PRUDENTIAL FINANCIAL INC
Form 10-Q
August 07, 2009

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 June 30, 2009

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	**22-3703799**
(State or Other Jurisdiction of Incorporation or Organization)	**(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 x 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 x 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 x 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 x

As of July 31, 2009, 461 million shares of the registrant s Common Stock (par value $0.01) were outstanding. In addition, 2 million shares of the registrant s Class B Stock, for which there is no established public trading market, were outstanding.

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FORWARD-LOOKING STATEMENTS

Certain of the statements included in this Quarterly Report on Form 10-Q, including but not limited to those in Management s Discussion and Analysis of Financial Condition and Results of Operations, constitute forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. Words such as expects, believes, anticipates, includes, plans, assumes, estimates, projects, should, will, shall or variations of such words are generally part of forward-looking statements. Forward-looking statements are made based on management s current expectations and beliefs concerning future developments and their potential effects upon Prudential Financial, Inc. and its subsidiaries. There can be no assurance that future developments affecting Prudential Financial, Inc. and its subsidiaries will be those anticipated by management. These forward-looking statements are not a guarantee of future performance and involve risks and uncertainties, and there are certain important factors that could cause actual results to differ, possibly materially, from expectations or estimates reflected in such forward-looking statements, including, among others: (1) general economic, market and political conditions, including the performance and fluctuations of fixed income, equity, real estate and other financial markets, particularly in light of ongoing severe economic conditions and the severe stress experienced by the global financial markets since the second half of 2007; (2) the availability and cost of external financing for our operations, which has been affected by the stress experienced by the global financial markets; (3) interest rate fluctuations; (4) reestimates of our reserves for future policy benefits and claims; (5) 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; (6) changes in our assumptions related to deferred policy acquisition costs, valuation of business acquired or goodwill; (7) changes in our claims-paying or credit ratings; (8) investment losses, defaults and counterparty non-performance; (9) competition in our product lines and for personnel; (10) changes in tax law; (11) economic, political, currency and other risks relating to our international operations; (12) fluctuations in foreign currency exchange rates and foreign securities markets; (13) regulatory or legislative changes, including government actions in response to the stress experienced by the global financial markets; (14) adverse determinations in litigation or regulatory matters and our exposure to contingent liabilities, including in connection with our divestiture or winding down of businesses; (15) 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; (16) ineffectiveness of risk management policies and procedures in identifying, monitoring and managing risks; (17) effects of acquisitions, divestitures and restructurings, including possible difficulties in integrating and realizing the projected results of acquisitions; (18) changes in statutory or U.S. GAAP accounting principles, practices or policies; (19) changes in assumptions for retirement expense; (20) 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 (21) risks due to the lack of legal separation between our Financial Services Businesses and our Closed Block Business. As noted above, the period since the second half of 2007 has been characterized by extreme adverse market and economic conditions. The foregoing risks are even more pronounced in these unprecedented market and economic conditions. 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 this Quarterly Report on Form 10-Q for discussion of certain risks relating to our businesses and investment in our securities.

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

June 30, 2009 and December 31, 2008 (in millions, except share amounts)

	June 30, 2009	December 31, 2008
ASSETS		
Fixed maturities, available for sale, at fair value (amortized cost: 2009 $166,075; 2008 $168,691)	$ 158,913	$ 158,056
Fixed maturities, held to maturity, at amortized cost (fair value: 2009 $4,938; 2008 $3,832)	4,935	3,808
Trading account assets supporting insurance liabilities, at fair value	14,766	13,875
Other trading account assets, at fair value	3,715	4,336
Equity securities, available for sale, at fair value (cost: 2009 $6,019; 2008 $7,288)	5,917	6,065
Commercial mortgage and other loans (includes $508 measured at fair value at June 30, 2009)	32,694	33,114
Policy loans	9,856	9,703
Securities purchased under agreements to resell		480
Other long-term investments	5,716	7,012
Short-term investments	7,137	5,576
Total investments	243,649	242,025
Cash and cash equivalents	13,491	15,028
Accrued investment income	2,231	2,266
Deferred policy acquisition costs	14,474	15,126
Deferred income taxes, net		1,106
Other assets	19,605	22,365
Separate account assets	151,266	147,095
TOTAL ASSETS	$ 444,716	$ 445,011
LIABILITIES AND EQUITY		
LIABILITIES		
Future policy benefits	$ 121,394	$ 121,951
Policyholders account balances	101,277	99,613
Policyholders dividends	1,667	1,670
Securities sold under agreements to repurchase	7,168	7,900
Cash collateral for loaned securities	3,662	4,168
Income taxes	777	459
Short-term debt	3,643	10,535
Long-term debt (includes $1,167 measured at fair value at June 30, 2009)	20,981	20,290
Other liabilities	14,206	17,544
Separate account liabilities	151,266	147,095
Total liabilities	426,041	431,225

