as available-for-sale fixed maturities containing embedded derivatives that are bifurcated and marked-to-market through Realized investment gains (losses), net, based upon the change in value of the underlying portfolio. The Company's variable interest in each of these VIEs represents less than 50% of the only class of variable interests issued by the VIE. The Company's maximum exposure to loss from these interests was \$602 million and \$664 million at March 31, 2012 and December 31, 2011, respectively, which includes the fair value of the embedded derivatives.

6. CLOSED BLOCK

On the date of demutualization, Prudential Insurance established a Closed Block for certain individual life insurance policies and annuities issued by Prudential Insurance in the U.S. The recorded assets and liabilities were allocated to the Closed Block at their historical carrying amounts. The Closed Block forms the principal component of the Closed Block Business.

The policies included in the Closed Block are specified individual life insurance policies and individual annuity contracts that were in force on the effective date of the Plan of Reorganization and for which Prudential Insurance is currently paying or expects to pay experience-based policy dividends. Assets have been allocated to the Closed Block in an amount that has been determined to produce cash flows which, together with revenues from policies included in the Closed Block, are expected to be sufficient to support obligations and liabilities relating to these policies, including provision for payment of benefits, certain expenses, and taxes and to provide for continuation of the policyholder dividend scales in effect in 2000, assuming experience underlying such scales continues. To the extent that, over time, cash flows from the assets allocated to the Closed Block and claims and other experience related to the Closed Block are, in the aggregate, more or less favorable than what was assumed when the Closed Block was established, total dividends paid to Closed Block policyholders may be greater than or less than the total dividends that would have been paid to these policyholders if the policyholder dividend scales in effect in 2000 had been continued. Any cash flows in excess of amounts assumed will be available for distribution over time to Closed Block policyholders and will not be available to stockholders. If the Closed Block has insufficient funds to make guaranteed policy benefit payments, such payments will be made from assets outside of the Closed Block. The Closed Block will continue in effect as long as any policy in the Closed Block remains in force unless, with the consent of the New Jersey insurance regulator, it is terminated earlier.

The excess of Closed Block Liabilities over Closed Block Assets at the date of the demutualization (adjusted to eliminate the impact of related amounts in Accumulated other comprehensive income (loss)) represented the estimated maximum future earnings at that date from the Closed Block expected to result from operations attributed to the Closed Block after income taxes. In establishing the Closed Block, the Company developed an actuarial calculation of the timing of such maximum future earnings. If actual cumulative earnings of the Closed Block from inception through the end of any given period are greater than the expected cumulative earnings, only the expected earnings will be recognized in income. Any excess of actual cumulative earnings over expected cumulative earnings will represent undistributed accumulated earnings attributable to policyholders, which are recorded as a policyholder dividend obligation. The policyholder dividend obligation represents amounts to be paid to Closed Block policyholders as an additional policyholder dividend unless otherwise offset by future Closed Block performance that is less favorable than originally expected. If the actual cumulative earnings of the Closed Block from its inception through the end of any given period are less than the expected cumulative earnings of the Closed Block, the Company will recognize only the actual earnings in income. However, the Company may reduce policyholder dividend scales, which would be intended to increase future actual earnings until the actual cumulative earnings equaled the expected cumulative earnings.

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

As of March 31, 2012 and December 31, 2011, the Company recognized a policyholder dividend obligation of \$686 million and \$762 million, respectively, to Closed Block policyholders for the excess of actual cumulative earnings over the expected cumulative earnings. Additionally, accumulated net unrealized investment gains that have arisen subsequent to the establishment of the Closed Block have been reflected as a policyholder dividend obligation of \$3,926 million and \$3,847 million at March 31, 2012 and December 31, 2011, respectively, to be paid to Closed Block policyholders unless offset by future experience, with an offsetting amount reported in Accumulated other comprehensive income (loss). See the table below for changes in the components of the policyholder dividend obligation for the three months ended March 31, 2012.

Closed Block Liabilities and Assets designated to the Closed Block, as well as maximum future earnings to be recognized from Closed Block Liabilities and Closed Block Assets, are as follows:

	March 31, 2012	December 31, 2011
	(in millions)	
Closed Block Liabilities		
Future policy benefits	\$ 51,280	\$ 51,424
Policyholders' dividends payable	938	902
Policyholders' dividend obligation	4,612	4,609
Policyholders' account balances	5,467	5,484
Other Closed Block liabilities	4,800	4,030
Total Closed Block Liabilities	67,097	66,449
Closed Block Assets		
Fixed maturities, available-for-sale, at fair value	41,709	42,024
Other trading account assets, at fair value	269	269
Equity securities, available-for-sale, at fair value	3,396	3,122
Commercial mortgage and other loans	8,675	8,322
Policy loans	5,228	5,296
Other long-term investments	2,058	2,080
Short-term investments	694	485
Total investments	62,029	61,598
Cash and cash equivalents	1,135	1,006
Accrued investment income	600	571
Other Closed Block assets	341	284
Total Closed Block Assets	64,105	63,459
Excess of reported Closed Block Liabilities over Closed Block Assets	2,992	2,990
Portion of above representing accumulated other comprehensive income:		
Net unrealized investment gains (losses)	3,910	3,836
Allocated to policyholder dividend obligation	(3,926)	(3,847)

Future earnings to be recognized from Closed Block Assets and Closed Block Liabilities	\$ 2,976	\$ 2,979
--	----------	----------

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

Information regarding the policyholder dividend obligation is as follows:

	Three Months Ended March 31, 2012 (in millions)	
Balance, January 1	\$	4,609
Impact from earnings allocable to policyholder dividend obligation		(76)
Change in net unrealized investment gains (losses) allocated to policyholder dividend obligation		79
Balance, March 31	\$	4,612

Closed Block revenues and benefits and expenses for the three months ended March 31, 2012 and 2011 were as follows:

	Three Months Ended March 31, 2012 2011 (in millions)	
Revenues		
Premiums	\$ 671	\$ 691
Net investment income	733	748
Realized investment gains (losses), net	(9)	30
Other income	20	16
Total Closed Block revenues	1,415	1,485
Benefits and Expenses		
Policyholders' benefits	859	814
Interest credited to policyholders' account balances	34	34
Dividends to policyholders	404	517
General and administrative expenses	127	132
Total Closed Block benefits and expenses	1,424	1,497
Closed Block revenues, net of Closed Block benefits and expenses, before income taxes and discontinued operations	(9)	(12)
Income tax expense (benefit)	(12)	(14)
Closed Block revenues, net of Closed Block benefits and expenses and income taxes, before discontinued operations	3	2
Income from discontinued operations, net of taxes	0	0
Closed Block revenues, net of Closed Block benefits and expenses, income taxes and discontinued operations	\$ 3	\$ 2

Table of Contents**PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)****7. EQUITY**

The Company has outstanding two classes of common stock: the Common Stock and the Class B Stock. The changes in the number of shares issued, held in treasury and outstanding are as follows for the periods indicated:

	Issued	Common Stock Held In Treasury	Outstanding (in millions)	Class B Stock Issued and Outstanding
Balance, December 31, 2011	660.1	192.1	468.0	2.0
Common Stock issued	0	0	0	0
Common Stock acquired	0	4.0	(4.0)	0
Stock-based compensation programs(1)	0	(4.0)	4.0	0
Balance, March 31, 2012	660.1	192.1	468.0	2.0

(1) Represents net shares issued from treasury pursuant to the Company's stock-based compensation program.

Common Stock Held in Treasury

In June 2011, Prudential Financial's Board of Directors authorized the Company to repurchase at management's discretion up to \$1.5 billion of its outstanding Common Stock through June 2012. As of March 31, 2012, 23.8 million shares of the Company's common stock were repurchased under this authorization at a total cost of \$1,250 million, of which 4 million shares were repurchased in the first quarter of 2012 at a total cost of \$250 million. The timing and amount of any share repurchases will be determined by management based on market conditions and other considerations, and the repurchases may be effected in the open market, through derivative, accelerated repurchase and other negotiated transactions and through plans designed to comply with Rule 10b5-1(c) under the Exchange Act.

The balance of and changes in each component of Accumulated other comprehensive income (loss) attributable to Prudential Financial, Inc. for the three months ended March 31, 2012 and 2011 are as follows (net of taxes):

Accumulated Other Comprehensive Income (Loss) Attributable to Prudential Financial, Inc.			
Foreign Currency Translation Adjustment	Net Unrealized Investment Gains (Losses)(1)	Pension and Postretirement Unrecognized Net	Total Accumulated Other

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

			Periodic Benefit (Cost)	Comprehensive Income (Loss)
	(in millions)			
Balance, December 31, 2011	\$ 1,107	\$ 5,805	\$ (1,494)	\$ 5,418
Change in component during period	(141)	1,901	48	1,808
Balance, March 31, 2012	\$ 966	\$ 7,706	\$ (1,446)	\$ 7,226

Table of Contents**PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)****Accumulated Other Comprehensive Income (Loss) Attributable to Prudential Financial, Inc.**

	Foreign Currency Translation Adjustment	Net Unrealized Investment Gains (Losses)(1)	Pension and Postretirement Unrecognized Net Periodic Benefit (Cost)	Total Accumulated Other Comprehensive Income (Loss)
	(in millions)			
Balance, December 31, 2010	\$ 1,145	\$ 3,145	\$ (1,312)	\$ 2,978
Cumulative effect of accounting adoption	(279)	100	0	(179)
Change in component during period	113	(566)	11	(442)
Balance, March 31, 2011	\$ 979	\$ 2,679	\$ (1,301)	\$ 2,357

- (1) Includes cash flow hedges \$(126) million and \$(55) million as of March 31, 2012 and December 31, 2011, respectively, and \$(208) million and \$(169) million as of March 31, 2011 and December 31, 2010, respectively. See Note 4 for additional information regarding unrealized investment gains (losses), including the split between amounts related to fixed maturity securities on which an other-than-temporary impairment loss has been recognized, and all other unrealized investment gains (losses).

8. EARNINGS PER SHARE

The Company has outstanding two separate classes of common stock. The Common Stock reflects the performance of the Financial Services Businesses and the Class B Stock reflects the performance of the Closed Block Business. Accordingly, earnings per share is calculated separately for each of these two classes of common stock.

Net income for the Financial Services Businesses and the Closed Block Business is determined in accordance with U.S. GAAP and includes general and administrative expenses charged to each of the respective businesses based on the Company's methodology for the allocation of such expenses. Cash flows between the Financial Services Businesses and the Closed Block Business related to administrative expenses are determined by a policy servicing fee arrangement that is based upon insurance and policies in force and statutory cash premiums. To the extent reported administrative expenses vary from these cash flow amounts, the differences are recorded, on an after tax basis, as direct equity adjustments to the equity balances of the businesses.

The direct equity adjustments modify the earnings available to each of the classes of common stock for earnings per share purposes.

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

A reconciliation of the numerators and denominators of the basic and diluted per share computations for the three months ended March 31, is as follows:

	Three Months Ended March 31,					
	Income	2012 Weighted Average Shares	Per Share Amount	Income	2011 Weighted Average Shares	Per Share Amount
Basic earnings per share						
Income (loss) from continuing operations attributable to the Financial Services Businesses	\$ (984)			\$ 550		
Direct equity adjustment	8			9		
Less: Income attributable to noncontrolling interests	11			25		
Less: Earnings allocated to participating unvested share-based payment awards	0			7		
Income (loss) from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment	\$ (987)	469.2	\$ (2.10)	\$ 527	484.9	\$ 1.09
Effect of dilutive securities and compensation programs(1)						
Add: Earnings allocated to participating unvested share-based payment awards Basic	\$ 0			\$ 7		
Less: Earnings allocated to participating unvested share-based payment awards Diluted	0			7		
Stock options		0.0			3.5	
Deferred and long-term compensation programs		0.0			0.4	
Exchangeable Surplus Notes	0	0.0		4	5.1	
Diluted earnings per share						
Income (loss) from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment	\$ (987)	469.2	\$ (2.10)	\$ 531	493.9	\$ 1.08

- (1) For the three months ended March 31, 2012, weighted average shares for basic earnings per share is also used for calculating diluted earnings per share because dilutive shares and dilutive earnings per share are not applicable when a loss from continuing operations is reported. As a result of the loss from continuing operations available to holders of Common Stock after direct equity adjustment for the three months ended March 31, 2012, all potential stock options and compensation programs were considered antidilutive.

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Unvested share-based payment awards that contain nonforfeitable rights to dividends are participating securities and included in the computation of earnings per share pursuant to the two-class method. Under this method, earnings of the Financial Services Businesses attributable to Prudential Financial, Inc. are allocated between Common Stock and the participating awards, as if the awards were a second class of stock. For the three months ended March 31, 2012, undistributed earnings were not allocated to participating unvested share-based payment awards as these awards do not participate in losses. Undistributed earnings allocated to participating unvested share-based payment awards for the three months ended March 31, 2011 were based on 6.5 million of

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

such awards weighted for the period they were outstanding. The computation of earnings per share of Common Stock excludes the dilutive impact of participating unvested share-based awards based on the application of the two-class method.

For the three months ended March 31, 2012, 20.7 million options and 5.8 million shares related to deferred and long-term compensation programs, weighted for the portion of the period they were outstanding, are considered antidilutive as a result of the loss from continuing operations available to holders of Common Stock after direct equity adjustment. For the three months ended March 31, 2011, 9.0 million options, weighted for the portion of the period they were outstanding, with a weighted average exercise price of \$76.10 per share, were excluded from the computation of diluted earnings per share because the options, based on application of the treasury stock method, were antidilutive.

In September 2009, the Company issued \$500 million of surplus notes with an interest rate of 5.36% per annum which are exchangeable at the option of the note holders for shares of Common Stock. The exchange rate used in the diluted earnings per share calculation for the surplus notes is 10.1235 shares of Common Stock per each \$1,000 principal amount of surplus notes. In calculating diluted earnings per share under the if-converted method, the potential shares that would be issued assuming a hypothetical exchange, weighted for the period the notes are outstanding, is added to the denominator, and interest expense, net of tax, is added to the numerator, if the overall effect is dilutive.

Class B Stock

Income from continuing operations per share of Class B Stock for the three months ended March 31, are presented below. There are no potentially dilutive shares associated with the Class B Stock.

	Three Months Ended March 31,					
	Income	2012 Weighted Average Shares	Per Share Amount	Income	2011 Weighted Average Shares	Per Share Amount
	(in millions, except per share amounts)					
Basic earnings per share						
Income from continuing operations attributable to the Closed Block Business	\$ 21			\$ 22		
Less: Direct equity adjustment	8			9		
Income from continuing operations attributable to the Closed Block Business available to holders of Class B Stock after direct equity adjustment	\$ 13	2.0	\$ 6.50	\$ 13	2.0	\$ 6.50

9. SHORT-TERM AND LONG-TERM DEBT

Commercial Paper

The Company issues commercial paper under the two programs described below. At March 31, 2012 and December 31, 2011, the weighted average maturity of total commercial paper outstanding was 26 and 21 days, respectively.

Prudential Financial has a commercial paper program with an authorized capacity of \$3.0 billion. Prudential Financial commercial paper borrowings generally have been used to fund the working capital needs of Prudential Financial's subsidiaries and provide short-term liquidity at Prudential Financial.

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

Prudential Funding, LLC, a wholly-owned subsidiary of Prudential Insurance, has a commercial paper program with an authorized capacity of \$7.0 billion. Prudential Funding commercial paper borrowings generally have served as an additional source of financing to meet the working capital needs of Prudential Insurance and its subsidiaries. Prudential Funding also lends to other subsidiaries of Prudential Financial up to limits agreed with the New Jersey Department of Banking and Insurance. Prudential Financial has issued a subordinated guarantee covering Prudential Funding's commercial paper program.

The table below presents the Company's total outstanding commercial paper borrowings as of the dates indicated:

	March 31, 2012	December 31, 2011
	(in millions)	
Prudential Financial	\$ 283	\$ 296
Prudential Funding, LLC	1,023	870
Total outstanding commercial paper borrowings	\$ 1,306	\$ 1,166

Federal Home Loan Bank of New York

Prudential Insurance is a member of the Federal Home Loan Bank of New York or FHLBNY. Membership allows Prudential Insurance access to the FHLBNY's financial services, including the ability to obtain collateralized loans and to issue collateralized funding agreements that can be used as an alternative source of liquidity. FHLBNY borrowings and funding agreements are collateralized by qualifying mortgage-related assets or U.S. Treasury securities, the fair value of which must be maintained at certain specified levels relative to outstanding borrowings, depending on the type of asset pledged. FHLBNY membership requires Prudential Insurance to own member stock and borrowings require the purchase of activity-based stock in an amount equal to 4.5% of outstanding borrowings. Under FHLBNY guidelines, if Prudential Insurance's financial strength ratings decline below A/A2/A Stable by S&P/Moody's/Fitch, respectively, and the FHLBNY does not receive written assurances from the New Jersey Department of Banking and Insurance, or NJDOBI, regarding Prudential Insurance's solvency, new borrowings from the FHLBNY would be limited to a term of 90 days or less. Currently there are no restrictions on the term of borrowings from the FHLBNY.

NJDOBI permits Prudential Insurance to pledge collateral to the FHLBNY in an amount of up to 5% of its prior year-end statutory net admitted assets, excluding separate account assets. Based on Prudential Insurance's statutory net admitted assets as of December 31, 2011, the 5% limitation equates to a maximum amount of pledged assets of \$7.7 billion and an estimated maximum borrowing capacity (after taking into account required collateralization levels and purchases of activity-based stock) of approximately \$6.3 billion. Nevertheless, FHLBNY borrowings are subject to the FHLBNY's discretion and to the availability of qualifying assets at Prudential Insurance.

As of March 31, 2012, Prudential Insurance had pledged qualifying assets with a fair value of \$2.9 billion, which supported outstanding collateralized advances of \$924 million and collateralized funding agreements of \$1.5 billion with maturities ranging from 2013 through 2018.

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

As of March 31, 2012, \$199 million of the FHLBNY outstanding advances is reflected in Short-term debt and matures in December 2012 and the remaining \$725 million is in Long-term debt and matures in December 2015. The funding agreements issued to the FHLBNY, which are reflected in Policyholders' account balances, have priority claim status above debt holders of Prudential Insurance. The fair value of qualifying assets that were available to Prudential Insurance but not pledged amounted to \$4.5 billion as of March 31, 2012.

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

Federal Home Loan Bank of Boston

Prudential Retirement Insurance and Annuity Company, or PRIAC, became a member of the Federal Home Loan Bank of Boston or FHLBB, in December 2009. Membership allows PRIAC access to collateralized advances which will be classified in Short-term debt or Long-term debt, depending on the maturity date of the obligation. PRIAC's membership in FHLBB requires the ownership of member stock and borrowings from FHLBB require the purchase of activity-based stock in an amount between 3.0% and 4.5% of outstanding borrowings depending on the maturity date of the obligation. As of March 31, 2012, PRIAC had no advances outstanding under the FHLBB facility.

The Connecticut Department of Insurance, or CTDOI, permits PRIAC to pledge up to \$2.6 billion in qualifying assets to secure FHLBB borrowings through December 31, 2013. PRIAC must seek re-approval from CTDOI prior to borrowing additional funds after that date. Based on available eligible assets as of March 31, 2012, PRIAC had an estimated maximum borrowing capacity, after taking into consideration required collateralization levels and required purchases of activity-based FHLBB stock, of approximately \$1.6 billion.

Credit Facilities

As of March 31, 2012, Prudential Financial and Prudential Funding maintained an aggregate of \$3,750 million of unsecured committed credit facilities, which includes a \$2,000 million five-year credit facility on which Prudential Financial is the sole borrower party. These facilities have remaining terms ranging from 2.75 years to 4.75 years. There were no outstanding borrowings under these credit facilities as of March 31, 2012. Each of the facilities is available to the applicable borrowers up to the aggregate committed credit and may be used for general corporate purposes, including as backup liquidity for the Company's commercial paper programs discussed above. For additional information on these credit facilities, see Note 14 to the Company's Consolidated Financial Statements included in the 2011 Annual Report on Form 10-K.

Sale of Asset-Backed Notes

On March 30, 2012, Prudential Insurance sold, in a Rule 144A private placement, \$1.0 billion aggregate principal amount of 2.997% notes with a final maturity of September 30, 2015. The notes are secured by the assets of a trust, consisting of approximately \$2.8 billion aggregate principal balance of residential mortgage-backed securities deposited into the trust by Prudential Insurance. Payments of interest and principal on the notes will be made only to the extent of funds available to the trust in accordance with a priority of payments set forth in the indenture governing the notes. Prudential Financial guaranteed to the holders of the notes the timely payment of all principal and interest due on the notes and any make-whole payments that may become due as a result of the payment of principal on the notes prior to its scheduled payment date.

Termination of Existing Replacement Capital Covenants and Execution of New Replacement Capital Covenant

On April 11, 2012, the Company terminated the replacement capital covenants that were entered into in 2008 in connection with its issuance of \$600 million of 8.875% fixed-to-floating rate junior subordinated notes and \$920 million of 9.0% junior subordinated notes. The Company received the consent of holders of a majority in principal amount of its 6.625% medium-term notes due 2037, as was required for the termination of the replacement capital covenants. The Company also entered into a new replacement capital covenant with respect to the 8.875% junior subordinated notes only. The new replacement capital covenant was entered into for the benefit of the holders of the Company's 5.90% medium-term notes due March 2036 and requires that the Company not repay, redeem or purchase the 8.875% junior subordinated notes prior to June 15, 2038 unless it

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

has received proceeds from the sale or issuance of common stock or other qualifying securities that have certain characteristics that are at least as equity-like as the 8.875% junior subordinated notes. However, the terms of the new replacement capital covenant will not apply in certain instances, including (i) if Standard & Poor's upgrades the Company's corporate credit rating by at least one notch above A- or (ii) if the Company repurchases or redeems up to 10% of the outstanding principal amount of the 8.875% junior subordinated notes in any one-year period, provided that no more than 25% of the outstanding principal amount of the 8.875% junior subordinated notes are repurchased or redeemed in any ten-year period.

10. EMPLOYEE BENEFIT PLANS***Pension and Other Postretirement Plans***

The Company has funded and non-funded contributory and non-contributory defined benefit pension plans, which cover substantially all of its employees. For some employees, benefits are based on final average earnings and length of service, while benefits for other employees are based on an account balance that takes into consideration age, service and earnings during their career.

The Company provides certain health care and life insurance benefits for its retired employees, their beneficiaries and covered dependents (other postretirement benefits). The health care plan is contributory; the life insurance plan is non-contributory. Substantially all of the Company's U.S. employees may become eligible to receive other postretirement benefits if they retire after age 55 with at least 10 years of service or under certain circumstances after age 50 with at least 20 years of continuous service.

Net periodic (benefit) cost included in General and administrative expenses includes the following components:

	Three Months Ended March 31,			
	Pension Benefits		Other Postretirement Benefits	
	2012	2011	2012	2011
	(in millions)			
Components of net periodic (benefit) cost				
Service cost	\$ 61	\$ 50	\$ 3	\$ 3
Interest cost	119	120	25	27
Expected return on plan assets	(181)	(180)	(21)	(24)
Amortization of prior service cost	3	6	(3)	(3)
Amortization of actuarial (gain) loss, net	26	10	14	9
Special termination benefits	2	1		

Net periodic (benefit) cost	\$ 30	\$ 7	\$ 18	\$ 12
-----------------------------	-------	------	-------	-------

11. SEGMENT INFORMATION

Segments

The Company has organized its principal operations into the Financial Services Businesses and the Closed Block Business. Within the Financial Services Businesses, the Company operates through three divisions, which together encompass six reportable segments. 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. Collectively, the businesses that comprise the three operating divisions and Corporate and Other are referred to as the Financial Services Businesses.

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

Adjusted Operating Income

In managing the Financial Services Businesses, the Company analyzes the operating performance of each segment using adjusted operating income. Adjusted operating income does not equate to income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures or net income as determined in accordance with U.S. GAAP but is the measure of segment profit or loss used by the Company to evaluate segment performance and allocate resources, and consistent with authoritative guidance, is the measure of segment performance presented below.

Adjusted operating income is calculated by adjusting each segment's income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures for the following items, which are described in greater detail below:

realized investment gains (losses), net, and related charges and adjustments;

net investment gains and losses on trading account assets supporting insurance liabilities and changes in experience-rated contractholder liabilities due to asset value changes;

the contribution to income/loss of divested businesses that have been or will be sold or exited but that did not qualify for discontinued operations accounting treatment under U.S. GAAP; and

equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests.

These items are important to an understanding of overall results of operations. Adjusted operating income is not a substitute for income determined in accordance with U.S. GAAP, and the Company's definition of adjusted operating income may differ from that used by other companies. However, the Company believes that the presentation of adjusted operating income as measured for management purposes enhances the understanding of results of operations by highlighting the results from ongoing operations and the underlying profitability factors of the Financial Services Businesses.

Realized investment gains (losses), net, and related charges and adjustments. Adjusted operating income excludes realized investment gains (losses), net, except as indicated below. Significant elements of realized investment gains and losses include impairments and credit-related and interest rate-related gains and losses from sales of securities. Impairments and losses from sales of credit-impaired securities, the timing of which depends largely on market credit cycles, can vary considerably across periods. The timing of other sales that would result in gains or losses, such as interest rate-related gains or losses, is largely subject to the Company's discretion and influenced by market opportunities, as well as the Company's tax and capital profile. Trends in the underlying profitability of the Company's businesses can be more clearly identified without the fluctuating effects of these transactions.

Charges that relate to realized investment gains (losses), net, are also excluded from adjusted operating income. The related charges are associated with: policyholder dividends; amortization of deferred policy acquisition costs, value of business acquired (VOBA), unearned revenue reserves and deferred sales inducements; interest credited to policyholders' account balances; reserves for future policy benefits; and payments associated with the market value adjustment features related to certain of the annuity products the Company sells. Deferred policy acquisition costs, VOBA, unearned revenue reserves and deferred sales inducements for certain products are amortized based on estimated gross profits, which include net realized investment gains and losses on the underlying invested assets including certain portions of the net realized investment gains and losses related to the embedded derivatives and related hedging positions associated with the living benefit features of certain products. The related charge for these items represents the portion of this amortization associated with net realized investment gains and losses. The related charges for policyholder

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

dividends and interest credited to policyholders' account balances relate to certain foreign life policies and certain domestic group life policies, respectively, that pass back certain realized investment gains and losses to the policyholder. The reserves for certain policies are adjusted when cash flows related to these policies are affected by net realized investment gains and losses, and the related charge for reserves for future policy benefits represents that adjustment. Certain of the Company's annuity products contain a market value adjustment feature that requires the Company to pay to the contractholder or entitles the Company to receive from the contractholder, upon surrender, a market value adjustment based on the crediting rates on the contract surrendered compared to crediting rates on newly issued contracts or based on an index rate at the time of purchase compared to an index rate at time of surrender, as applicable. These payments mitigate the net realized investment gains or losses incurred upon the disposition of the underlying invested assets. The related charge represents the payments or receipts associated with these market value adjustment features.

Adjustments to Realized investment gains (losses), net, for purposes of calculating adjusted operating income, include the following:

Gains and losses pertaining to derivative contracts that do not qualify for hedge accounting treatment are included in Realized investment gains (losses), net. This includes mark-to-market adjustments of open contracts as well as periodic settlements. As discussed further below, adjusted operating income includes a portion of realized gains and losses pertaining to certain derivative contracts.

Adjusted operating income of the International Insurance segment reflects the impact of an intercompany arrangement with Corporate and Other operations pursuant to which the segment's non-U.S. dollar-denominated earnings in all countries for a particular year, including its interim reporting periods, are translated at fixed currency exchange rates. The fixed rates are determined in connection with a currency hedging program designed to mitigate the risk that unfavorable rate changes will reduce the segment's U.S. dollar-equivalent earnings. Pursuant to this program, the Company's Corporate and Other operations execute forward currency contracts with third parties to sell the net exposure of projected earnings from the hedged currency in exchange for U.S. dollars at a specified exchange rate. The maturities of these contracts correspond with the future periods in which the identified non-U.S. dollar-denominated earnings are expected to be generated. These contracts do not qualify for hedge accounting under U.S. GAAP and, as noted above, all resulting profits or losses from such contracts are included in Realized investment gains (losses), net. When the contracts are terminated in the same period that the expected earnings emerge, the resulting positive or negative cash flow effect is included in adjusted operating income (net losses of \$27 million and \$34 million for the three months ended March 31, 2012 and 2011, respectively). As of March 31, 2012 and December 31, 2011, the fair value of open contracts used for this purpose was a net asset of \$34 million and a net liability of \$184 million, respectively.

The Company uses interest rate and currency swaps and other derivatives to manage interest and currency exchange rate exposures arising from mismatches between assets and liabilities, including duration mismatches. For the derivative contracts that do not qualify for hedge accounting treatment, mark-to-market adjustments of open contracts as well as periodic settlements are included in Realized investment gains (losses), net. However, the periodic swap settlements, as well as other derivative related yield adjustments, are included in adjusted operating income to reflect the after-hedge yield of the underlying instruments. In certain instances, when these derivative contracts are terminated or offset before their final maturity, the resulting realized gains or losses recorded within Realized investment gains (losses), net are recognized in adjusted operating income over periods that generally approximate the expected terms of the derivatives or underlying instruments in order for adjusted operating income to reflect the after-hedge yield of the underlying instruments. Adjusted operating income includes net gains of \$66 million and \$64 million for the three months ended March 31, 2012 and 2011, respectively, due to periodic settlements and yield adjustments of such contracts, and includes net gains of \$14 million and \$12 million for the three months ended March 31, 2012 and 2011, respectively, related to certain

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

derivative contracts that were terminated or offset in prior periods. The table below reflects the total deferred gain (loss) as of March 31, 2012, related to certain derivative contracts that were terminated or offset in prior periods that will be recognized in adjusted operating income in future periods for each segment, as well as the weighted average period over which these deferred amounts will be recognized.

Segment:	Deferred Amount (in millions)	Weighted Average Period (in years)
International Insurance	\$ 642	28
Asset Management	20	8
Corporate and Other	(37)	6
Total deferred gain (loss)	\$ 625	

Adjustments are also made for the purposes of calculating adjusted operating income for the following items:

The Company conducts certain activities for which Realized investment gains (losses), net are a principal source of earnings for its businesses and therefore included in adjusted operating income, particularly within the Company's Asset Management segment. For example, Asset Management's strategic investing business makes investments for sale or syndication to other investors or for placement or co-investment in the Company's managed funds and structured products. The Realized investment gains (losses), net associated with the sale of these strategic investments, as well as related derivative results, are a principal activity for this business and included in adjusted operating income. In addition, the Realized investment gains (losses), net associated with loans originated by the Company's commercial mortgage operations, as well as related derivative results and retained mortgage servicing rights, are a principal activity for this business and included in adjusted operating income. Net realized investment gains of \$11 million and \$27 million for the three months ended March 31, 2012 and 2011, respectively, related to these and other businesses were reflected as an adjustment to Realized investment gains (losses), net.

The Company has certain investments in its general account portfolios that are classified as trading. These trading investments are carried at fair value and included in Other trading account assets, at fair value on the Company's statements of financial position. Realized and unrealized gains and losses for these investments are recorded in Asset management fees and other income, and interest and dividend income for these investments is recorded in Net investment income. Consistent with the exclusion of realized investment gains and losses with respect to other investments managed on a consistent basis, the net gains or losses on these investments, which is recorded within Asset management fees and other income, is excluded from adjusted operating income and is reflected as an adjustment to Realized investment gains (losses), net. The net impact of these adjustments was to exclude from adjusted operating income net gains of \$66 million and \$47 million, for the three months ended March 31, 2012 and 2011, respectively.

The Company has certain assets and liabilities for which, under U.S. GAAP, the changes in value, including those associated with changes in foreign currency exchange rates during the period, are recorded in Asset management fees and other income. To the extent the foreign currency exposure on these assets and liabilities is economically hedged or considered part of the Company's capital funding strategies for its international

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

subsidiaries, the change in value included in Asset management fees and other income is excluded from adjusted operating income and is reflected as an adjustment to Realized investment gains (losses), net. The net impact of this adjustment was to exclude from adjusted operating income net losses of \$1,379 million and \$211 million for the three months ended March 31, 2012 and 2011, respectively.

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

For the three months ended March 31, 2011, the Company recorded an out of period adjustment that decreased income from continuing operations before equity in earnings of operating joint ventures by \$95 million. The adjustment is related to the amortization of unrealized losses associated with U.S. dollar-denominated collateralized mortgage-backed securities held by the Gibraltar Life operations that were reclassified from available-for-sale to held-to-maturity in December 2008. The adjustment, which had no impact on the carrying value of the U.S. dollar-denominated collateralized mortgage-backed securities, resulted from amortizing the unrealized losses that existed when the securities were reclassified over a period greater than the expected effective duration of the securities. The adjustment does not impact current or prior period adjusted operating income of any segments and is included as a component of the foreign currency related adjustments discussed above.

The Company records an adjustment for non-performance risk that relates to the uncollateralized portion of certain derivative contracts between a subsidiary of the Company and third parties. Consistent with the exclusion of realized investment gains and losses with respect to the mark-to-market on other derivatives, the impact of the non-performance risk is excluded from adjusted operating income and is reflected as an adjustment to Realized investment gains (losses), net. The net impact of the non-performance risk and certain other adjustments was to exclude from adjusted operating income net gains of \$21 million and \$2 million for the three months ended March 31, 2012 and 2011, respectively.

In connection with the settlement of disputes arising out of the Chapter 11 bankruptcy petition filed by Lehman Brothers Holdings Inc., the Company recorded additional losses of \$65 million in the first quarter of 2011 related to a portion of its counterparty exposure on derivative transactions it had previously held with Lehman Brothers and its affiliates. These losses are recorded within Asset management fees and other income within the Company's Corporate and Other operations and are excluded from adjusted operating income as a related adjustment to Realized investment gains (losses), net, which is consistent with the adjusted operating income treatment of similar credit-related losses that are recorded within Realized investment gains (losses), net. Any subsequent recoveries arising from this settlement will also be excluded from adjusted operating income.

Changes in experience-rated contractholder liabilities due to asset value changes and investment gains and losses on trading account assets supporting insurance liabilities. Certain products included in the Retirement and International Insurance segments, are experience-rated in that investment results associated with these products are expected to ultimately accrue to contractholders. The majority of investments supporting these experience-rated products are classified as trading and are carried at fair value. These trading investments are reflected on the statements of financial position as Trading account assets supporting insurance liabilities, at fair value (TAASIL). Realized and unrealized gains and losses for these investments are reported in Asset management fees and other income. Interest and dividend income for these investments is reported in Net investment income. To a lesser extent, these experience-rated products are also supported by derivatives and commercial mortgage and other loans. The derivatives that support these experience-rated products are reflected on the statement of financial position as Other long-term investments and are carried at fair value, and the realized and unrealized gains and losses are reported in Realized investment gains (losses), net. The commercial mortgage and other loans that support these experience-rated products are carried at unpaid principal, net of unamortized discounts and an allowance for losses, and are reflected on the statements of financial position as Commercial mortgage and other loans. Gains and losses on sales and changes in the valuation allowance for commercial mortgage and other loans are reported in Realized investment gains (losses), net.

Adjusted operating income excludes net investment gains and losses on TAASIL. This is consistent with the exclusion of realized investment gains and losses with respect to other investments supporting insurance liabilities managed on a consistent basis. In addition, to be consistent with the historical treatment of charges

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

related to realized investment gains and losses on investments, adjusted operating income also excludes the change in contractholder liabilities due to asset value changes in the pool of investments (including changes in the fair value of commercial mortgage and other loans) supporting these experience-rated contracts, which are reflected in Interest credited to policyholders' account balances. Adjusted operating income also excludes net investment gains and losses on related derivatives and commercial mortgage and other loans reported in Realized investment gains (losses), net. The result of this approach is that adjusted operating income for these products includes net fee revenue and interest spread the Company earns on these experience-rated contracts, and excludes changes in fair value of the pool of investments, both realized and unrealized, that are expected to ultimately accrue to the contractholders.

Divested businesses. The contribution to income/loss of divested businesses that have been or will be sold or exited, but that did not qualify for discontinued operations' accounting treatment under U.S. GAAP, are excluded from adjusted operating income as the results of divested businesses are not relevant to understanding the Company's ongoing operating results.

Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests. Equity in earnings of operating joint ventures, on a pre-tax basis, are included in adjusted operating income as these results are a principal source of earnings. These earnings are reflected on a U.S. GAAP basis on an after-tax basis as a separate line on the Company's Unaudited Interim Consolidated Statements of Operations.

Earnings attributable to noncontrolling interests are excluded from adjusted operating income. Earnings attributable to noncontrolling interests represents the portion of earnings from consolidated entities that relates to the equity interests of minority investors, and are reflected on a U.S. GAAP basis as a separate line on the Company's Unaudited Interim Consolidated Statements of Operations.

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

The summary below reconciles adjusted operating income before income taxes for the Financial Services Businesses to income from continuing operations before income taxes and equity in earnings of operating joint ventures:

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
Adjusted Operating Income before income taxes for Financial Services Businesses by Segment:		
Individual Annuities	\$ 421	\$ 274
Retirement	156	172
Asset Management	121	154
Total U.S. Retirement Solutions and Investment Management Division	698	600
Individual Life	112	98
Group Insurance	(38)	39
Total U.S. Individual Life and Group Insurance Division	74	137
International Insurance	606	628
Total International Insurance Division	606	628
Corporate Operations	(363)	(269)
Total Corporate and Other	(363)	(269)
Adjusted Operating Income before income taxes for Financial Services Businesses	1,015	1,096
Reconciling items:		
Realized investment gains (losses), net, and related adjustments	(2,716)	(365)
Charges related to realized investment gains (losses), net	878	(10)
Investment gains (losses) on trading account assets supporting insurance liabilities, net	234	(17)
Change in experience-rated contractholder liabilities due to asset value changes	(246)	34
Divested businesses	1	(9)
Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests	5	(133)
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures for Financial Services Businesses	(829)	596
Income from continuing operations before income taxes and equity in earnings of operating joint ventures for Closed Block Business	30	32
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures	\$ (799)	\$ 628

The U.S. Retirement Solutions and Investment Management Division and U.S. Individual Life and Group Insurance Division results reflect deferred policy acquisition costs as if the individual annuity business and group insurance business were stand-alone operations. The elimination of intersegment costs capitalized in accordance with this policy is included in consolidating adjustments within Corporate and Other operations.

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

The summary below presents revenues for the Company's reportable segments:

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
Financial Services Businesses:		
Individual Annuities	\$ 958	\$ 898
Retirement	1,107	1,206
Asset Management	539	548
Total U.S. Retirement Solutions and Investment Management Division	2,604	2,652
Individual Life	776	725
Group Insurance	1,547	1,506
Total U.S. Individual Life and Group Insurance Division	2,323	2,231
International Insurance	5,849	4,321
Total International Insurance Division	5,849	4,321
Corporate Operations	(125)	(57)
Total Corporate and Other	(125)	(57)
Total	10,651	9,147
Reconciling items:		
Realized investment gains (losses), net, and related adjustments	(2,717)	(365)
Charges related to realized investment gains (losses), net	(29)	(34)
Investment gains (losses) on trading account assets supporting insurance liabilities, net	234	(17)
Divested businesses	15	50
Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests	(6)	(158)
Total Financial Services Businesses	8,148	8,623
Closed Block Business	1,475	1,547
Total per Unaudited Interim Consolidated Financial Statements	\$ 9,623	\$ 10,170

The Asset Management segment revenues include intersegment revenues primarily consisting of asset-based management and administration fees as follows:

	Three Months Ended	
	March 31,	
	2012	2011
	(in millions)	
Asset Management segment intersegment revenues	\$ 128	\$ 112

Management has determined the intersegment revenues with reference to market rates. Intersegment revenues are eliminated in consolidation in Corporate and Other.

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

The summary below presents total assets for the Company's reportable segments as of the dates indicated:

	March 31, 2012	December 31, 2011
	(in millions)	
Individual Annuities	\$ 132,478	\$ 123,394
Retirement	136,451	131,947
Asset Management	38,421	37,307
Total U.S. Retirement Solutions and Investment Management Division	307,350	292,648
Individual Life	45,017	43,063
Group Insurance	38,686	36,981
Total U.S. Individual Life and Group Insurance Division	83,703	80,044
International Insurance	168,257	168,961
Total International Insurance Division	168,257	168,961
Corporate Operations	8,504	9,347
Total Corporate and Other	8,504	9,347
Total Financial Services Businesses	567,814	551,000
Closed Block Business	69,923	69,244
Total	\$ 637,737	\$ 620,244

12. INCOME TAXES

The Company's liability for income taxes includes the liability for unrecognized tax benefits, interest and penalties which relate to tax years still subject to review by the Internal Revenue Service (IRS) or other taxing authorities. Audit periods remain open for review until the statute of limitations has passed. Generally, for tax years which produce net operating losses, capital losses or tax credit carryforwards (tax attributes), the statute of limitations does not close, to the extent of these tax attributes, until the expiration of the statute of limitations for the tax year in which they are fully utilized. The completion of review or the expiration of the statute of limitations for a given audit period could result in an adjustment to the liability for income taxes. The statute of limitations for the 2004 through 2006 tax years will expire in December 2012, unless extended. The statute of limitations for the 2007 tax year will expire in December 2013, unless extended. Tax years 2008 through 2011 are still open for IRS examination. It is reasonably possible that the total amount of unrecognized tax benefits will decrease anywhere from \$0 to \$83 million within the next 12 months due to the completion of the IRS examination for tax years 2007 through 2010.

During 2004 through 2006, the Company entered into two transactions that involved, among other things, the payment of foreign income taxes that were credited against the Company's U.S. tax liability. On May 23, 2011, the IRS issued notices of proposed adjustments disallowing the foreign tax credits claimed and related transaction expenses. The total amount of the proposed adjustments for the transactions was approximately \$200 million of tax and penalties. During the fourth quarter of 2011, the Company reached agreement with the IRS on the resolution of the proposed foreign tax credits disallowance. The impact to the 2011 results attributable to the settlement was an increase to tax expense of approximately \$93 million. The settlement of the foreign tax credit transactions for 2004 through 2006 marked the conclusion of the IRS audits for those years. As a result, all unrecognized tax positions plus interest relating to tax years prior to 2007 were recognized in 2011. As such, 2011 benefited from a reduction to the liability for unrecognized tax benefits of \$70 million, including the impact from the foreign tax credit disallowance.

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

The dividends received deduction (DRD) reduces the amount of dividend income subject to U.S. tax and is a significant component of the difference between the Company's effective tax rate and the federal statutory tax rate of 35%. The DRD for the current period was estimated using information from 2011, current year results, and was adjusted to take into account the current year's equity market performance. The actual current year DRD can vary from the estimate based on factors such as, but not limited to, changes in the amount of dividends received that are eligible for the DRD, changes in the amount of distributions received from mutual fund investments, changes in the account balances of variable life and annuity contracts, and the Company's taxable income before the DRD.

In August 2007, the IRS released Revenue Ruling 2007-54, which included, among other items, guidance on the methodology to be followed in calculating the DRD related to variable life insurance and annuity contracts. In September 2007, the IRS released Revenue Ruling 2007-61. Revenue Ruling 2007-61 suspended Revenue Ruling 2007-54 and informed taxpayers that the U.S. Treasury Department and the IRS intend to address through new guidance the issues considered in Revenue Ruling 2007-54, including the methodology to be followed in determining the DRD related to variable life insurance and annuity contracts. On February 13, 2012, the Obama Administration released the General Explanations of the Administration's Revenue Proposals. One proposal would change the method used to determine the amount of the DRD. A change in the DRD, including the possible retroactive or prospective elimination of this deduction through guidance or legislation, could increase actual tax expense and reduce the Company's consolidated net income. These activities had no impact on the Company's 2011 or first quarter 2012 results.

For tax years 2007 through 2011, the Company is participating in the IRS's Compliance Assurance Program (CAP). Under CAP, the IRS assigns an examination team to review completed transactions contemporaneously during these tax years in order to reach agreement with the Company on how they should be reported in the tax returns. If disagreements arise, accelerated resolutions programs are available to resolve the disagreements in a timely manner before the tax returns are filed. It is management's expectation this program will shorten the time period between the filing of the Company's federal income tax returns and the IRS's completion of its examination of the returns.

Total income tax expense includes additional tax expense related to the utilization of deferred tax assets recorded in the Statement of Financial Position as of the acquisition date for Prudential Gibraltar Financial Life Insurance Company, Ltd. (PGFL) and the Star and Edison Businesses. The balance of additional tax expense to be recognized in the future related to the utilization of opening balance sheet deferred tax assets is as follows:

	PGFL	Star and Edison Businesses (in millions)	Total
Opening balance sheet deferred tax assets after valuation allowance that will result in additional tax expense	\$ 42	\$ 678	\$ 720
Additional tax expense recognized in the Statement of Operations:			
2009	6	0	6
2010	6	0	6
2011	(29)	252	223
1Q 2012	(2)	339	337

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Subtotal	(19)	591	572
Additional tax expense recognized in Other Comprehensive Income	19	10	29
Additional tax expense to be recognized in future periods	\$ 42	\$ 77	\$ 119

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

13. FAIR VALUE OF ASSETS AND LIABILITIES

Fair Value Measurement Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The authoritative guidance around fair value establishes a framework for measuring fair value that includes a hierarchy used to classify the inputs used in measuring fair value. The hierarchy prioritizes the inputs to valuation techniques into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement. The levels of the fair value hierarchy are as follows:

Level 1 Fair value is based on unadjusted quoted prices in active markets that are accessible to the Company for identical assets or liabilities. These generally provide the most reliable evidence and are used to measure fair value whenever available. Active markets are defined as having the following characteristics for the measured asset/liability: (i) many transactions, (ii) current prices, (iii) price quotes not varying substantially among market makers, (iv) narrow bid/ask spreads and (v) most information publicly available. The Company's Level 1 assets and liabilities primarily include certain cash equivalents and short term investments, equity securities and derivative contracts that are traded in an active exchange market. Prices are obtained from readily available sources for market transactions involving identical assets or liabilities.

Level 2 Fair value is based on significant inputs, other than Level 1 inputs, that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability through corroboration with observable market data. Level 2 inputs include quoted market prices in active markets for similar assets and liabilities, quoted market prices in markets that are not active for identical or similar assets or liabilities, and other market observable inputs. The Company's Level 2 assets and liabilities include: fixed maturities (corporate public and private bonds, most government securities, certain asset-backed and mortgage-backed securities, etc.), certain equity securities (mutual funds, which do not actively trade and are priced based on a net asset value), certain commercial mortgage loans, short-term investments and certain cash equivalents (primarily commercial paper), and certain over-the-counter derivatives. Valuations are generally obtained from third party pricing services for identical or comparable assets or liabilities or through the use of valuation methodologies using observable market inputs. Prices from services are validated through comparison to trade data and internal estimates of current fair value, generally developed using market observable inputs and economic indicators.

Level 3 Fair value is based on at least one or more significant unobservable inputs for the asset or liability. These inputs reflect the Company's assumptions about the inputs market participants would use in pricing the asset or liability. The Company's Level 3 assets and liabilities primarily include: certain private fixed maturities and equity securities, certain manually priced public equity securities and fixed maturities, certain highly structured over-the-counter derivative contracts, certain commercial mortgage loans, certain consolidated real estate funds for which the Company is the general partner, and embedded derivatives resulting from certain products with guaranteed benefits. Prices are determined using valuation methodologies such as option pricing models, discounted cash flow models and other similar techniques. Non-binding broker quotes, which are utilized when pricing service information is not available, are reviewed for reasonableness based on the Company's understanding of the market, and are generally considered Level 3. Under certain conditions, based on its observations of transactions in active markets, the Company may conclude the prices received from independent third party pricing services or brokers are not reasonable or reflective of market activity. In those instances, the Company may choose to over-ride the third party pricing information or quotes received and apply internally-developed values to the related assets or liabilities. To the extent the internally-developed valuations use significant unobservable inputs, they are classified as Level 3. As of March 31, 2012 and December 31, 2011, these over-rides on a net basis were not material.

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

The Company has established policies and guidelines that require the establishment of valuation methodologies and consistent application of such methodologies. These policies and guidelines govern the use of inputs and price source hierarchies and provide controls around the valuation processes. These controls include appropriate review and analysis of prices against market activity or indicators of reasonableness, approval of price source changes, price overrides, methodology changes and classification of fair value hierarchy levels. The valuation policies and guidelines are reviewed and updated as appropriate.

Assets and Liabilities by Hierarchy Level The tables below present the balances of assets and liabilities measured at fair value on a recurring basis, as of the dates indicated.

	As of March 31, 2012				
	Level 1	Level 2	Level 3	Netting(1)	Total
	(in millions)				
Fixed maturities, available-for-sale:					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ 0	\$ 14,061	\$ 68	\$	\$ 14,129
Obligations of U.S. states and their political subdivisions	0	3,044	10		3,054
Foreign government bonds	0	76,308	26		76,334
Corporate securities	43	126,793	1,633		128,469
Asset-backed securities	0	8,239	2,665		10,904
Commercial mortgage-backed securities	0	12,082	161		12,243
Residential mortgage-backed securities	0	9,444	14		9,458
Subtotal	43	249,971	4,577		254,591
Trading account assets supporting insurance liabilities:					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	0	177	11		188
Obligations of U.S. states and their political subdivisions	0	261	0		261
Foreign government bonds	0	657	0		657
Corporate securities	0	11,573	103		11,676
Asset-backed securities	0	919	389		1,308
Commercial mortgage-backed securities	0	2,145	2		2,147
Residential mortgage-backed securities	0	1,874	2		1,876
Equity securities	848	132	19		999
Short-term investments and cash equivalents	490	77	0		567
Subtotal	1,338	17,815	526		19,679
Other trading account assets:					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	0	141	0		141
Obligations of U.S. states and their political subdivisions	0	0	0		0
Foreign government bonds	2	43	0		45
Corporate securities	17	520	39		576
Asset-backed securities	0	400	57		457
Commercial mortgage-backed securities	0	96	12		108
Residential mortgage-backed securities	0	99	1		100
Equity securities	335	56	1,243		1,634
All other(2)	15	11,036	48	(8,979)	2,120
Subtotal	369	12,391	1,400	(8,979)	5,181
Equity securities, available-for-sale	5,345	2,259	422		8,026
Commercial mortgage and other loans	0	203	75		278

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Other long-term investments	187	70	1,086		1,343
Short-term investments	4,281	3,423	0		7,704
Cash equivalents	2,673	7,044	0		9,717
Other assets	135	99	8		242
Subtotal excluding separate account assets	14,371	293,275	8,094	(8,979)	306,761
Separate account assets(3)	45,626	171,006	19,935		236,567
Total assets	\$ 59,997	\$ 464,281	\$ 28,029	\$ (8,979)	\$ 543,328
Future policy benefits	\$ 0	\$ 0	\$ 1,709	\$	\$ 1,709
Other liabilities	0	7,129	299	(6,861)	567
Total liabilities	\$ 0	\$ 7,129	\$ 2,008	\$ (6,861)	\$ 2,276

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

	As of December 31, 2011				
	Level 1	Level 2	Level 3	Netting(1)	Total
	(in millions)				
Fixed maturities, available-for-sale:					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ 0	\$ 15,038	\$ 66	\$	\$ 15,104
Obligations of U.S. states and their political subdivisions	0	3,055	0		3,055
Foreign government bonds	0	76,962	25		76,987
Corporate securities	12	125,411	1,450		126,873
Asset-backed securities	0	8,165	2,528		10,693
Commercial mortgage-backed securities	0	11,935	145		12,080
Residential mortgage-backed securities	0	9,840	16		9,856
Subtotal	12	250,406	4,230		254,648
Trading account assets supporting insurance liabilities:					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	0	177	9		186
Obligations of U.S. states and their political subdivisions	0	284	0		284
Foreign government bonds	0	655	0		655
Corporate securities	0	10,927	109		11,036
Asset-backed securities	0	1,010	357		1,367
Commercial mortgage-backed securities	0	2,226	21		2,247
Residential mortgage-backed securities	0	1,842	2		1,844
Equity securities	769	122	20		911
Short-term investments and cash equivalents	684	267	0		951
Subtotal	1,453	17,510	518		19,481
Other trading account assets:					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	0	31	0		31
Obligations of U.S. states and their political subdivisions	0	0	0		0
Foreign government bonds	2	45	0		47
Corporate securities	14	502	39		555
Asset-backed securities	0	593	59		652
Commercial mortgage-backed securities	0	96	14		110
Residential mortgage-backed securities	0	94	2		96
Equity securities	305	40	1,276		1,621
All other(2)	15	13,547	93	(11,222)	2,433
Subtotal	336	14,948	1,483	(11,222)	5,545
Equity securities, available-for-sale	5,004	2,171	360		7,535
Commercial mortgage and other loans	0	514	86		600
Other long-term investments	193	(11)	1,110		1,292
Short-term investments	5,506	3,254	0		8,760
Cash equivalents	2,667	6,762	0		9,429
Other assets	3	86	9		98
Subtotal excluding separate account assets	15,174	295,640	7,796	(11,222)	307,388
Separate account assets(3)	40,319	158,703	19,358		218,380
Total assets	\$ 55,493	\$ 454,343	\$ 27,154	\$ (11,222)	\$ 525,768
Future policy benefits					
Other liabilities	\$ 0	\$ 0	\$ 2,886	\$	\$ 2,886
	0	8,013	285	(7,854)	444

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Total liabilities	\$	0	\$	8,013	\$	3,171	\$	(7,854)	\$	3,330
-------------------	----	---	----	-------	----	-------	----	---------	----	-------

- (1) Netting amounts represent cash collateral of \$2,118 million and \$3,368 million as of March 31, 2012 and December 31, 2011, respectively, and the impact of offsetting asset and liability positions held with the same counterparty.
- (2) Primarily represents derivative assets.
- (3) Separate account assets represent segregated funds that are invested for certain customers. Investment risks associated with market value changes are borne by the customers, except to the extent of minimum guarantees made by the Company with respect to certain accounts. Separate account assets classified as Level 3 consist primarily of real estate and real estate investment funds. Separate account liabilities are not included in the above table as they are reported at contract value and not fair value in the Company's Unaudited Interim Consolidated Statement of Financial Position.

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

The methods and assumptions the Company uses to estimate the fair value of assets and liabilities measured at fair value on a recurring basis are summarized below.

Fixed Maturity Securities The fair values of the Company's public fixed maturity securities are generally based on prices obtained from independent pricing services. Prices from pricing services are sourced from multiple vendors, and a vendor hierarchy is maintained by asset type based on historical pricing experience and vendor expertise. The Company generally receives prices from multiple pricing services for each security, but ultimately uses the price from the pricing service highest in the vendor hierarchy based on the respective asset type. To validate reasonableness, prices are reviewed by internal asset managers through comparison with directly observed recent market trades and internal estimates of current fair value, developed using market observable inputs and economic indicators. Consistent with the fair value hierarchy described above, securities with validated quotes from pricing services are generally reflected within Level 2, as they are primarily based on observable pricing for similar assets and/or other market observable inputs. If the pricing information received from third party pricing services is not reflective of market activity or other inputs observable in the market, the Company may challenge the price through a formal process with the pricing service. If the pricing service updates the price to be more consistent in comparison to the presented market observations, the security remains within Level 2.

If the Company ultimately concludes that pricing information received from the independent pricing service is not reflective of market activity, non-binding broker quotes are used, if available. If the Company concludes the values from both pricing services and brokers are not reflective of market activity, it may over-ride the information from the pricing service or broker with an internally-developed valuation. As of March 31, 2012 and December 31, 2011, over-rides on a net basis were not material. Internally-developed valuations or non-binding broker quotes are also used to determine fair value in circumstances where vendor pricing is not available. These estimates may use significant unobservable inputs, which reflect the Company's own assumptions about the inputs market participants would use in pricing the asset. Circumstances where observable market data are not available may include events such as market illiquidity and credit events related to the security. Pricing service over-rides, internally-developed valuations and non-binding broker quotes are generally included in Level 3 in the fair value hierarchy.

The fair value of private fixed maturities, which are primarily comprised of investments in private placement securities, originated by internal private asset managers, are primarily determined using a discounted cash flow model. In certain cases these models primarily use observable inputs with a discount rate based upon the average of spread surveys collected from private market intermediaries who are active in both primary and secondary transactions, taking into account, among other factors, the credit quality and industry sector of the issuer and the reduced liquidity associated with private placements. Generally, these securities have been reflected within Level 2. For certain private fixed maturities, the discounted cash flow model may also incorporate significant unobservable inputs, which reflect the Company's own assumptions about the inputs market participants would use in pricing the asset. To the extent management determines that such unobservable inputs are not significant to the price of a security, a Level 2 classification is made. Otherwise, a Level 3 classification is used.

Private fixed maturities also include debt investments in funds that, in addition to a stated coupon, pay a return based upon the results of the underlying portfolios. The fair values of these securities are determined by reference to the funds' net asset value (NAV). Since the NAV at which the funds trade can be observed by redemption and subscription transactions between third parties, the fair values of these investments have been reflected within Level 2 in the fair value hierarchy.

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

Trading Account Assets Trading account assets (including trading account assets supporting insurance liabilities) consist primarily of public corporate bonds, treasuries, equity securities and derivatives whose fair values are determined consistent with similar instruments described above under Fixed Maturity Securities and below under Equity Securities and Derivative Instruments.

Equity Securities Equity securities consist principally of investments in common and preferred stock of publicly traded companies, perpetual preferred stock, privately traded securities, as well as common stock mutual fund shares. The fair values of most publicly traded equity securities are based on quoted market prices in active markets for identical assets and are classified within Level 1 in the fair value hierarchy. Estimated fair values for most privately traded equity securities are determined using valuation and discounted cash flow models that require a substantial level of judgment. In determining the fair value of certain privately traded equity securities the discounted cash flow model may also use unobservable inputs, which reflect the Company's assumptions about the inputs market participants would use in pricing the asset. Most privately traded equity securities are classified within Level 3. The fair values of common stock mutual fund shares that transact regularly (but do not trade in active markets because they are not publicly available) are based on transaction prices of identical fund shares and are classified within Level 2 in the fair value hierarchy. The fair values of preferred equity securities are based on prices obtained from independent pricing services. These prices are then validated for reasonableness against recently traded market prices. Accordingly, these securities are generally classified within Level 2 in the fair value hierarchy. Fair values of perpetual preferred stock based on observable market inputs are classified within Level 2. However, when prices from independent pricing services are based on non-binding broker quotes as the directly observable market inputs become unavailable, the fair values of perpetual preferred stock are classified as Level 3.

Commercial Mortgage and Other Loans The fair value of commercial mortgage loans held for investment (i.e. interim portfolio) and accounted for using the Fair Value Option are determined based on the present value of the expected future cash flows discounted at the appropriate U.S. Treasury rate, adjusted for the current market spread for similar quality loans. The quality ratings for these loans, a primary determinant of the appropriate credit spread and a significant component of the pricing input, are based on internally-developed methodology. As a result, these loans are included in Level 3 in the fair value hierarchy.

The fair value of loans held and accounted for using the Fair Value Option is determined utilizing pricing indicators from the whole loan market, where investors are committed to purchase these loans at a pre-determined price, which is considered the principal exit market for these loans. The Company has evaluated the valuation inputs used for these assets, including the existence of pre-determined exit prices, the terms of the loans, prevailing interest rates and credit risk, and deemed that the primary pricing inputs are Level 2 inputs in the fair value hierarchy.

Other Long-Term Investments Other long-term investments include limited partnerships which are consolidated because the Company is either deemed to exercise control or considered the primary beneficiary of a variable interest entity. These entities are considered investment companies and follow specialized industry accounting whereby their assets are carried at fair value. The investments held by these entities include various feeder fund investments in underlying master funds (whose underlying holdings generally include public fixed maturities, equity securities and mutual funds), as well as wholly-owned real estate held within other investment funds. The fair value of the feeder fund investments in master funds are generally determined by reference to the investments in the underlying master funds.

The fair value of investments in funds holding publicly traded equity securities are generally based on quoted prices in active markets for identical investments and are therefore reflected as Level 1. The fair value of investments in funds holding public fixed maturities and mutual

funds are generally based on validated quotes

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

from pricing services or observable data as described above, and are reflected in Level 2. The fair value of investments in funds that are subject to significant liquidity restrictions are reflected in Level 3.

The fair value of fund investments, where the fair value option has been elected, is primarily determined by the fund managers. Since the valuations may be based on unobservable market inputs and cannot be validated by the Company, these investments have been included within Level 3 in the fair value hierarchy.

The fair value of real estate held in consolidated investment funds is determined through an independent appraisal process. The appraisals generally utilize a discounted cash flow model, following an income approach that incorporates various assumptions including rental revenue, operating expenses and discount rates. The cash flow approach is supplemented with replacement cost estimates and comparable recent sales data when available. These appraisals and the related assumptions are updated at least annually, and incorporate historical property experience and any observable market data, including any market transactions. Since many of the assumptions utilized are unobservable and are considered to be significant inputs to the valuation, the real estate investments within other long-term investments have been reflected within Level 3 in the fair value hierarchy.

Derivative Instruments Derivatives are recorded at fair value either as assets, within Other trading account assets, or Other long-term investments, or as liabilities, within Other liabilities, except for embedded derivatives which are recorded with the associated host contract. The fair values of derivative contracts are determined based on quoted prices in active exchanges or through the use of valuation models. The fair values of derivative contracts can be affected by changes in interest rates, foreign exchange rates, commodity prices, credit spreads, market volatility, expected returns, non-performance risk, liquidity and other factors.

Liquidity valuation adjustments are made to reflect the cost of exiting significant risk positions, and consider the bid-ask spread, maturity, complexity, and other specific attributes of the underlying derivative position.

The Company's exchange-traded futures and options include treasury futures, eurodollar futures, commodity futures, eurodollar options and commodity options. Exchange-traded futures and options are valued using quoted prices in active markets and are classified within Level 1 in the fair value hierarchy.

The majority of the Company's derivative positions are traded in the over-the-counter (OTC) derivative market and are classified within Level 2 in the fair value hierarchy. OTC derivatives classified within Level 2 are valued using models generally accepted in the financial services industry that use actively quoted or observable market input values from external market data providers, third-party pricing vendors and/or recent trading activity. The fair values of most OTC derivatives, including interest rate and cross currency swaps, currency forward contracts, commodity swaps, commodity forward contracts, single name credit default swaps, loan commitments held for sale and to-be-announced (or TBA) forward contracts on highly rated mortgage-backed securities issued by U.S. government sponsored entities are determined using discounted cash flow models. The fair values of European style option contracts are determined using Black-Scholes option pricing models. These models' key inputs include the contractual terms of the respective contract, along with significant observable inputs, including interest rates, currency rates, credit spreads, equity prices, index dividend yields, non-performance risk, volatility and other factors.

OTC derivative contracts are executed under master netting agreements with counterparties with a Credit Support Annex, which is a bilateral ratings-sensitive agreement that requires collateral postings at established credit threshold levels. These agreements protect the interests of the Company and its counterparties, should either party suffer a credit rating deterioration. The vast majority of the Company's derivative agreements are with highly rated major international financial institutions. To reflect the market's perception of its own and the counterparty's non-performance risk, the Company incorporates additional spreads over London Interbank Offered Rate (LIBOR) into the discount rate used in determining the fair value of OTC derivative assets and

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

liabilities. The additional credit spread over LIBOR rates is determined taking into consideration publicly available information relating to the financial strength of the Company. The Company adjusts these credit spreads to remove any illiquidity risk premium, which is subject to a floor based on a percentage of the credit spread. However, the non-performance risk adjustment is applied only to the uncollateralized portion of the OTC derivative assets and liabilities, after consideration of the impacts of two-way collateral posting. Most OTC derivative contract inputs have bid and ask prices that are actively quoted or can be readily obtained from external market data providers. The Company's policy is to use mid-market pricing in determining its best estimate of fair value.

Derivatives classified as Level 3 include first-to-default credit basket swaps, look-back equity options and other structured products. These derivatives are valued based upon models with some significant unobservable market inputs or inputs from less actively traded markets. The fair values of first-to-default credit basket swaps are derived from relevant observable inputs (e.g. individual credit default spreads, interest rates and recovery rates), and unobservable model-specific input values such as correlation between different credits within the same basket. Look-back equity options and other structured options and derivatives are valued using simulation models such as the Monte Carlo and other techniques. The input values for look-back equity options are derived from observable market indices (e.g. interest rates, dividend yields and equity indices), and unobservable model-specific input values including certain volatility parameters. Level 3 methodologies are validated through periodic comparison of the Company's fair values to broker-dealer values.

Cash Equivalents and Short-Term Investments Cash equivalents and short-term investments include money market instruments, commercial paper and other highly liquid debt instruments. Money market instruments are generally valued using unadjusted quoted prices in active markets that are accessible for identical assets and are primarily classified as Level 1. The remaining instruments in the Cash Equivalents and Short-term Investments category are typically not traded in active markets; however, their fair values are based on market observable inputs and, accordingly, these investments have been classified within Level 2 in the fair value hierarchy.

Separate Account Assets Separate Account Assets primarily include fixed maturity securities, treasuries, equity securities and real estate investments for which values are determined consistent with similar instruments described above under Fixed Maturity Securities, Equity Securities and Other Long-Term Investments.

Other Liabilities Other liabilities include derivative instruments, the fair values of which are determined consistent with similar derivative instruments described above under Derivative Instruments.

Future Policy Benefits The liability for future policy benefits primarily includes general account liabilities for guarantees on variable annuity contracts, including guaranteed minimum accumulation benefits (GMAB), guaranteed minimum withdrawal benefits (GMWB) and guaranteed minimum income and withdrawal benefits (GMIWB), accounted for as embedded derivatives. The fair values of the GMAB, GMWB and GMIWB liabilities are calculated as the present value of future expected benefit payments to customers less the present value of assessed rider fees attributable to the embedded derivative feature. This methodology could result in either a liability or contra-liability balance, given changing capital market conditions and various policyholder behavior assumptions. Since there is no observable active market for the transfer of these obligations, the valuations are calculated using internally-developed models with option pricing techniques. The models are based on a risk neutral valuation framework and incorporate premiums for risks inherent in valuation techniques, inputs, and the general uncertainty around the timing and amount of future cash flows. The determination of these risk premiums requires the use of management judgment.

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

The significant inputs to the valuation models for the embedded derivatives associated with the optional living benefit features of the Company's variable annuity products include capital market assumptions, such as interest rate and implied volatility assumptions, the Company's market-perceived risk of its own non-performance (NPR), as well as various assumptions that are actuarially determined, including lapse rates, benefit utilization rates, withdrawal rates, and mortality rates. Since many of the assumptions utilized in the valuation of the embedded derivatives associated with the Company's optional living benefit features are unobservable and are considered to be significant inputs to the liability valuation, the liability included in future policy benefits has been reflected within Level 3 in the fair value hierarchy.

Capital market inputs and actual policyholders' account values are updated each quarter based on capital market conditions as of the end of the quarter, including interest rates, equity markets and implied volatility. In the risk neutral valuation, interest rates are used to both grow the policyholders' account values and discount all projected future cash flows. The Company's discount rate assumption is based on the LIBOR swap curve, and is adjusted for NPR, as discussed below. Assuming all other assumptions remain unchanged, a decline in interest rates will generally cause account values to grow more slowly, increasing future expected benefit payments, as well as decreasing the discounting impact in the present value calculation, both of which would cause increases in the fair value of the liability. The opposite impacts occur as interest rates rise. Implied volatility also impacts the estimate of future expected benefit payments. An increase in implied volatility will generally increase future expected benefit payments, causing an increase in the fair value of the liability. The opposite impact occurs as implied volatility declines.

Actuarial assumptions are reviewed at least annually, and updated based upon historical experience giving consideration to any observable market data, including market transactions such as acquisitions and reinsurance transactions. Assumptions relating to contractholder behavior such as lapse, benefit utilization, withdrawal, and mortality rates, are based on experience by product type and/or year of contract issuance. Unless a material change in contractholder behavior or mortality experience that the Company feels is indicative of a long term trend is observed in an interim period, assumptions related to contractholder behavior and mortality are generally updated in the third quarter of each year by considering the actual experience that has occurred during the period from the most recent update to the expected amounts. These assumptions require the use of management judgment and are discussed in further detail below.

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

Level 3 Assets and Liabilities by Price Source The table below presents the balances of Level 3 assets and liabilities measured at fair value with their corresponding pricing sources.

	As of March 31, 2012		
	Internal(1)	External(2) (in millions)	Total
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ 4	\$ 75	\$ 79
Obligations of U.S. states and their political subdivisions	0	10	10
Foreign government bonds	0	26	26
Corporate securities	1,020	755	1,775
Asset-backed securities	316	2,795	3,111
Commercial mortgage-backed securities	144	31	175
Residential mortgage-backed securities	3	14	17
Equity securities	177	1,507	1,684
Commercial mortgage and other loans	75	0	75
Other long-term investments	(3)	1,089	1,086
Other assets	48	8	56
Subtotal excluding separate account assets(3)	1,784	6,310	8,094
Separate account assets:			
Corporate securities	79	430	509
Equity securities	0	505	505
Commercial mortgage loans	1,185	0	1,185
Real estate	661	0	661
Other invested assets	17,075	0	17,075
Subtotal separate account assets	19,000	935	19,935
Total assets	\$ 20,784	\$ 7,245	\$ 28,029
Future policy benefits	\$ 1,709	\$ 0	\$ 1,709
Other liabilities	4	295	299
Total liabilities	\$ 1,713	\$ 295	\$ 2,008

(1) Represents valuations reflecting both internally-derived and market inputs, as well as third-party pricing information or quotes. See below for additional information related to internally-developed valuation for significant items in the above table.

(2) Represents unadjusted prices from independent pricing services and independent non-binding broker quotes where pricing inputs are not readily available.

(3) Includes assets classified as fixed maturities available-for-sale, trading account assets supporting insurance liabilities and other trading account assets.

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

Quantitative Information Regarding Internally-Priced Level 3 Assets and Liabilities The table below represents quantitative information on significant internally-priced Level 3 assets and liabilities.

	Fair Value (in millions)	Valuation Techniques	As of March 31, 2012	
			Unobservable Input	Range (Weighted Average)
Assets:				
Corporate securities	\$ 1,020	Discounted cash flow Market comparables Cap at call price Liquidation	Discount rate EBITDA multiples(1) Call price Liquidation value	1.5% -23.5% (10.65%) 5X - 8X (7.24X) 100% -102% (100.45%) 7.2% - 96% (78.98%)
Asset-backed securities	\$ 316	Discounted cash flow	Prepayment rate Default rate Loss severity Liquidity premium Average life (years) Comparable spreads Comparable security yields	2.8% - 20% (7.10%) 0.5% - 2.4% (0.99%) 25% - 35% (29.13%) 0.5% - 3.75% (1.62%) 0.5 years -5 years (3.19 years) 0.5% - 5.4% (1.71%) 10.7% - 24.4% (13.23%)
Separate account assets:				
Commercial mortgage loans	\$ 1,185	Discounted cash flow Third-party appraisals -	Credit spread	1.70% - 8.99% (2.13%)
Other invested assets	\$ 17,075	see discussion below		
Liabilities:				
Future policy benefits	\$ 1,709	Discounted cash flow	Lapse rate NPR spread Utilization rate Withdrawal rate Mortality rate(2) Equity volatility curve	0% - 15% 0.4% - 2% 60% - 90% 90% - 100% 0% - 10% 18% - 30%

(1) EBITDA multiples represent multiples of earnings before interest, taxes, depreciation and amortization, and are amounts used when the reporting entity has determined that market participants would use such multiples when pricing the investments.

(2) Range reflects the mortality rate for the vast majority of business with living benefits, with policyholders ranging from 35 to 90 years old. While the majority of living benefits have a minimum age requirement, certain benefits do not have an age restriction. This results in contractholders for certain benefits with mortality rates approaching 0%.

Corporate Securities Internally-priced corporate securities classified in Level 3 include certain below investment grade watchlist and distressed fixed maturity securities. For securities where discounted cash flows are used, the primary unobservable input is the internally-developed discount rate. Significant increases in the discount rate would result in a significantly lower fair value, with the reverse being true for decreases

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

in the discount rate. In certain cases, the Company uses an estimated liquidation value of the borrower or underlying assets. The Company also applies market comparables, such as earnings before interest, taxes, depreciation and

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

amortization (EBITDA) multiples for certain securities. In isolation, an increase in the value of these inputs would result in an increase in fair value, with the reverse being true for decreases in the value of these inputs.

Asset-Backed Securities Asset-backed securities classified in Level 3 are primarily valued internally using a discounted cash flow technique. Unobservable inputs are the prepayment rate, default rate, loss severity, liquidity premium and comparable security spreads. In isolation, an increase in prepayment rate or a decrease in default rate or loss severity would generally result in an increase in fair value, although the interrelationships between these inputs depend on specific market conditions. However, in stressed markets, prepayment rates tend to decrease, while default rates and loss severities tend to increase. These changes will result in a decrease in fair value. In other cases where a liquidity premium and/or comparable security spreads and yields are used, a significant increase in either of these inputs can produce a significant decrease in fair value.

Separate Account Assets Commercial Mortgage Loans Commercial mortgage loans held within separate accounts and classified as Level 3 are primarily valued internally using a discounted cash flow technique. See Commercial Mortgage and Other Loans under Fair Value of Financial Instruments below for a further discussion on valuation technique. The primary unobservable input used is the spread to discount cash flows. In isolation, an increase in the value of this input would result in a decrease in fair value, with the reverse being true for decreases in the value of these inputs.

Changes in fair value of these investments are borne by customers and thus are offset by changes in separate account liabilities on the Company's Unaudited Interim Consolidated Statement of Financial Position. As a result, changes in value associated with these investments do not impact the Company's Unaudited Interim Consolidated Statement of Operations.

Separate Account Assets Other Invested Assets Other Invested Assets held within separate accounts and classified as Level 3 include investments in real estate that are reported at fair value. In general, these fair value estimates are based on property appraisal reports prepared by independent real estate appraisers. Key inputs and assumptions to the appraisal process include rental income and expense amounts, related growth rates, discount rates and capitalization rates. In cases where real estate investments are made through indirect investments, fair value is generally determined by the Company's equity in net assets of the entities. Because of the subjective nature of inputs and the judgment involved in the appraisal process, real estate investments are typically included in the Level 3 classification.

Changes in fair value of these investments are borne by customers and thus are offset by changes in separate account liabilities on the Company's Unaudited Interim Consolidated Statement of Financial Position. As a result, changes in value associated with these investments do not impact the Company's Unaudited Interim Consolidated Statement of Operations. In addition, fees earned by the Company related to the management of these assets do not change due to changes in the fair value of these investments.

Future Policy Benefits Future policy benefits classified as Level 3 are calculated using internally-developed models with option pricing techniques. The models are based on a risk neutral valuation framework and incorporate premiums for risks inherent in valuation techniques, inputs and the general uncertainty around the timing and amount of future cash flows. As described above, the significant unobservable inputs to

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

the valuation models for the embedded derivatives associated with the optional living benefit features of the Company's variable annuity products include various assumptions that are actuarially determined, including lapse rates, benefit utilization rates, withdrawal rates and mortality rates as well as volatility assumptions and assumptions used to reflect NPR.

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

The Company's dynamic lapse rate assumption adjusts the base lapse rate at the contract level based on a comparison of the actuarially calculated guaranteed amount and the current policyholder account value as well as other factors, such as the applicability of any surrender charges. The dynamic lapse adjustment reduces the base lapse rate based on the magnitude of the difference between the guaranteed amount and the account value. In-the-money contracts are those with a guaranteed benefit in excess of the current policyholder account value. Since in-the-money contracts are less likely to lapse, the dynamic lapse adjustment will reduce the lapse rate assumption for these contracts. All else being equal, contracts having a larger difference between the guaranteed amount and the account value will have a smaller lapse rate after applying the dynamic lapse rate adjustment. For less in-the-money contracts, the lapse rate assumption will be closer to the base lapse rate. Lapse rates are also generally assumed to be lower for the period where surrender charges apply. A lower base lapse rate is applied to contracts in the surrender charge period. A higher base lapse rate is applied to contracts in the year the surrender charge period expires.

To reflect NPR, the Company incorporates an additional spread over LIBOR into the discount rate used in the valuations of the embedded derivatives associated with its optional living benefit features. Since insurance liabilities are senior to debt, the Company believes that reflecting the financial strength ratings of the Company's insurance subsidiaries in the valuation of the liability or asset appropriately takes into consideration NPR. The additional spread over LIBOR is determined taking into consideration publicly available information relating to the financial strength of the Company's insurance subsidiaries, as indicated by the credit spreads associated with funding agreements issued by these subsidiaries. The Company adjusts these credit spreads to remove any illiquidity risk premium, which is subject to a floor based on a percentage of the credit spread. This additional spread is applied at an individual contract level and only to those individual living benefit contracts in a liability position and generally not to those in a contra-liability position. An increase in the spread over LIBOR increases the discounting impact in the present value calculation and will generally cause a decrease in the fair value of the liability.

The Company's benefit utilization rate assumption estimates the percentage of contracts that will utilize the benefit during the contract duration, including the estimated timing of the first lifetime income withdrawal by the contractholder. These assumptions vary based on the product type, the age of the contractholder and the age of the contract. The utilization rate varies by product, based on the availability of an enhanced guarantee after a certain waiting period. For example, the utilization rates for a product with the opportunity to double the guaranteed value after a 10, 12 or 20 year accumulation period are adjusted based on contractholder experience related to such enhancement. Generally, the Company assumes about 60-90% of contractholders that utilize the guaranteed benefit (depending on the product type, contractholder age and contract age) will begin lifetime withdrawals at various time intervals from contract inception, with the remaining contractholders either beginning lifetime withdrawals immediately or never utilizing the benefit. The impact of changes in these assumptions is highly dependent on the contract type and age of the contractholder at the time of the sale and the timing of the first lifetime income withdrawal.

The Company's withdrawal rate assumption estimates the magnitude of annual contractholder withdrawals relative to the amount allowable under the contract. Larger differences in the withdrawal rate assumption compared to the contractual guaranteed income withdrawal percentage, either positive or negative, will generally result in a decrease in the fair value of the liability. Prior to the exhaustion of the contractholder's total account value, the Company assumes contractholders will withdraw a certain percentage of the maximum allowable amount under the contract and will withdraw the maximum once the contractholder account value is completely exhausted.

Based on historical experience, the Company applies a mortality rate adjustment compared to standard industry tables. Overall mortality rates vary by contract group based on the age of the contractholder. Generally,

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

the Company does not expect actual mortality trends to change significantly in the short-term and, to the extent these trends may change, the Company expects such changes to be gradual over the long-term. Since the variable annuity living benefits generally provide for a minimum withdrawal benefit for life, increases in mortality rates will decrease the fair value of the liability, with the reverse being true with decreases in mortality rates.

Market volatility also impacts the estimate of future expected benefit payments. The Company uses an equity volatility curve based on third-party inputs. The curve starts with first year implied volatility and grades to a long-term realized volatility. The first year implied volatility determines the overall slope of the equity volatility curve. An increase in implied volatility will generally increase future expected benefit payments, causing an increase in the fair value of the liability.

Transfers between Levels 1 and 2 There were no transfers between Levels 1 and 2 for the three months ended March 31, 2012 and 2011.

Changes in Level 3 assets and liabilities The following tables provide a summary of the changes in fair value of Level 3 assets and liabilities for the three months ended March 31, 2012, as well as the portion of gains or losses included in income for the three months ended March 31, 2012 attributable to unrealized gains or losses related to those assets and liabilities still held at March 31, 2012.

	Three Months Ended March 31, 2012					
	Fixed Maturities Available-For-Sale - U.S. Government Authorities	Fixed Maturities Available-For-Sale - U.S. States	Fixed Maturities Available-For-Sale - Foreign Government Bonds	Fixed Maturities Available-For-Sale - Corporate Securities	Fixed Maturities Available-For-Sale - Asset-Backed Securities	Fixed Maturities Available-For-Sale - Commercial Mortgage-Backed Securities
Fair Value, beginning of period	\$ 66	\$ 0	\$ 25	\$ 1,450	\$ 2,528	\$ 145
Total gains (losses) (realized/unrealized):						
Included in earnings:						
Realized investment gains (losses), net	0	0	0	2	2	0
Included in other comprehensive income (loss)	0	0	0	104	37	17
Net investment income	0	0	0	1	7	(2)
Purchases	0	10	1	172	507	19
Sales	0	0	0	(31)	(9)	0
Issuances	0	0	0	0	0	0
Settlements	0	0	0	(108)	(132)	(3)
Foreign currency translation	0	0	0	(24)	(29)	(3)
Other(1)	2	0	0	(2)	0	0
Transfers into Level 3(2)	0	0	0	138	0	0
Transfers out of Level 3(2)	0	0	0	(69)	(246)	(12)

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Fair Value, end of period	\$ 68	\$ 10	\$ 26	\$ 1,633	\$ 2,665	\$ 161
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(3):						
Included in earnings:						
Realized investment gains (losses), net	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Included in other comprehensive income (loss)	\$ 0	\$ 0	\$ 0	\$ 109	\$ 41	\$ 17

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

	Three Months Ended March 31, 2012					
	Fixed Maturities Available- For-Sale - Residential Mortgage- Backed Securities	Trading Account Assets Supporting Insurance Liabilities- U.S. Government Authorities	Trading Account Assets Supporting Insurance Liabilities- Corporate Securities	Trading Account Assets Supporting Insurance Liabilities- Asset- Backed Securities	Trading Account Assets Supporting Insurance Liabilities- Commercial Mortgage- Backed Securities	Trading Account Assets Supporting Insurance Liabilities- Residential Mortgage- Backed Securities
	(in millions)					
Fair Value, beginning of period	\$ 16	\$ 9	\$ 109	\$ 357	\$ 21	\$ 2
Total gains (losses) (realized/unrealized):						
Included in earnings:						
Asset management fees and other income	0	0	(4)	5	0	0
Net investment income	0	0	0	1	0	0
Purchases	0	0	3	89	0	0
Sales	0	0	0	0	0	0
Issuances	0	0	0	0	0	0
Settlements	(2)	0	(5)	(28)	0	0
Other(1)	0	2	(2)	0	0	0
Transfers into Level 3(2)	0	0	2	0	0	0
Transfers out of Level 3(2)	0	0	0	(35)	(19)	0
Fair Value, end of period	\$ 14	\$ 11	\$ 103	\$ 389	\$ 2	\$ 2
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(3):						
Included in earnings:						
Asset management fees and other income	\$ 0	\$ 0	\$ (6)	\$ 4	\$ 0	\$ 0

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

	Three Months Ended March 31, 2012				
	Trading Account Assets Supporting Insurance Liabilities- Equity Securities	Other Trading Account Assets- Corporate Securities	Other Trading Account Assets- Asset- Backed Securities (in millions)	Other Trading Account Assets- Commercial Mortgage- Backed Securities	Other Trading Account Assets- Residential Mortgage- Backed Securities
Fair Value, beginning of period	\$ 20	\$ 39	\$ 59	\$ 14	\$ 2
Total gains (losses) (realized/unrealized):					
Included in earnings:					
Asset management fees and other income	0	0	3	1	0
Net investment income	0	0	0	0	0
Purchases	0	1	0	0	0
Sales	0	(1)	(1)	(1)	(1)
Issuances	0	0	0	0	0
Settlements	0	0	(1)	(1)	0
Foreign currency translation	(1)	0	(2)	0	0
Transfers into Level 3(2)	0	0	0	0	0
Transfers out of Level 3(2)	0	0	(1)	(1)	0
Fair Value, end of period	\$ 19	\$ 39	\$ 57	\$ 12	\$ 1
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(3):					
Included in earnings:					
Asset management fees and other income	\$ 0	\$ 0	\$ 2	\$ 1	\$ 0

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

	Three Months Ended March 31, 2012				
	Other Trading Account Assets- Equity Securities	Other Trading Account Assets-All Other Activity	Equity Securities Available- For-Sale (in millions)	Commercial Mortgage and Other Loans	Other Long-term Investments
Fair Value, beginning of period	\$ 1,276	\$ 93	\$ 360	\$ 86	\$ 1,110
Total gains (losses) (realized/unrealized):					
Included in earnings:					
Realized investment gains (losses), net	0	(49)	2	(2)	(1)
Asset management fees and other income	44	0	0	0	21
Included in other comprehensive income (loss)	0	0	10	0	0
Net investment income	0	0	0	0	4
Purchases	2	0	63	0	42
Sales	(8)	0	(4)	0	(18)
Issuances	0	0	0	0	0
Settlements	(23)	4	0	(9)	(73)
Foreign currency translation	(48)	0	(13)	0	1
Transfers into Level 3(2)	0	0	5	0	0
Transfers out of Level 3(2)	0	0	(1)	0	0
Fair Value, end of period	\$ 1,243	\$ 48	\$ 422	\$ 75	\$ 1,086
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(3):					
Included in earnings:					
Realized investment gains (losses), net	\$ 0	\$ (49)	\$ 0	\$ (3)	\$ 0
Asset management fees and other income	\$ 40	\$ 0	\$ 0	\$ 0	\$ 19
Included in other comprehensive income (loss)	\$ 0	\$ 0	\$ 10	\$ 0	\$ 0

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

	Three Months Ended March 31, 2012			
	Other Assets	Separate Account Assets(4)	Future Policy Benefits (in millions)	Other Liabilities
Fair Value, beginning of period	\$ 9	\$ 19,358	\$ (2,886)	\$ (285)
Total gains (losses) (realized/unrealized):				
Included in earnings:				
Realized investment gains (losses), net	0	0	1,333	(9)
Asset management fees and other income	2	0	0	0
Interest credited to policyholders' account	0	749	0	0
Net investment income	0	0	0	0
Purchases	0	423	0	0
Sales	(3)	(174)	0	0
Issuances	0	6	(157)	(11)
Settlements	0	(254)	0	9
Foreign currency translation	0	0	1	0
Other(1)	0	0	0	(3)
Transfers into Level 3(2)	0	90	0	0
Transfers out of Level 3(2)	0	(263)	0	0
Fair Value, end of period	\$ 8	\$ 19,935	\$ (1,709)	\$ (299)
Unrealized gains (losses) for the period relating to those Level 3 assets and liabilities that were still held at the end of the period(3):				
Included in earnings:				
Realized investment gains (losses), net	\$ 0	\$ 0	\$ 1,311	\$ (10)
Asset management fees and other income	\$ 2	\$ 0	\$ 0	\$ 0
Interest credited to policyholders' account	\$ 0	\$ 489	\$ 0	\$ 0

(1) Other primarily represents reclasses of certain assets between reporting categories.

(2) Transfers into or out of Level 3 are generally reported as the value as of the beginning of the quarter in which the transfer occurs.

(3) Unrealized gains or losses related to assets still held at the end of the period do not include amortization or accretion of premiums and discounts.

(4) Separate account assets represent segregated funds that are invested for certain customers. Investment risks associated with market value changes are borne by the customers, except to the extent of minimum guarantees made by the Company with respect to certain accounts. Separate account liabilities are not included in the above table as they are reported at contract value and not fair value in the Company's Unaudited Interim Consolidated Statement of Financial Position.

Transfers Transfers into Level 3 were primarily the result of unobservable inputs utilized within valuation methodologies and the use of broker quotes (that could not be validated) when previously, information from third party pricing services (that could be validated) was utilized. Transfers out of Level 3 were primarily due to the use of observable inputs in valuation methodologies as well as the utilization of pricing service information for certain assets that the Company was able to validate.

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

The following tables provide a summary of the changes in fair value of Level 3 assets and liabilities for the three months ended March 31, 2011, as well as the portion of gains or losses included in income for the three months ended March 31, 2011 attributable to unrealized gains or losses related to those assets and liabilities still held at March 31, 2011.

	Three Months Ended March 31, 2011				
	Fixed Maturities Available-For- Sale-Foreign Government Bonds	Fixed Maturities Available-For- Sale- Corporate Securities	Fixed Maturities Available-For- Sale-Asset- Backed Securities (in millions)	Fixed Maturities Available-For- Sale- Commercial Mortgage- Backed Securities	Fixed Maturities Available-For- Sale- Residential Mortgage- Backed Securities
Fair Value, beginning of period	\$ 27	\$ 1,187	\$ 1,753	\$ 130	\$ 23
Total gains (losses) (realized/unrealized):					
Included in earnings:					
Realized investment gains (losses), net	0	(17)	24	(2)	0
Asset management fees and other income	0	0	0	0	0
Included in other comprehensive income (loss)	0	(10)	26	(1)	0
Net investment income	0	3	8	(1)	0
Purchases	0	360	424	0	0
Sales	0	(7)	(105)	(16)	0
Issuances	0	3	0	0	0
Settlements	0	(63)	(51)	0	(1)
Foreign currency translation	0	2	9	2	0
Other(1)	0	146	502	31	(1)
Transfers into Level 3(2)	0	108	221	0	0
Transfers out of Level 3(2)	0	(15)	(55)	0	0
Fair Value, end of period	\$ 27	\$ 1,697	\$ 2,756	\$ 143	\$ 21
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(3):					
Included in earnings:					
Realized investment gains (losses), net	\$ 0	\$ (13)	\$ 2	\$ (8)	\$ 0
Included in other comprehensive income (loss)	\$ 0	\$ (7)	\$ 32	\$ 5	\$ 0

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

	Three Months Ended March 31, 2011			
	Trading Account Assets Supporting Insurance Liabilities- Corporate Securities	Trading Account Assets Supporting Insurance Liabilities- Asset-Backed Securities	Trading Account Assets Supporting Insurance Liabilities- Commercial Mortgage- Backed Securities	Trading Account Assets Supporting Insurance Liabilities- Residential Mortgage- Backed Securities
	(in millions)			
Fair Value, beginning of period	\$ 82	\$ 226	\$ 5	\$ 18
Total gains (losses) (realized/unrealized):				
Included in earnings:				
Asset management fees and other income	(4)	3	0	0
Net investment income	0	1	0	0
Purchases	45	178	0	0
Sales	(11)	0	0	0
Issuances	0	0	0	0
Settlements	(8)	(17)	0	0
Foreign currency translation	0	0	0	0
Other(1)	0	15	0	(15)
Transfers into Level 3(2)	5	0	0	0
Transfers out of Level 3(2)	0	(20)	0	0
Fair Value, end of period	\$ 109	\$ 386	\$ 5	\$ 3
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(3):				
Included in earnings:				
Asset management fees and other income	\$ (1)	\$ 3	\$ 0	\$ 0

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

	Three Months Ended March 31, 2011				
	Trading Account Assets Supporting Insurance Liabilities- Equity Securities	Other Trading Account Assets- Corporate Securities	Other Trading Account Assets- Asset- Backed Securities (in millions)	Other Trading Account Assets- Commercial Mortgage- Backed Securities	Other Trading Account Assets- Residential Mortgage- Backed Securities
Fair Value, beginning of period	\$ 4	\$ 35	\$ 54	\$ 19	\$ 18
Total gains (losses) (realized/unrealized):					
Included in earnings:					
Asset management fees and other income	1	0	5	4	3
Net investment income	0	0	1	0	0
Purchases	1	5	0	0	0
Sales	(1)	(2)	(3)	(3)	(5)
Issuances	0	0	0	0	0
Settlements	0	0	(2)	0	0
Foreign currency translation	0	0	1	0	0
Other(1)	0	0	0	0	0
Transfers into Level 3(2)	76	0	37	2	1
Transfers out of Level 3(2)	0	0	(10)	(1)	(1)
Fair Value, end of period	\$ 81	\$ 38	\$ 83	\$ 21	\$ 16
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(3):					
Included in earnings:					
Asset management fees and other income	\$ 1	\$ 0	\$ 4	\$ 3	\$ 2

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

	Three Months Ended March 31, 2011				
	Other Trading Account Assets- Equity Securities	Other Trading Account Assets- All Other Activity	Equity Securities Available- For-Sale (in millions)	Commercial Mortgage and Other Loans	Other Long-term Investments
Fair Value, beginning of period	\$ 26	\$ 134	\$ 355	\$ 212	\$ 768
Total gains (losses) (realized/unrealized):					
Included in earnings:					
Realized investment gains (losses), net	0	(32)	(9)	0	3
Asset management fees and other income	13	2	0	0	31
Included in other comprehensive income (loss)	0	0	22	0	0
Net investment income	0	0	0	0	1
Purchases	1	0	10	0	10
Sales	0	0	(8)	0	(4)
Issuances	0	0	0	0	0
Settlements	(2)	(1)	(1)	(34)	(5)
Foreign currency translation	0	0	14	0	0
Other(1)	0	0	449	0	0
Transfers into Level 3(2)	126	0	824	0	0
Transfers out of Level 3(2)	0	0	(1)	0	0
Fair Value, end of period	\$ 164	\$ 103	\$ 1,655	\$ 178	\$ 804
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(3):					
Included in earnings:					
Realized investment gains (losses), net	\$ 0	\$ (31)	\$ (10)	\$ 0	\$ 3
Asset management fees and other income	\$ 12	\$ 2	\$ 0	\$ 0	\$ 21
Included in other comprehensive income (loss)	\$ 0	\$ 0	\$ 23	\$ 0	\$ 0

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

	Three Months Ended March 31, 2011				
	Other Assets	Separate Account Assets(4)	Future Policy Benefits (in millions)	Long-term Debt	Other Liabilities
Fair Value, beginning of period	\$ 9	\$ 15,792	\$ 204	\$ 0	\$ (3)
Total gains (losses) (realized/unrealized):					
Included in earnings:					
Realized investment gains (losses), net	0	0	602	0	(8)
Asset management fees and other income	0	0	0	0	0
Interest credited to policyholders' account balances	0	868	0	0	0
Net investment income	0	0	0	0	0
Purchases	0	831	(111)	0	0
Sales	0	(22)	(1)	0	0
Issuances	0	1	0	0	0
Settlements	0	(512)	0	0	8
Foreign currency translation	0	0	0	0	0
Other(1)	0	0	0	0	0
Transfers into Level 3(2)	0	26	0	0	0
Transfers out of Level 3(2)	0	(352)	0	0	0
Fair Value, end of period	\$ 9	\$ 16,632	\$ 694	\$ 0	\$ (3)
Unrealized gains (losses) for the period relating to those Level 3 assets and liabilities that were still held at the end of the period(3):					
Included in earnings:					
Realized investment gains (losses), net	\$ 0	\$ 0	\$ 598	\$ 0	\$ (8)
Asset management fees and other income	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Interest credited to policyholders' account balances	\$ 0	\$ 644	\$ 0	\$ 0	\$ 0

- (1) Other primarily represents assets acquired through the acquisition of the Star and Edison Businesses. Other also includes reclasses of certain assets between reporting categories.
- (2) Transfers into or out of Level 3 are generally reported as the value as of the beginning of the quarter in which the transfer occurs.
- (3) Unrealized gains or losses related to assets still held at the end of the period do not include amortization or accretion of premiums and discounts.
- (4) Separate account assets represent segregated funds that are invested for certain customers. Investment risks associated with market value changes are borne by the customers, except to the extent of minimum guarantees made by the Company with respect to certain accounts. Separate account liabilities are not included in the above table as they are reported at contract value and not fair value in the Company's Unaudited Interim Consolidated Statement of Financial Position.

Transfers As a part of an ongoing monitoring assessment of pricing inputs to ensure appropriateness of the level classification in the fair value hierarchy the Company may reassign level classification from time to time. As a result of such a review, in the first quarter of 2011, it was determined that the pricing inputs for perpetual preferred stocks provided by third party pricing services were primarily based on non-binding broker quotes which could not always be verified against directly observable market information. Consequently, perpetual preferred stocks were transferred into Level 3 within the fair value hierarchy. This represents the majority of the transfers into Level 3 for Equity Securities Available-for-Sale, Trading Account Assets Supporting Insurance Liabilities - Equity Securities and Other Trading Account Assets - Equity Securities. Other transfers into Level 3 were primarily the result of unobservable inputs utilized within valuation methodologies and the use of broker quotes (that could not be validated) when previously, information from third party pricing services (that could be validated) was utilized. Transfers out of Level 3 were primarily due to the use of observable inputs in valuation methodologies as well as the utilization of pricing

service information for certain assets that the Company was able to validate.

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

The following tables present the balance of derivative assets and liabilities measured at fair value on a recurring basis, as of the date indicated, by primary underlying. These tables exclude embedded derivatives which are recorded with the associated host contract. The derivative assets and liabilities shown below are included in Other trading account assets, Other long-term investments or Other liabilities in the tables presented previously in this note, under the headings Assets and Liabilities by Hierarchy Level and Changes in Level 3 Assets and Liabilities.

	As of March 31, 2012				Total
	Level 1	Level 2	Level 3 (in millions)	Netting(1)	
Derivative assets:					
Interest Rate	\$ 23	\$ 9,976	\$ 3	\$	\$ 10,002
Currency	0	251	0		251
Credit	0	28	0		28
Currency/Interest Rate	0	428	0		428
Equity	142	380	40		562
Netting(1)				(8,979)	(8,979)
Total derivative assets	\$ 165	\$ 11,063	\$ 43	\$ (8,979)	\$ 2,292
Derivative liabilities:					
Interest Rate	\$ 16	\$ 5,812	\$ 7	\$	\$ 5,835
Currency	0	417	0		417
Credit	0	94	0		94
Currency/Interest Rate	0	673	0		673
Equity	10	218	0		228
Netting(1)				(6,861)	(6,861)
Total derivative liabilities	\$ 26	\$ 7,214	\$ 7	\$ (6,861)	\$ 386

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

	As of December 31, 2011				Total
	Level 1	Level 2	Level 3	Netting(1)	
	(in millions)				
Derivative assets:					
Interest Rate	\$ 10	\$ 12,383	\$ 5	\$	\$ 12,398
Currency	0	219	0		219
Credit	0	56	1		57
Currency/Interest Rate	0	562	0		562
Equity	149	365	83		597
Netting(1)				(11,222)	(11,222)
Total derivative assets	\$ 159	\$ 13,585	\$ 89	\$ (11,222)	\$ 2,611
Derivative liabilities:					
Interest Rate	\$ 9	\$ 6,587	\$ 6	\$	\$ 6,602
Currency	0	297	0		297
Credit	0	130	0		130
Currency/Interest Rate	0	928	0		928
Equity	0	246	0		246
Netting(1)				(7,854)	(7,854)
Total derivative liabilities	\$ 9	\$ 8,188	\$ 6	\$ (7,854)	\$ 349

(1) Netting amounts represent cash collateral and the impact of offsetting asset and liability positions held with the same counterparty.

Changes in Level 3 derivative assets and liabilities The following tables provide a summary of the changes in fair value of Level 3 derivative assets and liabilities for the three months ended March 31, 2012, as well as the portion of gains or losses included in income for the three months ended March 31, 2012, attributable to unrealized gains or losses related to those assets and liabilities still held at March 31, 2012.

	Three Months Ended March 31, 2012		
	Derivative Assets-Equity	Derivative Assets-Credit	Derivative Liabilities-Interest Rate
	(in millions)		
Fair Value, beginning of period	\$ 83	\$ 1	\$ (1)
Total gains (losses) (realized/unrealized):			
Included in earnings:			
Realized investment gains (losses), net	(48)	(1)	(3)
Asset management fees and other income	0	0	0
Purchases	5	0	0
Sales	0	0	0
Insurances	0	0	0
Settlements	0	0	0
Transfers into Level 3(1)	0	0	0

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Transfers out of Level 3(1)	0	0	0
Fair Value, end of period	\$ 40	\$ 0	\$ (4)
Unrealized gains (losses) for the period relating to those level 3 assets that were still held at the end of the period:			
Included in earnings:			
Realized investment gains (losses), net	\$ (48)	\$ (1)	\$ (3)
Asset management fees and other income	\$ 0	\$ 0	\$ 0

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

	Three Months Ended March 31, 2011		
	Derivative Assets- Equity	Derivative Liabilities- Credit (in millions)	Derivative Liabilities- Interest Rate
Fair Value, beginning of period	\$ 126	\$ 0	\$ (12)
Total gains (losses) (realized/unrealized):			
Included in earnings:			
Realized investment gains (losses), net	(33)	3	4
Asset management fees and other income	0	0	0
Purchases	0	0	0
Sales	0	0	0
Insurances	0	0	0
Settlements	(1)	0	0
Transfers into Level 3(1)	0	0	0
Transfers out of Level 3(1)	0	0	0
Fair Value, end of period	\$ 92	\$ 3	\$ (8)
Unrealized gains (losses) for the period relating to those level 3 assets that were still held at the end of the period:			
Included in earnings:			
Realized investment gains (losses), net	\$ (33)	\$ 3	\$ 4
Asset management fees and other income	\$ 0	\$ 0	\$ 0

Nonrecurring Fair Value Measurements Certain assets and liabilities are measured at fair value on a nonrecurring basis. Nonrecurring fair value reserve adjustments resulted in \$4 million of net gains being recorded for the three months ended March 31, 2012 on certain commercial mortgage loans. The carrying value of these loans as of March 31, 2012 was \$92 million. Similar commercial mortgage loan reserve adjustments of \$14 million in net losses were recorded for the three months ended March 31, 2011. The reserve adjustments were based on discounted cash flows utilizing market rates and were classified as Level 3 in the hierarchy.

Impairments of \$1 million and \$3 million were recorded for the three months ended March 31, 2012 and 2011, respectively on real estate held for investment. The impairment was based on appraised value and is classified as Level 3 in the valuation hierarchy. Impairments of \$1 million and \$0 million were recorded for the three months ended March 31, 2012 and 2011, respectively, on certain cost method investments. These fair value adjustments were based on inputs classified as Level 3 in the valuation hierarchy. The inputs utilized were primarily discounted estimated future cash flows and, where appropriate, valuations provided by the general partners taken into consideration with deal and management fee expenses.

Impairments of \$3 million and \$1 million were recorded for the three months ended March 31, 2012 and 2011, respectively, on mortgage servicing rights. The impairments were based on internal models and were classified as Level 3 in the hierarchy.

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

Fair Value Option The following table presents information regarding changes in fair values recorded in earnings for commercial mortgage loans, other long-term investments and other liabilities, still held as of the reporting dates indicated, where the fair value option has been elected.

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
Assets:		
Commercial mortgage loans:		
Changes in instrument-specific credit risk	\$ (2)	\$ 1
Other changes in fair value		(2)
Other long-term investments:		
Changes in fair value	15	4
Liabilities:		
Other Liabilities:		
Changes in fair value	(3)	

Changes in fair value are reflected in Realized investment gains (losses), net for commercial mortgage loans and Asset management fees and other income for other long-term investments and other liabilities. Changes in fair value due to instrument-specific credit risk are estimated based on changes in credit spreads and quality ratings for the period reported.

Interest income on commercial mortgage loans is included in net investment income. For the three months ended March 31, 2012 and 2011, the Company recorded \$4 million and \$4 million of interest income, respectively, on these fair value option loans. Interest income on these loans is recorded based on the effective interest rates as determined at the closing of the loan.

The fair values and aggregate contractual principal amounts of commercial mortgage loans, for which the fair value option has been elected, were \$282 million and \$280 million, respectively, as of March 31, 2012, and \$603 million and \$598 million, respectively, as December 31, 2011. As of March 31, 2012, such loans that were in nonaccrual status had fair values of \$19 million and aggregate contractual principal amounts of \$23 million. None of the loans where the fair value option has been elected are more than 90 days past due and still accruing.

The fair value of other long-term investments were \$364 million and \$366 million as of March 31, 2012 and December 31, 2011, respectively.

The fair value and aggregate contractual principal amounts of other liabilities, for which the fair value option has been elected, were \$295 million and \$309 million, respectively, as of March 31, 2012 and \$282 million and \$294 million, respectively, as December 31, 2011.

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

The table below presents the carrying amount and fair value by fair value hierarchy level of certain financial instruments that are not reported at fair value. However, in some cases, as described below, the carrying amount equals or approximates fair value.

	March 31, 2012				Carrying Amount(1) Total
	Fair Value			Total	
	Level 1	Level 2	Level 3 (in millions)		
Assets:					
Fixed maturities, held-to-maturity	\$ 0	\$ 3,201	\$ 1,805	\$ 5,006	\$ 4,775
Commercial mortgage and other loans	88	1,090	37,132	38,310	35,623
Policy loans	0	0	13,873	13,873	11,419
Short-term investments	0	221	0	221	221
Cash and cash equivalents	3,384	1,100	0	4,484	4,484
Accrued investment income	0	2,799	0	2,799	2,799
Other assets	57	2,238	793	3,088	3,082
Total assets	\$ 3,529	\$ 10,649	\$ 53,603	\$ 67,781	\$ 62,403
Liabilities:					
Policyholders' account balances-investment contracts	\$ 0	\$ 42,199	\$ 61,474	\$ 103,673	\$ 101,476
Securities sold under agreements to repurchase	0	7,195	0	7,195	7,195
Cash collateral for loaned securities	0	2,950	0	2,950	2,950
Short-term debt	0	3,693	0	3,693	3,655
Long-term debt	995	20,854	4,519	26,368	24,379
Bank customer liabilities(2)	0	1,716	0	1,716	1,682
Other liabilities	0	4,562	862	5,424	5,457
Separate account liabilities-investment contracts	0	94,889	0	94,889	94,889
Total liabilities	\$ 995	\$ 178,058	\$ 66,855	\$ 245,908	\$ 241,683

(1) Carrying values presented herein differ from those in the Company's Unaudited Interim Consolidated Statement of Financial Position because certain items within the respective financial statement captions are not considered financial instruments or out of scope under authoritative guidance relating to disclosures of the fair value of financial instruments. Financial statement captions excluded from the above table are not considered financial instruments.

(2) Amount included in Other liabilities in the Company's Unaudited Interim Consolidated Statement of Financial Position.

The fair values presented above have been determined by using available market standard information and by applying market valuation methodologies, as described in more detail below.

Fixed Maturities, Held-to-Maturity

The fair values of public fixed maturity securities are generally based on prices from third-party pricing services, which are reviewed to validate reasonableness. However, for certain public fixed maturity securities and investments in private placement fixed maturity securities, this information is either not available or not reliable. For these public fixed maturity securities, the fair value is based on non-binding broker quotes, if available, or determined using a discounted cash flow model or internally-developed values. For private fixed maturities fair value is determined using a discounted cash flow model, which utilizes a discount rate based upon the average of spread surveys collected from private market intermediaries who are active in both primary and secondary

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

transactions and takes into account, among other factors, the credit quality and industry sector of the issuer and the reduced liquidity associated with private placements. In determining the fair value of certain fixed maturity securities, the discounted cash flow model may also use unobservable inputs, which reflect the Company's own assumptions about the inputs market participants would use in pricing the security.

Commercial Mortgage and Other Loans

The fair value of most commercial mortgage loans is based upon the present value of the expected future cash flows discounted at the appropriate U.S. Treasury rate or foreign government bond rate (for non-U.S. dollar-denominated loans) plus an appropriate credit spread for similar quality loans. The quality ratings for these loans, a primary determinant of the credit spreads and a significant component of the pricing process, are based on an internally-developed methodology. Credit spreads take into account public corporate bond spreads of similar quality and maturity, commercial mortgage-backed security spreads, whole loan spreads and other relevant market information such as spread indications from market participants on new originations, as well as unobservable inputs such as specific adjustments for property types.

Certain commercial mortgage loans are valued incorporating other factors, including the terms of the loans, the principal exit strategies for the loans, prevailing interest rates and credit risk.

Other loan valuations are primarily based upon the present value of the expected future cash flows discounted at the appropriate Japanese government bond rate and local market swap rates or credit default swap spreads, plus an appropriate credit spread and liquidity premium. The credit spread and liquidity premium are a significant component of the pricing inputs, and are based upon an internally-developed methodology, which takes into account, among other factors, the credit quality of the loans, the property type of the collateral, the weighted average coupon and the weighted average life of the loans.

Policy Loans

The fair value of U.S. insurance policy loans is calculated using a discounted cash flow model based upon current U.S. Treasury rates and historical loan repayment patterns, while Japanese insurance policy loans use the risk-free proxy based on the yen LIBOR. For group corporate-, bank- and trust-owned life insurance contracts and group universal life contracts, the fair value of the policy loans is the amount due, excluding interest, as of the reporting date.

Short-Term Investments

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Certain short-term investments which are not securities are recorded at amortized cost. Due to the short-term nature and quality of the loans, the Company believes that carrying value approximates fair value.

Cash & Cash Equivalents

The Company monitors cash and cash equivalent instruments to ensure there is sufficient demand and maintenance of issuer credit quality or sufficient solvency in the case of depository institutions. As such, due to the short-term nature of cash and cash equivalents, the Company believes that carrying value approximates fair value.

Accrued Investment Income

Due to the short term until settlement of accrued investment income, the Company believes that carrying value approximates fair value.

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

Other Assets

Other assets included in the table above reflect those other assets that meet the definition of financial instruments, and include short-term receivables, such as reinsurance recoverables, unsettled trades, accounts receivable and restricted cash. Due to the short term until settlement of these assets, the Company believes that carrying value approximates fair value.

Policyholders Account Balances Investment Contracts

Only the portion of policyholders' account balances related to products that are investment contracts (those without significant mortality or morbidity risk) are reflected in the table above. For fixed deferred annuities, single premium endowments, payout annuities and other similar contracts without life contingencies, fair values are derived using discounted projected cash flows based on interest rates that are representative of the Company's financial strength ratings, and hence reflect the Company's own non-performance risk. For guaranteed investment contracts, funding agreements, structured settlements without life contingencies and other similar products, fair values are derived using discounted projected cash flows based on interest rates being offered for similar contracts with maturities consistent with those of the contracts being valued. For those balances that can be withdrawn by the customer at any time without prior notice or penalty, the fair value is the amount estimated to be payable to the customer as of the reporting date, which is generally the carrying value. For defined contribution and defined benefit contracts and certain other products, the fair value is the market value of the assets supporting the liabilities.

Securities Sold Under Agreements to Repurchase

The Company receives collateral for selling securities under agreements to repurchase, or pledges collateral under agreements to resell. For securities sold under agreements to repurchase, the market value of the securities to be repurchased is monitored, and additional collateral is obtained where appropriate, to protect against credit exposure. Repurchase and resale agreements are also generally short-term in nature, and therefore, the carrying amounts of these instruments approximate fair value.

Cash Collateral for Loaned Securities

Cash collateral for loaned securities represents the collateral received or paid in connection with loaning or borrowing securities, similar to the securities sold under agreement to repurchase above. The Company monitors the market value of the securities loaned on a daily basis with additional collateral obtained as necessary. For these transactions, the carrying value of the related asset or liability approximates fair value, as they equal the amount of cash collateral received/paid.

Debt

The fair value of short-term and long-term debt, as well as debt of consolidated VIEs, is generally determined by either prices obtained from independent pricing services, which are validated by the Company, or discounted cash flow models. With the exception of the debt of consolidated VIEs, these fair values consider the Company's own non-performance risk. Discounted cash flow models predominately use market observable inputs such as the borrowing rates currently available to the Company for debt and financial instruments with similar terms and remaining maturities. For commercial paper issuances and other debt with a maturity of less than 90 days, the carrying value approximates fair value. Debt of consolidated VIEs is reflected within Other liabilities.

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

A portion of the senior secured notes issued by Prudential Holdings, LLC (the IHC debt) is insured by a third-party financial guarantee insurance policy. The effect of the third-party credit enhancement is not included in the fair value measurement of the IHC debt and the methodologies used to determine fair value consider the Company's own non-performance risk.

Bank Customer Liabilities

The carrying amount for certain deposits (interest and non-interest demand, savings and money market accounts) approximates or equals their fair values. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates being offered on certificates at the reporting dates to a schedule of aggregated expected monthly maturities. Bank customer liabilities are reflected within Other liabilities.

Other Liabilities

Other liabilities are primarily short-term payables, such as reinsurance payables, unsettled trades, drafts and accrued expense payables. Due to the short term until settlement of these liabilities, the Company believes that carrying value approximates fair value.

Separate Account Liabilities Investment Contracts

Only the portion of separate account liabilities related to products that are investments contracts are reflected in the table above. Separate account liabilities are recorded at the amount credited to the contractholder, which equals contractholder deposits less withdrawals, plus the change in fair value of the corresponding separate account assets. Therefore, carrying value approximates fair value.

14. DERIVATIVE INSTRUMENTS

Types of Derivative Instruments and Derivative Strategies used in a non-dealer or broker capacity

Interest Rate Contracts

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Interest rate swaps are used by the Company to manage interest rate exposures arising from mismatches between assets and liabilities (including duration mismatches) and to hedge against changes in the value of assets it anticipates acquiring and other anticipated transactions and commitments. Swaps may be attributed to specific assets or liabilities or may be used on a portfolio basis. Under interest rate swaps, the Company agrees with other parties to exchange, at specified intervals, the difference between fixed-rate and floating-rate interest amounts calculated by reference to an agreed upon notional principal amount. Generally, no cash is exchanged at the outset of the contract and no principal payments are made by either party. These transactions are entered into pursuant to master agreements that provide for a single net payment to be made by one counterparty at each due date.

Exchange-traded futures and options are used by the Company to reduce risks from changes in interest rates, to alter mismatches between the duration of assets in a portfolio and the duration of liabilities supported by those assets, and to hedge against changes in the value of securities it owns or anticipates acquiring or selling. In exchange-traded futures transactions, the Company agrees to purchase or sell a specified number of contracts, the values of which are determined by the values of underlying referenced investments, and to post variation margin on a daily basis in an amount equal to the difference in the daily market values of those contracts. The Company enters into exchange-traded futures and options with regulated futures commission s merchants who are members of a trading exchange.

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

Equity Contracts

Equity index options are contracts which will settle in cash based on differentials in the underlying indices at the time of exercise and the strike price. The Company uses combinations of purchases and sales of equity index options to hedge the effects of adverse changes in equity indices within a predetermined range. These hedges do not qualify for hedge accounting.

Foreign Exchange Contracts

Currency derivatives, including exchange-traded currency futures and options, currency forwards and currency swaps, are used by the Company to reduce risks from changes in currency exchange rates with respect to investments denominated in foreign currencies that the Company either holds or intends to acquire or sell. The Company also uses currency forwards to hedge the currency risk associated with net investments in foreign operations and anticipated earnings of its foreign operations.

Under currency forwards, the Company agrees with other parties to deliver a specified amount of an identified currency at a specified future date. Typically, the price is agreed upon at the time of the contract and payment for such a contract is made at the specified future date. As noted above, the Company uses currency forwards to mitigate the impact of changes in currency exchange rates on U.S. dollar equivalent earnings generated by certain of its non-U.S. businesses, primarily its international insurance and investments operations. The Company executes forward sales of the hedged currency in exchange for U.S. dollars at a specified exchange rate. The maturities of these forwards correspond with the future periods in which the non-U.S. dollar-denominated earnings are expected to be generated. These earnings hedges do not qualify for hedge accounting.

Under currency swaps, the Company agrees with other parties to exchange, at specified intervals, the difference between one currency and another at an exchange rate and calculated by reference to an agreed principal amount. Generally, the principal amount of each currency is exchanged at the beginning and termination of the currency swap by each party. These transactions are entered into pursuant to master agreements that provide for a single net payment to be made by one counterparty for payments made in the same currency at each due date.

Credit Contracts

Credit derivatives are used by the Company to enhance the return on the Company's investment portfolio by creating credit exposure similar to an investment in public fixed maturity cash instruments. With credit derivatives the Company sells credit protection on an identified name, or a basket of names in a first to default structure, and in return receives a quarterly premium. With single name credit default derivatives, this premium or credit spread generally corresponds to the difference between the yield on the referenced name's public fixed maturity cash instruments and swap rates, at the time the agreement is executed. With first to default baskets, the premium generally corresponds to a high

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

proportion of the sum of the credit spreads of the names in the basket. If there is an event of default by the referenced name or one of the referenced names in a basket, as defined by the agreement, then the Company is obligated to pay the counterparty the referenced amount of the contract and receive in return the referenced defaulted security or similar security. See credit derivatives written section for discussion of guarantees related to credit derivatives written. In addition to selling credit protection the Company has purchased credit protection using credit derivatives in order to hedge specific credit exposures in the Company's investment portfolio.

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

TBAs. The Company uses to be announced (TBA) forward contracts to gain exposure to the investment risk and return of mortgage-backed securities. TBA transactions can help the Company to achieve better diversification and to enhance the return on its investment portfolio. TBAs can provide a more liquid and cost effective method of achieving these goals than purchasing or selling individual mortgage-backed pools. Typically, the price is agreed upon at the time of the contract and payment for such a contract is made at a specified future date. Additionally, pursuant to the Company's mortgage dollar roll program, TBAs or mortgage-backed securities are transferred to counterparties with a corresponding agreement to repurchase them at a future date. These transactions do not qualify as secured borrowings and are accounted for as derivatives.

Loan Commitments. In its mortgage operations, the Company enters into commitments to fund commercial mortgage loans at specified interest rates and other applicable terms within specified periods of time. These commitments are legally binding agreements to extend credit to a counterparty. Loan commitments for loans that will be held for sale are recognized as derivatives and recorded at fair value. The determination of the fair value of loan commitments accounted for as derivatives considers various factors including, among others, terms of the related loan, the intended exit strategy for the loans based upon either securitization valuation models or investor purchase commitments, prevailing interest rates, origination income or expense, and the value of service rights. Loan commitments that relate to the origination of mortgage loans that will be held for investment are not accounted for as derivatives and accordingly are not recognized in the Company's financial statements. See Note 15 for a further discussion of these loan commitments.

Embedded Derivatives. The Company sells variable annuity products, which may include guaranteed benefit features that are accounted for as embedded derivatives. These embedded derivatives are marked to market through Realized investment gains (losses), net based on the change in value of the underlying contractual guarantees, which are determined using valuation models. The Company maintains a portfolio of derivative instruments that is intended to economically hedge the risks related to the above products' features. The derivatives may include, but are not limited to equity options, total return swaps, interest rate swap options, caps, floors, and other instruments. In addition, some variable annuity products feature an automatic rebalancing element to minimize risks inherent in the Company's guarantees which reduces the need for hedges.

The Company invests in fixed maturities that, in addition to a stated coupon, provide a return based upon the results of an underlying portfolio of fixed income investments and related investment activity. The Company accounts for these investments as available-for-sale fixed maturities containing embedded derivatives. Such embedded derivatives are marked to market through Realized investment gains (losses), net, based upon the change in value of the underlying portfolio.

Synthetic Guarantees. The Company sells fee-based synthetic guaranteed investment contracts, which include investment-only, stable value contracts, to qualified pension plans. The assets are owned by the trustees of such plans, who invest the assets under the terms of investment guidelines agreed to with the Company. The contracts contain a guarantee of a minimum rate of return on participant balances supported by the underlying assets, and a guarantee of liquidity to meet certain participant-initiated plan cash flow requirements. These contracts are accounted for as derivatives, recorded at fair value and classified as interest rate derivatives.

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

The table below provides a summary of the gross notional amount and fair value of derivatives contracts used in a non-dealer or broker capacity, excluding embedded derivatives which are recorded with the associated host, by the primary underlying. Many derivative instruments contain multiple underlyings. The fair value amounts below represent the gross fair value of derivative contracts prior to taking into account the netting effects of master netting agreements and cash collateral held with the same counterparty. This netting impact results in total derivative assets of \$2,292 million and \$2,611 million as of March 31, 2012 and December 31, 2011, respectively, and total derivative liabilities of \$386 million and \$349 million as of March 31, 2012 and December 31, 2011, respectively, reflected in the Unaudited Interim Consolidated Statement of Financial Position.

Primary Underlying/ Instrument Type	March 31, 2012			December 31, 2011		
	Notional Amount	Fair Value		Notional Amount	Fair Value	
		Assets	Liabilities		Assets	Liabilities
	(in millions)					
Qualifying Hedges:						
Interest Rate						
Interest Rate Swaps	\$ 4,495	\$ 50	\$ (434)	\$ 5,048	\$ 62	\$ (468)
Foreign Currency						
Foreign Currency Forwards	801	3	(36)	753	6	(4)
Currency/Interest Rate						
Foreign Currency Swaps	4,985	142	(362)	4,807	227	(438)
Total Qualifying Hedges	\$ 10,281	\$ 195	\$ (832)	\$ 10,608	\$ 295	\$ (910)
Non-Qualifying Hedges:						
Interest Rate						
Interest Rate Swaps	\$ 111,433	\$ 7,547	\$ (2,870)	\$ 107,560	\$ 9,357	\$ (3,084)
Interest Rate Futures	7,129	23	(16)	6,192	10	(9)
Interest Rate Options	556	9	(4)	601	13	(3)
Interest Rate Forwards	816		(1)	2,139	6	0
Synthetic GIC s	50,064	3		46,844	4	0
Foreign Currency						
Foreign Currency Forwards	14,706	222	(394)	16,228	176	(335)
Foreign Currency Options	94	19		98	23	0
Currency/Interest Rate						
Foreign Currency Swaps	5,297	223	(257)	5,390	224	(399)
Credit						
Credit Default Swaps	2,710	29	(94)	3,298	58	(130)
Equity						
Equity Futures	2,792	142	(10)	2,114	149	0
Equity Options	30,558	420	(57)	14,951	415	(66)
Total Return Swaps	6,131	4	(150)	6,797	34	(175)
Total Non-Qualifying Hedges	\$ 232,286	\$ 8,641	\$ (3,853)	\$ 212,212	\$ 10,469	\$ (4,201)
Total Derivatives(1)	\$ 242,567	\$ 8,836	\$ (4,685)	\$ 222,821	\$ 10,764	\$ (5,111)

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

- (1) Excludes embedded derivatives which contain multiple underlyings. The fair value of these embedded derivatives was a net liability of \$1,895 million as of March 31, 2012 and a net liability of \$3,131 million as of December 31, 2011, included in Future policy benefits and Fixed maturities, available-for-sale.

Table of Contents**PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)****Cash Flow, Fair Value and Net Investment Hedges**

The primary derivative instruments used by the Company in its fair value, cash flow, and net investment hedge accounting relationships are interest rate swaps, currency swaps and currency forwards. These instruments are only designated for hedge accounting in instances where the appropriate criteria are met. The Company does not use futures, options, credit, equity or embedded derivatives in any of its fair value, cash flow or net investment hedge accounting relationships.

The following table provides the financial statement classification and impact of derivatives used in qualifying and non-qualifying hedge relationships, excluding the offset of the hedged item in an effective hedge relationship.

	Three Months Ended March 31, 2012					
	Realized Investment Gains/ (Losses)	Net Investment Income	Other Income	Interest Expense	Interest Credited To Policyholders Account Balances	Accumulated Other Comprehensive Income(1)
	(in millions)					
Qualifying Hedges						
Fair value hedges						
Interest Rate	\$ 28	\$ (25)	\$ 0	\$ 1	\$ 11	\$ 0
Currency	(32)	(1)	0	0	0	0
Total fair value hedges	(4)	(26)	0	1	11	0
Cash flow hedges						
Interest Rate	0	0	0	(5)	0	6
Currency/Interest Rate	0	(2)	(10)	0	0	(117)
Total cash flow hedges	0	(2)	(10)	(5)	0	(111)
Net investment hedges						
Currency(2)	0	0	0	0	0	(7)
Currency/Interest Rate	0	0	0	0	0	123
Total net investment hedges	0	0	0	0	0	116
Non-qualifying hedges						
Interest Rate	(1,426)	0	0	0	0	0
Currency	(49)	0	0	0	0	0
Currency/Interest Rate	110	0	0	0	0	0
Credit	(3)	0	0	0	0	0

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Equity	(1,309)	0	0	0	0	0
Embedded Derivatives	1,367	0	0	0	0	0
Total non-qualifying hedges	(1,310)	0	0	0	0	0
Total	\$ (1,314)	\$ (28)	\$ (10)	\$ (4)	\$ 11	\$ 5

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

	Three Months Ended March 31, 2011					
	Realized Investment Gains/ (Losses)	Net Investment Income	Other Income	Interest Expense (in millions)	Interest Credited To Policyholders Account Balances	Accumulated Other Comprehensive Income(1)
Qualifying Hedges						
Fair value hedges						
Interest Rate	\$ 30	\$ (31)	\$ 0	\$ 2	\$ 16	\$ 0
Currency	(29)	(1)	0	0	0	0
Total fair value hedges	1	(32)	0	2	16	0
Cash flow hedges						
Interest Rate	0	0	0	(5)	(1)	10
Currency/Interest Rate	0	(2)	3	0	0	(70)
Total cash flow hedges	0	(2)	3	(5)	(1)	(60)
Net investment hedges						
Currency(2)	0	0	0	0	0	(9)
Currency/Interest Rate	0	0	0	0	0	38
Total net investment hedges	0	0	0	0	0	29
Non-qualifying hedges						
Interest Rate	(294)	0	0	0	0	0
Currency	(17)	0	0	0	0	0
Currency/Interest Rate	(3)	0	0	0	0	0
Credit	(75)	0	0	0	0	0
Equity	(389)	0	0	0	0	0
Embedded Derivatives	635	0	0	0	0	0
Total non-qualifying hedges	(143)	0	0	0	0	0
Total	\$ (142)	\$ (34)	\$ 3	\$ (3)	\$ 15	\$ (31)

(1) Amounts deferred in Accumulated other comprehensive income (loss).

(2) Relates to the sale of equity method investments.

For the period ending March 31 2012, the ineffective portion of derivatives accounted for using hedge accounting was not material to the Company's results of operations and there were no material amounts reclassified into earnings relating to instances in which the Company discontinued cash flow hedge accounting because the forecasted transaction did not occur by the anticipated date or within the additional time

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

period permitted by the authoritative guidance for the accounting for derivatives and hedging. In addition, there were no instances in which the Company discontinued fair value hedge accounting due to a hedged firm commitment no longer qualifying as a fair value hedge.

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

Presented below is a roll forward of current period cash flow hedges in Accumulated other comprehensive income (loss) before taxes:

	(in millions)
Balance, December 31, 2011	\$ (86)
Net deferred losses on cash flow hedges from January 1 to March 31, 2012	(127)
Amount reclassified into current period earnings	17
 Balance, March 31, 2012	 \$ (196)

Using March 31, 2012 values, it is anticipated that a pre-tax loss of approximately \$7 million will be reclassified from Accumulated other comprehensive income (loss) to earnings during the subsequent twelve months ending March 31, 2013, offset by amounts pertaining to the hedged items. As of March 31, 2012, the Company does not have any qualifying cash flow hedges of forecasted transactions other than those related to the variability of the payment or receipt of interest or foreign currency amounts on existing financial instruments. The maximum length of time for which these variable cash flows are hedged is 19 years. Income amounts deferred in Accumulated other comprehensive income (loss) as a result of cash flow hedges are included in Net unrealized investment gains (losses) in the Consolidated Statements of Equity.

For effective net investment hedges, the amounts, before applicable taxes, recorded in the cumulative translation adjustment account within Accumulated other comprehensive income (loss) was \$14 million and \$(102) million as of March 31, 2012 and December 31, 2011.

Credit Derivatives Written

The following table sets forth the Company's exposure from credit derivatives where the Company has written credit protection, by NAIC rating of the underlying credits as of March 31, 2012 and December 31, 2011. The Company's maximum amount at risk under these credit derivatives listed below assumes the value of the underlying referenced securities become worthless. These credit derivatives generally have maturities of less than 10 years. The table excludes a credit derivative related to surplus notes issued by a subsidiary of Prudential Insurance and embedded derivatives contained in externally-managed investments in the European market.

NAIC Designation	March 31, 2012		December 31, 2011	
	Notional	Fair Value	Notional	Fair value
	(in millions)			
1	\$ 295	\$ 1	\$ 795	\$ 3
2	25	0	25	0
Subtotal	320	1	820	3
3	0	0	0	0

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

	4	0	0	0	0
	5	0	0	0	0
	6	0	0	0	0
Subtotal		0	0	0	0
Total		\$ 320	\$ 1	\$ 820	\$ 3

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

The following table sets forth the composition of the Company's credit derivatives where the Company has written credit protection by industry category as of the dates indicated.

Industry	March 31, 2012		December 31, 2011	
	Notional	Fair Value	Notional	Fair Value
(in millions)				
Corporate Securities:				
Manufacturing	\$ 230	\$ 1	\$ 230	\$ 2
Utilities	5	0	5	0
Finance	0	0	500	1
Services	20	0	20	0
Energy	20	0	20	0
Transportation	25	0	25	0
Retail and Wholesale	20	0	20	0
Total Credit Derivatives	\$ 320	\$ 1	\$ 820	\$ 3

In addition to the above, the Company entered into a credit derivative that will require the Company to make certain payments in the event of deterioration in the value of the surplus notes issued by a subsidiary of Prudential Insurance. The notional of this credit derivative is \$500 million and the fair value as of March 31, 2012 and December 31, 2011 was a liability of \$33 million and \$77 million, respectively. No collateral was pledged in either period.

The Company holds certain externally-managed investments in the European market which contain embedded derivatives whose fair value are primarily driven by changes in credit spreads. These investments are medium-term notes that are collateralized by investment portfolios primarily consisting of investment grade European fixed income securities, including corporate bonds and asset-backed securities, and derivatives, as well as varying degrees of leverage. The notes have a stated coupon and provide a return based on the performance of the underlying portfolios and the level of leverage. The Company invests in these notes to earn a coupon through maturity, consistent with its investment purpose for other debt securities. The notes are accounted for under U.S. GAAP as available-for-sale fixed maturity securities with bifurcated embedded derivatives (total return swaps). Changes in the value of the fixed maturity securities are reported in Equity under the heading Accumulated Other Comprehensive Income (Loss) and changes in the market value of the embedded total return swaps are included in current period earnings in Realized investment gains (losses), net. The Company's maximum exposure to loss from these investments was \$602 million and \$664 million at March 31, 2012 and December 31, 2011, respectively.

In addition to writing credit protection, the Company has purchased credit protection using credit derivatives in order to hedge specific credit exposures in the Company's investment portfolio. As of March 31, 2012 and December 31, 2011, the Company had \$1.890 billion and \$1.978 billion of outstanding notional amounts, respectively, reported at fair value as a liability of \$33 million and an asset of \$2 million, respectively.

Types of Derivative Instruments and Derivative Strategies used in a dealer or broker capacity

Futures, forwards and options contracts, and swap agreements, were also used in a derivative dealer or broker capacity in the Company's commodities operations, prior to the sale of this business to Jefferies on July 1, 2011, to facilitate transactions of clients, hedge proprietary trading activities and as a means of risk management. These derivatives allowed the Company to structure transactions to manage its exposure to commodities and securities prices, foreign exchange rates and interest rates. Risk exposures were managed through diversification, by controlling position sizes and by entering into offsetting positions.

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

The fair value of the Company's derivative contracts used in a derivative dealer or broker capacity were reported on a net-by-counterparty basis in the Company's Consolidated Statements of Financial Position when management believes a legal right of setoff exists under an enforceable netting agreement.

Realized and unrealized gains and losses from marking-to-market the derivatives used in proprietary positions were recognized on a trade date basis and reported in Income from discontinued operations, net of taxes. The pre-tax amounts reported in Income (loss) from discontinued operations, net of taxes for these derivatives was \$0 and \$32 million for the three months ended March 31, 2012 and 2011, respectively.

Credit Risk

The Company is exposed to credit-related losses in the event of non-performance by counterparties to financial derivative transactions. The Company manages credit risk by entering into derivative transactions with highly rated major international financial institutions and other creditworthy counterparties, and by obtaining collateral where appropriate. Additionally, limits are set on single party credit exposures which are subject to periodic management review.

The credit exposure of the Company's over-the-counter (OTC) derivative transactions is represented by the contracts with a positive fair value (market value) at the reporting date. To reduce credit exposures, the Company seeks to (i) enter into OTC derivative transactions pursuant to master agreements that provide for a netting of payments and receipts with a single counterparty (ii) enter into agreements that allow the use of credit support annexes (CSAs), which are bilateral rating-sensitive agreements that require collateral postings at established threshold levels. Likewise, the Company effects exchange-traded futures and options transactions through regulated exchanges and these transactions are settled on a daily basis, thereby reducing credit risk exposure in the event of non-performance by counterparties to such financial instruments.

Under fair value measurements, the Company incorporates the market's perception of its own and the counterparty's non-performance risk in determining the fair value of the portion of its OTC derivative assets and liabilities that are uncollateralized. Credit spreads are applied to the derivative fair values on a net basis by counterparty. To reflect the Company's own credit spread a proxy based on relevant debt spreads is applied to OTC derivative net liability positions. Similarly, the Company's counterparty's credit spread is applied to OTC derivative net asset positions.

Certain of the Company's derivative agreements with some of its counterparties contain credit-risk related triggers. If the Company's credit rating were to fall below a certain level, the counterparties to the derivative instruments could request termination at the then fair value of the derivative or demand immediate full collateralization on derivative instruments in net liability positions. If a downgrade occurred and the derivative positions were terminated, the Company anticipates it would be able to replace the derivative positions with other counterparties in the normal course of business. The aggregate fair value of all derivative instruments with credit-risk-related contingent features that are in a net liability position were \$260 million as of March 31, 2012. In the normal course of business the Company has posted collateral related to these instruments of \$219 million as of March 31, 2012. If the credit-risk-related contingent features underlying these agreements had been triggered on March 31, 2012, the Company estimates that it would be required to post a maximum of \$41 million of additional collateral to its

counterparties.

Table of Contents**PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)****15. COMMITMENTS AND GUARANTEES, CONTINGENT LIABILITIES AND LITIGATION AND REGULATORY MATTERS****Commitments and Guarantees***Commercial Mortgage Loan Commitments*

	As of March 31, 2012 (in millions)
Total outstanding mortgage loan commitments	\$ 1,658
Portion of commitment where prearrangement to sell to investor exists	\$ 878

In connection with the Company's commercial mortgage operations, it originates commercial mortgage loans. Commitments for loans that will be held for sale are recognized as derivatives and recorded at fair value. In certain of these transactions, the Company pre-arranges that it will sell the loan to an investor, including to governmental sponsored entities as discussed below, after the Company funds the loan.

Commitments to Purchase Investments (excluding Commercial Mortgage Loans)

	As of March 31, 2012 (in millions)
Expected to be funded from the general account and other operations outside the separate accounts(1)	\$ 3,813
Expected to be funded from separate accounts	\$ 921
Portion of separate account commitments with recourse to Prudential Insurance	\$ 165

- (1) Includes a remaining commitment of \$330 million related to the Company's agreement to co-invest with the Fosun Group (Fosun) in a private equity fund, managed by Fosun, for the Chinese marketplace.

The Company has other commitments to purchase or fund investments, some of which are contingent upon events or circumstances not under the Company's control, including those at the discretion of the Company's counterparties. The Company anticipates a portion of these commitments will ultimately be funded from its separate accounts. Some of the separate account commitments have recourse to Prudential Insurance if the separate accounts are unable to fund the amounts when due.

Transitional Financing Facilities Issued in Connection with Sale of PRERS

	As of March 31, 2012 (in millions)
Total remaining available credit lines	\$ 241

In connection with the sale of the real estate brokerage franchise and relocation business, the Company has agreed to provide the buyer with transitional financing for the transferred relocation services business. The Company provided two six month facilities with a total of \$275 million of available financing and one three year facility with \$155 million of available financing. The effective date of these agreements was December 6, 2011.

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

	As of March 31, 2012 (in millions)
Total guarantees of debt issued by entities in which the separate accounts have invested	\$ 2,811
Amount of above guarantee that is limited to separate account assets	\$ 2,743
Accrued liability associated with guarantee	\$ 0

A number of guarantees provided by the Company relate to real estate investments held in its separate accounts, in which entities that the separate account has invested in have borrowed funds, and the Company has guaranteed their obligations. The Company provides these guarantees to assist these entities in obtaining financing. The Company's maximum potential exposure under these guarantees is mostly limited to the assets of the separate account. The exposure that is not limited to the separate account assets relates mostly to guarantees limited to fraud, criminal activity or other bad acts. These guarantees generally expire at various times over the next thirteen years. At March 31, 2012, the Company's assessment is that it is unlikely payments will be required. Any payments that may become required under these guarantees would either first be reduced by proceeds received by the creditor on a sale of the underlying collateral, or would provide rights to obtain the underlying collateral.

Indemnification of Securities Lending Transactions

	As of March 31, 2012 (in millions)
Indemnification provided to mutual fund and separate account clients for securities lending	\$ 15,442
Fair value of related collateral associated with above indemnifications	\$ 15,857
Accrued liability associated with guarantee	\$ 0

In the normal course of business, the Company may facilitate securities lending transactions on behalf of mutual funds and separate accounts for which the Company is the investment advisor and/or the asset manager. In certain of these arrangements, the Company has provided an indemnification to the mutual funds or separate accounts to hold them harmless against losses caused by counterparty (i.e., borrower) defaults associated with the securities lending activity facilitated by the Company. Collateral is provided by the counterparty to the mutual fund or separate account at the inception of the loan equal to or greater than 102% of the fair value of the loaned securities and the collateral is maintained daily at 102% or greater of the fair value of the loaned securities. The Company is only at risk if the counterparty to the securities lending transaction defaults and the value of the collateral held is less than the value of the securities loaned to such counterparty. The Company believes the possibility of any payments under these indemnities is remote.

Credit Derivatives Written

As discussed further in Note 14, the Company writes credit derivatives under which the Company is obligated to pay the counterparty the referenced amount of the contract and receive in return the defaulted security or similar security.

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

	As of March 31, 2012 (in millions)
Exposure under the guarantees	\$ 23
Accrued liability associated with guarantees	\$ 0

In conjunction with the sale of the Global Commodities Business, the Company entered into a guarantees transition and collateral agreement with Jefferies, pursuant to which the Company agreed to keep these guarantees outstanding for a period of 18 months following the closing, including with respect to business conducted by the transferred entities with beneficiaries of these guarantees subsequent to the closing date. Jefferies has agreed to indemnify the Company for any amounts payable under the guarantees and, under certain conditions, provide collateral for such obligation. As of March 31, 2012, no collateral has been provided by Jefferies.

Guarantees of Asset Values

	As of March 31, 2012 (in millions)
Guaranteed value of third parties assets	\$ 50,277
Fair value of collateral supporting these assets	\$ 52,537
Liability associated with guarantee, carried at fair value	\$ 1

Certain contracts underwritten by the Retirement segment include guarantees related to financial assets owned by the guaranteed party. These contracts are accounted for as derivatives and carried at fair value. The collateral supporting these guarantees is not reflected on the Company's balance sheet.

Guarantees of Credit Enhancements

	As of March 31, 2012 (in millions)
Guarantees of credit enhancements of debt instruments associated with commercial real estate assets	\$ 148

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Fair value of properties and associated tax credits that secure the guarantee	\$	190
Accrued liability associated with guarantee	\$	0

The Company arranges for credit enhancements of certain debt instruments that provide financing primarily for affordable multi-family real estate assets, including certain tax-exempt bond financings. The credit enhancements provide assurances to the debt holders as to the timely payment of amounts due under the debt instruments. The remaining contractual maturities for these guarantees are up to fifteen years. The Company's obligations to reimburse required credit enhancement payments are secured by mortgages on the related real estate. The Company receives certain ongoing fees for providing these enhancement arrangements and anticipates the extinguishment of its obligation under these enhancements prior to maturity through the aggregation and transfer of its positions to a substitute enhancement provider.

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

	As of March 31, 2012 (in millions)
Maximum exposure under indemnification agreements for mortgage loans serviced by the Company	\$ 1,090
First-loss exposure portion of above	\$ 352
Accrued liability associated with guarantees	\$ 20

As part of the commercial mortgage activities of the Company's Asset Management segment, the Company provides commercial mortgage origination, underwriting and servicing for certain government sponsored entities, such as Fannie Mae and Freddie Mac. The Company has agreed to indemnify the government sponsored entities for a portion of the credit risk associated with certain of the mortgages it services through a delegated authority arrangement. Under these arrangements, the Company originates multi-family mortgages for sale to the government sponsored entities based on underwriting standards they specify, and makes payments to them for a specified percentage share of losses they incur on certain loans serviced by the Company. The Company's percentage share of losses incurred generally varies from 2% to 20% of the loan balance, and is typically based on a first-loss exposure for a stated percentage of the loan balance, plus a shared exposure with the government sponsored entity for any losses in excess of the stated first-loss percentage, subject to a contractually specified maximum percentage. The Company services \$8,353 million of mortgages subject to these loss-sharing arrangements as of March 31, 2012, all of which are collateralized by first priority liens on the underlying multi-family residential properties. As of March 31, 2012, these mortgages had an average debt service coverage ratio of 1.80 times and an average loan-to-value ratio of 66%. The Company's total share of losses related to indemnifications that were settled was \$0 million and \$1 million for the three months ending March 31, 2012, and 2011, respectively.

Contingent Consideration

	As of March 31, 2012 (in millions)
Maximum potential contingent consideration associated with acquisitions	\$ 58

In connection with an acquisition, the Company has agreed to pay additional consideration in future periods, contingent upon the attainment by the acquired business of defined operating objectives. The arrangement will be resolved over the following fifteen months. Any payment would result in an increase to assets.

Other Guarantees

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

	As of March 31, 2012 (in millions)
Other guarantees where amount can be determined	\$ 449
Accrued liability for other guarantees and indemnifications	\$ 14

The Company is also subject to other financial guarantees and indemnity arrangements. The Company has provided indemnities and guarantees related to acquisitions, dispositions, investments and other transactions that are triggered by, among other things, breaches of representations, warranties or covenants provided by the Company. These obligations are typically subject to various time limitations, defined by the contract or by operation of law,

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

such as statutes of limitation. In some cases, the maximum potential obligation is subject to contractual limitations, while in other cases such limitations are not specified or applicable. Included above are \$289 million of yield maintenance guarantees related to certain investments the Company sold. The Company does not expect to make any payments on these guarantees and is not carrying any liabilities associated with these guarantees.

Since certain of these obligations are not subject to limitations, it is not possible to determine the maximum potential amount due under these guarantees. The accrued liabilities identified above do not include retained liabilities associated with sold businesses.

Contingent Liabilities

On an ongoing basis, the Company's internal supervisory and control functions review the quality of sales, marketing and other customer interface procedures and practices and may recommend modifications or enhancements. From time to time, this review process results in the discovery of product administration, servicing or other errors, including errors relating to the timing or amount of payments or contract values due to customers. In certain cases, if appropriate, the Company may offer customers remediation and may incur charges, including the cost of such remediation, administrative costs and regulatory fines.

The Company is subject to the laws and regulations of states and other jurisdictions concerning the identification, reporting and escheatment of unclaimed or abandoned funds, and is subject to audit and examination for compliance with these requirements. For additional discussion of these matters, see *Litigation and Regulatory Matters* below.

It is possible that the results of operations or the cash flow of the Company in a particular quarterly or annual period could be materially affected as a result of payments in connection with the matters discussed above or other matters depending, in part, upon the results of operations or cash flow for such period. Management believes, however, that ultimate payments in connection with these matters, after consideration of applicable reserves and rights to indemnification, should not have a material adverse effect on the Company's financial position.

Litigation and Regulatory Matters

The Company is subject to legal and regulatory actions in the ordinary course of its businesses. Pending legal and regulatory actions include proceedings relating to aspects of the Company's businesses and operations that are specific to it and proceedings that are typical of the businesses in which it operates, including in both cases businesses that have been either divested or placed in wind-down status. Some of these proceedings have been brought on behalf of various alleged classes of complainants. In certain of these matters, the plaintiffs are seeking large and/or indeterminate amounts, including punitive or exemplary damages. The outcome of litigation or a regulatory matter, and the amount or range of potential loss at any particular time, is often inherently uncertain.

Individual Life and Group Insurance

In January 2012, a *qui tam* action on behalf of the State of Illinois, *Total Asset Recovery Services v. Met Life Inc, et al., Prudential Financial, Inc., The Prudential Insurance Company of America, and Prudential Holdings, LLC*, filed in the Circuit Court of Cook County, Illinois, was served on the Company. The complaint alleges that the Company failed to escheat life insurance proceeds to the State of Illinois in violation of the Illinois False Claims Whistleblower Reward and Protection Act and seeks injunctive relief, compensatory damages, civil

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

penalties, treble damages, prejudgment interest, attorneys' fees and costs. In March 2012, a *qui tam* action on behalf of the State of Minnesota, *Total Asset Recovery v. MetLife Inc., et al., Prudential Financial Inc., The Prudential Insurance Company of America and Prudential Holdings, Inc.*, filed in the Fourth Judicial District, Hennepin County, in the State of Minnesota was served on the Company. The complaint alleges that the Company failed to escheat life insurance proceeds to the State of Minnesota in violation of the Minnesota False Claims Act and seeks injunctive relief, compensatory damages, civil penalties, treble damages, prejudgment interest, attorneys' fees and costs.

In January 2012, a Global Resolution Agreement entered into by the Company and a third party auditor became effective upon its acceptance by the unclaimed property departments of 20 states and jurisdictions. Under the terms of the Global Resolution Agreement, the third party auditor acting on behalf of the signatory states will compare expanded matching criteria to the Social Security Master Death File (SSMDF) to identify deceased insureds and contract holders where a valid claim has not been made. In February 2012, a Regulatory Settlement Agreement entered into by the Company to resolve a multi-state market conduct examination regarding its adherence to state claim settlement practices became effective upon its acceptance by the insurance departments of 20 states and jurisdictions. The Regulatory Settlement Agreement applies prospectively and requires the Company to adopt and implement additional procedures comparing its records to the SSMDF to identify unclaimed death benefits and proscribes procedures for identifying and locating beneficiaries once deaths are identified. Other jurisdictions that are not signatories to the Regulatory Settlement Agreement are considering proposals that would apply prospectively and require life insurance companies to take additional steps to identify unreported deceased policy and contract holders. These prospective changes and any escheatable property identified as a result of the audits and inquiries could result in: (1) additional payments of previously unclaimed death benefits; (2) the payment of abandoned funds to U.S. jurisdictions; and (3) changes in the Company's practices and procedures for the identification of escheatable funds and beneficiaries, which would impact claim payments and reserves, among other consequences.

The Company is one of several companies subpoenaed by the New York Attorney General regarding its unclaimed property procedures. Additionally, the New York State Department of Financial Services (NYDFS) has requested that 172 life insurers (including the Company) provide data to the NYDFS regarding use of the SSMDF. The New York Office of Unclaimed Funds recently notified the Company that it intends to conduct an audit of the Company's compliance with New York's unclaimed property laws. The Minnesota Attorney General has also requested information regarding the Company's use of the SSMDF and its claim handling procedures and the Company is one of several companies subpoenaed by the Minnesota Department of Commerce, Insurance Division. In February 2012, the Massachusetts Office of the Attorney General requested information regarding the Company's unclaimed property procedures.

From July 2010 to December 2010, four purported nationwide class actions were filed challenging the use of retained asset accounts to settle death benefit claims of beneficiaries of a group life insurance contract owned by the United States Department of Veterans Affairs (VA Contract) that covers the lives of members and veterans of the U.S. armed forces. In 2011, the cases were consolidated in the United States District Court for the District of Massachusetts by the Judicial Panel for Multi-District Litigation as *In re Prudential Insurance Company of America SGLI/VGLI Contract Litigation*. The consolidated complaint alleges that the use of the retained assets accounts that earn interest and are available to be withdrawn by the beneficiary, in whole or in part, at any time, to settle death benefit claims is in violation of federal law, and asserts claims of breach of contract, breaches of fiduciary duty and the duty of good faith and fair dealing, fraud and unjust enrichment and seeks compensatory and punitive damages, disgorgement of profits, equitable relief and pre and post-judgment interest. In March 2011, the motion to dismiss was denied. In January 2012, plaintiffs filed a motion to certify the class.

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

In September 2010, *Huffman v. The Prudential Insurance Company*, a purported nationwide class action brought on behalf of beneficiaries of group life insurance contracts owned by ERISA-governed employee welfare benefit plans was filed in the United States District Court for the Eastern District of Pennsylvania, challenging the use of retained asset accounts in employee welfare benefit plans to settle death benefit claims as a violation of ERISA and seeking injunctive relief and disgorgement of profits. In July 2011, the Company's motion for judgment on the pleadings was denied. In February 2012, plaintiffs filed a motion to certify the class. In April 2012, the Court stayed the case pending the outcome of a case involving another insurer that is on appeal to the Third Circuit Court of Appeals.

In January 2011, a purported state-wide class action, *Garcia v. The Prudential Insurance Company of America* was dismissed by the Second Judicial District Court, Washoe County, Nevada. The complaint was brought on behalf of Nevada beneficiaries of individual life insurance policies for which, unless the beneficiaries elected another settlement method, death benefits were placed in retained asset accounts. The complaint alleges that by failing to disclose material information about the accounts, the Company wrongfully delayed payment and improperly retained undisclosed profits, and seeks damages, injunctive relief, attorneys' fees and pre and post-judgment interest. In February 2011, plaintiff appealed the dismissal to the Nevada Supreme Court. As previously reported, in December 2009, an earlier purported nationwide class action raising substantially similar allegations brought by the same plaintiff in the United States District Court for the District of New Jersey, *Garcia v. Prudential Insurance Company of America*, was dismissed. In December 2010, a purported state-wide class action complaint, *Phillips v. Prudential Financial, Inc.*, was filed in state court and removed to the United States District Court for the Southern District of Illinois. The complaint makes allegations under Illinois law, substantially similar to the *Garcia* cases, on behalf of a class of Illinois residents whose death benefit claims were settled by retained assets accounts. In March 2011, the complaint was amended to drop the Company as a defendant and add Pruco Life Insurance Company as a defendant and is now captioned *Phillips v. Prudential Insurance and Pruco Life Insurance Company*. In November 2011, the complaint was dismissed. In December 2011, plaintiffs appealed the dismissal.

In July 2010, the Company, along with other life insurance industry participants, received a formal request for information from the State of New York Attorney General's Office in connection with its investigation into industry practices relating to the use of retained asset accounts. In August 2010, the Company received a similar request for information from the State of Connecticut Attorney General's Office. The Company is cooperating with these investigations. The Company has also been contacted by state insurance regulators and other governmental entities, including the U.S. Department of Veterans Affairs and Congressional committees regarding retained asset accounts. These matters may result in additional investigations, information requests, claims, hearings, litigation, adverse publicity and potential changes to business practices.

In February 2011, a fifth amended complaint was filed in the United States District Court for the District of New Jersey in *Clark v. Prudential Insurance Company*. The complaint brought on behalf of a purported class of California, Indiana, Ohio and Texas residents who purchased individual health insurance policies alleges that Prudential Insurance failed to disclose that it had ceased selling this type of policy in 1981 and that, as a result, premiums would increase significantly. The complaint alleges claims of fraudulent misrepresentation and omission, breach of the duty of good faith and fair dealing, and California's Unfair Competition Law and seeks compensatory and punitive damages. The matter was originally filed in 2008 and certain of the claims in the first four complaints were dismissed. In February 2012, plaintiffs filed a motion for class certification.

In April 2009, *Schultz v. The Prudential Insurance Company of America*, a purported nationwide class action on behalf of participants claiming disability benefits under certain employee benefit plans insured by Prudential, was filed in the United States District Court for the Northern District of Illinois. As amended, the complaint alleges that Prudential Insurance and the defendant plans violated ERISA by characterizing family

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

Social Security benefits as well as loss of time benefits that were offset against Prudential contract benefits. The complaint seeks a declaratory judgment that the offsets were improper, damages and other relief. The Company has agreed to indemnify the named defendant plans. In April 2011, *Schultz* was dismissed with prejudice, and plaintiffs appealed to the Seventh Circuit Court of Appeals. In March 2012, the court affirmed the dismissal.

From November 2002 to March 2005, eleven separate complaints were filed against the Company and the law firm of Leeds Morelli & Brown in New Jersey state court and in the New Jersey Superior Court, Essex County as *Lederman v. Prudential Financial, Inc., et al.* The complaints allege that an alternative dispute resolution agreement entered into among Prudential Insurance, over 235 claimants who are current and former Prudential Insurance employees, and Leeds Morelli & Brown (the law firm representing the claimants) was illegal and that Prudential Insurance conspired with Leeds Morelli & Brown to commit fraud, malpractice, breach of contract, and violate racketeering laws by advancing legal fees to the law firm with the purpose of limiting Prudential's liability to the claimants. In February 2010, the New Jersey Supreme Court assigned the cases for centralized case management to the Superior Court, Bergen County. The Company participated in a court-ordered mediation that resulted in a settlement involving 193 of the remaining 235 plaintiffs. The amounts paid to the 193 plaintiffs were within existing reserves for this matter. The remaining 42 plaintiffs continue to pursue their individual lawsuits, and have filed offers of judgment totaling approximately \$90 million. In February 2012, the court granted summary judgment against two of the remaining plaintiffs.

Retirement Solutions and Investment Management

In October 2007, Prudential Retirement Insurance and Annuity Co. (PRIAC) filed an action in the United States District Court for the Southern District of New York, *Prudential Retirement Insurance & Annuity Co. v. State Street Global Advisors*, in PRIAC's fiduciary capacity and on behalf of certain defined benefit and defined contribution plan clients of PRIAC, against an unaffiliated asset manager, State Street Global Advisors (SSGA) and SSGA's affiliate, State Street Bank and Trust Company (State Street). This action seeks, among other relief, restitution of certain losses attributable to certain investment funds sold by SSGA as to which PRIAC believes SSGA employed investment strategies and practices that were misrepresented by SSGA and failed to exercise the standard of care of a prudent investment manager. Given the unusual circumstances surrounding the management of these SSGA funds and in order to protect the interests of the affected plans and their participants while PRIAC pursues these remedies, PRIAC implemented a process under which affected plan clients that authorized PRIAC to proceed on their behalf have received payments from funds provided by PRIAC for the losses referred to above. The Company's consolidated financial statements, and the results of the Retirement segment included in the Company's U.S. Retirement Solutions and Investment Management Division, for the year ended December 31, 2007 include a pre-tax charge of \$82 million, reflecting these payments to plan clients and certain related costs. In September 2008, the United States District Court for the Southern District of New York denied the State Street defendants motion to dismiss claims for damages and other relief under Section 502(a)(2) of ERISA, but dismissed the claims for equitable relief under Section 502(a)(3) of ERISA. In October 2008, defendants answered the complaint and asserted counterclaims for contribution and indemnification, defamation and violations of Massachusetts unfair and deceptive trade practices law. In February 2010, State Street reached a settlement with the SEC over charges that it misled investors about their exposure to sub-prime investments, resulting in significant investor losses in mid-2007. Under the settlement, State Street paid approximately \$313 million in disgorgement, pre-judgment interest, penalty and compensation into a Fair Fund that was distributed to injured investors and consequently, State Street paid PRIAC, for deposit into its separate accounts, approximately \$52.5 million. By the terms of the settlement, State Street's payment to PRIAC does not resolve any claims PRIAC has against State Street or SSGA in connection with the losses in the investment funds SSGA managed, and the penalty component of State Street's SEC settlement cannot be used to offset or reduce compensatory damages in the action against State Street and SSGA. In June 2010, PRIAC moved

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

for partial summary judgment on State Street's counterclaims. At the same time, State Street moved for summary judgment on PRIAC's complaint. In March 2011, the district court denied State Street's motion for summary judgment and denied in part and granted in part PRIAC's motion for partial summary judgment on State Street's counterclaims. In October 2011, the court held a bench trial to determine whether State Street had breached its fiduciary duty to PRIAC's plan clients. In February 2012, the court issued a decision holding that State Street breached its fiduciary duty to the plans under ERISA to manage the investment funds prudently and to diversify them. The court held that PRIAC did not prove that State Street breached its duty of loyalty to the plans under ERISA. The court held that State Street's breaches caused the plans' losses in the amount of \$76.7 million and, after crediting State Street for an earlier payment, awarded \$28.1 million in damages in addition to the amount previously recovered as a result of the SEC settlement. The court has not yet ruled on State Street's counterclaims and has reserved judgment on PRIAC's requests for pre-judgment interest and attorney's fees.

Other Matters

In October 2006, a purported class action lawsuit, *Bouder v. Prudential Financial, Inc. and Prudential Insurance Company of America*, was filed in the United States District Court for the District of New Jersey, claiming that Prudential failed to pay overtime to insurance agents in violation of federal and Pennsylvania law, and that improper deductions were made from these agents' wages in violation of state law. The complaint seeks back overtime pay and statutory damages, recovery of improper deductions, interest, and attorneys' fees. In March 2008, the court conditionally certified a nationwide class on the federal overtime claim. Separately, in March 2008, a purported nationwide class action lawsuit was filed in the United States District Court for the Southern District of California, *Wang v. Prudential Financial, Inc. and Prudential Insurance*, claiming that the Company failed to pay its agents overtime and provide other benefits in violation of California and federal law and seeking compensatory and punitive damages in unspecified amounts. In September 2008, *Wang* was transferred to the United States District Court for the District of New Jersey and consolidated with the *Bouder* matter. Subsequent amendments to the complaint have resulted in additional allegations involving purported violations of an additional nine states' overtime and wage payment laws. In February 2010, Prudential moved to decertify the federal overtime class that had been conditionally certified in March 2008 and moved for summary judgment on the federal overtime claims of the named plaintiffs. In July 2010, plaintiffs filed a motion for class certification of the state law claims. In August 2010, the district court granted Prudential's motion for summary judgment, dismissing the federal overtime claims. The motion for class certification of the state law claims is pending.

Summary

The Company's litigation and regulatory matters are subject to many uncertainties, and given their complexity and scope, their outcome cannot be predicted. It is possible that the Company's results of operations or cash flow in a particular quarterly or annual period could be materially affected by an ultimate unfavorable resolution of pending litigation and regulatory matters depending, in part, upon the results of operations or cash flow for such period. In light of the unpredictability of the Company's litigation and regulatory matters, it is also possible that in certain cases an ultimate unfavorable resolution of one or more pending litigation or regulatory matters could have a material adverse effect on the Company's financial position. Management believes, however, that, based on information currently known to it, the ultimate outcome of all pending litigation and regulatory matters, after consideration of applicable reserves and rights to indemnification, is not likely to have a material adverse effect on the Company's financial position.

Table of Contents**PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Supplemental Combining Statements of Financial Position****March 31, 2012 and December 31, 2011 (in millions)**

	March 31, 2012			December 31, 2011		
	Financial Services Businesses	Closed Block Business	Consolidated	Financial Services Businesses	Closed Block Business	Consolidated
ASSETS						
Fixed maturities, available-for-sale, at fair value	\$ 208,419	\$ 46,172	\$ 254,591	\$ 208,132	\$ 46,516	\$ 254,648
Fixed maturities, held-to-maturity, at amortized cost	4,775	0	4,775	5,107	0	5,107
Trading account assets supporting insurance liabilities, at fair value	19,679	0	19,679	19,481	0	19,481
Other trading account assets, at fair value	4,860	321	5,181	5,228	317	5,545
Equity securities, available-for-sale, at fair value	4,629	3,397	8,026	4,413	3,122	7,535
Commercial mortgage and other loans	26,205	9,418	35,623	26,391	9,040	35,431
Policy loans	6,191	5,228	11,419	6,263	5,296	11,559
Other long-term investments	5,517	1,964	7,481	5,830	1,990	7,820
Short-term investments	7,196	729	7,925	8,593	528	9,121
Total investments	287,471	67,229	354,700	289,438	66,809	356,247
Cash and cash equivalents	12,980	1,221	14,201	13,201	1,050	14,251
Accrued investment income	2,147	652	2,799	2,177	616	2,793
Deferred policy acquisition costs	13,008	453	13,461	12,056	461	12,517
Other assets	15,641	368	16,009	15,748	308	16,056
Separate account assets	236,567	0	236,567	218,380	0	218,380
TOTAL ASSETS	\$ 567,814	\$ 69,923	\$ 637,737	\$ 551,000	\$ 69,244	\$ 620,244
LIABILITIES AND EQUITY						
LIABILITIES						
Future policy benefits	\$ 116,721	\$ 51,280	\$ 168,001	\$ 119,248	\$ 51,423	\$ 170,671
Policyholders' account balances	128,038	5,467	133,505	129,074	5,484	134,558
Policyholders' dividends	261	5,550	5,811	286	5,511	5,797
Securities sold under agreements to repurchase	3,806	3,394	7,200	3,118	3,100	6,218
Cash collateral for loaned securities	2,226	724	2,950	2,254	719	2,973
Income taxes	8,094	(542)	7,552	6,993	(435)	6,558
Short-term debt	3,655	0	3,655	2,336	0	2,336
Long-term debt	22,629	1,750	24,379	22,872	1,750	24,622
Other liabilities	11,712	867	12,579	13,034	256	13,290
Separate account liabilities	236,567	0	236,567	218,380	0	218,380
Total liabilities	533,709	68,490	602,199	517,595	67,808	585,403
COMMITMENTS AND CONTINGENT LIABILITIES						
EQUITY						
Accumulated other comprehensive income (loss)	7,073	153	7,226	5,250	168	5,418
Other attributed equity	26,436	1,280	27,716	27,567	1,268	28,835
Total attributed equity	33,509	1,433	34,942	32,817	1,436	34,253

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Noncontrolling interests	596	0	596	588	0	588
Total equity	34,105	1,433	35,538	33,405	1,436	34,841
TOTAL LIABILITIES AND EQUITY	\$ 567,814	\$ 69,923	\$ 637,737	\$ 551,000	\$ 69,244	\$ 620,244

See Notes to Unaudited Interim Supplemental Combining Financial Information

Table of Contents**PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Supplemental Combining Statements of Operations****Three Months Ended March 31, 2012 and 2011 (in millions)**

	Financial Services Businesses	2012 Closed Block Business	Consolidated	Financial Services Businesses	2011 Closed Block Business	Consolidated
REVENUES						
Premiums	\$ 6,102	\$ 671	\$ 6,773	\$ 4,819	\$ 691	\$ 5,510
Policy charges and fee income	1,049	0	1,049	948	0	948
Net investment income	2,529	791	3,320	2,308	810	3,118
Asset management fees and other income	(158)	23	(135)	628	16	644
Realized investment gains (losses), net						
Other-than-temporary impairments on fixed maturity securities	(311)	(262)	(573)	(337)	(238)	(575)
Other-than-temporary impairments on fixed maturity securities transferred to Other Comprehensive Income	229	232	461	258	213	471
Other realized investment gains (losses), net	(1,292)	20	(1,272)	(1)	55	54
Total realized investment gains (losses), net	(1,374)	(10)	(1,384)	(80)	30	(50)
Total revenues	8,148	1,475	9,623	8,623	1,547	10,170
BENEFITS AND EXPENSES						
Policyholders benefits	5,584	859	6,443	4,619	814	5,433
Interest credited to policyholders account balances	932	34	966	789	34	823
Dividends to policyholders	38	404	442	31	517	548
Amortization of deferred policy acquisition costs	(237)	12	(225)	343	11	354
General and administrative expenses	2,660	136	2,796	2,245	139	2,384
Total benefits and expenses	8,977	1,445	10,422	8,027	1,515	9,542
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES						
	(829)	30	(799)	596	32	628
Income tax expense	162	9	171	150	10	160
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES						
	(991)	21	(970)	446	22	468
Equity in earnings of operating joint ventures, net of taxes	7	0	7	104	0	104
INCOME (LOSS) FROM CONTINUING OPERATIONS						
	(984)	21	(963)	550	22	572
Income from discontinued operations, net of taxes	7	0	7	14	0	14
NET INCOME (LOSS)	(977)	21	(956)	564	22	586

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Less: Income attributable to noncontrolling interests	11	0	11	25	0	25
NET INCOME (LOSS) ATTRIBUTABLE TO PRUDENTIAL FINANCIAL, INC.	\$ (988)	\$ 21	\$ (967)	\$ 539	\$ 22	\$ 561

See Notes to Unaudited Interim Supplemental Combining Financial Information

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Supplemental Combining Financial Information

1. BASIS OF PRESENTATION

The supplemental combining financial information presents the consolidated financial position and results of operations for Prudential Financial, Inc. and its subsidiaries (together, the Company), separately reporting the Financial Services Businesses and the Closed Block Business. The Financial Services Businesses and the Closed Block Business are both fully integrated operations of the Company and are not separate legal entities. The supplemental combining financial information presents the results of the Financial Services Businesses and the Closed Block Business as if they were separate reporting entities and should be read in conjunction with the Consolidated Financial Statements.

The Company has outstanding two classes of common stock. The Common Stock reflects the performance of the Financial Services Businesses and the Class B Stock reflects the performance of the Closed Block Business.

The Closed Block Business was established on the date of demutualization and includes the assets and liabilities of the Closed Block (see Note 6 to the Unaudited Interim Consolidated Financial Statements for a description of the Closed Block). It also includes assets held outside the Closed Block necessary to meet insurance regulatory capital requirements related to products included within the Closed Block; deferred policy acquisition costs related to the Closed Block policies; the principal amount of the IHC debt (as discussed below) and related unamortized debt issuance costs, as well as an interest rate swap related to the IHC debt; and certain other related assets and liabilities. The Financial Services Businesses consist of the U.S. Retirement Solutions and Investment Management, U.S. Individual Life and Group Insurance, and International Insurance divisions and Corporate and Other operations.

2. ALLOCATION OF RESULTS

This supplemental combining financial information reflects the assets, liabilities, revenues and expenses directly attributable to the Financial Services Businesses and the Closed Block Business, as well as allocations deemed reasonable by management in order to fairly present the financial position and results of operations of the Financial Services Businesses and the Closed Block Business on a stand-alone basis. While management considers the allocations utilized to be reasonable, management has the discretion to make operational and financial decisions that may affect the allocation methods and resulting assets, liabilities, revenues and expenses of each business. In addition, management has limited discretion over accounting policies and the appropriate allocation of earnings between the two businesses. The Company is subject to agreements which provide that, in most instances, the Company may not change the allocation methodology or accounting policies for the allocation of earnings between the Financial Services Businesses and Closed Block Business without the prior consent of the Class B Stock holders or IHC debt bond insurer.

General corporate overhead not directly attributable to a specific business that has been incurred in connection with the generation of the businesses' revenues is generally allocated between the Financial Services Businesses and the Closed Block Business based on the general and administrative expenses of each business as a percentage of the total general and administrative expenses for all businesses.

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Prudential Holdings, LLC, a wholly-owned subsidiary of Prudential Financial, Inc., has outstanding senior secured notes (the IHC debt), of which net proceeds of \$1.66 billion were allocated to the Financial Services Businesses concurrent with the demutualization on December 18, 2001. The IHC debt is serviced by the cash flows of the Closed Block Business, and the results of the Closed Block Business reflect interest expense associated with the IHC debt.

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Supplemental Combining Financial Information (Continued)

Income taxes are allocated between the Financial Services Businesses and the Closed Block Business as if they were separate companies based on the taxable income or losses and other tax characterizations of each business. If a business generates benefits, such as net operating losses, it is entitled to record such tax benefits to the extent they are expected to be utilized on a consolidated basis.

Holders of Common Stock have no interest in a separate legal entity representing the Financial Services Businesses; holders of the Class B Stock have no interest in a separate legal entity representing the Closed Block Business; and holders of each class of common stock are subject to all of the risks associated with an investment in the Company.

In the event of a liquidation, dissolution or winding-up of the Company, holders of Common Stock and holders of Class B Stock would be entitled to receive a proportionate share of the net assets of the Company that remain after paying all liabilities and the liquidation preferences of any preferred stock.

The results of the Financial Services Businesses are subject to certain risks pertaining to the Closed Block. These include any expenses and liabilities from litigation affecting the Closed Block policies as well as the consequences of certain potential adverse tax determinations. In connection with the sale of the Class B Stock and IHC debt, the cost of indemnifying the investors with respect to certain matters will be borne by the Financial Services Businesses.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) addresses the consolidated financial condition of Prudential Financial as of March 31, 2012, compared with December 31, 2011, and its consolidated results of operations for the three months ended March 31, 2012 and 2011. You should read the following analysis of our consolidated financial condition and results of operations in conjunction with the MD&A, the Risk Factors section, and the audited Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, as well as the statements under Forward-Looking Statements and the Unaudited Interim Consolidated Financial Statements included elsewhere in this Quarterly Report on Form 10-Q.

Overview

Prudential Financial has two classes of common stock outstanding. The Common Stock, which is publicly traded (NYSE:PRU), reflects the performance of the Financial Services Businesses, while the Class B Stock, which was issued through a private placement and does not trade on any exchange, reflects the performance of the Closed Block Business. The Financial Services Businesses and the Closed Block Business are discussed below.

Financial Services Businesses

Our Financial Services Businesses consist of three operating divisions, which together encompass six segments, and our Corporate and Other operations. The U.S. Retirement Solutions and Investment Management division consists of our Individual Annuities, Retirement and Asset Management segments. The U.S. Individual Life and Group Insurance division consists of our Individual Life and Group Insurance segments. The International Insurance division consists of our International Insurance segment. Our Corporate and Other operations include corporate items and initiatives that are not allocated to business segments, as well as businesses that have been or will be divested.

We attribute financing costs to each segment based on the amount of financing used by each segment, excluding financing costs associated with corporate debt which are reflected in Corporate and Other operations. The net investment income of each segment includes earnings on the amount of capital that management believes is necessary to support the risks of that segment.

We seek growth internally and through acquisitions, joint ventures or other forms of business combinations or investments. Our principal acquisition focus is in our current business lines, both domestic and international.

Closed Block Business

In connection with the demutualization, we ceased offering domestic participating products. The liabilities for our traditional domestic in force participating products were segregated, together with assets, in a regulatory mechanism referred to as the Closed Block. The Closed Block is designed generally to provide for the reasonable expectations for future policy dividends after demutualization of holders of participating individual life insurance policies and annuities included in the Closed Block by allocating assets that will be used exclusively for payment of

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

benefits, including policyholder dividends, expenses and taxes with respect to these products. See Note 6 to the Unaudited Interim Consolidated Financial Statements for more information on the Closed Block. At the time of demutualization, we determined the amount of Closed Block assets so that the Closed Block assets initially had a lower book value than the Closed Block liabilities. We expect that the Closed Block assets will generate sufficient cash flow, together with anticipated revenues from the Closed Block policies, over the life of the Closed Block to fund payments of all expenses, taxes, and policyholder benefits to be

Table of Contents

paid to, and the reasonable dividend expectations of, holders of the Closed Block policies. We also segregated for accounting purposes the assets that we need to hold outside the Closed Block to meet capital requirements related to the Closed Block policies. No policies sold after demutualization will be added to the Closed Block, and its in force business is expected to ultimately decline as we pay policyholder benefits in full. We also expect the proportion of our business represented by the Closed Block to decline as we grow other businesses. The long-term risks associated with the policies in the Closed Block are 90% reinsured, including 17% by a wholly-owned subsidiary of Prudential Financial. In 2011, we also began reinsuring 90% of the short-term risks associated with the Closed Block policies to a wholly-owned subsidiary of Prudential Financial.

Concurrently with our demutualization, Prudential Holdings, LLC, a wholly-owned subsidiary of Prudential Financial that owns the capital stock of Prudential Insurance, issued \$1.75 billion in senior secured notes, which we refer to as the IHC debt. The net proceeds from the issuances of the Class B Stock and IHC debt, except for \$72 million used to purchase a guaranteed investment contract to fund a portion of the bond insurance cost associated with that debt, were allocated to the Financial Services Businesses. However, we expect that the IHC debt will be serviced by the net cash flows of the Closed Block Business over time, and we include interest expenses associated with the IHC debt when we report results of the Closed Block Business.

The Closed Block Business consists principally of the Closed Block, assets that we must hold outside the Closed Block to meet capital requirements related to the Closed Block policies, invested assets held outside the Closed Block that represent the difference between the Closed Block assets and Closed Block liabilities and the interest maintenance reserve, deferred policy acquisition costs related to Closed Block policies, the principal amount of the IHC debt and related hedging activities, and certain other related assets and liabilities.

The Closed Block Business is not a separate legal entity from the Financial Services Businesses; however, they are operated as separate entities and are separated for financial reporting purposes. The Financial Services Businesses are not obligated to pay dividends on Closed Block policies. Dividends on Closed Block policies reflect the experience of the Closed Block over time and are subject to adjustment by Prudential Insurance's Board of Directors. Further, our plan of demutualization provides that we are not required to pay dividends on policies within the Closed Block from assets that are not within the Closed Block and that the establishment of the Closed Block does not represent a guarantee that any certain level of dividends will be maintained.

Executive Summary

Prudential Financial, a financial services leader with approximately \$942.9 billion of assets under management as of March 31, 2012, has operations in the United States, Asia, Europe and Latin America. Through our subsidiaries and affiliates, we offer a wide array of financial products and services, including life insurance, annuities, retirement-related services, mutual funds, and investment management. We offer these products and services to individual and institutional customers through one of the largest distribution networks in the financial services industry.

Effective January 1, 2012, the Company adopted the amended authoritative guidance issued by the FASB to address diversity in practice regarding the interpretation of which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral. The Company has applied the retrospective method of adoption. Accordingly, all financial information presented has been revised to reflect the retrospective adoption of the amended guidance. For further information, see [Accounting Policies and Pronouncements](#) Adoption of New Accounting Pronouncements.

On April 11, 2012, the Financial Stability Oversight Council, created under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), published final regulations setting forth the criteria by which it will designate the non-bank financial companies that are

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

to be subject to stricter prudential standards (a Covered Company). These final regulations establish a three-stage process for designating a

Table of Contents

Covered Company. Based on the stage 1 criteria, which include having at least \$50 billion in assets and meeting one of five additional quantitative measures, Prudential Financial would be subject to stage 2 consideration. The Dodd-Frank Act requires that the prudential standards include requirements regarding risk-based capital and leverage; liquidity; overall risk management; resolution plans; early remediation; and credit concentration; and it authorizes additional standards regarding contingent capital; public disclosure; short-term debt limits; and other related subjects as appropriate. The Federal Reserve Board has proposed rules to implement these standards, the comment period for most of which closed on April 30, 2012. See *Business Regulation* in our 2011 Annual Report on Form 10-K for more information regarding the potential impact of the Dodd-Frank Act on the Company, including as a result of these stricter prudential standards.

Our financial condition and results of operations as of and for the three months ended March 31, 2012 reflect the following:

Net loss of our Financial Services Businesses attributable to Prudential Financial, Inc. for the first quarter of 2012 was \$988 million compared to net income of \$539 million for the first quarter of 2011.

Pre-tax net realized investment losses and related charges and adjustments of the Financial Services Businesses in the first quarter of 2012 were \$1,838 million, primarily reflecting the impact of changes in foreign currency exchange rates during the period on certain assets and liabilities for which we economically hedge the foreign currency exposure. These currency-driven value changes were largely offset by corresponding adjustments to accumulated other comprehensive income which are not reflected in net income or loss. Also contributing to pre-tax net realized investment losses were net losses related to the embedded derivatives and related hedge positions associated with certain of our variable annuity contracts, other-than-temporary impairments of fixed maturity and equity securities and net decreases in the market value of derivatives used to manage investment portfolio duration reflecting changing interest rates. Partially offsetting these net losses were net realized investment gains from our general account investment portfolio.

Net unrealized gains on general account fixed maturity investments of the Financial Services Businesses amounted to \$12.960 billion as of March 31, 2012, compared to net unrealized gains of \$10.493 billion as of December 31, 2011. Gross unrealized gains increased from \$14.749 billion as of December 31, 2011 to \$15.624 billion as of March 31, 2012 and gross unrealized losses decreased from \$4.256 billion to \$2.664 billion for the same periods. Net unrealized gains on general account fixed maturity investments of the Closed Block Business amounted to \$3.607 billion as of March 31, 2012, compared to net unrealized gains of \$3.876 billion as of December 31, 2011.

Individual Annuity total account values reached a record high of \$124.1 billion as of March 31, 2012. Gross sales in the first quarter of 2012 were \$5.0 billion compared to \$6.8 billion in the first quarter of 2011, and net sales in the first quarter of 2012 were \$3.2 billion compared to \$4.8 billion in the first quarter of 2011.

Full Service Retirement account values were \$146.0 billion as of March 31, 2012. Institutional Investment Products account values reached a record high of \$93.9 billion as of March 31, 2012, driven by \$2.9 billion of net additions in the first quarter of 2012.

Asset Management total third party institutional and retail net flows were \$8.6 billion in the first quarter of 2012, contributing to a record high \$636.8 billion in the segment's assets under management as of March 31, 2012.

International Insurance constant dollar basis annualized new business premiums were a record high of \$819 million in the first quarter of 2012, compared to \$660 million for the first quarter of 2011.

Individual Life annualized new business premiums were \$79 million in the first quarter of 2012, compared to \$65 million in the first quarter of 2011.

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Group Insurance annualized new business premiums were \$313 million in the first quarter of 2012 compared to \$500 million in the first quarter of 2011.

Table of Contents

As of March 31, 2012, Prudential Financial, the parent holding company, had cash and short-term investments of \$4.135 billion.

Results of Operations

We analyze performance of the segments and Corporate and Other operations of the Financial Services Businesses using a measure called adjusted operating income. See Consolidated Results of Operations Segment Measures for a discussion of adjusted operating income and its use as a measure of segment operating performance.

Shown below are the contributions of each segment and Corporate and Other operations to our adjusted operating income for the three months ended March 31, 2012 and 2011 and a reconciliation of adjusted operating income of our segments and Corporate and Other operations to income from continuing operations before income taxes and equity in earnings of operating joint ventures.

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
Adjusted operating income before income taxes for segments of the Financial Services Businesses:		
Individual Annuities	\$ 421	\$ 274
Retirement	156	172
Asset Management	121	154
Total U.S. Retirement Solutions and Investment Management Division	698	600
Individual Life	112	98
Group Insurance	(38)	39
Total U.S. Individual Life and Group Insurance Division	74	137
International Insurance	606	628
Total International Insurance Division	606	628
Corporate and Other	(363)	(269)
Adjusted operating income before income taxes for the Financial Services Businesses	1,015	1,096
Reconciling Items:		
Realized investment gains (losses), net, and related adjustments	(2,716)	(365)
Charges related to realized investment gains (losses), net	878	(10)
Investment gains (losses) on trading account assets supporting insurance liabilities, net	234	(17)
Change in experience-rated contractholder liabilities due to asset value changes	(246)	34
Divested businesses	1	(9)
Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests	5	(133)
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures for Financial Services Businesses	(829)	596
Income from continuing operations before income taxes for Closed Block Business	30	32
	\$ (799)	\$ 628

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Consolidated income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures

122

Table of Contents

Results for the three months ended March 31, 2012 presented above reflect the following:

Individual Annuities segment results for the first quarter of 2012 increased in comparison to the first quarter of 2011, primarily reflecting a higher net benefit in the current quarter from adjustments to the reserves for the guaranteed minimum death benefit and guaranteed minimum income benefit features of our variable annuity products, and to amortization of deferred policy acquisition and other costs. These adjustments were driven by the impact on the estimated profitability of the business of quarterly adjustments to reflect current period market performance and experience. Also contributing to the increase was higher fee income, net of distribution costs, due to higher average variable annuity account values invested in separate accounts, partially offset by higher general and administrative expenses, net of capitalization.

Retirement segment results for the first quarter of 2012 decreased in comparison to the first quarter of 2011, primarily reflecting lower net investment spread results and a less favorable reserve benefit from case experience, partially offset by higher asset-based fee income.

Asset Management segment results in the first quarter of 2012 decreased in comparison to the first quarter of 2011 largely due to a lower contribution from the segment's incentive, transaction, strategic investing and commercial mortgage activities, which benefited in the prior year quarter from net gains on sales of foreclosed properties and more favorable strategic investing results. The lower contribution from these segment activities, together with higher expenses in the current quarter, more than offset the benefit from higher asset management fees.

Individual Life segment results for the first quarter of 2012 increased from the first quarter of 2011, primarily due to less unfavorable mortality experience.

Group Insurance segment results for the first quarter of 2012 decreased in comparison to the first quarter of 2011 primarily reflecting an adverse fluctuation in group life claims experience, less favorable group disability claims experience, and higher expenses in the current quarter.

International Insurance segment results declined in the first quarter of 2012 in comparison to the first quarter of 2011. Results from the segment's Life Planner operations improved in the 2012 period, reflecting the continued growth of our Japanese Life Planner operations, more favorable mortality experience than that of the year-ago quarter, and the impact of estimated claims associated with 2011 earthquake in Japan on the year-ago quarter results. The decline in results from the segment's Gibraltar Life and Other operations reflects the absence of a \$153 million benefit recognized in the prior year period related to a partial sale of our investment, through a consortium, in China Pacific Group, and reflects higher costs in the current year period associated with the integration of the Star and Edison Businesses. Excluding the impact of these items, results from the segment's Gibraltar Life and Other operations increased compared to the prior year period primarily reflecting business growth across all distribution channels and \$31 million of cost savings resulting from the Star and Edison integration synergies. In addition, the benefit resulting from the impact of including the additional two months of earnings from the former Star and Edison Businesses was partially offset by higher policy benefits and expenses including unfavorable mortality experience in the current year quarter. Current quarter results for International Insurance also benefited in comparison to the year-ago quarter from foreign currency exchange rates including the impact of the Company's currency hedging program.

Corporate and Other operations resulted in an increased loss for the first quarter of 2012 compared to the first quarter of 2011 primarily due to higher corporate expenses and increased interest expense on capital debt, reflecting an increase in capital debt used to support our annuities business. In addition, the first quarter of 2012 reflected a decrease in qualified pension income.

Income from continuing operations before income taxes in the Closed Block Business decreased \$2 million in the first quarter of 2012 compared to the first quarter of 2011, primarily reflecting unfavorable mortality experience and net realized investment losses, partially offset by a decrease in the policyholder dividend obligation expense.

Table of Contents

Accounting Policies & Pronouncements

Application of Critical Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America, or U.S. GAAP, requires the application of accounting policies that often involve a significant degree of judgment. Management, on an ongoing basis, reviews estimates and assumptions used in the preparation of financial statements. If management determines that modifications in assumptions and estimates are appropriate given current facts and circumstances, results of operations and financial position as reported in the Consolidated Financial Statements could change significantly.

Management believes the accounting policies relating to the following areas are most dependent on the application of estimates and assumptions and require management's most difficult, subjective, or complex judgments:

Deferred policy acquisition and other costs, including value of business acquired;

Goodwill;

Valuation of investments, including derivatives, and the recognition of other-than-temporary impairments;

Policyholder liabilities;

Pension and other postretirement benefits;

Taxes on income; and

Reserves for contingencies, including reserves for losses in connection with unresolved legal matters.

In the first quarter of 2012, we revised the treatment of the results of the living benefits hedging program in our best estimate of total gross profits used to calculate the amortization of deferred policy acquisition costs (DAC) and deferred sales inducements (DSI) associated with certain of the variable annuity contracts of our Individual Annuities segment. In 2011, we included the results of our living benefits hedging program, excluding any items we chose not to hedge, in our best estimate of gross profits used to determine amortization rates only to the extent this net amount was determined by management to be other-than-temporary. Beginning with the first quarter of 2012, we are including the results of our living benefits hedging program, excluding any items we choose not to hedge, in our best estimate of total gross profits used for determining amortization rates each quarter without regard to the permanence of the changes. Aside from this change, our policy for amortizing DAC and DSI remains as described in our Annual Report on Form 10-K for the year ended December 31, 2011, under Management's Discussion and Analysis of Financial Condition and Results of Operations Accounting Policies & Pronouncements Application of Critical Accounting Estimates.

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

A discussion of each of the additional critical accounting estimates listed above may also be found in our Annual Report on Form 10-K for the year ended December 31, 2011, under Management's Discussion and Analysis of Financial Condition and Results of Operations Accounting Policies & Pronouncements Application of Critical Accounting Estimates.

Adoption of New Accounting Pronouncements

In October 2010, the FASB issued authoritative guidance to address diversity in practice regarding the interpretation of which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral. The Company adopted this guidance effective January 1, 2012, and applied the retrospective method of adoption. Accordingly, prior period financial information has been adjusted to reflect the retrospective adoption of the amended guidance. The impact of the retrospective adoption of this guidance on previously reported December 31, 2011 balances was a reduction in deferred policy acquisition costs by \$4.1 billion for the Financial

Table of Contents

Services Businesses and by \$0.2 billion for the Closed Block Business, an increase in policy reserves for certain limited pay contracts by \$0.2 billion for the Financial Services Businesses, and a reduction in total equity by \$2.8 billion for the Financial Services Businesses and \$0.2 billion for the Closed Block Business. The impact of the retrospective adoption of this guidance on previously reported income from continuing operations before income taxes for the three months ended March 31, 2011 was a decrease of \$81 million for the Financial Services Businesses and an increase of \$5 million for the Closed Block Business. 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.

See Note 2 to our Unaudited Interim Consolidated Financial Statements for a discussion of newly adopted accounting pronouncements, including further discussion of the new authoritative guidance addressing which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral.

Table of Contents**Consolidated Results of Operations**

The following table summarizes net income (loss) for the Financial Services Businesses and the Closed Block Business for the periods presented.

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
Financial Services Businesses by segment:		
Individual Annuities	\$ (462)	\$ 246
Retirement	(18)	110
Asset Management	132	161
Total U.S. Retirement Solutions and Investment Management Division	(348)	517
Individual Life	142	124
Group Insurance	(56)	33
Total U.S. Individual Life and Group Insurance Division	86	157
International Insurance	(876)	156
Total International Insurance Division	(876)	156
Corporate and Other	309	(234)
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures for Financial Services Businesses	(829)	596
Income tax expense	162	150
Income (loss) from continuing operations before equity in earnings of operating joint ventures for Financial Services Businesses	(991)	446
Equity in earnings of operating joint ventures, net of taxes	7	104
Income (loss) from continuing operations for Financial Services Businesses	(984)	550
Income from discontinued operations, net of taxes	7	14
Net income (loss) Financial Services Businesses	(977)	564
Less: Income attributable to noncontrolling interests	11	25
Net income (loss) of Financial Services Businesses attributable to Prudential Financial, Inc.	\$ (988)	\$ 539
Basic income (loss) from continuing operations attributable to Prudential Financial, Inc. per share Common Stock	\$ (2.10)	\$ 1.09
Diluted income (loss) from continuing operations attributable to Prudential Financial, Inc. per share Common Stock	\$ (2.10)	\$ 1.08
Basic net income (loss) attributable to Prudential Financial, Inc. per share Common Stock	\$ (2.09)	\$ 1.12
Diluted net income (loss) attributable to Prudential Financial, Inc. per share Common Stock	\$ (2.09)	\$ 1.10
Closed Block Business:		
Income from continuing operations before income taxes for Closed Block Business	\$ 30	\$ 32
Income tax expense	9	10

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Income from continuing operations for Closed Block Business	21	22
Income from discontinued operations, net of taxes	0	0
Net income - Closed Block Business	21	22
Less: Income attributable to noncontrolling interests	0	0
Net income of Closed Block Business attributable to Prudential Financial, Inc.	\$ 21	\$ 22
Basic and diluted income from continuing operations attributable to Prudential Financial, Inc. per share - Class B Stock	\$ 6.50	\$ 6.50
Basic and diluted net income attributable to Prudential Financial, Inc. per share - Class B Stock	\$ 6.50	\$ 6.50
Consolidated:		
Net income (loss) attributable to Prudential Financial, Inc.	\$ (967)	\$ 561

Table of Contents

Results of Operations Financial Services Businesses

2012 to 2011 Three Month Comparison. Income (loss) from continuing operations for the Financial Services Businesses decreased \$1,534 million, from income of \$550 million in the first quarter of 2011 to a loss of \$984 million in the first quarter of 2012. Results for the first quarter of 2012 compared to the first quarter of 2011 reflect the following:

Higher net pre-tax losses resulting from the impact of foreign currency exchange rate movements on certain non-yen denominated assets and liabilities within our Japanese insurance operations, for which we economically hedge the foreign currency exposure, driven by the weakening of the yen during 2012. These currency-driven value changes were largely offset by corresponding adjustments to accumulated other comprehensive income which are not reflected in net income or loss.

A \$319 million unfavorable variance, before taxes, reflecting the net impact from the mark-to-market of our embedded derivatives and related hedge positions associated with certain variable annuities, primarily driven by the impact of non-performance risk, partially offset by the impact on amortization of deferred policy acquisition and other costs and the impact of temporarily hedging to an amount that differs from our hedge target definition;

Higher net pre-tax losses associated with our general account portfolio, excluding the impact of the hedging program associated with certain variable annuities as described above, primarily reflecting losses from changes in the market value of derivatives used to manage the investment portfolio duration resulting from increasing interest rates in the first quarter of 2012;

A \$153 million pre-tax benefit in the first quarter of 2011 on the sale of a portion of our indirect interest in China Pacific Insurance (Group) Co., Ltd.; and

An increase in income tax expense of \$12 million, including an additional U.S. tax expense in the first quarter of 2012 of \$339 million relating to the realization of a portion of the local deferred tax assets existing on the opening day balance sheet for the Star and Edison Businesses, offset by the impact on income tax expense of lower pre-tax income from continuing operations. See [Income Taxes](#) for further information.

Partially offsetting these decreases in income from continuing operations were the following items:

A \$138 million favorable variance, before taxes, from adjustments to deferred policy acquisition and other costs and the reserves for guaranteed minimum death and income benefit features of our variable annuity products, reflecting updates to the estimated profitability of the business primarily resulting from market performance; and

A net increase in premiums and policy charges and fee income, net of an increase in policyholders' benefits, including changes in reserves, reflecting business growth, as well as the impact of favorable currency fluctuations, in our International Insurance operations.

On a diluted per share basis, income (loss) from continuing operations attributable to the Financial Services Businesses for the first quarter of 2012 of \$(2.10) per share of Common Stock decreased from \$1.08 per share of Common Stock for the first quarter of 2011. We analyze the operating performance of the segments included in the Financial Services Businesses using adjusted operating income as described in [Segment Measures](#), below. For a discussion of our segment results on this basis, see [Results of Operations for Financial Services Businesses by Segment](#), below. In addition, for a discussion of the realized investment gains (losses), net attributable to the Financial Services Businesses, see [Realized Investment Gains and Losses and General Account Investments Realized Investment Gains and Losses](#), below. For additional information regarding investment income, excluding realized investment gains (losses) see [Realized Investment Gains and Losses and General Account](#)

Investments General Account Investments, below.

Table of Contents

Results of Operations Closed Block Business

2012 to 2011 Three Month Comparison. Income from continuing operations for the Closed Block Business for the three months ended March 31, 2012, was \$21 million, or \$6.50 per share of Class B Stock, compared to \$22 million, or \$6.50 per share of Class B Stock, for the three months ended March 31, 2011. For a discussion of the results of operations for the Closed Block Business, see Results of Operations of Closed Block Business, below.

Segment Measures

In managing our business, we analyze operating performance separately for our Financial Services Businesses and our Closed Block Business. For the Financial Services Businesses, we analyze our segments' operating performance using adjusted operating income. Results of the Closed Block Business for all periods are evaluated and presented only in accordance with U.S. GAAP. Adjusted operating income does not equate to income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures or net income as determined in accordance with U.S. GAAP but is the measure of segment profit or loss we use to evaluate segment performance and allocate resources, and consistent with authoritative guidance, is our measure of segment performance. The adjustments to derive adjusted operating income are important to an understanding of our overall results of operations. Adjusted operating income is not a substitute for income determined in accordance with U.S. GAAP, and our definition of adjusted operating income may differ from that used by other companies. However, we believe that the presentation of adjusted operating income as we measure it for management purposes enhances the understanding of our results of operations by highlighting the results from ongoing operations and the underlying profitability of the Financial Services Businesses.

See Note 11 to the Unaudited Interim Consolidated Financial Statements for further information on the presentation of segment results and our definition of adjusted operating income.

Results of Operations for Financial Services Businesses by Segment

U.S. Retirement Solutions and Investment Management Division

Individual Annuities

Operating Results

The following table sets forth the Individual Annuities segment's operating results for the periods indicated.

**Three Months Ended
March 31,**

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

	2012	2011
	(in millions)	
Operating results:		
Revenues	\$ 958	\$ 898
Benefits and expenses	537	624
Adjusted operating income	421	274
Realized investment gains (losses), net, and related adjustments(1)	(1,803)	(17)
Related charges(2)	920	(11)
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures	\$ (462)	\$ 246

- (1) Revenues exclude Realized investment gains (losses), net, and related adjustments, which include the net impact of embedded derivatives related to our living benefit features and related hedge positions as described below. See Realized Investment Gains and Losses and General Account Investments Realized Investment Gains and Losses.

Table of Contents

- (2) Revenues exclude related charges which represent payments related to the market value adjustment features of certain of our annuity products. Benefits and expenses exclude related charges which represent the unfavorable (favorable) impact of Realized investment gains (losses), net, on changes in reserves and the amortization of deferred policy acquisition costs, deferred sales inducements and value of business acquired.

Adjusted Operating Income

2012 to 2011 Three Month Comparison. Adjusted operating income increased \$147 million, from \$274 million in the first quarter of 2011 to \$421 million in the first quarter of 2012. The increase in adjusted operating income was driven by a \$138 million higher net benefit in the current quarter from adjustments to the reserves for the guaranteed minimum death benefit (GMDB) and guaranteed minimum income benefit (GMIB) features of our variable annuity products and to amortization of deferred policy acquisition costs (DAC) and other costs. These adjustments are primarily driven by the impact on the estimated profitability of the business of quarterly adjustments to reflect current period market performance and experience, and are discussed in more detail below.

Excluding the items discussed above, adjusted operating income increased \$9 million. The increase was driven by higher fee income, net of distribution costs, due to higher average variable annuity account values invested in separate accounts primarily due to positive net flows over the last twelve months. See *Account Values* below for a further discussion of our account values and sales. The increase from fee income was partially offset by higher general and administrative expenses, net of capitalization, reflecting higher costs to support business growth.

As shown in the following table, adjusted operating income for the first quarter of 2012 included \$196 million of benefits from adjustments to the reserves for the GMDB and GMIB features of our variable annuity products and to the amortization of DAC and other costs, compared to \$58 million of benefits included in the first quarter of 2011.

	Three Months Ended March 31, 2012			Three Months Ended March 31, 2011		
	Amortization of DAC and Other Costs(1)	Reserves for GMDB / GMIB(2)	Total (in millions)	Amortization of DAC and Other Costs(1)	Reserves for GMDB / GMIB(2)	Total
Quarterly market performance adjustments	\$ 62	\$ 135	\$ 197	\$ 17	\$ 32	\$ 49
Quarterly adjustments for current period experience and other updates(3)	(2)	1	(1)	1	8	9
Total	\$ 60	\$ 136	\$ 196	\$ 18	\$ 40	\$ 58

(1) Amounts reflect (charges) or benefits for (increases) or decreases, respectively, in the amortization of DAC and other costs resulting from adjustments to our estimate of total gross profits.

(2) Amounts reflect (charges) or benefits for reserve (increases) or decreases, respectively, related to the GMDB / GMIB features of our variable annuity products.

(3) Represents the impact of differences between actual gross profits for the period and the previously estimated expected gross profits for the period, as well as updates for current and future expected claims costs associated with the GMDB / GMIB features of our variable annuity products.

The \$197 million and \$49 million of net benefits in the first quarter of 2012 and 2011, respectively, shown in the table above, relating to the quarterly market performance adjustments are attributable to changes to our estimate of total gross profits to reflect actual fund performance. The following table shows the actual quarterly rates of return on variable annuity account values compared to our previously expected quarterly rates of return used in our estimate of total gross profits for the periods indicated.

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

	First Quarter 2012	First Quarter 2011
Actual rate of return	7.6%	3.7%
Expected rate of return	2.1%	1.7%

Table of Contents

Higher than expected returns in the first quarter of 2012 increased our estimate of total gross profits used as a basis for amortizing DAC and other costs and decreased our estimate of future expected claims costs associated with the GMDB and GMIB features of our variable annuity products, by establishing a new, higher starting point for the variable annuity account values used in estimating those items for future periods. This change results in a lower required rate of amortization and lower required reserve provisions, which are applied to all prior periods. The resulting cumulative adjustment to prior amortization and reserve provisions are recognized in the current period. Higher than expected returns in the first quarter of 2011 had similar, but less significant impacts due to a lesser variance between actual and expected returns.

We derive our near-term future rate of return assumptions using a reversion to the mean approach, a common industry practice. Under this approach, we consider actual returns over a period of time and initially adjust projected returns over the next four years (the near-term) so that the assets are projected to grow at the long-term expected rate of return for the entire period. The near-term future projected blended rate of return across all contract groups is 7.7% per annum as of March 31, 2012, or approximately 1.9% per quarter, and includes the impact of those contract groups whose near-term future projected returns are based on our near-term blended maximum future rate of return assumption, as discussed below.

As of March 31, 2012, for certain contract groups, the near-term future projected annual rate of return calculated using the reversion to the mean approach was greater than our maximum future rate of return assumption across all asset types for this business. In those cases, we utilize the maximum future rate of return over the four year period, thereby limiting the impact of the reversion to the mean on our estimate of total gross profits. The near-term blended maximum future rate of return under the reversion to the mean approach is 9.7% as of March 31, 2012. Included in the near-term blended maximum future rate are assumptions for returns on various asset classes, including a 4.3% annual weighted average rate of return on fixed income investments, and a 13% maximum annual rate of return on equity investments. Given that the estimates of future gross profits are based upon our maximum future rate of return assumption for some contract groups, all else being equal, future rates of return higher than the above mentioned near-term future projected four year return of 7.7% per annum, but less than the near-term blended maximum future rate of return of 9.7%, may still result in increases in the amortization of DAC and other costs, and the costs relating to the reserves for the GMDB and GMIB features of our variable annuity products.

The \$1 million net charge and \$9 million net benefit in the first quarter of 2012 and 2011, respectively, shown in the table above, reflect the quarterly adjustments for current period experience and other updates, also referred to as experience true-up adjustments. The experience true-up adjustments for the first quarter of 2011 were primarily driven by a reduction to the reserves related to the GMDB and GMIB features of our variable annuity products resulting from lower than expected actual contract guarantee claim costs.

As noted previously, the quarterly adjustments to reflect current period market performance and experience and other updates impact the estimated profitability of our business. Therefore, in addition to the current period impacts discussed above, these items will also drive changes in our GMDB and GMIB reserves and the amortization of DAC and other costs in future periods. Additionally, we include the results of our living benefits hedging program, excluding any items we choose not to hedge, in our best estimate of gross profits used to determine amortization rates, which also drives changes in the amortization of DAC and other costs in future periods. The table above excludes the current period impacts of resetting the amortization rates for this item, as both the results of our living benefits hedging program and related amortization of DAC and other costs are excluded from adjusted operating income, as described in Net impact of embedded derivatives related to our living benefit features and related hedge positions. However, adjusted operating income in future periods will include the impact on amortization of applying the new rates to actual gross profits. For additional information on our policy for amortizing DAC and DSI, see

Accounting Policies & Pronouncements Application of Critical Accounting Estimates.

Table of Contents

Revenues

2012 to 2011 Three Month Comparison. Revenues, as shown in the table above under Operating Results, increased \$60 million, from \$898 million in the first quarter of 2011 to \$958 million in the first quarter of 2012. Policy charges and fees and asset management fees and other income increased \$76 million driven by higher average variable annuity account values invested in separate accounts primarily resulting from positive net flows. See Account Values below for a further discussion of our account values and sales. Partially offsetting the increase in revenues was a decrease in premiums of \$12 million, reflecting a decline in annuitizations of our variable annuity contracts.

Benefits and Expenses

2012 to 2011 Three Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, decreased \$87 million, from \$624 million in the first quarter of 2011 to \$537 million in the first quarter of 2012. Absent the net \$138 million decrease related to the adjustments to the reserves for the GMDB and GMIB features of our variable annuity products and to our estimate of total gross profits used as a basis for amortizing DAC and other costs, discussed above, benefits and expenses increased \$51 million. General and administrative expenses, net of capitalization, increased \$35 million, driven by higher distribution and asset management costs, reflecting business and account value growth. The amortization of DAC increased \$35 million driven by higher gross profits primarily related to the increase in fee income discussed above, and higher amortization rates driven by the inclusion of unfavorable results from our living benefits hedging program in the second half of 2011 in our best estimate of total gross profits used to determine amortization rates. Interest credited to policyholders' account balances decreased \$11 million, primarily due to lower crediting rates on account values in the fixed-rate account of the general account. Insurance and annuity benefits also decreased \$9 million, primarily driven by the decrease in premiums noted above.

Table of Contents*Account Values*

The following table sets forth changes in account values for the individual annuity business, for the periods indicated. For our individual annuity business, assets are reported at account value, and net sales (redemptions) are gross sales minus redemptions or surrenders and withdrawals, as applicable. Gross sales do not correspond to revenues under U.S. GAAP, but are used as a relevant measure of business activity.

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
Variable Annuities(1):		
Beginning total account value	\$ 109,743	\$ 102,348
Sales	4,943	6,815
Surrenders and withdrawals	(1,676)	(1,967)
Net sales	3,267	4,848
Benefit payments	(285)	(254)
Net flows	2,982	4,594
Change in market value, interest credited and other activity	8,171	3,552
Policy charges	(620)	(525)
Ending total account value(2)	\$ 120,276	\$ 109,969
Fixed Annuities:		
Beginning total account value	\$ 3,792	\$ 3,837
Sales	16	18
Surrenders and withdrawals	(43)	(48)
Net redemptions	(27)	(30)
Benefit payments	(83)	(67)
Net flows	(110)	(97)
Interest credited and other activity	96	102
Policy charges	0	(1)
Ending total account value	\$ 3,778	\$ 3,841
Total Individual Annuities Ending total account value:	\$ 124,054	\$ 113,810

(1) Variable annuities include only those sold as retail investment products. Investments sold through defined contribution plan products are included with such products within the Retirement segment.

(2) As of March 31, 2012, variable annuity account values are invested in equity portfolios (\$64 billion or 53%), bond portfolios (\$40 billion or 33%), market value adjusted or fixed-rate accounts (\$8 billion or 7%), and other (\$8 billion or 7%).

2012 to 2011 Three Month Comparison. Total account values for variable and fixed annuities amounted to \$124.1 billion as of March 31, 2012, representing increases of \$10.5 billion and \$10.2 billion from December 31, 2011 and March 31, 2011, respectively. The increase from December 31, 2011 was primarily driven by increases in the market value of customers' variable annuities due to favorable equity markets in the first quarter of 2012, as well as by positive variable annuity net flows, partially offset by policy charges. The increase from March 31, 2011 was

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

primarily driven by positive variable annuity net flows, as well as by increases in the market value of customers' variable annuities due to overall favorable equity markets over the last twelve months, partially offset by policy charges. Gross sales of our variable annuities decreased \$1.9 billion from \$6.8 billion in the first quarter of 2011 to \$4.9 billion in the first quarter of 2012, reflecting the impacts of modifications we implemented in the first quarter of 2011 to scale back benefits and increase pricing. Despite these impacts, we believe that our current product offerings remain competitively positioned and expect our living benefit features will provide us an attractive risk and profitability profile, as all of our currently-sold optional living benefit

Table of Contents

features include an automatic rebalancing element, also referred to as an asset transfer feature. Our automatic rebalancing element occurs at the contractholder level, rather than at the fund level, which we believe enhances our risk management capabilities. Individual variable annuity surrenders and withdrawals decreased \$0.3 billion despite the increase in account values, since newly acquired business typically experiences lower lapse rates. See *Variable Annuity Net Amount at Risk* for a more detailed discussion of our automatic rebalancing element.

Variable Annuity Net Amount at Risk

The net amount at risk is generally defined as the present value of the guaranteed minimum benefit amount in excess of the contractholder's current account balance. Changes in the global financial markets can create volatility in the net amounts at risk embedded in our variable annuity products that include optional living benefit and GMDB features. As part of our risk management strategy, we hedge or limit our exposure to certain of the risks associated with these products, primarily through a combination of product design elements, such as an automatic rebalancing element, and externally purchased hedging instruments. Our hedging program is discussed below in *Net impact of embedded derivatives related to our living benefit features and related hedge positions*. The rate of return we realize from our variable annuity contracts can vary by contract based on our risk management strategy, including the impact of any capital market movements that we may hedge, the impact of that portion of our variable annuity contracts that benefit from the automatic rebalancing element, the impact of risks we have deemed suitable to retain and the impact of risks that are not able to be hedged.

All new sales of optional living benefit features of our variable annuity products include an automatic rebalancing element, which transfers assets between certain variable investments selected by the annuity contractholder and, depending on the benefit feature, the fixed-rate account in the general account or a bond portfolio within the separate accounts. The automatic rebalancing element associated with currently-sold products transfers assets between certain variable investments selected by the annuity contractholder and a designated bond portfolio within the separate accounts. The transfers are based on the static mathematical formula used with the particular benefit which considers a number of factors, including, but not limited to, the impact of investment performance on the contractholder's total account value. In general, negative investment performance may result in transfers to either the fixed-rate account in the general account or a bond portfolio within the separate accounts, and positive investment performance may result in transfers to contractholder-selected variable investments. Overall, the automatic rebalancing element helps to mitigate our exposure to equity market risk and market volatility.

The following table sets forth the account values of our variable annuities with living benefit features and the net amount at risk of the living benefit features split between those that include an automatic rebalancing element and those that do not, as of the dates indicated.

	March 31, 2012		December 31, 2011		March 31, 2011	
	Account Value	Net Amount at Risk	Account Value	Net Amount at Risk	Account Value	Net Amount at Risk
	(\$ in millions)					
Automatic rebalancing element(1)	\$ 78,622	\$ 2,650	\$ 70,341	\$ 4,238	\$ 64,786	\$ 1,227
No automatic rebalancing element	16,198	1,652	15,300	2,361	17,782	1,574
Total variable annuity account values with living benefit features	\$ 94,820	\$ 4,302	\$ 85,641	\$ 6,599	\$ 82,568	\$ 2,801
	(% of total)					
Automatic rebalancing element	83%	62%	82%	64%	78%	44%
No automatic rebalancing element	17%	38%	18%	36%	22%	56%

(1)

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

As of March 31, 2012, December 31, 2011 and March 31, 2011, asset values that have transferred to the general account or a separate account bond portfolio due to the automatic rebalancing element represent 13% or \$10.5 billion of the \$78.6 billion total account value, 30% or \$20.9 billion of the \$70.3 billion total account value and 10% or \$6.3 billion of the \$64.8 billion total account value, respectively.

Table of Contents

The increase in account values that include an automatic rebalancing element as of March 31, 2012 compared to prior periods primarily reflects sales of our latest product offerings which include this feature. The decrease in the net amount at risk for these contracts as of March 31, 2012 compared to December 31, 2011 primarily reflects the impact of favorable equity markets in the first quarter of 2012, while the increase compared to March 31, 2011 primarily reflects the overall growth in our variable annuity business over the past twelve months, as well as the impact of equity market declines in the second half of 2011.

Our GMDBs guarantee a minimum return on the contract value or an enhanced value, if applicable, to be used solely for purposes of determining benefits payable in the event of death. The net amount at risk associated with the GMDBs provided by our variable annuity contracts includes risk we have deemed suitable to retain. However, certain of these account values are affected by an automatic rebalancing element because the contractholder selected a living benefit feature which includes an automatic rebalancing element. All of the variable annuity account values with living benefit features shown in the table above also contain GMDBs. An additional \$22.3 billion, \$21.1 billion and \$24.0 billion of variable annuity account values, as of March 31, 2012, December 31, 2011 and March 31, 2011, respectively, contain GMDBs, but no living benefit features. The following table sets forth the account values of our variable annuities with GMDBs and the net amount at risk of these benefits split between those that are affected by an automatic rebalancing element and those that are not, as of the dates indicated.

	March 31, 2012		December 31, 2011		March 31, 2011	
	Account Value	Net Amount at Risk	Account Value	Net Amount at Risk	Account Value	Net Amount at Risk
	(\$ in millions)					
Automatic rebalancing element	\$ 78,622	\$ 995	\$ 70,341	\$ 2,154	\$ 64,786	\$ 557
No automatic rebalancing element	38,505	4,141	36,407	5,628	41,835	4,243
Total variable annuity account values with death benefit features	\$ 117,127	\$ 5,136	\$ 106,748	\$ 7,782	\$ 106,621	\$ 4,800
	(% of total)					
Automatic rebalancing element	67%	19%	66%	28%	61%	12%
No automatic rebalancing element	33%	81%	34%	72%	39%	88%

The increase in account values that include an automatic rebalancing element as of March 31, 2012 compared to prior periods primarily reflects sales of our latest product offerings which include this feature. The decrease in the net amount at risk for these contracts as of March 31, 2012 compared to December 31, 2011 primarily reflects the impact of favorable equity markets in the first quarter of 2012, while the increase compared to March 31, 2011 primarily reflects the overall growth in our variable annuity business over the past twelve months.

Net impact of embedded derivatives related to our living benefit features and related hedge positions

As mentioned above, in addition to our automatic rebalancing element, we also manage certain risks associated with our variable annuity products through our hedging programs. In our living benefit hedging program, we purchase interest rate swaps, swaptions, floors and caps as well as equity options and futures to hedge certain living benefit features accounted for as embedded derivatives against changes in certain capital market assumptions such as interest rates, equity markets and market volatility. Our hedging strategy is grounded in a U.S. GAAP/capital markets valuation framework, but excludes the impact of the market's perception of our own non-performance risk (NPR) and also incorporates two modifications to the U.S. GAAP valuation assumptions. We add a credit spread to the U.S. GAAP risk-free rate of return assumption used to estimate future growth of bond investments in the customer separate account funds to account for the fact that the underlying customer separate account funds which support these living benefits are invested in assets that contain risk. We also adjust our volatility assumption to remove certain risk margins embedded in the valuation technique used to determine the fair value of the embedded derivative liability under U.S. GAAP, as we believe the impact on the

Table of Contents

liability driven by these margins is temporary and does not reflect the economic value of the liability. This hedging strategy results in differences each period between the change in the value of the embedded derivative liability as defined by U.S. GAAP and the change in the value of the hedge positions, potentially increasing volatility in U.S. GAAP earnings.

In addition, we evaluate hedge levels versus our hedge target based on the overall capital considerations of the Company and prevailing capital market conditions, and may decide to temporarily hedge to an amount that differs from our hedge target definition. Based on these considerations, beginning in the latter half of 2010, we decided to temporarily hedge to an amount less than our hedge target definition to be consistent with our long-term economic view and overall capital considerations of the Company. From the inception of this decision through March 31, 2012, we have experienced cumulative increases in the hedge target liability of approximately \$0.8 billion related to the under-hedged risk, with no corresponding hedge asset increase. This cumulative impact includes \$0.6 billion of gains attributable to the first quarter of 2012, and \$1.4 billion of net losses attributable to prior periods. Because this decision is based on the overall capital considerations of the Company as a whole, the impact on results from temporarily hedging to an amount that differs from our hedge target definition is reported within Corporate and Other operations, as described in Corporate and Other.

As of March 31, 2012, the fair value of the living benefit embedded derivative under U.S. GAAP was a \$1.7 billion liability. Excluding the impact of the cumulative adjustment for NPR of \$3.2 billion, the value of the living benefit embedded derivative was a \$4.9 billion liability. As of March 31, 2012, the value of our hedge target, based on our hedge target definition, was a \$3.9 billion liability. The difference between the value of the hedge target and the value of the living benefit embedded derivative under U.S. GAAP, excluding NPR, as of March 31, 2012 is primarily attributable to the impact of the margins and return assumptions as discussed above.

As described above, our hedging strategy uses capital markets instruments to generally match certain capital market sensitivities of the portion of the hedge target liability we choose to hedge. As of March 31, 2012, the fair value of our hedge positions was a net asset position of \$3.9 billion. Due to cash flow timing differences between our hedging instruments and the corresponding hedge target, as well as our decision to temporarily hedge to an amount that differs from our hedge target definition and other factors, the amount of hedge assets compared to our hedge target measured as of any specific point in time may be different, and is not expected to be fully offsetting.

For additional information regarding the Capital Protection Framework we use to evaluate and support the risks of our hedging program, see Liquidity and Capital Resources Liquidity and Capital Resources of Subsidiaries Domestic Insurance Subsidiaries Capital.

Table of Contents

The net impact of both the change in the value of the embedded derivative liabilities associated with our living benefit features and the change in fair value of the related derivative hedge positions are included in Realized investment gains (losses), net, and related adjustments and the related impact to the amortization of DAC and other costs is included in Related charges, both of which are excluded from adjusted operating income. The following table shows the net impact of changes in the embedded derivative liability and related hedge positions, as well as the related amortization of DAC and other costs, for the periods indicated.

	Three Months Ended March 31,	
	2012	2011
	(1)	
	(in millions)	
Change in fair value of hedge positions	\$ (2,519)	\$ (567)
Change in value of hedge target liability, excluding unhedged portions(2)	2,803	501
Net hedging impact, excluding unhedged portions	284	(66)
Change in portions of embedded derivative liability, before NPR, excluded from hedge target definition(3)	220	165
Change in the NPR adjustment(4)	(2,294)	(125)
Net impact from changes in embedded derivative liability and hedge positions reported in the Individual Annuities segment	(1,790)	(26)
Related benefit to amortization of DAC and other costs(5)	935	17
Net impact from changes in embedded derivative liability and hedge positions, after the impact of NPR, DAC and other costs, reported in the Individual Annuities segment	\$ (855)	\$ (9)
Change in value of unhedged portion of hedge target liability reported in Corporate & Other operations(6)	\$ 582	\$ 55

(1) Positive amount represents income; negative amount represents a loss.

(2) Represents the change in value based on our hedge target definition as described above, excluding the impacts of temporarily hedging to an amount that differs from our hedge target definition.

(3) Represents the impact attributable to the difference between the value of the hedge target liability, based on our hedge target definition, and the value of the embedded derivative liability as defined by U.S. GAAP, before adjusting for NPR.

(4) To reflect NPR, we incorporate an additional spread over LIBOR into the discount rate used in the valuation of those individual living benefit contracts in a liability position and not to those in a contra-liability position. As of March 31, 2012, the value of the embedded derivatives, before the adjustment for NPR, was a net liability of \$4.9 billion. This net liability was comprised of \$5.4 billion of individual living benefit contracts in a liability position, net of \$0.5 billion of individual living benefit contracts in a contra-liability position.

(5) Related charge to amortization of DAC and other costs is excluded from adjusted operating income and included in operating results in Related charges.

(6) Represents the impact of temporarily hedging to an amount that differs from our hedge target definition. This amount is not reported in the Individual Annuities segment. See Corporate and Other for details.

As shown in the table above, the net impacts from changes in the embedded derivative liability and hedge positions, after the impact of DAC and other costs, were net charges of \$855 million and \$9 million for the first quarter of 2012 and 2011, respectively.

The net charge of \$855 million for the first quarter of 2012 included a net benefit of \$284 million resulting from the net impact of hedging, excluding the unhedged portions, driven by differences in the actual performance of the underlying separate accounts funds relative to the performance of the market indices we utilized as a basis for developing our hedging strategy. Also included in the net charge of \$855 million was a net benefit of \$220 million attributable to the difference between the valuation of the embedded derivative liability as defined by U.S. GAAP and the valuation of the hedge target liability, which we choose not to hedge. These benefits were offset by a \$2,294 million net charge to reflect NPR, primarily due to a lower base of embedded derivatives in a

Table of Contents

liability position driven by favorable market conditions, as well as an overall tightening of the credit spreads used in valuing NPR, which reflect the financial strength ratings of our insurance subsidiaries. We also recorded a net benefit of \$935 million from the inclusion of these items in current period gross profits used in calculating the amortization of DAC. The net benefit of \$935 million includes a \$42 million benefit from the current period impact of including the \$284 million net impact of hedging in our best estimate of gross profits used to set amortization rates.

The net charge of \$9 million for the first quarter 2011 included a net charge of \$66 million resulting from the net impact of hedging, excluding the unhedged portions, driven by differences in the actual performance of the underlying separate accounts funds relative to the performance of the market indices we utilized as a basis for developing our hedging strategy. Also included in the net charge of \$9 million was a net benefit of \$165 million attributable to the difference between the valuation of the embedded derivative liability as defined by U.S. GAAP and the valuation of the hedge target liability, which we choose not to hedge. These items were partially offset by a \$125 million net charge to reflect NPR, primarily due to a lower base of embedded derivatives in a liability position driven by favorable market conditions. We also recorded a net benefit of \$17 million from the inclusion of these items in current period gross profits used in calculating the amortization of DAC.

For additional information regarding the methodologies used in determining the fair value of the embedded derivative liability associated with our living benefit features as defined by U.S. GAAP, and for calculating the impact of NPR, see Note 13 to the Unaudited Interim Consolidated Financial Statements and Valuation of Assets and Liabilities Fair Value of Assets and Liabilities Variable Annuity Optional Living Benefit Features.

Retirement***Operating Results***

The following table sets forth the Retirement segment's operating results for the periods indicated.

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
Operating results:		
Revenues	\$ 1,107	\$ 1,206
Benefits and expenses	951	1,034
Adjusted operating income	156	172
Realized investment gains (losses), net, and related adjustments(1)	(160)	(75)
Related charges(2)	(2)	(4)
Investment gains (losses) on trading account assets supporting insurance liabilities, net(3)	81	(4)
Change in experience-rated contractholder liabilities due to asset value changes(4)	(93)	21
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures	\$ (18)	\$ 110

(1)

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Revenues exclude Realized investment gains (losses), net, and related adjustments. See Realized Investment Gains and Losses and General Account Investments Realized Investment Gains and Losses and Experience-Rated Contractholder Liabilities, Trading Account Assets Supporting Insurance Liabilities and Other Related Investments.

- (2) Benefits and expenses exclude related charges which represent the unfavorable (favorable) impact of Realized investment gains (losses), net, on changes in reserves and the amortization of deferred policy acquisition costs.
- (3) Revenues exclude net investment gains and losses on trading account assets supporting insurance liabilities. See Experience-Rated Contractholder Liabilities, Trading Account Assets Supporting Insurance Liabilities and Other Related Investments.

Table of Contents

- (4) Benefits and expenses exclude changes in contractholder liabilities due to asset value changes in the pool of investments supporting experience-rated contracts. See Experience-Rated Contractholder Liabilities, Trading Account Assets Supporting Insurance Liabilities and Other Related Investments.

Adjusted Operating Income

2012 to 2011 Three Month Comparison. Adjusted operating income decreased \$16 million, from \$172 million in the first quarter of 2011 to \$156 million in the first quarter of 2012. The decrease reflects lower net investment spread results and a less favorable reserve benefit from case experience, partially offset by higher asset-based fee income and lower general and administrative expenses, net of capitalization. Lower net investment spread results primarily reflect a decline in reinvestment rates, partially offset by the impacts of lower crediting rates driven by rate resets in the first quarter of 2012 and higher general account stable value account values in our full service business. The less favorable reserve benefit from case experience was primarily driven by lower than expected mortality rates in the first quarter of 2012. Higher asset-based fee income reflects an increase in fee-based investment-only stable value account values in our institutional investment products business driven by net additions, partially offset by lower average full service fee-based retirement account values driven by net outflows. The decrease in general and administrative expenses, net of capitalization, primarily reflects higher costs incurred in the first quarter of 2011 related to certain legal matters.

Revenues

2012 to 2011 Three Month Comparison. Revenues, as shown in the table above under Operating Results, decreased \$99 million, from \$1,206 million in the first quarter of 2011 to \$1,107 million in the first quarter of 2012. Premiums decreased \$83 million, driven by lower sales of life-contingent structured settlements, non-participating group annuity separate accounts and single premium annuities, partially offset by higher premiums assumed on longevity reinsurance contracts, which we introduced in the second quarter of 2011. The overall decrease in premiums resulted in a corresponding decrease in policyholders' benefits, including the change in policy reserves, as discussed below. Net investment income decreased \$26 million primarily reflecting lower portfolio yields. Policy charges and fee income and asset management fees and other income increased \$10 million, primarily driven by higher asset-based fees due to an increase in fee-based investment-only stable value account values in our institutional investment products business driven by net additions, partially offset by lower average full service fee-based retirement account values driven by net outflows.

Benefits and Expenses

2012 to 2011 Three Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, decreased \$83 million, from \$1,034 million in the first quarter of 2011 to \$951 million in the first quarter of 2012. Policyholders' benefits, including the change in policy reserves, decreased \$70 million, primarily reflecting a decrease in change in policy reserves associated with the decrease in premiums as discussed above, partially offset by a less favorable reserve benefit from case experience. The amortization of deferred policy acquisition costs decreased \$20 million primarily driven by a refinement in the first quarter of 2011 to the methodology applied in calculating amortization for certain structured settlement contracts, with an equally offsetting impact to interest credited to policyholders' account balances. Also, general and administrative expenses, net of capitalization, decreased \$6 million, primarily driven by costs incurred in the first quarter of 2011 related to certain legal matters and a decline in life-contingent structured settlement commissions. Interest credited to policyholders' account balances increased \$13 million including a refinement in the first quarter of 2011 to the methodology applied in calculating reserves for certain structured settlement contracts, as mentioned above, and higher general account stable value account values in our full service business. Partially offsetting the increase was the impact of lower crediting rates driven by rate resets.

Sales Results and Account Values

The following table shows the changes in the account values and net additions (withdrawals) of Retirement segment products for the periods indicated. Net additions (withdrawals) are deposits and sales or additions, as

Table of Contents

applicable, minus withdrawals and benefits. These concepts do not correspond to revenues under U.S. GAAP, but are used as a relevant measure of business activity. Account values include both internally- and externally-managed client balances as the total balances drive revenue for the Retirement segment. For more information on internally-managed balances see Asset Management.

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
Full Service(1):		
Beginning total account value	\$ 139,430	\$ 141,313
Deposits and sales	4,646	4,848
Withdrawals and benefits	(7,103)	(4,927)
Change in market value, interest credited and interest income and other activity	9,018	4,743
Ending total account value	\$ 145,991	\$ 145,977
Net withdrawals	\$ (2,457)	\$ (79)
Institutional Investment Products(2):		
Beginning total account value	\$ 90,089	\$ 64,183
Additions	4,399	5,785
Withdrawals and benefits(3)	(1,538)	(1,128)
Change in market value, interest credited and interest income	928	482
Other(4)	(25)	(430)
Ending total account value(5)	\$ 93,853	\$ 68,892
Net additions(5)	\$ 2,861	\$ 4,657

- (1) Ending total account value for the full service business includes assets of Prudential's retirement plans of \$6.7 billion and \$6.0 billion as of March 31, 2012 and 2011, respectively.
- (2) Ending total account value for the institutional investment products business includes assets of Prudential's defined benefit plan of \$5.7 billion and \$5.2 billion as of March 31, 2012 and 2011, respectively. Ending total account value for the institutional investment products business also includes \$1.5 billion as of both March 31, 2012 and 2011 related to collateralized funding agreements issued to the Federal Home Loan Bank of New York (FHLBNY), and \$0.5 billion and \$0.8 billion as of March 31, 2012 and 2011, respectively, related to affiliated funding agreements issued using the proceeds from the sale of Prudential Financial retail medium-term notes. For additional information regarding the FHLBNY and the retail medium-term notes program see, Liquidity and Capital Resources.
- (3) Withdrawals and benefits include \$(7) million and \$(34) million for the three months ended March 31, 2012 and 2011, respectively, representing transfers of client balances from accounts we manage to externally-managed accounts. These withdrawals are offset within Other, as there is no net impact on ending account values for these transfers.
- (4) Other includes transfers from (to) the Asset Management segment of \$(402) million for the three months ended March 31, 2011. Other also includes \$7 million and \$34 million for the three months ended March 31, 2012 and 2011, respectively, representing net transfers of externally-managed client balances from/(to) accounts we manage. These transfers are offset within Additions or Withdrawals and benefits, as there is no net impact on ending account values for these transfers. Remaining amounts for all periods presented primarily represent changes in asset balances for externally-managed accounts.
- (5) Ending total account value for the institutional investment products business includes investment-only stable value account values of \$44.9 billion and \$23.0 billion as of March 31, 2012 and 2011, respectively. Net additions for the institutional investment products business include investment-only stable value account value additions of \$3.5 billion and \$5.3 billion for the three months ended March 31, 2012 and 2011, respectively.

2012 to 2011 Three Month Comparison. Account values in our full service business amounted to \$146.0 billion as of March 31, 2012, representing an increase of \$6.6 billion from December 31, 2011, driven by increases in the market value of customer funds due to favorable equity markets, partially offset by net withdrawals. Account values were flat compared to values as of March 31, 2011, as the impacts of increases in the market value of customer funds and net withdrawals were offsetting over the last twelve months. Net withdrawals increased \$2.4 billion, from net withdrawals of \$0.1 billion in the first quarter of 2011 to net withdrawals of \$2.5 billion in the first quarter of 2012, primarily driven by a higher volume of large plan lapses.

Table of Contents

Account values in our institutional investment products business amounted to \$93.9 billion as of March 31, 2012, representing an increase of \$3.8 billion from December 31, 2011 and an increase of \$25.0 billion from March 31, 2011. These increases were driven by additions of our fee-based investment-only stable value and longevity reinsurance products. To a lesser extent, the increases were also driven by increases in the market value of customer funds primarily from equity market appreciation and declines in fixed income yields. These increases were partially offset by decreases due to withdrawals and benefit payments. Net additions decreased \$1.8 billion, from \$4.7 billion in the first quarter of 2011 to \$2.9 billion in the first quarter of 2012 primarily reflecting lower sales of our fee-based investment-only stable value product, as the first quarter of 2011 benefited from the introduction of our offering of investment-only wraps on certain externally-managed accounts at the end of 2010. Despite the decline in sales, we believe our fee-based investment-only stable value product remains competitively positioned.

Asset Management***Operating Results***

The following table sets forth the Asset Management segment's operating results for the periods indicated.

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
Operating results:		
Revenues	\$ 539	\$ 548
Expenses	418	394
Adjusted operating income	121	154
Realized investment gains (losses), net, and related adjustments(1)	(5)	(20)
Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests(2)	16	27
Income from continuing operations before income taxes and equity in earnings of operating joint ventures	\$ 132	\$ 161

- (1) Revenues exclude Realized investment gains (losses), net, and related adjustments. See Realized Investment Gains and Losses and General Account Investments Realized Investment Gains and Losses.
- (2) Equity in earnings of operating joint ventures are included in adjusted operating income but excluded from income from continuing operations before income taxes and equity in earnings of operating joint ventures as they are reflected on a U.S. GAAP basis on an after-tax basis as a separate line in our Unaudited Interim Consolidated Statements of Operations. Earnings attributable to noncontrolling interests are excluded from adjusted operating income but included in income from continuing operations before income taxes and equity in earnings of operating joint ventures as they are reflected on a U.S. GAAP basis as a separate line in our Unaudited Interim Consolidated Statements of Operations. Earnings attributable to noncontrolling interests represent the portion of earnings from consolidated entities that relate to the equity interests of minority investors.

Adjusted Operating Income

2012 to 2011 Three Month Comparison. Adjusted operating income decreased \$33 million, from \$154 million in the first quarter of 2011 to \$121 million in the first quarter of 2012 reflecting a lower contribution from the segment's incentive, transaction, strategic investing and commercial mortgage activities.

The decrease in the segment's commercial mortgage activities reflects gains on sales of foreclosed real estate assets in the first quarter of 2011. The decrease in strategic investing activities was driven by a decline in real estate values on certain co-investments in the first quarter of 2012, partially offset by more favorable investment performance in fixed income and public equity funds. Also, results for the first quarter of 2012 reflect an increase in operating expenses, largely related to compensation and other costs to support business growth.

Table of Contents

These decreases were partially offset by an increase in asset management fees, before associated expenses, primarily from retail and institutional customer assets as a result of higher asset values due to market appreciation and positive net asset flows since the first quarter of 2011.

Revenues

The following table sets forth the Asset Management segment's revenues, presented on a basis consistent with the table above under Operating Results, by type and asset management fees by source for the periods indicated.

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
Revenues by type:		
Asset management fees by source:		
Institutional customers	\$ 187	\$ 174
Retail customers(1)	115	104
General account	84	78
Total asset management fees	386	356
Incentive fees	(9)	(7)
Transaction fees	8	11
Strategic investing	11	24
Commercial mortgage(2)	20	29
Total incentive, transaction, strategic investing and commercial mortgage revenues	30	57
Service, distribution and other revenues(3)	123	135
Total revenues	\$ 539	\$ 548

- (1) Consists of fees from: (a) individual mutual funds and both variable annuities and variable life insurance asset management revenues from our separate accounts; (b) funds invested in proprietary mutual funds through our defined contribution plan products; and (c) third-party sub-advisory relationships. Revenues from fixed annuities and the fixed-rate accounts of both variable annuities and variable life insurance are included in the general account.
- (2) Includes mortgage origination and spread lending revenues of our commercial mortgage origination and servicing business.
- (3) Includes payments from Wells Fargo under an agreement dated as of July 30, 2004 implementing arrangements with respect to money market mutual funds in connection with the combination of our retail securities brokerage and clearing operations with those of Wells Fargo. The agreement extends for ten years after termination of the Wachovia Securities joint venture, which occurred on December 31, 2009. The revenue from Wells Fargo under this agreement was \$15 million and \$17 million for the three months ended March 31, 2012 and 2011, respectively.

2012 to 2011 Three Month Comparison. Revenues, as shown in the table above under Operating Results, decreased \$9 million, from \$548 million in the first quarter of 2011 to \$539 million in the first quarter of 2012. Strategic investing revenues decreased \$13 million reflecting less favorable results in real estate co-investments, partially offset by more favorable investment performance in fixed income and public equity funds, as discussed above. Service, distribution and other revenues decreased \$12 million, which includes lower revenues from certain consolidated funds, which were fully offset by lower expenses related to noncontrolling interest in these funds. Commercial mortgage revenues decreased \$9 million primarily reflecting lower gains on sales of foreclosed real estate assets, as discussed above, partially offset by higher agency fees due to higher production.

Performance-based incentive fees decreased \$2 million in the first quarter of 2012 compared to the first quarter of 2011. A portion of these incentive-based fees are offset in incentive compensation expense in

Table of Contents

accordance with the terms of the contractual agreements. Certain of our incentive fees continue to be subject to positive or negative future adjustment based on cumulative fund performance in relation to specified benchmarks. As of March 31, 2012, \$88 million of cumulative incentive fee revenue, net of compensation, is subject to future adjustment. Future incentive, transaction, strategic investing and commercial mortgage revenues will be impacted by the level and diversification of our strategic investments, the commercial real estate market, and other domestic and international market conditions.

Partially offsetting the decreases in revenue above was an increase in asset management fees of \$30 million primarily from retail and institutional customer assets as a result of higher asset values due to market appreciation and positive net asset flows since the first quarter of 2011.

Expenses

2012 to 2011 Three Month Comparison. Expenses, as shown in the table above under Operating Results, increased \$24 million, from \$394 million in the first quarter of 2011 to \$418 million in the first quarter of 2012, primarily driven by increased compensation costs, due to higher earnings subject to compensation and increased headcount, as well as increases in other costs to support business growth. These increases were partially offset by lower expenses related to revenues associated with certain consolidated funds, as discussed above.

Assets Under Management

The following tables set forth assets under management by asset class and source as of the dates indicated and net additions, excluding money market activity, by source for the periods indicated. In managing our business, we analyze assets under management, which do not correspond to U.S. GAAP assets, because the principal source of revenues are fees based on assets under management

	March 31, 2012	December 31, 2011 (in billions)	March 31, 2011
Assets Under Management (at fair market value):			
Institutional customers:			
Equity	\$ 51.0	\$ 44.2	\$ 52.6
Fixed income	202.4	197.2	168.5
Real estate	29.8	27.7	25.1
Institutional customers(1)(2)	283.2	269.1	246.2
Retail customers:			
Equity	82.9	70.8	79.3
Fixed income	39.3	45.7	27.9
Real estate	1.4	1.4	1.6
Retail customers(3)	123.6	117.9	108.8
General account:			
Equity	4.6	4.2	4.4
Fixed income	224.0	226.6	208.4

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Real estate	1.4	1.3	1.0
General account	230.0	232.1	213.8
Total assets under management	\$ 636.8	\$ 619.1	\$ 568.8

Table of Contents

	Three Months Ended March 31,	
	2012	2011
(in billions)		
Net additions (withdrawals), excluding money market activity:		
Third Party:		
Institutional customers(4)	\$ 5.4	\$ 5.9
Retail customers	3.2	2.0
Affiliated:		
Institutional customers	(0.1)	(1.3)
Retail customers	(9.4)	1.3
General account(5)	(0.8)	14.4
Total net additions (withdrawals), excluding money market activity	\$ (1.7)	\$ 22.3

- (1) Consists of third-party institutional assets and group insurance contracts.
- (2) As of March 31, 2012, December 31, 2011 and March 31, 2011, includes \$30.8 billion, \$29.7 billion and \$24.0 billion, respectively, of assets under management related to investment-only stable value products.
- (3) Consists of: (a) individual mutual funds and both variable annuities and variable life insurance assets in our separate accounts; (b) funds invested in proprietary mutual funds through our defined contribution plan products; and (c) third-party sub-advisory relationships. Fixed annuities and the fixed-rate accounts of both variable annuities and variable life insurance are included in the general account.
- (4) As of March 31, 2012 and 2011, includes \$1.0 billion and \$2.8 billion, respectively, of net additions related to investment-only stable value products.
- (5) The three months ended March 31, 2011 includes \$15.2 billion in net additions from the acquisition of the Star and Edison Businesses.

2012 to 2011 Three Month Comparison. Assets under management were \$636.8 billion at March 31, 2012, an increase of \$17.7 billion from December 31, 2011. Institutional assets under management increased \$14.1 billion from December 31, 2011 to March 31, 2012 driven by market appreciation of \$8.7 billion, as well as net additions of \$5.4 billion from third-party clients, primarily from positive flows into fixed income accounts, including \$1.0 billion of net additions associated with investment-only stable value products. Retail assets under management increased \$5.7 billion from December 31, 2011 to March 31, 2012 primarily from market appreciation of \$11.2 billion as well as net additions of \$3.2 billion from third-party clients, partially offset by net affiliated withdrawals of \$9.4 billion, primarily from assets being transferred out of a fixed income fund due to the automatic rebalancing feature within the variable annuity products. General account assets decreased \$2.1 billion due largely to net withdrawals from fixed income funds.

Assets under management increased \$68.0 billion from March 31, 2011. Institutional assets under management increased \$37.0 billion from March 31, 2011 to March 31, 2012 driven by market appreciation of \$22.5 billion, as well as net additions of \$16.2 billion from third-party clients, primarily from positive flows into fixed income accounts, including \$8.2 billion of net additions associated with investment-only stable value products. Retail assets under management increased \$14.8 billion from March 31, 2011 to March 31, 2012 from market appreciation of \$6.5 billion and net additions of \$4.7 billion from third-party clients as well as net additions from affiliated assets under management of \$3.7 billion, primarily from variable annuity assets rebalancing into a fixed income fund. General account assets increased \$16.2 billion primarily driven by market appreciation of \$16.8 billion.

Table of Contents*Strategic Investments*

The following table sets forth the strategic investments of the Asset Management segment at carrying value (including the value of derivative instruments used to mitigate equity market and currency risk) by asset class and source as of the dates indicated.

	March 31, 2012 2011 (in millions)	
Co-Investments:		
Real estate	\$ 455	\$ 388
Fixed income	24	30
Seed Investments:		
Real estate	21	258
Public equity	232	101
Fixed income	210	178
Loans Secured by Investor Equity Commitments or Fund Assets:		
Real estate secured by investor equity	40	11
Private equity secured by investor equity	0	5
Real estate secured by fund assets	85	231
Total	\$ 1,067	\$ 1,202

Commercial Mortgage Interim Loan Portfolio

The following table sets forth information regarding the interim loan portfolio of the Asset Management segment's commercial mortgage operations as of the dates indicated.

	March 31, 2012 2011 (\$ in millions)	
Interim Loan Portfolio:		
Principal balance of loans outstanding(1)	\$ 599	\$ 1,181
Allowance for credit or valuation-related losses	\$ 40	\$ 159
Weighted average loan-to-value ratio(2)(3)	96%	111%
Weighted average debt service coverage ratio(2)	1.45	1.33

(1) As of March 31, 2012 and 2011, excludes \$10 million and \$25 million, respectively, of commitments for future fundings that would need to be disbursed if borrowers meet the conditions for these fundings and \$44 million and \$38 million, respectively, of commercial real estate held for sale related to foreclosed interim loans.

(2) A stabilized value and projected net operating income are used in the calculation of the loan-to-value and debt service coverage ratios.

(3) For those loans where the loan amount is greater than the collateral value, the excess of the loan amount over the collateral value was \$45 million and \$160 million as of March 31, 2012 and 2011, respectively.

Table of Contents**U.S. Individual Life and Group Insurance Division***Individual Life**Operating Results*

The following table sets forth the Individual Life segment's operating results for the periods indicated.

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
Operating results:		
Revenues	\$ 776	\$ 725
Benefits and expenses	664	627
Adjusted operating income	112	98
Realized investment gains (losses), net, and related adjustments(1)	30	26
Income from continuing operations before income taxes and equity in earnings of operating joint ventures	\$ 142	\$ 124

(1) Revenues exclude Realized investment gains (losses), net, and related adjustments. See Realized Investment Gains and Losses and General Account Investments Realized Investment Gains and Losses.

Adjusted Operating Income

2012 to 2011 Three Month Comparison. Adjusted operating income increased \$14 million, from \$98 million in the first quarter of 2011 to \$112 million in the first quarter of 2012, including \$16 million from mortality experience, net of reinsurance, which was less unfavorable relative to expected levels, compared to the first quarter of 2011. The increase in adjusted operating income also reflects a \$4 million decrease in amortization of deferred policy acquisition costs, net of related amortization of unearned revenue reserves, resulting from changes in our estimates of total gross profits arising from separate account fund performance, which is described in more detail below. This decrease in amortization largely reflects the impact of equity markets on separate account fund performance. These increases to adjusted operating income were partially offset by higher general and administrative expenses.

The changes in our estimates of total gross profits arising from separate account fund performance, as discussed above, reflect the impact on our estimates of total gross profits of the difference between our actual quarterly rate of return on separate accounts compared to our previously expected quarterly rate of return. The following table shows the actual quarterly rate of return on separate accounts for the first quarter of 2012 and 2011 compared to our previously expected quarterly rate of return used in our estimates of total gross profits.

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

	First Quarter 2012	First Quarter 2011
Actual rate of return	8.8%	4.4%
Expected rate of return	2.5%	2.2%

The overall higher than expected market returns in the first quarter of 2012 and 2011 resulted in an increase in total future gross profits by establishing a higher starting point for the fund balances used in estimating those profits in future periods. The increase in our estimates of total gross profits resulted in a net benefit of \$6 million and \$2 million in the first quarter of 2012 and 2011, respectively, reflecting a lower required rate of amortization of deferred policy acquisition costs, partially offset by a lower required rate of amortization of unearned revenue reserves. We derive our near-term future rate of return assumptions using a reversion to the mean approach, a common industry practice. Under this approach, we consider actual returns over a period of time and initially adjust projected returns over the next four years (the near-term) so that the assets are projected to grow at the

Table of Contents

long-term expected rate of return for the entire period. The near-term future projected blended rate of return across all contract groups is 8.1% per annum as of March 31, 2012, or approximately 2.0% per quarter.

Revenues

2012 to 2011 Three Month Comparison. Revenues, as shown in the table above under Operating Results, increased \$51 million, from \$725 million in the first quarter of 2011 to \$776 million in the first quarter of 2012. Policy charges and fees and asset management fees and other income increased \$30 million driven by an increase from income on an affiliated note received as consideration for a surplus note issued in September 2011 to an affiliate related to the financing of regulatory capital requirements associated with statutory reserves for certain universal life insurance policies. The income from these notes is offset by higher interest expense as described below. Partially offsetting this increase in policy charges and fees and asset management fees and other income was a decrease in amortization of unearned revenue reserves due to changes in our estimates of total gross profits primarily reflecting the impact of more favorable market conditions on separate account fund performance in the first quarter of 2012 compared to the first quarter of 2011. Net investment income increased \$18 million reflecting higher asset balances resulting from growth in our universal life insurance products including higher policyholders' account balances resulting from increased policyholder deposits and higher capital requirements. Lower invested asset yields from declines in portfolio reinvestment rates were a partial offset to the increase in net investment income.

Benefits and Expenses

2012 to 2011 Three Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, increased \$37 million, from \$627 million in the first quarter of 2011 to \$664 million in the first quarter of 2012. Interest expense increased \$32 million reflecting higher borrowings including the issuance of a surplus note in September 2011 to an affiliate related to the financing of regulatory capital requirements associated with statutory reserves for certain universal life insurance policies, as mentioned above. Higher general and administrative expenses, net of capitalization, of \$13 million reflecting a charge related to the correction of a delay in the execution of certain client mutual fund transactions also contributed to the increase. Insurance and annuity benefits, including interest credited to policyholders' account balances, increased \$3 million as an increase in interest credited to policyholders from higher universal life account balances from increased policyholder deposits and increases in policyholder reserves driven by growth in our term life block of business was mostly offset by less unfavorable mortality experience of \$16 million. Partially offsetting these items was an \$11 million decrease in amortization of deferred policy acquisition costs primarily reflecting the impact of more favorable market conditions on separate account fund performance in the first quarter of 2012 compared to the first quarter of 2011.

Table of Contents*Sales Results*

The following table sets forth individual life insurance annualized new business premiums for the periods indicated. In managing our individual life insurance business, we analyze annualized new business premiums, which do not correspond to revenues under U.S. GAAP, because annualized new business premiums measure the current sales performance of the business, while revenues primarily reflect the renewal persistency and aging of in force policies written in prior years and net investment income, in addition to current sales. Annualized new business premiums include 10% of first year excess premiums and deposits.

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
Annualized New Business Premiums(1):		
Variable Life	\$ 4	\$ 7
Universal Life	34	23
Term Life	41	35
Total	\$ 79	\$ 65
Annualized New Business Premiums by Distribution Channel(1):		
Prudential Agents	\$ 20	\$ 20
Third party	59	45
Total	\$ 79	\$ 65

(1) Annualized scheduled premiums plus 10% of excess (unscheduled) and single premiums from new sales. Excludes corporate-owned life insurance.

2012 to 2011 Three Month Comparison. Sales of new life insurance, measured as described above, increased \$14 million, from \$65 million in the first quarter of 2011 to \$79 million in the first quarter of 2012, primarily driven by increased sales in the third party distribution channel. This reflected an \$11 million increase in sales of universal life insurance products driven by a change in the competitive position of our products due to pricing.

Policy Surrender Experience

The following table sets forth the individual life insurance business policy surrender experience for variable and universal life insurance, measured by cash value of surrenders, for the periods indicated. These amounts do not correspond to expenses under U.S. GAAP. In managing this business, we analyze the cash value of surrenders because it is a measure of the degree to which policyholders are maintaining their in force business with us, a driver of future profitability. Generally, our term life insurance products do not provide for cash surrender values.

	Three Months Ended March 31,	
	2012	2011
	(\$ in millions)	

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Cash value of surrenders	\$ 170	\$ 189
Cash value of surrenders as a percentage of mean future policy benefit reserves, policyholders' account balances, and separate account balances	2.8%	3.1%

2012 to 2011 Three Month Comparison. The total cash value of surrenders decreased \$19 million, from \$189 million in the first quarter of 2011 to \$170 million in the first quarter of 2012, driven by a lower volume of variable life surrenders in the first quarter of 2012. The decline in variable life surrenders also drove the decrease.

Table of Contents

in the level of surrenders as a percentage of mean future policy benefit reserves, policyholders' account balances and separate account balances from 3.1% in the first quarter of 2011 to 2.8% in the first quarter of 2012.

Group Insurance*Operating Results*

The following table sets forth the Group Insurance segment's operating results for the periods indicated.

	Three Months Ended March 31, 2012 2011 (in millions)	
Operating results:		
Revenues	\$ 1,547	\$ 1,506
Benefits and expenses	1,585	1,467
Adjusted operating income	(38)	39
Realized investment gains (losses), net, and related adjustments(1)	(18)	(6)
Related charges(2)	0	0
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures	\$ (56)	\$ 33

(1) Revenues exclude Realized investment gains (losses), net, and related adjustments. See Realized Investment Gains and Losses and General Account Investments Realized Investment Gains and Losses.

(2) Benefits and expenses exclude related charges which represent the unfavorable (favorable) impact of Realized investment gains (losses), net, on interest credited to policyholders' account balances.

Adjusted Operating Income

2012 to 2011 Three Month Comparison. Adjusted operating income decreased \$77 million, from income of \$39 million in the first quarter of 2011 to a loss of \$38 million in the first quarter of 2012, reflecting an adverse fluctuation in underwriting results in the first quarter of 2012 in our group life business primarily due to unfavorable claims experience from an increase in severity on non-retrospectively experience-rated contracts. Results for the first quarter of 2012 reflect less favorable underwriting results in our group disability business due to an increase in the number and severity of long-term disability claims reflecting the continued economic downturn. In addition, the decrease in adjusted operating income reflects higher operating expenses in the first quarter of 2012, resulting from an increase in general and administrative expenses driven by higher legal costs and costs related to strategic initiatives. Additionally, the first quarter of 2011 benefited \$9 million from a cumulative premium adjustment relating to prior periods on a group life non-retrospectively experience-rated case.

Revenues

2012 to 2011 Three Month Comparison. Revenues, as shown in the table above under Operating Results, increased by \$41 million, from \$1,506 million in the first quarter of 2011 to \$1,547 million in the first quarter of 2012. Group disability premiums and policy charges and fee income, which include long-term care and dental products, increased by \$51 million, from \$299 million in the first quarter of 2011 to \$350 million in the first quarter of 2012 primarily reflecting an increase in premiums associated with the assumption of existing liabilities from third parties, which is offset in policyholders' benefits, as discussed below, as well as growth of business in force and from new sales. Also, contributing to the increase in revenue is an increase in investment income of \$10 million in the first quarter of 2012 reflecting higher invested assets due to growth in the business.

Table of Contents

The above increases in revenue were partially offset by a \$20 million decrease in group life premiums and policy charges and fee income, from \$1,010 million in the first quarter of 2011 to \$990 million in the first quarter of 2012 reflecting lower premiums from retrospectively experience-rated contracts resulting from the decrease in policyholder benefits on these contracts, as discussed below, as well as a decline in the persistency rate from 97% in the first quarter of 2011 compared to 95% in the first quarter of 2012 reflecting two large case lapses in the first quarter of 2012. Additionally, the first quarter of 2011 benefited \$9 million from a cumulative premium adjustment relating to prior periods on a group life non-retrospectively experience-rated case. Partially offsetting these decreases were higher premiums from non-retrospectively experience-rated contracts reflecting growth in the business.

Benefits and Expenses

The following table sets forth the Group Insurance segment's benefits and administrative operating expense ratios for the periods indicated.

	Three Months Ended March 31,	
	2012	2011
Benefits ratio(1):		
Group life	95.4%	92.3%
Group disability	104.6%	94.3%
Administrative operating expense ratio(2):		
Group life	8.9%	8.1%
Group disability	21.6%	21.9%

(1) Ratio of policyholder benefits to earned premiums, policy charges and fee income. Group disability ratios include long-term care and dental products.

(2) Ratio of administrative operating expenses (excluding commissions) to gross premiums, policy charges and fee income. Group disability ratios include long-term care and dental products.

2012 to 2011 Three Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, increased by \$118 million, from \$1,467 million in the first quarter of 2011 to \$1,585 million in the first quarter of 2012. This increase reflects a \$96 million increase in policyholders' benefits, including the change in policy reserves, from \$1,213 million in the first quarter of 2011 to \$1,309 million in the first quarter of 2012. Our group life business reflected greater benefit costs from unfavorable claims experience and growth in the non-retrospectively experience-rated business, partially offset by a decrease in benefits on retrospectively experience-rated business that resulted in decreased premiums, as discussed above. Our group disability business reflected an increase in policyholders' benefits primarily from an increase in the number and severity of long-term disability claims, as well as an increase in policyholders' benefits associated with the assumption of existing liabilities from third parties, which is offset in premiums, as discussed above. Also contributing to the increase in benefits and expenses were higher general and administrative expenses, as discussed above.

The group life benefits ratio deteriorated 3.1 percentage points from the first quarter of 2011 to the first quarter of 2012, primarily due to unfavorable claims experience reflecting an increase in severity on non-retrospectively experience-rated business. The group disability benefits ratio deteriorated 10.3 percentage points from the first quarter of 2011 to the first quarter of 2012 primarily due to an increase in the number and severity of long-term disability claims. The group life administrative operating expense ratio deteriorated 0.8 percentage points from the first quarter of 2011 to the first quarter of 2012 due to an increase in legal costs and costs related to strategic initiatives. The group disability administrative operating expense ratio improved 0.3 percentage points from the first quarter of 2011 to the first quarter of 2012 due to higher premiums associated with the assumption of existing liabilities from third parties offset by an increase in legal costs and costs related to strategic initiatives.

Table of Contents*Sales Results*

The following table sets forth the Group Insurance segment's annualized new business premiums for the periods indicated. In managing our group insurance business, we analyze annualized new business premiums, which do not correspond to revenues under U.S. GAAP, because annualized new business premiums measure the current sales performance of the business unit, while revenues primarily reflect the renewal persistency and aging of in force policies written in prior years and net investment income, in addition to current sales.

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
Annualized new business premiums(1):		
Group life	\$ 211	\$ 392
Group disability(2)	102	108
 Total	 \$ 313	 \$ 500

(1) Amounts exclude new premiums resulting from rate changes on existing policies, from additional coverage under our Servicemembers' Group Life Insurance contract and from excess premiums on group universal life insurance that build cash value but do not purchase face amounts, and include premiums from the takeover of claim liabilities.

(2) Includes long-term care and dental products.

2012 to 2011 Three Month Comparison. Total annualized new business premiums decreased \$187 million, from \$500 million in the first quarter of 2011 to \$313 million in the first quarter of 2012. Group life sales decreased \$181 million reflecting the impact of a large market life case sale to a new customer in the first quarter of 2011. Group disability sales, which include long-term care and dental products, remained relatively unchanged.

In March 2012, we discontinued sales of our individual long-term care products. This decision reflects the challenging economics of the individual long-term care market and our desire to focus our resources on the group long-term care products. Individual long-term care sales are not a significant contributor to our annualized new business premiums in any period shown above.

International Insurance Division*Foreign Currency Exchange Rate Movements and Related Hedging Strategies*

As a U.S.-based company with significant business operations outside the U.S., particularly in Japan, we are subject to foreign currency exchange rate movements that could impact our U.S. dollar-equivalent earnings or our equity in foreign subsidiaries. We seek to mitigate this impact through various hedging strategies, including the use of derivative contracts and through holding U.S. dollar-denominated assets in certain of our foreign subsidiaries.

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

The operations of our International Insurance Division are subject to currency fluctuations that can materially affect their U.S. dollar-equivalent earnings from period to period even if earnings on a local currency basis are relatively constant. We enter into forward currency derivative contracts, and hold dual currency and synthetic dual currency investments, as part of our strategy to effectively fix the currency exchange rates for a portion of our prospective non-U.S. dollar-denominated earnings streams, thereby reducing earnings volatility from foreign currency exchange rate movements. The forward currency hedging program is primarily associated with our insurance operations in Japan and Korea. In addition, our Japanese insurance operations offer a variety of non-yen denominated products which are supported by investments in corresponding currencies. While these non-yen denominated assets and liabilities are economically hedged, the accounting for changes in the value of these assets and liabilities due to changes in foreign currency exchange rate movements differs, resulting in volatility in reported U.S. GAAP earnings. For further information on the various hedging strategies used to mitigate the risks of foreign currency exchange rate movements on earnings, see [Impact of foreign currency exchange rate movements on earnings](#).

Table of Contents

We also seek to mitigate the impact of foreign currency exchange rate movements on our U.S. dollar-equivalent equity in foreign subsidiaries through various hedging strategies. In our Japanese insurance subsidiaries, we hedge a portion of the estimated available economic capital of the business using a variety of instruments, including U.S. dollar-denominated assets financed by the combination of U.S. GAAP equity and yen-denominated liabilities. We may also hedge using instruments held in our U.S. domiciled entities, such as U.S. dollar-denominated debt that has been swapped to yen. We are evaluating the hedging strategy related to our Japanese insurance subsidiaries to consider the Japanese operations' relative contribution to the Company's overall return on equity which may result in a change in the amount of yen exposure we hedge. In our Taiwan insurance operation, the U.S. GAAP equity exposure is mitigated by holding a variety of instruments, including U.S. dollar-denominated investments. For further information on the various instruments used to mitigate the risks of foreign currency exchange rate movements on our U.S. dollar-equivalent equity in foreign subsidiaries, see [Impact of foreign currency exchange rate movements on equity](#).

The table below presents the aggregate amount of instruments that serve to hedge the impact of foreign currency exchange movements on our U.S. dollar-equivalent earnings and U.S. dollar-equivalent equity in our Japanese insurance subsidiaries for the periods indicated.

	March 31, 2012	December 31, 2011
	(in billions)	
Instruments hedging foreign currency exchange rate exposure on U.S. dollar-equivalent earnings:		
Forward currency hedging program(1)	\$ 2.7	\$ 2.5
Dual currency and synthetic dual currency investments(2)	0.9	1.0
	3.6	3.5
Instruments hedging foreign currency exchange rate exposure on U.S. dollar-equivalent equity:		
U.S. dollar-denominated assets held in yen-based entities(3)	7.3	7.2
Yen-denominated liabilities held in U.S.-based entities(4)	0.8	0.8
	8.1	8.0
Total hedges	\$ 11.7	\$ 11.5
Total U.S. GAAP equity of Japanese insurance subsidiaries, as adjusted(5)	\$ 9.3	\$ 9.8

(1) Represents the notional amount of forward currency contracts outstanding.

(2) Represents the present value of future cash flows, on a U.S. dollar-denominated basis.

(3) Excludes \$24.6 billion and \$23.7 billion as of March 31, 2012 and December 31, 2011, respectively, of U.S. dollar assets supporting U.S. dollar liabilities related to U.S. dollar-denominated products issued by our Japanese insurance operations.

(4) The yen-denominated liabilities are reported in Corporate and Other operations.

(5) Excludes Accumulated other comprehensive income (loss) components of equity and certain other adjustments.

The U.S. dollar-denominated investments that hedge the U.S. GAAP equity exposure in our Japanese insurance operations pay a coupon, which is reflected within Net investment income, and, therefore, included in adjusted operating income, which is generally higher than what a similar yen-based investment would pay. The incremental impact of this higher yield of our U.S. dollar-denominated investments, as well as our dual currency and synthetic dual currency investments discussed below, will vary over time, and is dependent on the duration of the underlying investments, as well as interest rate environments in the U.S. and Japan at the time of the investments. See [Realized Investment Gains and Losses and General Account Investments](#) [General Account Investments](#) [Investment Results](#) for a discussion of the investment yields generated by our Japanese insurance operations.

Table of Contents**Impact of foreign currency exchange rate movements on earnings***Forward currency hedging program*

The financial results of our International Insurance segment for all periods presented reflect the impact of an intercompany arrangement with Corporate and Other operations pursuant to which the segment's non-U.S. dollar-denominated earnings in certain countries are translated at fixed currency exchange rates. The fixed rates are determined in connection with a foreign currency income hedging program designed to mitigate the impact of exchange rate changes on the segment's U.S. dollar-equivalent earnings. Pursuant to this program, Corporate and Other operations execute forward currency contracts with third parties to sell the net exposure of projected earnings from the hedged currency in exchange for U.S. dollars at specified exchange rates. The maturities of these contracts correspond with the future periods in which the identified non-U.S. dollar-denominated earnings are expected to be generated. In establishing the level of non-U.S. dollar-denominated earnings that will be hedged through this program, we exclude the anticipated level of U.S. dollar-denominated earnings that will be generated by dual currency and synthetic dual currency investments, as well as the anticipated level of U.S. dollar-denominated earnings that will be generated by U.S. dollar-denominated products and investments, both of which are discussed in greater detail below. As a result of this intercompany arrangement, our International Insurance segment results for 2011 reflect the impact of translating yen and Korean won-denominated earnings at fixed currency exchange rates of 92 yen per U.S. dollar and 1190 Korean won per U.S. dollar. Results for 2012 reflect the impact of translating yen and Korean won-denominated earnings at fixed currency exchange rates of 85 yen per U.S. dollar and 1180 Korean won per U.S. dollar.

Results of Corporate and Other operations include any differences between the translation adjustments recorded by the segment at the fixed rate and the gains or losses recorded from the forward currency contracts that settled during the period, which includes the impact of any over or under hedging of actual earnings that differ from projected earnings. The table below presents, for the periods indicated, the increase (decrease) to revenues and adjusted operating income for the International Insurance segment and for Corporate and Other operations, reflecting the impact of this intercompany arrangement.

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
International Insurance Segment:		
Impact of intercompany arrangement(1)	\$ (21)	\$ (35)
Corporate and Other operations:		
Impact of intercompany arrangement(1)	21	35
Settlement gains/(losses) on forward currency contracts	(27)	(35)
Net benefit to Corporate and Other operations	(6)	0
Net impact on consolidated revenues and adjusted operating income	\$ (27)	\$ (35)

(1) Represents the difference between non-U.S. dollar-denominated earnings translated on the basis of weighted average monthly currency exchange rates versus fixed currency exchange rates determined in connection with the forward currency hedging program.

As of March 31, 2012 and December 31, 2011, the notional amounts of these forward currency contracts were \$3.2 billion and \$3.0 billion, respectively, of which \$2.7 billion and \$2.5 billion, respectively, were related to our Japanese insurance operations.

Dual currency and synthetic dual currency investments hedging program

In addition, our Japanese insurance operations hold dual currency investments in the form of fixed maturities and loans. The principal of these dual currency investments are yen-denominated while the related interest income is U.S. dollar-denominated. These investments are the economic equivalent of exchanging what

Table of Contents

would otherwise be fixed streams of yen-denominated interest income for fixed streams of U.S. dollar-denominated interest income. Our Japanese insurance operations also hold yen-denominated investments that have been coupled with cross-currency coupon swap agreements, creating synthetic dual currency investments. The yen/U.S. dollar exchange rate is effectively fixed, as we are obligated in future periods to exchange fixed amounts of Japanese yen interest payments generated by the yen-denominated investments for fixed amounts of U.S. dollar interest payments at the yen/U.S. dollar exchange rates specified by the cross-currency coupon swap agreements. As of March 31, 2012 and December 31, 2011, the notional amount of these investments was ¥279 billion, or \$2.5 billion, and ¥280 billion, or \$2.5 billion, respectively, based upon the foreign currency exchange rates applicable at the time these investments were acquired. The weighted average yields generated by these investments were 3.2% and 2.8% for the three months ended March 31, 2012 and 2011, respectively.

Below is the fair value of these instruments as reflected on our balance sheet for the periods indicated.

	March 31, 2012	December 31, 2011
	(in millions)	
Cross-currency coupon swap agreements	\$ (57)	\$ (105)
Foreign exchange component of interest on dual currency investments	(109)	(128)
Total	\$ (166)	\$ (233)

The table below presents as of March 31, 2012, the yen-denominated earnings subject to our dual currency and synthetic dual currency investments and the related weighted average exchange rates resulting from these investments.

Year	Interest component of dual currency investments(1)	Cross-currency coupon swap element of synthetic dual currency investments (in billions)	Total yen-denominated earnings subject to these investments	Weighted average forward exchange rate per U.S. Dollar (yen per \$)
Remainder of 2012	3.1	2.2	5.3	83.3
2013	3.3	2.5	5.8	81.0
2014	3.2	2.5	5.7	80.8
2015	3.0	2.5	5.5	81.0
2016-2034	24.8	46.2	71.0	78.9
Total	¥ 37.4	¥ 55.9	¥ 93.3	79.5

(1) Yen amounts are imputed from the contractual U.S. dollar-denominated interest cash flows.

The present value of the earnings reflected in the table above, on a U.S. dollar-denominated basis, is \$0.9 billion as of March 31, 2012.

U.S. GAAP earnings impact of products denominated in non-local currencies

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Our international insurance operations primarily offer products denominated in local currency. However, our Japanese insurance operations also offer products denominated in non-local currencies, primarily comprised of U.S. and Australian dollar-denominated products. The non-yen denominated insurance liabilities related to these products are supported by investments denominated in corresponding currencies, including a significant portion designated as available-for-sale, and other related non-yen denominated net assets, including accrued investment income, to support these products. These assets and liabilities are impacted by foreign currency exchange rate movements, as they are non-yen denominated items on the books of yen-based entities. While these non-yen denominated assets and liabilities are economically hedged, the accounting for changes in the value of these assets and liabilities due to changes in foreign currency exchange rate movements differs, resulting in volatility in U.S. GAAP earnings. For example, available-for-sale investments under U.S. GAAP are carried at

Table of Contents

fair value with changes in fair value (except as described below for impairments), including those from changes in foreign currency exchange rate movements, recorded as unrealized gains or losses in Accumulated other comprehensive income (loss), whereas the non-yen denominated liabilities are remeasured for foreign currency exchange rate movements, and the related change in value is recorded in earnings within Asset management fees and other income. Investments designated as held-to-maturity under U.S. GAAP, are recorded at amortized cost on the balance sheet, but are remeasured for foreign currency exchange rate movements, with the related change in value recorded in earnings within Asset management fees and other income. Due to this non-economic volatility that is reflected in U.S. GAAP earnings, the change in value due to changes in foreign currency exchange rate movements, or remeasurement, of these non-yen denominated assets and related liabilities associated with these products is excluded from adjusted operating income and included in Realized investment gains (losses), net, and related adjustments. For the three months ended March 31, 2012 and 2011, Realized investment gains (losses), net, and related adjustments includes net losses of \$1,232 million and \$177 million, respectively, reflecting the remeasurement of these non-yen denominated insurance liabilities, which are presented in the table below, and the remeasurement of certain non-yen denominated related assets, and were primarily driven by the strengthening of both the U.S. and Australian dollar against the yen.

The table below presents the carrying value of insurance liabilities related to products offered in non-local currencies within our Japanese insurance operations as of the periods indicated.

	March 31, 2012	December 31, 2011
	(in billions)	
U.S. dollar-denominated products	\$ 24.0	\$ 23.6
Australian dollar-denominated products	6.8	5.9
Euro-denominated products	0.3	0.2
Total	\$ 31.1	\$ 29.7

As of March 31, 2012 and December 31, 2011, \$4.8 billion and \$4.5 billion, respectively, of insurance liabilities for U.S. dollar-denominated products presented in the table above are associated with Prudential of Japan and coinsured to our U.S. domiciled insurance operations. These U.S. dollar-denominated liabilities are supported by U.S. dollar-denominated assets and are not subject to the remeasurement mismatch described above.

Impact of foreign currency exchange rate movements on equity

The table below presents the composition of instruments that serve to hedge the impact of foreign currency exchange movements on our U.S. dollar-equivalent equity in our Japanese insurance subsidiaries for the periods indicated.

	March 31, 2012	December 31, 2011
	(in billions)	
Available-for-sale U.S. dollar-denominated investments, at amortized cost	\$ 6.7	\$ 6.8
Held-to-maturity U.S. dollar-denominated investments, at amortized cost	0.4	0.3
Other(1)	0.2	0.1
U.S. dollar-denominated assets held in yen-based entities(2)	7.3	7.2
Yen-denominated liabilities held in U.S.-based entities(3)	0.8	0.8

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Total instruments hedging foreign currency exchange rate exposure on U.S. dollar-equivalent equity	\$ 8.1	\$	8.0
Total U.S. GAAP equity of Japanese insurance subsidiaries, as adjusted(4)	\$ 9.3	\$	9.8

(1) Primarily reflects accrued investment income on U.S. dollar-denominated investments.

Table of Contents

- (2) Excludes \$24.6 billion and \$23.7 billion as of March 31, 2012 and December 31, 2011, respectively, of U.S. dollar assets supporting U.S. dollar liabilities related to U.S. dollar-denominated products issued by our Japanese insurance operations.
- (3) The yen-denominated liabilities are reported in Corporate and Other operations.
- (4) Excludes Accumulated other comprehensive income (loss) components of equity and certain other adjustments.

Available-for-sale investments under U.S. GAAP are carried at fair value with unrealized changes in fair value (except as described below for impairments), including those from changes in foreign currency exchange rate movements, recorded as unrealized gains or losses in

Accumulated other comprehensive income (loss). Changes in the U.S. GAAP equity of our Japanese insurance operations due to foreign currency exchange rate movements are also recorded in Accumulated other comprehensive income (loss) as a Foreign currency translation adjustment, and can serve as an offset to the unrealized changes in fair value of the available-for-sale investments. For the portion of available-for-sale investments that support our Japanese insurance operations U.S. GAAP equity, this offset creates a natural equity hedge. If U.S. dollar-denominated investments, including available-for-sale investments, supporting the hedge are in excess of our U.S. GAAP equity, then there is no offsetting impact to equity. In addition, the impact of foreign currency exchange rate movements on the U.S. GAAP equity of our Japanese insurance operations is partially offset by foreign currency exchange related changes in designated yen-denominated debt and other hedging instruments held in our U.S. domiciled entities and recorded in Accumulated other comprehensive income (loss) as a Foreign currency translation adjustment.

The investments designated as held-to-maturity under U.S. GAAP are recorded at amortized cost on the balance sheet, but are remeasured for foreign currency exchange rate movements, with the related change in value recorded within Asset management fees and other income. The remeasurement related to the change in value for foreign currency exchange rate movements for these investments is excluded from adjusted operating income.

We also incorporate the impact of foreign currency exchange rate movements on the remaining U.S. dollar-denominated net asset position of our Japanese insurance operations, which primarily relates to accrued investment income, as part of our overall application of the hedge strategy. These U.S. dollar-denominated assets and liabilities are remeasured for foreign currency exchange rate movements, as they are non-yen denominated items on the books of yen-based entities, and the related change in value is recorded within Asset management fees and other income. The remeasurement related to the change in value for foreign currency exchange rate movements for these items is excluded from adjusted operating income.

For U.S. dollar-denominated investments recorded on the books of yen-based entities, foreign currency exchange movements will impact their value. To the extent the value of the yen strengthens as compared to the U.S. dollar, the value of these U.S. dollar-denominated investments will decrease. Upon the ultimate sale or maturity of the U.S. dollar-denominated investments, any realized change in value related to changes in the foreign currency exchange rates will be included in Realized investment gains (losses), net within the income statement and excluded from adjusted operating income. Similarly, changes in the foreign currency exchange rates that result in other-than-temporary impairments on these investments will be included in Realized investment gains (losses), net within the income statement and, as such, excluded from adjusted operating income. See Realized Investment Gains and Losses and General Account Investments General Account Investments Fixed Maturity Securities Other-than-Temporary Impairments of Fixed Maturity Securities for a discussion of our policies regarding impairments. We seek to mitigate the risk that future unfavorable foreign currency exchange rate movements will decrease the value of our U.S. dollar-denominated investments and negatively impact the equity of our yen-based entities by employing internal hedging strategies between a subsidiary of Prudential Financial and certain of our yen-based entities. See Liquidity and Capital Resources Liquidity and Capital Resources of Subsidiaries International Insurance Subsidiaries for a discussion of our internal hedging strategies.

Table of Contents**International Insurance****Operating Results**

The results of our International Insurance operations are translated on the basis of weighted average monthly exchange rates, inclusive of the effects of the intercompany arrangement discussed above. To provide a better understanding of operating performance within the International Insurance segment, where indicated below, we have analyzed our results of operations excluding the effect of the year over year change in foreign currency exchange rates. Our results of operations excluding the effect of foreign currency fluctuations were derived by translating foreign currencies to U.S. dollars at uniform exchange rates for all periods presented, including for constant dollar information discussed below. The exchange rates used were Japanese yen at a rate of 85 yen per U.S. dollar and Korean won at a rate of 1180 won per U.S. dollar, both of which were determined in connection with the foreign currency income hedging program discussed above. In addition, for constant dollar information discussed below, activity denominated in U.S. dollars is reported based on the amounts as transacted in U.S. dollars. Annualized new business premiums presented on a constant exchange rate basis in the Sales Results section below reflect translation based on these same uniform exchange rates.

The following table sets forth the International Insurance segment's operating results for the periods indicated.

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
Operating results:		
Revenues:		
Life Planner operations	\$ 2,317	\$ 2,097
Gibraltar Life and Other operations	3,532	2,224
	5,849	4,321
Benefits and expenses:		
Life Planner operations	1,935	1,797
Gibraltar Life and Other operations	3,308	1,896
	5,243	3,693
Adjusted operating income:		
Life Planner operations	382	300
Gibraltar Life and Other operations	224	328
	606	628
Realized investment gains (losses), net, and related adjustments(1)	(1,464)	(322)
Related charges(2)	(10)	8
Investment gains (losses) on trading account assets supporting insurance liabilities, net(3)	153	(13)
Change in experience-rated contractholder liabilities due to asset value changes(4)	(153)	13
Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests(5)	(8)	(158)
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures	\$ (876)	\$ 156

- (1) Revenues exclude Realized investment gains (losses), net, and related adjustments. Realized investment gains (losses), net, and related adjustments includes gains and losses from changes in value of certain assets and liabilities relating to foreign currency exchange movements that have been economically hedged, as discussed above. See Realized Investment Gains and Losses and General Account Investments Realized Investment Gains and Losses.

Table of Contents

- (2) Revenues exclude related charges resulting from payments related to market value adjustment features of certain of our annuity products and the impact of Realized investment gains (losses), net, on the amortization of unearned revenue reserves. Benefits and expenses exclude related charges that represent the element of Dividends to policyholders that is based on a portion of certain realized investment gains required to be paid to policyholders and the impact of Realized investment gains (losses), net, on the amortization of deferred policy acquisition costs.
- (3) Revenues exclude net investment gains and losses on trading account assets supporting insurance liabilities. See Experience-Rated Contractholder Liabilities, Trading Account Assets Supporting Insurance Liabilities and Other Related Investments.
- (4) Benefits and expenses exclude changes in contractholder liabilities due to asset value changes in the pool of investments supporting these experience-rated contracts. See Experience-Rated Contractholder Liabilities, Trading Account Assets Supporting Insurance Liabilities and Other Related Investments.
- (5) Equity in earnings of operating joint ventures are included in adjusted operating income but excluded from income from continuing operations before income taxes and equity in earnings of operating joint ventures as they are reflected on a U.S. GAAP basis on an after-tax basis as a separate line in our Unaudited Interim Consolidated Statements of Operations. Earnings attributable to noncontrolling interests are excluded from adjusted operating income but included in income from continuing operations before taxes and equity earnings of operating joint ventures as they are reflected on a U.S. GAAP basis as a separate line in our Unaudited Interim Consolidated Statements of Operations. Earnings attributable to noncontrolling interests represent the portion of earnings from consolidated entities that relates to the equity interests of minority investors.

Adjusted Operating Income

2012 to 2011 Three Month Comparison. Adjusted operating income from our Life Planner operations increased \$82 million, from \$300 million in the first quarter of 2011 to \$382 million in the first quarter of 2012, including a net favorable impact of \$12 million from currency fluctuations. Results for the first quarter of 2011 included a charge of \$19 million associated with estimated claims resulting from the 2011 earthquake in Japan. Excluding the impact of these items, adjusted operating income increased \$51 million, primarily reflecting the growth of business in force and continued strong persistency, as well as more favorable mortality experience in our Japanese Life Planner operations.

Adjusted operating income from our Gibraltar Life and Other operations decreased \$104 million, from \$328 million in the first quarter of 2011 to \$224 million in the first quarter of 2012, including a favorable impact of \$10 million from currency fluctuations. Adjusted operating income for the first quarter of 2011 includes a \$153 million benefit reflecting the impact of a partial sale of our investment, through a consortium, in China Pacific Group. Results for the first quarter of 2011 also includes \$47 million of transaction and integration costs relating to the acquisition of the Star and Edison Businesses, compared to \$57 million of integration costs in the first quarter of 2012.

Excluding the effect of the items discussed above, adjusted operating income from our Gibraltar Life and Other operations increased \$49 million, primarily reflecting business growth across all distribution channels and approximately \$30 million of cost savings resulting from Star and Edison integration synergies, partially offset by unfavorable results from our equity method investments. In addition, the benefit resulting from the impact of including two additional months of earnings from the former Star and Edison Businesses was largely offset by higher policy benefits and expenses including unfavorable mortality experience in the current year quarter compared to favorable mortality experience in the previous year quarter.

Revenues

2012 to 2011 Three Month Comparison. Revenues, as shown in the table above under Operating Results, increased \$1,528 million, from \$4,321 million in the first quarter of 2011 to \$5,849 million in the first quarter of 2012, including a net favorable impact of \$237 million relating to currency fluctuations. Excluding the impact of currency fluctuations, revenues increased \$1,291 million, from \$4,284 million in the first quarter of 2011 to \$5,575 million in the first quarter of 2012.

Revenues from our Life Planner operations increased \$220 million, from \$2,097 million in the first quarter of 2011 to \$2,317 million in the first quarter of 2012, including a net favorable impact of \$39 million from currency fluctuations. Excluding the impact of currency fluctuations,

revenues increased \$181 million, from

Table of Contents

\$2,066 million in the first quarter of 2011 to \$2,247 million in the first quarter of 2012. This increase in revenues came primarily from increases in premiums and policy charges and fee income of \$147 million, from \$1,691 million in the first quarter of 2011 to \$1,838 million in the first quarter of 2012, driven by continued growth of business in force and continued strong persistency. Net investment income increased \$31 million, from \$340 million in the first quarter of 2011 to \$371 million in the first quarter of 2012, primarily due to investment portfolio growth, partially offset by lower yields in our investment portfolio compared to the prior year quarter.

Revenues from our Gibraltar Life and Other operations increased \$1,308 million, from \$2,224 million in the first quarter of 2011 to \$3,532 million in the first quarter of 2012, including a favorable impact of \$198 million from currency fluctuations. Excluding the impact of currency fluctuations, revenues for Gibraltar Life increased \$1,110 million, from \$2,218 million in the first quarter of 2011 to \$3,328 million in the first quarter of 2012 driven by a \$1,048 million increase in premiums and policy charges and fee income, from \$1,585 million in the first quarter of 2011 to \$2,633 million in the first quarter of 2012. The increase in premiums and policy charges and fee income reflects higher renewal premiums of \$566 million including the impact of the additional two months of premiums from the former Star and Edison Businesses, and growth in protection products within the bank distribution channel including \$341 million of higher sales of single premium whole life policies. Also contributing to the increase in revenues is higher net investment income of \$191 million primarily reflecting investment portfolio growth and the impact of the additional two months of investment income from the former Star and Edison Businesses, partially offset by lower investment portfolio yields and the impact of unfavorable results from our equity method investments. Asset management fees and other income declined compared to the previous year quarter primarily driven by the absence of a \$153 million benefit recognized in the prior year quarter from the partial sale of our indirect investment in China Pacific Group, discussed above.

In some of the markets in which we operate, it is difficult to find appropriate long-duration assets to match the characteristics of our long-duration product liabilities. In Japan, we have historically sought to increase the duration of our Japanese yen investment portfolio by employing various strategies, including investing in longer-term securities or by entering into long-duration floating-to-fixed interest rate swaps. These strategies better support the characteristics of our long-dated product liabilities and have resulted in higher portfolio yields. Based on an evaluation of market conditions, beginning in the fourth quarter of 2008 and continuing into the first quarter of 2009, we terminated or offset many of these interest rate swaps in consideration of, among other things, the interest rate environment. The resulting realized investment gains from terminating or offsetting these interest rate swaps will be recognized in adjusted operating income over periods that generally approximate the expected terms of the derivatives. For the three months ended March 31, 2012 and 2011, we recognized gains of \$15 million and \$13 million, respectively, in adjusted operating income related to these realized investment gains. As of March 31, 2012, \$642 million of deferred gains remain to be recognized in adjusted operating income over a weighted average period of 28 years. We continue to manage the interest rate risk profile of our businesses in the context of market conditions and relative opportunities, and may implement these hedging strategies to lengthen the duration of our Japanese investment portfolio as our assessment of market conditions dictates. As we do so, the impact to our portfolio yields will depend on the interest rate environment at that time.

Benefits and Expenses

2012 to 2011 Three Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, increased \$1,550 million, from \$3,693 million in the first quarter of 2011 to \$5,243 million in the first quarter of 2012, including a net unfavorable impact of \$215 million related to currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased \$1,335 million, from \$3,608 million in the first quarter of 2011 to \$4,943 million in the first quarter of 2012.

Benefits and expenses of our Life Planner operations increased \$138 million, from \$1,797 million in the first quarter of 2011 to \$1,935 million in the first quarter of 2012, including a net unfavorable impact of \$27 million from currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased \$111 million, from \$1,747 million in the first quarter of 2011 to \$1,858 million in the first quarter of 2012, primarily driven by an \$86 million increase in policyholder benefits due to changes in reserves reflecting

Table of Contents

growth in business in force, partially offset by more favorable mortality experience and by the absence of charges recorded in the prior year quarter associated with estimated claims from the 2011 earthquake in Japan.

Benefits and expenses of our Gibraltar Life and Other operations increased \$1,412 million, from \$1,896 million in the first quarter of 2011 to \$3,308 million in the first quarter of 2012, including an unfavorable impact of \$188 million from currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased \$1,224 million, from \$1,861 million in the first quarter of 2011 to \$3,085 million in the first quarter of 2012. Policyholder benefits including changes in reserves increased \$827 million, driven by the impact of the additional two months of benefit expenses from the former Star and Edison Businesses, higher single premium whole life sales in the current year quarter and unfavorable mortality experience. Interest credited to policyholders' account balances increased \$94 million and amortization of deferred policy acquisition costs increased \$51 million with both increases primarily reflecting the impact of the additional two months of the former Star and Edison Businesses as well as the continued growth in business. General and administrative expenses, net of capitalization, increased \$183 million also driven by the impact of the additional two months of the former Star and Edison Businesses and higher development costs supporting distribution channel growth, partially offset by approximately \$30 million of cost savings resulting from Star and Edison integration synergies.

Sales Results

In managing our international insurance business, we analyze revenues, as well as annualized new business premiums, which do not correspond to revenues under U.S. GAAP. Annualized new business premiums measure the current sales performance of the segment, while revenues primarily reflect the renewal persistency of policies written in prior years and net investment income, in addition to current sales. Annualized new business premiums include 10% of first year premiums or deposits from single pay products. No other adjustments are made for limited pay contracts. The following table sets forth annualized new business premiums on an actual and constant exchange rate basis for the periods indicated.

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
Annualized new business premiums:		
On an actual exchange rate basis:		
Life Planner operations	\$ 394	\$ 307
Gibraltar Life	469	373
Total	\$ 863	\$ 680
On a constant exchange rate basis:		
Life Planner operations	\$ 380	\$ 297
Gibraltar Life	439	363
Total	\$ 819	\$ 660

With a diversified product mix supporting the growing demand for retirement and savings products, our international insurance operations offer various traditional whole life, term, endowment (which provide for payment on the earlier of death or maturity) and retirement income life insurance products that combine an insurance protection element similar to that of term life policies with a retirement income feature. In most of our operations, we also offer certain health products with fixed benefits, some of which include a high savings element, as well as annuity products, which are primarily represented by U.S. and Australian dollar-denominated fixed annuities in our Gibraltar Life operations.

Table of Contents

Our Life Planners primary objective is to sell protection-oriented life insurance products on a needs basis to mass affluent and affluent customers, as well as to small businesses, whereas Gibraltar's Life Consultants, previously identified as Life Advisors, have primarily sold individual protection products to the broad middle income market in Japan, particularly through relationships with affinity groups. Supplementing our core Life Planner and Gibraltar Life Consultant distribution channels, bank distribution channel sales primarily consist of products intended to provide premature death protection and retirement income, as well as fixed annuity products primarily denominated in U.S. and Australian dollars. Our independent agency channel sells protection products and high cash value products for its retirement benefit through the business market and sells a variety of other products including protection, medical and fixed annuity products through the individual market.

Historically, growth in annualized new business premiums was closely correlated to growth of our Life Planner and Gibraltar Life Consultant distribution force. Recently, growth in annualized new business premiums is being driven by increased average premium per new policy resulting in part from the growing demand for retirement-oriented products, as well as expanded distribution through third party channels, especially banks. As noted in the table below, bank channel sales contain a disproportionate number of single pay or limited pay contracts which tend to be larger policies and therefore have higher average premiums per policy. Our expectation is that this trend will continue.

The amount of annualized new business premiums for any given period can be significantly impacted by several factors, including but not limited to, changes in crediting interest rates for certain products, changes in tax laws, changes in life insurance regulations or other product modifications. Sales volume may increase or decrease prior to such changes becoming effective, and then fluctuate in the other direction following such changes.

The table below presents annualized new business premiums on a constant exchange rate basis, by product and distribution channel, for the periods indicated.

	Three Months Ended March 31, 2012					Three Months Ended March 31, 2011				
	Life	Accident & Health(1)	Retirement(2)	Annuity	Total	Life	Accident & Health(1)	Retirement(2)	Annuity	Total
Life Planners	\$ 121	\$ 69	\$ 171	\$ 19	\$ 380	\$ 114	\$ 47	\$ 126	\$ 10	\$ 297
Gibraltar Life:										
Life Consultants	86	33	39	23	181	80	30	17	28	155
Banks(3)	140	10	4	28	182	95	10	5	22	132
Independent Agency	22	36	6	12	76	19	50	2	5	76
Subtotal	248	79	49	63	439	194	90	24	55	363
Total	\$ 369	\$ 148	\$ 220	\$ 82	\$ 819	\$ 308	\$ 137	\$ 150	\$ 65	\$ 660

(1) Includes medical insurance, cancer insurance and accident & sickness riders. The three months ended March 31, 2012 and 2011 include \$77 million and \$52 million, respectively, of annualized new business premiums from cancer whole life insurance products.

(2) Includes retirement income, endowment and savings variable universal life.

(3) Single pay life annualized new business premiums, which include 10% of first year premiums, and 3-year limited pay annualized new business premiums, which include 100% of new business premiums, represented 48% and 38%, respectively, of total bank distribution channel annualized new business premiums, excluding annuity products, for the three months ended March 31, 2012, and 34% and 48%, respectively, of total bank distribution channel annualized new business premiums, excluding annuity products, for the three months ended March 31, 2011.

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

2012 to 2011 Three Month Comparison. On a constant exchange rate basis, annualized new business premiums increased \$159 million, from \$660 million in the first quarter of 2011 to \$819 million in the first quarter of 2012.

Table of Contents

Annualized new business premiums, on a constant exchange rate basis, from our Life Planner operations increased \$83 million, from \$297 million in the first quarter of 2011 to \$380 million in the first quarter of 2012, including \$76 million of higher sales in Japan driven by growth in average premium per policy reflecting the increasing demand for both yen and U.S. dollar-denominated retirement income products. In addition, sales of cancer products increased \$19 million driven in part by the anticipated tax law change impacting the corporate tax deductibility of premiums paid for these products, which was enacted in April 2012.

Annualized new business premiums, on a constant exchange rate basis, from our Gibraltar Life operations increased \$76 million, from \$363 million in the first quarter of 2011 to \$439 million in the first quarter of 2012. The increase in annualized new business premiums was driven by higher bank channel sales of \$50 million, primarily due to increased sales of protection products including \$35 million from single premium whole life sales. Life Consultant sales increased \$26 million primarily reflecting the increasing demand for retirement income products. In addition, the benefit from including two additional months of sales from the former Star and Edison Businesses when compared to the previous year quarter was partially offset by a temporary decline in sales in January 2012 attributable to an expected disruption in productivity resulting from the integration of these businesses. Sales in the first quarter of 2012 were also negatively impacted by the recent discontinuation of certain products previously offered by Star and Edison.

The number of Life Planners increased by 238, or 4%, from 6,581 as of March 31, 2011 to 6,819 as of March 31, 2012, driven by increases of 82 in Brazil due to agency growth and by increases of 80 in Korea and 50 in Poland reflecting stronger recruitment and retention. Also contributing to the increase in Life Planners over the past twelve months were increases of 17 in Italy and 15 in Japan.

The number of Gibraltar Life Consultants decreased by 1,008 from 13,227 as of March 31, 2011 to 12,219 as of March 31, 2012 primarily driven by anticipated resignations and terminations of former Star and Edison Life Consultants due in part to their failure to meet minimum sales production standards.

Investment Margins and Other Profitability Factors

Many of our insurance products sold in international markets provide for the buildup of cash values for the policyholder at mandated guaranteed interest rates. Authorities in some jurisdictions regulate interest rates guaranteed in our insurance contracts. The regulated guaranteed interest rates do not necessarily match the actual returns on our underlying investments that support these products. The spread between the actual investment returns and these guaranteed rates of return to the policyholder is an element of the profit or loss that we will experience on these products. With regulatory approval, guaranteed rates may be changed on new business which enhances our ability to set rates commensurate with available investment returns. However, the major sources of profitability for many of our products, particularly those sold by Prudential of Japan, are margins on mortality, morbidity and expense charges rather than investment spreads.

We base premiums and cash values in most countries in which we operate on mandated mortality and morbidity tables. Our mortality and morbidity experience in the International Insurance segment on an overall basis in the first quarter of 2012 and 2011 was well within our pricing assumptions and below the guaranteed levels reflected in the premiums we charge.

Corporate and Other

Corporate and Other includes corporate operations, after allocations to our business segments.

Corporate operations consist primarily of: (1) investment returns on capital that is not deployed in any business segments; (2) returns from investments not allocated to business segments, including debt-financed investment portfolios, and certain strategic joint venture investments, as well as tax credit investments and other tax enhanced investments financed by business segments; (3) capital debt that is used or will be used to meet the

Table of Contents

capital requirements of the Company and the related interest expense; (4) income and expense from qualified pension and other employee benefit plans, after allocations to business segments; (5) corporate-level income and expense, after allocations to business segments, including corporate governance, corporate advertising, philanthropic activities, deferred compensation and costs related to certain contingencies; (6) certain retained obligations relating to pre-demutualization policyholders whom we had previously agreed to provide insurance for reduced or no premium in accordance with contractual settlements related to prior individual life insurance sales practices remediation; (7) results related to our Capital Protection Framework, as described below; and (8) the impact of transactions with other segments.

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
Operating results:		
Net investment income, net of interest expense, excluding capital debt interest expense	\$ (16)	\$ (3)
Capital debt interest expense	(171)	(149)
Pension income and employee benefits	16	36
Other corporate activities(1)	(192)	(153)
Adjusted operating income	(363)	(269)
Realized investment gains (losses), net, and related adjustments(2)	704	49
Related charges(3)	(30)	(3)
Divested businesses(4)	1	(9)
Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests(5)	(3)	(2)
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures	\$ 309	\$ (234)

(1) Includes consolidating adjustments.

(2) Revenues exclude Realized investment gains (losses), net, and related adjustments. See Realized Investment Gains and Losses and General Account Investments Realized Investment Gains and Losses.

(3) Benefits and expenses exclude related charges which represent consolidating adjustments.

(4) See Divested Businesses.

(5) Equity in earnings of operating joint ventures are included in adjusted operating income but excluded from income from continuing operations before income taxes and equity in earnings of operating joint ventures as they are reflected on a U.S. GAAP basis on an after-tax basis as a separate line in our Unaudited Interim Consolidated Statements of Operations. Earnings attributable to noncontrolling interests are excluded from adjusted operating income but included in income from continuing operations before income taxes and equity in earnings of operating joint ventures as they are reflected on a U.S. GAAP basis as a separate line in our Unaudited Interim Consolidated Statements of Operations. Earnings attributable to noncontrolling interests represent the portion of earnings from consolidated entities that relate to the equity interests of minority investors.

2012 to 2011 Three Month Comparison. The loss from Corporate and Other operations, on an adjusted operating income basis, increased \$94 million, from \$269 million in the first quarter of 2011 to \$363 million in the first quarter of 2012. Greater net charges from other corporate activities, primarily reflecting increased retained corporate expenses including corporate advertising, and an \$18 million increase in our estimate of payments arising from use of new Social Security Master Death File matching criteria to identify deceased policy and contract holders, contributed to the increased loss. In addition, capital debt interest expense increased \$22 million primarily due to an increase in capital debt supporting the capital needs in our annuities business accomplished through a reallocation of debt previously deployed for operating purposes. The capital needs in our annuities business were primarily driven by the impact on results from our living benefit hedging program, including the impact of temporarily hedging to an amount that differs from our hedge target definition as described below in Capital Protection Framework. The deficit included in results from net investment income, net of interest expense, excluding capital debt interest expense, increased \$13 million reflecting higher levels of short-term liquidity being maintained to provide additional flexibility to address our cash needs in view

Table of Contents

of changing financial market conditions. In addition, in the fourth quarter of 2011, we issued additional debt of which the majority of the proceeds will be used to refinance maturing capital debt. See [Liquidity and Capital Resources](#) for additional details.

Results from corporate operations pension income and employee benefits decreased \$20 million. The decrease reflects a decrease in income from our qualified pension plan and increases in employee benefit costs. Income from our qualified pension plan decreased \$15 million, from \$73 million in the first quarter of 2011 to \$58 million in the first quarter of 2012.

Capital Protection Framework

Corporate and Other operations includes the results of our Capital Protection Framework, which includes among other things, the capital hedge program. The capital hedge program broadly addresses the equity market exposure of the statutory capital of the Company as a whole, under stress scenarios, as described under [Liquidity and Capital Resources](#) [Liquidity and Capital Resources of Subsidiaries](#) [Domestic Insurance Subsidiaries](#). This hedge program resulted in charges for amortization of derivative costs of \$7 million and \$4 million for the three months ended March 31, 2012 and 2011, respectively. The market value changes of these derivatives included in [Realized investment gains \(losses\), net and related adjustments](#) was a loss of \$18 million for the three months ended March 31, 2012. The market value changes of these derivatives were less than \$1 million for the three months ended March 31, 2011.

In addition, we manage certain risks associated with our variable annuity products through our living benefit hedging program, which is described under [U.S. Retirement Solutions and Investment Management Division](#) [Individual Annuities](#). We evaluate hedge levels versus our target based on the overall capital considerations of the Company and prevailing capital market conditions. The GAAP/capital markets valuations framework underlying our hedge target assumes that current interest rate levels remain for the full projection period with no reversion to longer term averages. Due to the recent low interest rate environment, we decided to temporarily hedge to an amount that differs from our hedge target definition to be consistent with our long-term economic view. Because this decision was based on the overall capital considerations of the Company as a whole, the impact on results from temporarily hedging to an amount that differs from our hedge target definition is reported within Corporate and Other operations. From the inception of this decision through March 31, 2012, we have experienced cumulative increases in the hedge target liability of approximately \$0.8 billion related to the under-hedged risk, with no corresponding hedge asset increase. This cumulative impact includes \$0.6 billion of gains attributable to the first quarter of 2012, and \$1.4 billion of net losses attributable to prior periods. For the three months ended March 31, 2012 and 2011, [Realized investment gains \(losses\), net and related adjustments](#) includes a gain of \$582 million and \$55 million, respectively, resulting from our decision to temporarily hedge to a different target and the change in interest rates during the respective periods. Through our Capital Protection Framework, we have access to on-balance sheet capital and contingent sources of capital that are available to meet capital needs. The capital consequences associated with our decision to temporarily hedge to an amount that differs from our hedge target definition have been factored into our Capital Protection Framework. For more information on the Company's Capital Protection Framework, see [Liquidity and Capital Resources](#).

We assess the composition of our hedging program on an ongoing basis, and we may change it from time to time based on our evaluation of the Company's risk position or other factors.

Results of Operations of Closed Block Business

We established the Closed Block Business effective as of the date of demutualization. The Closed Block Business includes our in force traditional domestic participating life insurance and annuity products and assets that are used for the payment of benefits and policyholder dividends on these policies, as well as other assets and equity and related liabilities that support these policies. We no longer offer these

traditional domestic participating policies. See [Overview](#) [Closed Block Business](#) for additional details.

Table of Contents

Each year, the Board of Directors of Prudential Insurance determines the dividends payable on participating policies for the following year based on the experience of the Closed Block, including investment income, net realized and unrealized investment gains, mortality experience and other factors. Although Closed Block experience for dividend action decisions is based upon statutory results, at the time the Closed Block was established, we developed, as required by U.S. GAAP, an actuarial calculation of the timing of the maximum future earnings from the policies included in the Closed Block. If actual cumulative earnings in any given period are greater than the cumulative earnings we expected, we record this excess as a policyholder dividend obligation. We will subsequently pay this excess to Closed Block policyholders as an additional dividend unless it is otherwise offset by future Closed Block performance that is less favorable than we originally expected. The policyholder dividends we charge to expense within the Closed Block Business will include any change in our policyholder dividend obligation that we recognize for the excess of actual cumulative earnings in any given period over the cumulative earnings we expected in addition to the actual policyholder dividends declared by the Board of Directors of Prudential Insurance.

As of March 31, 2012, the excess of actual cumulative earnings over the expected cumulative earnings was \$686 million, which was recorded as a policyholder dividend obligation. Actual cumulative earnings, as required by U.S. GAAP, reflect the recognition of realized investment gains and losses in the current period, as well as changes in assets and related liabilities that support the Closed Block policies. Additionally, the accumulation of net unrealized investment gains that have arisen subsequent to the establishment of the Closed Block have been reflected as a policyholder dividend obligation of \$3,926 million at March 31, 2012, to be paid to Closed Block policyholders unless offset by future experience, with an offsetting amount reported in Accumulated other comprehensive income (loss).

Operating Results

Management does not consider adjusted operating income to assess the operating performance of the Closed Block Business. Consequently, results of the Closed Block Business for all periods are presented only in accordance with U.S. GAAP. The following table sets forth the Closed Block Business U.S. GAAP results for the periods indicated.

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
U.S. GAAP results:		
Revenues	\$ 1,475	\$ 1,547
Benefits and expenses	1,445	1,515
Income from continuing operations before income taxes and equity in earnings of operating joint ventures	\$ 30	\$ 32

Income from Continuing Operations Before Income Taxes and Equity in Earnings of Operating Joint Ventures

2012 to 2011 Three Month Comparison. Income from continuing operations before income taxes and equity in earnings of operating joint ventures decreased \$2 million, from \$32 million in the first quarter of 2011 to \$30 million in the first quarter of 2012. Results for the first quarter of 2012 compared to the first quarter of 2011 are primarily driven by \$40 million of lower realized investment results, a \$31 million increase in reserves for estimated payments arising from the use of new Social Security Master Death File matching criteria to identify deceased policy and contract holders, as well as unfavorable mortality experience. Net realized investment results decreased from gains of \$30 million in the first quarter of 2011 to losses of \$10 million in the first quarter of 2012, primarily due to lower trading gains in fixed maturity and equity security investments, partially offset by favorable changes in the value of derivatives. For a discussion of Closed Block Business realized investment

Table of Contents

gains (losses), net, see Realized Investment Gains and Losses and General Account Investments Realized Investment Gains and Losses. These decreases in income were partially offset by a policyholder dividend obligation benefit of \$76 million in the first quarter of 2012 due to a decline in the excess of actual cumulative earnings over expected cumulative earnings due to lower income in the current quarter. This benefit was \$106 million higher than the policyholder dividend obligation expense of \$30 million in the first quarter of 2011. As noted above, as of March 31, 2012, the excess of actual cumulative earnings over the expected cumulative earnings was \$686 million. If actual cumulative earnings fall below expected cumulative earnings in future periods, earnings volatility in the Closed Block Business, which is primarily due to changes in investment results, may not be offset by changes in the cumulative earnings policyholder dividend obligation.

Revenues

2012 to 2011 Three Month Comparison. Revenues, as shown in the table above under Operating Results, decreased \$72 million, from \$1,547 million in the first quarter of 2011 to \$1,475 million in the first quarter of 2012, principally driven by the \$40 million decrease in net realized investment gains (losses), as discussed above. Premiums declined by \$20 million, with a related decrease in changes in reserves, primarily due to the expected in force decline as policies terminate. Net investment income also decreased primarily driven by the unfavorable impact of lower reinvestment yields and lower average invested assets.

Benefits and Expenses

2012 to 2011 Three Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, decreased \$70 million, from \$1,515 million in the first quarter of 2011 to \$1,445 million in the first quarter of 2012. This decrease included a \$113 million decrease in dividends to policyholders reflecting a decrease in the policyholder dividend obligation expense of \$106 million, from an expense of \$30 million in 2011 to a benefit of \$76 million in 2012, and a decrease in dividends paid and accrued to policyholders of \$7 million primarily due to a decline in policies in force. Partially offsetting these items was a \$45 million increase in policyholders' benefits, primarily driven by a \$31 million increase in reserves for estimated payments arising from the use of new Social Security Master Death File matching criteria to identify deceased policy and contract holders, unfavorable mortality experience, and changes in reserves resulting from the decline in premiums, as discussed above.

Income Taxes

Our income tax provision amounted to an income tax expense of \$171 million in the first quarter of 2012 compared to an expense of \$160 million in the first quarter of 2011. First quarter income tax expense for 2012 and 2011 includes \$339 million and \$7 million, respectively, of an additional U.S. tax related to the realization of a portion of the local deferred tax assets existing on the opening day balance sheet for the Star and Edison Businesses. The increase in the additional U.S. tax is a result of the merger of Star and Edison Businesses into the Gibraltar Life Insurance Company, Ltd. It represents the recomputed U.S. tax liability on Gibraltar's prior earnings as a result of the repatriation assumption and the merger of the entities. The local utilization of the deferred tax asset coupled with the repatriation assumption to the applicable earnings of our Japanese entities creates the effect of a double tax for U.S. GAAP purposes. Excluding the impact of a double tax, the income tax expense decreased primarily due to the decrease in pre-tax income from continuing operations before income taxes and equity in earnings of operating joint ventures from the first quarter of 2011 to the first quarter of 2012.

For additional information regarding income taxes, see Note 12 to the Unaudited Interim Consolidated Financial Statements.

Table of Contents**Discontinued Operations**

Included within net income are the results of businesses which are reflected as discontinued operations under U.S. GAAP. Income from discontinued operations, net of taxes, was \$7 million and \$14 million for the three months ended March 31, 2012 and 2011, respectively.

For additional information regarding discontinued operations see Note 3 to the Unaudited Interim Consolidated Financial Statements.

Divested Businesses

Our income from continuing operations includes results from several businesses that have been or will be sold or exited that do not qualify for discontinued operations accounting treatment under U.S. GAAP. The results of these divested businesses are reflected in our Corporate and Other operations, but excluded from adjusted operating income. A summary of the results of these divested businesses that have been excluded from adjusted operating income is as follows for the periods indicated:

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
Real Estate and Relocation Services Business	\$ 4	\$ (3)
Individual Health Insurance	(4)	(6)
Financial Advisory	(2)	(2)
Other(1)	3	2
Total divested businesses excluded from adjusted operating income	\$ 1	\$ (9)

(1) Primarily includes Property and Casualty Insurance and Prudential Securities Capital Markets.

Experience-Rated Contractholder Liabilities,**Trading Account Assets Supporting Insurance Liabilities and Other Related Investments**

Certain products included in the Retirement and International Insurance segments are experience-rated in that investment results associated with these products are expected to ultimately accrue to contractholders. The majority of investments supporting these experience-rated products are classified as trading and are carried at fair value. These trading investments are reflected on the statements of financial position as Trading account assets supporting insurance liabilities, at fair value (TAASIL). Realized and unrealized gains and losses for these investments are reported in Asset management fees and other income. Interest and dividend income for these investments is reported in Net investment income. To a lesser extent, these experience-rated products are also supported by derivatives and commercial mortgage and other loans. The derivatives that support these experience-rated products are reflected on the statement of financial position as Other long-term investments and are carried at fair value, and the realized and unrealized gains and losses are reported in Realized investment gains (losses), net. The commercial mortgage and other loans that support these experience-rated products are carried at unpaid principal, net of unamortized discounts and an allowance for losses, and are reflected on the statements of financial position as Commercial mortgage and other loans. Gains and losses on sales and changes

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

in the valuation allowance for commercial mortgage and other loans are reported in Realized investment gains (losses), net.

Our Retirement segment has two types of experience-rated products that are supported by TAASIL and other related investments. Fully participating products are those for which the entire return on underlying investments is passed back to the policyholders through a corresponding adjustment to the related liability. The adjustment to the liability is based on changes in the fair value of all of the related assets, including commercial mortgage and other loans, which are carried at amortized cost, less any valuation allowance. Partially

Table of Contents

participating products are those for which only a portion of the return on underlying investments is passed back to the policyholders over time through changes to the contractual crediting rates. The crediting rates are typically reset semiannually, often subject to a minimum crediting rate, and returns are required to be passed back within ten years.

In our International Insurance segment, the experience-rated products are fully participating. As a result, the entire return on the underlying investments is passed back to policyholders through a corresponding adjustment to the related liability.

Adjusted operating income excludes net investment gains and losses on TAASIL, related derivatives and commercial mortgage and other loans. This is consistent with the exclusion of realized investment gains and losses with respect to other investments supporting insurance liabilities managed on a consistent basis. In addition, to be consistent with the historical treatment of charges related to realized investment gains and losses on investments, adjusted operating income also excludes the change in contractholder liabilities due to asset value changes in the pool of investments (including changes in the fair value of commercial mortgage and other loans) supporting these experience-rated contracts, which are reflected in Interest credited to policyholders account balances. The result of this approach is that adjusted operating income for these products includes net fee revenue and interest spread we earn on these experience-rated contracts, and excludes changes in fair value of the pool of investments, both realized and unrealized, that we expect will ultimately accrue to the contractholders.

The following tables set forth the impact of these items on results that are excluded from adjusted operating income for the periods indicated:

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
Retirement Segment:		
Investment gains (losses) on:		
Trading account assets supporting insurance liabilities, net	\$ 81	\$ (4)
Derivatives	11	(19)
Commercial mortgages and other loans	1	1
Change in experience-rated contractholder liabilities due to asset value changes(1)(2)	(93)	21
Net gains (losses)	\$ 0	\$ (1)
International Insurance Segment:		
Investment gains (losses) on trading account assets supporting insurance liabilities, net	\$ 153	\$ (13)
Change in experience-rated contractholder liabilities due to asset value changes	(153)	13
Net gains (losses)	\$ 0	\$ 0
Total:		
Investment gains (losses) on:		
Trading account assets supporting insurance liabilities, net	\$ 234	\$ (17)
Derivatives	11	(19)
Commercial mortgages and other loans	1	1
Change in experience-rated contractholder liabilities due to asset value changes(1)(2)	(246)	34
Net gains (losses)	\$ 0	\$ (1)

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

- (1) Decreases to contractholder liabilities due to asset value changes are limited by certain floors and therefore do not reflect cumulative declines in recorded asset values of \$7 million and \$8 million as of March 31, 2012 and 2011, respectively. We have recovered and expect to recover in future periods these declines in recorded asset values through subsequent increases in recorded asset values or reductions in crediting rates on contractholder liabilities.

Table of Contents

- (2) Included in the amounts above related to the change in the liability to contractholders as a result of commercial mortgage and other loans are increases of \$4 million and \$1 million for the three months ended March 31, 2012 and 2011, respectively. As prescribed by U.S. GAAP, changes in the fair value of commercial mortgage and other loans held for investment in our general account, other than when associated with impairments, are not recognized in income in the current period, while the impact of these changes in fair value are reflected as a change in the liability to fully participating contractholders in the current period.

As shown in the table above, the net impacts for the Retirement segment of changes in experience-rated contractholder liabilities and investment gains and losses on trading account assets supporting insurance liabilities and other related investments were net losses of less than \$1 million and \$1 million for the three months ended March 31, 2012 and 2011, respectively. These impacts primarily reflect timing differences between the recognition of the mark-to-market adjustments and the recognition of the recovery of these adjustments in future periods through subsequent increases in asset values or reductions in crediting rates on contractholder liabilities for partially participating products. These impacts also reflect the difference between the fair value of the underlying commercial mortgage and other loans and the amortized cost, less any valuation allowance, of these loans, as described above.

As shown in the table above, the International Insurance segment includes offsetting impacts, in all periods, from changes in investment gains and losses on trading account assets supporting insurance liabilities and experience-rated contractholder liabilities.

Valuation of Assets and Liabilities

Fair Value of Assets and Liabilities

The authoritative guidance related to fair value established a framework for measuring fair value that includes a hierarchy used to classify the inputs used in measuring fair value. The hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement. See Note 13 to the Unaudited Interim Consolidated Financial Statements for a description of these levels.

Table of Contents

The tables below present the balances of assets and liabilities measured at fair value on a recurring basis, as of March 31, 2012 and December 31, 2011, split between the Financial Services Businesses and Closed Block Business, by fair value hierarchy level. See Note 13 to the Unaudited Interim Consolidated Financial Statements for the balances of assets and liabilities measured at fair value on a recurring basis presented on a consolidated basis.

	Financial Services Businesses as of March 31, 2012				Total
	Level 1	Level 2	Level 3(1) (in millions)	Netting(2)	
Fixed maturities, available-for-sale:					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ 0	\$ 9,337	\$ 45	\$	\$ 9,382
Obligations of U.S. states and their political subdivisions	0	2,298	10		2,308
Foreign government bonds	0	75,730	13		75,743
Corporate securities	13	97,479	1,162		98,654
Asset-backed securities	0	4,576	1,960		6,536
Commercial mortgage-backed securities	0	8,140	141		8,281
Residential mortgage-backed securities	0	7,502	13		7,515
Subtotal	13	205,062	3,344		208,419
Trading account assets supporting insurance liabilities:					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	0	177	11		188
Obligations of U.S. states and their political subdivisions	0	261	0		261
Foreign government bonds	0	657	0		657
Corporate securities	0	11,573	103		11,676
Asset-backed securities	0	919	389		1,308
Commercial mortgage-backed securities	0	2,145	2		2,147
Residential mortgage-backed securities	0	1,874	2		1,876
Equity securities	848	132	19		999
Short-term investments and cash equivalents	490	77	0		567
Subtotal	1,338	17,815	526		19,679
Other trading account assets:					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	0	141	0		141
Obligations of U.S. states and their political subdivisions	0	0	0		0
Foreign government bonds	2	43	0		45
Corporate securities	17	398	39		454
Asset-backed securities	0	334	57		391
Commercial mortgage-backed securities	0	96	12		108
Residential mortgage-backed securities	0	99	1		100
Equity securities	331	56	1,114		1,501
All other(3)	15	11,036	48	(8,979)	2,120
Subtotal	365	12,203	1,271	(8,979)	4,860
Equity securities, available-for-sale	1,984	2,259	386		4,629
Commercial mortgage and other loans	0	203	75		278
Other long-term investments	184	180	1,086		1,450
Short-term investments	3,634	3,341	0		6,975
Cash equivalents	2,593	5,925	0		8,518
Other assets	135	(11)	8		132
Subtotal excluding separate account assets	10,246	246,977	6,696	(8,979)	254,940
Separate account assets(4)	45,626	171,006	19,935		236,567

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Total assets	\$ 55,872	\$ 417,983	\$ 26,631	\$ (8,979)	\$ 491,507
Future policy benefits	\$ 0	\$ 0	\$ 1,709	\$	\$ 1,709
Other liabilities	0	7,129	299	(6,861)	567
Total liabilities	\$ 0	\$ 7,129	\$ 2,008	\$ (6,861)	\$ 2,276

Table of Contents

	Closed Block Business as of March 31, 2012				
	Level 1	Level 2	Level 3(1)	Netting(2)	Total
	(in millions)				
Fixed maturities, available-for-sale:					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ 0	\$ 4,724	\$ 23	\$	\$ 4,747
Obligations of U.S. states and their political subdivisions	0	746	0		746
Foreign government bonds	0	578	13		591
Corporate securities	30	29,314	471		29,815
Asset-backed securities	0	3,663	705		4,368
Commercial mortgage-backed securities	0	3,942	20		3,962
Residential mortgage-backed securities	0	1,942	1		1,943
Subtotal	30	44,909	1,233		46,172
Trading account assets supporting insurance liabilities	0	0	0		0
Other trading account assets:					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	0	0	0		0
Obligations of U.S. states and their political subdivisions	0	0	0		0
Foreign government bonds	0	0	0		0
Corporate securities	0	122	0		122
Asset-backed securities	0	66	0		66
Commercial mortgage-backed securities	0	0	0		0
Residential mortgage-backed securities	0	0	0		0
Equity securities	4	0	129		133
All other(3)	0	0	0		0
Subtotal	4	188	129		321
Equity securities, available-for-sale	3,361	0	36		3,397
Commercial mortgage and other loans	0	0	0		0
Other long-term investments	3	(110)	0		(107)
Short-term investments	647	82	0		729
Cash equivalents	80	1,119	0		1,199
Other assets	0	110	0		110
Subtotal excluding separate account assets	4,125	46,298	1,398		51,821
Separate account assets(4)	0	0	0		0
Total assets	\$ 4,125	\$ 46,298	\$ 1,398	\$	\$ 51,821
Future policy benefits	\$ 0	\$ 0	\$ 0	\$	\$ 0
Other liabilities	0	0	0		0
Total liabilities	\$ 0	\$ 0	\$ 0	\$	\$ 0

- (1) The amount of Level 3 assets taken as a percentage of total assets measured at fair value on a recurring basis totaled 5% and 3% for Financial Services Businesses and Closed Block Business, respectively. Excluding separate account assets for which the risk is borne by the policyholder, the amount of Level 3 assets taken as a percentage of total assets measured at fair value on a recurring basis totaled 3% for our Financial Services Businesses. The amount of Level 3 liabilities was immaterial to our balance sheet.
- (2) Netting amounts represent cash collateral and the impact of offsetting asset and liability positions held with the same counterparty.
- (3) Primarily represents derivative assets.
- (4) Separate account assets represent segregated funds that are invested for certain customers. Investment risks associated with market value changes are borne by the customers, except to the extent of minimum guarantees made by us with respect to certain accounts. Separate account assets classified as Level 3 consist primarily of real estate and real estate investment funds. Separate account liabilities are not included in the above table as they are reported at contract value and not fair value in our Unaudited Interim Consolidated Statement of Financial Position.

Table of Contents

	Financial Services Businesses as of December 31, 2011				
	Level 1	Level 2	Level 3(1) (in millions)	Netting(2)	Total
Fixed maturities, available-for-sale:					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ 0	\$ 9,524	\$ 43	\$	\$ 9,567
Obligations of U.S. states and their political subdivisions	0	2,277	0		2,277
Foreign government bonds	0	76,401	13		76,414
Corporate securities	12	96,090	1,016		97,118
Asset-backed securities	0	4,654	1,867		6,521
Commercial mortgage-backed securities	0	8,220	145		8,365
Residential mortgage-backed securities	0	7,856	14		7,870
Subtotal	12	205,022	3,098		208,132
Trading account assets supporting insurance liabilities:					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	0	177	9		186
Obligations of U.S. states and their political subdivisions	0	284	0		284
Foreign government bonds	0	655	0		655
Corporate securities	0	10,927	109		11,036
Asset-backed securities	0	1,010	357		1,367
Commercial mortgage-backed securities	0	2,226	21		2,247
Residential mortgage-backed securities	0	1,842	2		1,844
Equity securities	769	122	20		911
Short-term investments and cash equivalents	684	267	0		951
Subtotal	1,453	17,510	518		19,481
Other trading account assets:					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	0	31	0		31
Obligations of U.S. states and their political subdivisions	0	0	0		0
Foreign government bonds	2	45	0		47
Corporate securities	14	383	39		436
Asset-backed securities	0	523	59		582
Commercial mortgage-backed securities	0	96	14		110
Residential mortgage-backed securities	0	94	2		96
Equity securities	300	40	1,153		1,493
All other(3)	15	13,547	93	(11,222)	2,433
Subtotal	331	14,759	1,360	(11,222)	5,228
Equity securities, available-for-sale	1,909	2,171	333		4,413
Commercial mortgage and other loans	0	514	86		600
Other long-term investments	192	(195)	1,110		1,107
Short-term investments	5,035	3,197	0		8,232
Cash equivalents	2,595	5,797	0		8,392
Other assets	3	(25)	9		(13)
Subtotal excluding separate account assets	11,530	248,750	6,514	(11,222)	255,572
Separate account assets(4)	40,319	158,703	19,358		218,380
Total assets	\$ 51,849	\$ 407,453	\$ 25,872	\$ (11,222)	\$ 473,952
Future policy benefits	\$ 0	\$ 0	\$ 2,886	\$	\$ 2,886
Other liabilities	0	8,013	285	(7,854)	444
Total liabilities	\$ 0	\$ 8,013	\$ 3,171	\$ (7,854)	\$ 3,330

Table of Contents

	Closed Block Business as of December 31, 2011				Total
	Level 1	Level 2	Level 3(1) (in millions)	Netting(2)	
Fixed maturities, available-for-sale:					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ 0	\$ 5,514	\$ 23	\$	\$ 5,537
Obligations of U.S. states and their political subdivisions	0	778	0		778
Foreign government bonds	0	561	12		573
Corporate securities	0	29,321	434		29,755
Asset-backed securities	0	3,511	661		4,172
Commercial mortgage-backed securities	0	3,715	0		3,715
Residential mortgage-backed securities	0	1,984	2		1,986
Subtotal	0	45,384	1,132		46,516
Trading account assets supporting insurance liabilities	0	0	0		0
Other trading account assets:					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	0	0	0		0
Obligations of U.S. states and their political subdivisions	0	0	0		0
Foreign government bonds	0	0	0		0
Corporate securities	0	119	0		119
Asset-backed securities	0	70	0		70
Commercial mortgage-backed securities	0	0	0		0
Residential mortgage-backed securities	0	0	0		0
Equity securities	5	0	123		128
All other(3)	0	0	0		0
Subtotal	5	189	123		317
Equity securities, available-for-sale	3,095	0	27		3,122
Commercial mortgage and other loans	0	0	0		0
Other long-term investments	1	184	0		185
Short-term investments	471	57	0		528
Cash equivalents	72	965	0		1,037
Other assets	0	111	0		111
Subtotal excluding separate account assets	3,644	46,890	1,282		51,816
Separate account assets(4)	0	0	0		0
Total assets	\$ 3,644	\$ 46,890	\$ 1,282	\$	\$ 51,816
Future policy benefits	\$ 0	\$ 0	\$ 0	\$	\$ 0
Other liabilities	0	0	0		0
Total liabilities	\$ 0	\$ 0	\$ 0	\$	\$ 0

- (1) The amount of Level 3 assets taken as a percentage of total assets measured at fair value on a recurring basis totaled 5% and 2% for Financial Services Businesses and Closed Block Business, respectively. Excluding separate account assets for which the risk is borne by the policyholder, the amount of Level 3 assets taken as a percentage of total assets measured at fair value on a recurring basis totaled 3% for our Financial Services Businesses. The amount of Level 3 liabilities was immaterial to our balance sheet.
- (2) Netting amounts represent cash collateral and the impact of offsetting asset and liability positions held with the same counterparty.
- (3) Primarily represents derivative assets.
- (4) Separate account assets represent segregated funds that are invested for certain customers. Investment risks associated with market value changes are borne by the customers, except to the extent of minimum guarantees made by us with respect to certain accounts. Separate account assets classified as Level 3 consist primarily of real estate and real estate investment funds. Separate account liabilities are not included in the above table as they are reported at contract value and not fair value in our Unaudited Interim Consolidated Statement of Financial Position.

Table of Contents

For additional information regarding the balances of assets and liabilities measured at fair value by hierarchy level see Note 13 to the Unaudited Interim Consolidated Financial Statements.

The determination of fair value, which for certain assets and liabilities is dependent on the application of estimates and assumptions, can have a significant impact on our results of operations. As discussed in more detail below, the determination of fair value for certain assets and liabilities may require the application of a greater degree of judgment depending on market conditions, as the ability to value assets and liabilities can be significantly impacted by a decrease in market activity or a lack of transactions executed in an orderly manner. For a description of the key estimates and assumptions used in our determination of fair value, see Note 13 to the Unaudited Interim Consolidated Financial Statements. The following sections provide information regarding certain assets and liabilities of our Financial Services Businesses and our Closed Block Business which are valued using Level 3 inputs and could have a significant impact on our results of operations.

Fixed Maturity and Equity Securities

Public fixed maturity securities are generally valued using the price provided by independent pricing services under our normal pricing protocol. Securities with prices based on validated quotes from pricing services are generally reflected within Level 2. Public fixed maturity securities included in Level 3 in our fair value hierarchy are generally priced based on internally-developed valuations or non-binding broker quotes. For certain private fixed maturity and equity securities, the discounted cash flow or other valuation model uses significant unobservable inputs, and accordingly, such securities are included in Level 3 in our fair value hierarchy.

Level 3 fixed maturity securities included approximately \$3.6 billion as of March 31, 2012 and \$3.2 billion as of December 31, 2011 of public fixed maturities, with values primarily based on non-binding broker-quotes, and approximately \$1.6 billion as of both March 31, 2012 and December 31, 2011 of private fixed maturities, with the majority of values based on internally-developed models. Significant unobservable inputs used included: issue specific credit adjustments, material non-public financial information, management judgment, estimation of future earnings and cash flows, default rate assumptions, liquidity assumptions and non-binding quotes from market makers. These inputs are usually considered unobservable, as not all market participants will have access to this data.

The impact our determination of fair value for fixed maturity and equity securities has on our results of operations is dependent on our classification of the security as either trading, available-for-sale, or held-to-maturity. For our investments classified as trading, the impact of changes in fair value is recorded within Asset management fees and other income. For our investments classified as available-for-sale, the impact of changes in fair value is recorded as an unrealized gain or loss in Accumulated other comprehensive income (loss), a separate component of equity. Our investments classified as held-to-maturity are carried at amortized cost.

Other Long-Term Investments

The fair value of real estate held in consolidated investment funds is determined through an independent appraisal process. The appraisals generally utilize a discounted cash flow model, following an income approach that incorporates various assumptions including rental revenue, operating expenses and discount rates. The appraisals also include replacement cost estimates and recent sales data as alternate methods of fair value. These appraisals and the related assumptions are updated at least annually, and incorporate historical property experience and any observable market data, including any market transactions. Since many of the assumptions utilized are unobservable and are considered to be significant inputs to the valuation, the real estate investments within other long-term investments have been reflected within Level 3 in our fair value hierarchy. Consolidated real estate investment funds classified as Level 3 totaled approximately \$0.4 billion as of both March 31, 2012 and December 31, 2011. Our direct investment in these funds is not material, and the majority of the assets recorded as a result of the consolidation

of these funds are offset by a noncontrolling interest reflected as a

Table of Contents

separate component of equity. The noncontrolling interest is not considered to be fair valued and therefore is not included in fair value reporting above. The fair value of fund investments, where the fair value option has been elected, is primarily determined by the fund managers. Since the valuations may be based on unobservable market inputs and cannot be validated by the Company, these investments have also been included within Level 3 in our fair value hierarchy. Investments in these funds included in Level 3 totaled approximately \$0.4 billion as of both March 31, 2012 and December 31, 2011.

Derivative Instruments

Derivatives are recorded at fair value either as assets, within Other trading account assets, or Other long-term investments, or as liabilities, within Other liabilities, except for embedded derivatives which are recorded with the associated host contract. The fair values of derivative contracts are determined based on quoted prices in active exchanges or through the use of valuation models, and are affected by changes in market factors including non-performance risk. The majority of our derivative positions are traded in the over the counter (OTC) derivative market and are classified within Level 2 in our fair value hierarchy since their significant inputs have bid and ask prices that are actively quoted or can be readily obtained from external market data providers. Our policy is to use mid-market pricing consistent with our best estimate of fair value.

Derivatives classified as Level 3 include first-to-default credit basket swaps, look-back equity options and other structured products. These derivatives are valued based upon models with some significant unobservable market inputs or inputs from less actively traded markets. Derivatives classified within Level 3 are validated through periodic comparison of our fair values to broker-dealer values. The fair values of OTC derivative assets and liabilities classified as Level 3 totaled approximately \$40 million and \$4 million, respectively, as of March 31, 2012 and \$84 million and \$3 million, respectively, as of December 31, 2011, without giving consideration to the impact of netting.

For additional information regarding embedded derivatives in our annuity and retirement products classified as Level 3, see Variable Annuity Optional Living Benefit Features below.

All realized and unrealized changes in fair value of derivatives, with the exception of the effective portion of qualifying cash flow hedges and hedges of net investments in foreign operations, are recorded in current earnings. Generally, the changes in fair value of non-dealer related derivatives, excluding those that qualify for hedge accounting, are recorded in Realized investment gains (losses), net. For additional information regarding the impact of changes in fair value of derivative instruments on our results of operations see Realized Investment Gains and Losses and General Account Investments Realized Investment Gains and Losses. Dealer-related derivative activity related to the Company's former global commodities group is reported in Income (loss) from discontinued operations, net of taxes.

Separate Account Assets

Separate Account Assets primarily include fixed maturity securities, treasuries, equity securities and real estate investments for which values are determined consistent with similar instruments described above under Fixed Maturity Securities and Equity Securities and Other Long-Term Investments.

Variable Annuity Optional Living Benefit Features

Our liability for future policy benefits primarily includes general account liabilities for guarantees on variable annuity contracts, including guaranteed minimum accumulation benefits (GMAB), guaranteed minimum withdrawal benefits (GMWB) and guaranteed minimum income and withdrawal benefits (GMIWB). While these guarantees primarily relate to the optional living benefit features of our Individual Annuities segment, they are also included in certain variable annuities in our International Insurance segment and certain retirement account based group variable annuities in our Retirement segment. These benefits are accounted for as embedded derivatives and are carried at fair value with changes in fair value included in Realized investment gains (losses), net.

Table of Contents

The fair values of the GMAB, GMWB and GMIWB liabilities are calculated as the present value of future expected benefit payments to customers less the present value of assessed rider fees attributable to the embedded derivative feature. This methodology could result in either a liability or contra-liability balance, given changing capital market conditions and various policyholder behavior assumptions. Since there is no observable active market for the transfer of these obligations, the valuations are calculated using internally-developed models with option pricing techniques. Because there are significant assumptions utilized in the valuation of the embedded derivatives associated with our optional living benefit features that are primarily unobservable, the liability included in future policy benefits has been reflected within Level 3 in our fair value hierarchy.

We are also required to incorporate the market-perceived risk of our own non-performance (NPR) in the valuation of the embedded derivatives associated with our optional living benefit features. Since insurance liabilities are senior to debt, we believe that reflecting the financial strength ratings of our insurance subsidiaries in the valuation of the liability appropriately takes into consideration our NPR. To reflect the NPR, we incorporate an additional credit spread over LIBOR rates into the discount rate used in the valuations of the embedded derivative liability. The additional credit spread over LIBOR rates incorporated into the discount rate as of March 31, 2012 generally ranged from 40 to 200 basis points for the portion of the interest rate curve most relevant to these liabilities. This additional spread is applied at an individual contract level and only to those individual living benefit contracts in a liability position and not to those in a contra-liability position. We also adjust these spreads to remove any illiquidity risk premium, subject to a floor based on a percentage of the credit spread.

As of March 31, 2012, the value of the embedded derivatives associated with the optional living benefit features of the Individual Annuities segment, before the adjustment for NPR, was a net liability of \$4,891 million. This net liability was comprised of \$5,397 million of individual living benefit contracts in a liability position, net of \$506 million of individual living benefit contracts in a contra-liability position. As of March 31, 2012, our adjustment for NPR resulted in a \$3,215 million cumulative decrease to the embedded derivative liability for the Individual Annuities segment, reflecting the additional credit spread over LIBOR rates we incorporated into the discount rate used in the valuations of those individual living benefit contracts in a liability position. This adjustment for NPR represents a decrease of \$2,294 million in the first quarter of 2012 for the Individual Annuities segment primarily resulting from a lower base of embedded derivative liabilities driven by favorable market conditions as well as an overall tightening of the spreads used in valuing NPR, which reflect the financial strength ratings of our insurance subsidiaries.

The change in fair value of the GMAB, GMWB and GMIWB resulted in a net liability of \$1,709 million as of March 31, 2012, compared to a net liability of \$2,886 million as of December 31, 2011. The change primarily reflects a lower base of embedded derivative liabilities driven by favorable market conditions as well as an overall tightening of the spreads used in valuing NPR, as noted above, which were primarily in our Individual Annuities segment as described in more detail under Results of Operations for Financial Services Businesses by Segment U.S. Retirement Solutions and Investment Management Division Individual Annuities.

Realized Investment Gains and Losses and General Account Investments**Realized Investment Gains and Losses**

Realized investment gains and losses are generated from 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 other-than-temporary impairments. Realized investment gains and losses are also generated from prepayment premiums received on private fixed maturity securities, net changes in the allowance for losses, as well as gains and losses on sales, certain restructurings, and foreclosures on commercial mortgage and other loans, fair value 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 our capacity as a broker or dealer.

Table of Contents

For a further discussion of our policies regarding other-than-temporary declines in investment value and the related methodology for recording fixed maturity other-than-temporary impairments, see [General Account Investments Fixed Maturity Securities Other-Than-Temporary Impairments of Fixed Maturity Securities](#) below. For a further discussion of our policies regarding other-than-temporary declines in investment value and the related methodology for recording equity impairments, see [General Account Investments Equity Securities Other-than-Temporary Impairments of Equity Securities](#) below. For a further discussion of our policy regarding commercial mortgage and other loans, see [General Account Investments Commercial Mortgage and Other Loans Commercial Mortgage and Other Loan Quality](#) below.

The level of other-than-temporary impairments generally reflects economic conditions and is generally expected to increase when economic conditions worsen and to decrease when economic conditions improve. Historically, the causes of other-than-temporary impairments have been specific to each individual issuer and have not directly resulted in impairments to other securities within the same industry or geographic region. As discussed in more detail below, other-than-temporary impairments recognized in the first quarter of 2012 primarily related to foreign currency translation losses on securities that are approaching maturity, adverse financial conditions of the respective issuer on asset-backed securities collateralized by sub-prime mortgages, and declines in value maintained for one year or greater on equity securities. Other-than-temporary impairments in the first quarter of 2011 primarily related to asset-backed securities collateralized by sub-prime mortgages and Japanese commercial mortgage-backed securities and reflect adverse financial conditions of the respective issuers and foreign currency translation losses related to foreign-denominated securities that are approaching maturity.

We may realize additional credit and interest rate related losses through sales of investments pursuant to our credit risk and portfolio management objectives. Other-than-temporary impairments, interest rate related losses and credit related losses on sales (other than those related to certain of our businesses which primarily originate investments for sale or syndication to unrelated investors) are excluded from adjusted operating income.

We require most issuers of private fixed maturity securities to pay us make-whole yield maintenance payments when they prepay the securities. Prepayments are driven by factors specific to the activities of our borrowers as well as the interest rate environment.

We use interest rate and currency swaps and other derivatives to manage interest and currency exchange rate exposures arising from mismatches between assets and liabilities, including duration mismatches. We use derivative contracts to mitigate the risk that unfavorable changes in currency exchange rates will reduce U.S. dollar equivalent earnings generated by certain of our non-U.S. businesses. We also use equity-based and interest rate derivatives to hedge the risks embedded in some of our annuity products. Derivative contracts also include forward purchases and sales of to-be-announced mortgage-backed securities primarily related to our dollar roll program. Many of these derivative contracts do not qualify for hedge accounting, and consequently, we recognize the changes in fair value of such contracts from period to period in current earnings, although we do not necessarily account for the related assets or liabilities the same way. Accordingly, realized investment gains and losses from our derivative activities can contribute significantly to fluctuations in net income.

Adjusted operating income generally excludes [Realized investment gains \(losses\), net](#), subject to certain exceptions (realized investment gains or losses within certain of our businesses for which such gains or losses are a principal source of earnings and those associated with terminating hedges of foreign currency earnings and current period yield adjustments), and related charges and adjustments.

Table of Contents

The following tables set forth Realized investment gains (losses), net, by investment type for the Financial Services Businesses and Closed Block Business, as well as related charges and adjustments associated with the Financial Services Businesses, for the periods indicated. For additional details regarding adjusted operating income, which is our measure of performance for the segments of our Financial Services Businesses, see Note 11 to the Unaudited Interim Consolidated Financial Statements.

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
Realized investment gains (losses), net:		
Financial Services Businesses	\$ (1,374)	\$ (80)
Closed Block Business	(10)	30
Consolidated realized investment gains (losses), net	\$ (1,384)	\$ (50)
Financial Services Businesses:		
Realized investment gains (losses), net:		
Fixed maturity securities	\$ (33)	\$ (4)
Equity securities	(55)	3
Commercial mortgage and other loans	10	6
Derivative instruments	(1,296)	(98)
Other	0	13
Total	\$ (1,374)	\$ (80)
Related adjustments	(1,342)	(285)
Realized investment gains (losses), net, and related adjustments	(2,716)	(365)
Related charges	878	(10)
Realized investment gains (losses), net, and related charges and adjustments	\$ (1,838)	\$ (375)
Closed Block Business:		
Realized investment gains (losses), net:		
Fixed maturity securities	\$ (30)	\$ 29
Equity securities	42	59
Commercial mortgage and other loans	1	5
Derivative instruments	(23)	(63)
Other	0	0
Total	\$ (10)	\$ 30

2012 to 2011 Three Month Comparison*Financial Services Businesses*

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

The Financial Services Businesses' net realized investment losses in the first quarter of 2012 were \$1,374 million, compared to net realized investment losses of \$80 million in the first quarter of 2011.

Table of Contents

Net realized losses on fixed maturity securities were \$33 million in the first quarter of 2012, compared to net realized losses of \$4 million in the first quarter of 2011, as set forth in the following table:

	Three Months Ended March 31,	
	2012	2011
	(in millions)	
Realized investment gains (losses), net Fixed Maturity Securities Financial Services Businesses		
Gross realized investment gains:		
Gross gains on sales and maturities(1)	\$ 106	\$ 123
Private bond prepayment premiums	0	10
Total gross realized investment gains	106	133
Gross realized investment losses:		
Net other-than-temporary impairments recognized in earnings(2)	(82)	(79)
Gross losses on sales and maturities(1)	(51)	(57)
Credit related losses on sales	(6)	(1)
Total gross realized investment losses	(139)	(137)
Realized investment gains (losses), net Fixed Maturity Securities	\$ (33)	\$ (4)
Net gains (losses) on sales and maturities Fixed Maturity Securities(1)	\$ 55	\$ 66

- (1) Amounts exclude prepayment premiums, other-than-temporary impairments, and credit related losses through sales of investments pursuant to our credit risk objectives.
- (2) 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.

Net trading gains on sales and maturities of fixed maturity securities in the first quarter of 2012 were \$55 million and were primarily due to sales within our Retirement, Individual Annuities, and International Insurance segments. Included in the net gains on sales and maturities of fixed maturity securities were \$3 million of net gains related to the sale of asset-backed securities collateralized by sub-prime mortgages. Net trading gains on sales and maturities of fixed maturity securities in the first quarter of 2011 were \$66 million and were primarily due to sales within our Retirement and Individual Annuities segments. Included in the net gains on sales and maturities of fixed maturity securities were \$28 million of net gains related to the sale of asset-backed securities collateralized by sub-prime mortgages. See General Account Investments Fixed Maturity Securities Asset-Backed Securities for additional information regarding our exposure to sub-prime mortgages. See below for additional information regarding the other-than-temporary impairments of fixed maturity securities in the first quarter of 2012 and 2011.

Net realized losses on equity securities were \$55 million in the first quarter of 2012, which included other-than-temporary impairments of \$48 million and net trading losses on sales of equity securities of \$7 million. Net trading losses in the first quarter of 2012 were primarily due to public equity sales within our International Insurance segment. Net realized gains on equity securities were \$3 million in the first quarter of 2011, which included net trading gains on sales of equity securities of \$16 million, partially offset by other-than-temporary impairments of \$13 million. Net trading gains in the first quarter of 2011 were primarily due to public equity sales within our International Insurance segment. See below for additional information regarding the other-than-temporary impairments of equity securities in the first quarter of 2012 and 2011.

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Net realized gains on commercial mortgage and other loans in the first quarter of 2012 were \$10 million and primarily related to a net decrease in the loan loss reserves of \$14 million, partially offset by \$4 million of realized losses on sales within our Asset Management business. Net realized gains on commercial mortgage and other loans in the first quarter of 2011 were \$6 million and primarily related to a net decrease in the loan loss

Table of Contents

reserves of \$12 million, partially offset by mark-to-market losses on our interim loan portfolio of \$6 million within our commercial mortgage operations. For additional information regarding our commercial mortgage and other loan loss reserves see [General Account Investments Commercial Mortgage and Other Loans Commercial Mortgage and Other Loan Quality](#).

Net realized losses on derivatives were \$1,296 million in the first quarter of 2012, compared to net realized losses of \$98 million in the first quarter of 2011. The net derivative losses in 2012 primarily reflect net losses of \$1,219 million on product related embedded derivatives and related hedge positions primarily associated with certain variable annuity contracts. See [Results of Operations for Financial Services Businesses by Segment U.S. Retirement Solutions and Investment Management Division Individual Annuities](#) for additional information. Also contributing to the net derivative losses were net mark-to-market losses of \$194 million on interest rate derivatives used to manage duration as interest rates increased, and net losses of \$217 million on foreign currency forward contracts used to hedge portfolio assets in our International Insurance segment due to the weakening of the Japanese yen against the U.S. dollar and other currencies. Partially offsetting these losses were net gains of \$214 million on foreign currency forward contracts used to hedge the future income of non-U.S. businesses primarily in Japan due to the strengthening of the U.S. dollar against the Japanese yen. The net derivative losses in the first quarter of 2011 primarily reflect net losses of \$167 million on interest rate derivatives used to manage duration as interest rates increased and net losses of \$28 million on credit derivatives as credit spreads generally tightened. Partially offsetting these losses were net gains of \$53 million on foreign currency forward contracts used to hedge the future income of non-U.S. businesses primarily in Japan due to the strengthening of the U.S. dollar, and net gains of \$28 million primarily related to product related embedded derivatives and related hedge positions associated with certain variable annuity contracts. See [Results of Operations for Financial Services Businesses by Segment U.S. Retirement Solutions and Investment Management Division Individual Annuities](#) for additional information. Also contributing to these net derivative gains were net gains of \$23 million on embedded derivatives associated with certain externally-managed investments in the European market.

Net realized gains on other investments were less than \$1 million in the first quarter of 2012. Net realized gains on other investments were \$13 million in the first quarter of 2011, which included \$3 million of other-than-temporary impairments on joint ventures and partnerships and real estate investments.

Related adjustments include that portion of [Realized investment gains \(losses\), net](#) that are included in adjusted operating income and that portion of [Asset management fees and other income](#) and [Net investment income](#) that are excluded from adjusted operating income. The adjustments are made to arrive at [Realized investment gains \(losses\), net, and related adjustments](#) which are excluded from adjusted operating income. Related adjustments to realized investment gains (losses) were net negative adjustments of \$1,342 million and \$285 million in the first quarter of 2012 and 2011, respectively. Adjustments for that portion of [Realized investment gains \(losses\), net](#) that are included in adjusted operating income were net negative adjustments of \$50 million and \$58 million for the first quarter of 2012 and 2011, respectively, primarily driven by gains from settlements on interest rate and currency swaps and gains that represent a principal source of earnings for certain of our businesses, partially offset by losses related to the settlements of swaps used to hedge foreign-denominated earnings in both periods. Adjustments for that portion of [Asset management fees and other income](#) and [Net investment income](#) that are excluded from adjusted operating income were net negative adjustments of \$1,292 million and \$227 million in the first quarter of 2012 and 2011, respectively, primarily driven by the impact of changes in foreign currency exchange rates on certain assets and liabilities for which we economically hedge the foreign currency exposure in both periods. Also included in the \$227 million adjustment for the first quarter of 2011 was a \$95 million loss from an out of period adjustment related to the amortization of unrealized losses associated with U.S. dollar-denominated collateralized mortgage-backed securities held by our Gibraltar Life operations, and a \$65 million loss related to our counterparty exposure on derivative transactions we had previously held with Lehman Brothers and affiliates. See Note 11 to the Unaudited Interim Consolidated Financial Statements for further details.

Table of Contents

Charges that relate to Realized investment gains (losses), net are also excluded from adjusted operating income. Related charges were a net positive adjustment of \$878 million for the first quarter of 2012 and a net negative adjustment of \$10 million for the first quarter of 2011. The net positive adjustment of \$878 million in the first quarter of 2012 was primarily driven by that portion of amortization of deferred policy acquisition and other costs relating to the net loss on embedded derivatives and related hedge positions associated with certain variable annuity contracts. See Note 11 to the Unaudited Interim Consolidated Financial Statements for further details.

During the first quarter of 2012, we recorded other-than-temporary impairments of \$132 million in earnings, compared to total other-than-temporary impairments of \$95 million recorded in earnings in the first quarter of 2011. The following tables set forth, for the periods indicated, the composition of other-than-temporary impairments recorded in earnings attributable to the Financial Services Businesses by asset type, and for fixed maturity securities, by reason.

	Three Months Ended March 31,	
	2012	2011
(in millions)		
Other-than-temporary impairments recorded in earnings Financial Services Businesses(1)		
Public fixed maturity securities	\$ 65	\$ 65
Private fixed maturity securities	17	14
Total fixed maturity securities	82	79
Equity securities	48	13
Other invested assets(2)	2	3
Total	\$ 132	\$ 95

(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.

(2) Includes other-than-temporary impairments relating to investments in joint ventures and partnerships and real estate investments.

	Three Months Ended March 31, 2012		
	Asset-Backed Securities Collateralized By Sub-Prime Mortgages	All Other Fixed Maturity Securities (in millions)	Total Fixed Maturity Securities
Other-than-temporary impairments on fixed maturity securities recorded in earnings Financial Services Businesses(1)			
Due to credit events or adverse conditions of the respective issuer(2)	\$ 19	\$ 17	\$ 36
Due to other accounting guidelines(3)	1	45	46
Total	\$ 20	\$ 62	\$ 82

Table of Contents

	Three Months Ended March 31, 2011		
	Asset-Backed Securities Collateralized By Sub-Prime Mortgages	All Other Fixed Maturity Securities (in millions)	Total Fixed Maturity Securities
Other-than-temporary impairments on fixed maturity securities recorded in earnings Financial Services Businesses(1)			
Due to credit events or adverse conditions of the respective issuer(2)	\$ 21	\$ 23	\$ 44
Due to other accounting guidelines(3)	10	25	35