COMMITMENTS AND CONTINGENT LIABILITIES (See Note 15)		
EQUITY		
Preferred Stock ($.01 par value; 10,000,000 shares authorized; none issued)		
Common Stock ($.01 par value; 1,500,000,000 shares authorized; 641,761,510 and 604,902,444 shares issued as of June 30, 2009 and December 31, 2008, respectively)	6	6
Class B Stock ($.01 par value; 10,000,000 shares authorized; 2,000,000 shares issued and outstanding as of June 30, 2009 and December 31, 2008, respectively)		
Additional paid-in capital	23,325	22,001
Common Stock held in treasury, at cost (181,278,929 and 183,582,565 shares as of June 30, 2009 and December 31, 2008, respectively)	(11,494)	(11,655)
Accumulated other comprehensive loss	(5,002)	(7,343)
Retained earnings	11,238	10,426
Total Prudential Financial, Inc. equity	18,073	13,435
Noncontrolling interests	602	351
Total equity	18,675	13,786
TOTAL LIABILITIES AND EQUITY	$ 444,716	$ 445,011

See Notes to Unaudited Interim Consolidated Financial Statements

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PRUDENTIAL FINANCIAL, INC.

Unaudited Interim Consolidated Statements of Operations

Three and Six Months Ended June 30, 2009 and 2008 (in millions, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
REVENUES				
Premiums	$ 4,187	$ 3,927	$ 8,221	$ 7,885
Policy charges and fee income	713	824	1,439	1,649
Net investment income	2,835	3,026	5,690	6,052
Asset management fees and other income	1,446	824	2,245	1,485
Realized investment gains (losses), net:				
Other-than-temporary impairments on fixed maturity securities	(1,312)	(661)	(3,167)	(1,200)
Other-than-temporary impairments on fixed maturity securities transferred to Other Comprehensive Income	813		2,063	
Other realized investment gains (losses), net	(1,776)	(237)	(1,026)	(610)
Total realized investment gains (losses), net	(2,275)	(898)	(2,130)	(1,810)
Total revenues	6,906	7,703	15,465	15,261
BENEFITS AND EXPENSES				
Policyholders benefits	3,886	4,011	8,227	8,046
Interest credited to policyholders account balances	1,099	745	2,268	1,382
Dividends to policyholders	277	158	276	717
General and administrative expenses	1,652	2,161	4,690	4,426
Total benefits and expenses	6,914	7,075	15,461	14,571
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES	(8)	628	4	690
Income tax expense (benefit)	(162)	60	(158)	83
INCOME FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES	154	568	162	607
Equity in earnings of operating joint ventures, net of taxes	5	24	(1)	67
INCOME FROM CONTINUING OPERATIONS	159	592	161	674
Income (loss) from discontinued operations, net of taxes	21	(3)	22	(1)
NET INCOME	180	589	183	673
Less: Income attributable to noncontrolling interests	17	8	6	32
NET INCOME ATTRIBUTABLE TO PRUDENTIAL FINANCIAL, INC.	$ 163	$ 581	$ 177	$ 641
EARNINGS PER SHARE (See Note 8)				
Financial Services Businesses				
Basic:				
Income from continuing operations attributable to Prudential Financial, Inc. per share of Common Stock	$ 1.21	$ 1.34	$ 1.23	$ 1.50
Income (loss) from discontinued operations, net of taxes	0.04	(0.01)	0.05	
Net income attributable to Prudential Financial, Inc. per share of Common Stock	$ 1.25	$ 1.33	$ 1.28	$ 1.50

Diluted:				
Income from continuing operations attributable to Prudential Financial, Inc. per share of Common Stock	$ 1.20	$ 1.33	$ 1.23	$ 1.49
Income (loss) from discontinued operations, net of taxes	0.05	(0.01)	0.05	
Net income attributable to Prudential Financial, Inc. per share of Common Stock	$ 1.25	$ 1.32	$ 1.28	$ 1.49
Closed Block Business				
Basic and Diluted:				
Income (loss) from continuing operations attributable to Prudential Financial, Inc. per share of Class B Stock	$ (193.00)	$ 0.50	$ (189.00)	$ (9.50)
Income from discontinued operations, net of taxes				
Net income (loss) attributable to Prudential Financial, Inc. per share of Class B Stock	$ (193.00)	$ 0.50	$ (189.00)	$ (9.50)

See Notes to Unaudited Interim Consolidated Financial Statements

PRUDENTIAL FINANCIAL, INC.

Unaudited Interim Consolidated Statement of Equity

Six Months Ended June 30, 2009 and 2008 (in millions)

	Prudential Financial, Inc. Equity								
	Common Stock	**Class B Stock**	**Additional Paid-in Capital**	**Retained Earnings**	**Common Stock Held in Treasury**	**Accumulated Other Comprehensive Loss**	**Total Prudential Financial, Inc. Equity**	**Noncontrolling Interests**	**Total Equity**
Balance, December 31, 2008	$ 6	$	$ 22,001	$ 10,426	$ (11,655)	$ (7,343)	$ 13,435	$ 351	$ 13,786
Common Stock issued			1,391				1,391		1,391
Contributions from noncontrolling interests								278	278
Distributions to noncontrolling interests								(8)	(8)
Stock-based compensation programs			(67)	(29)	161		65		65
Impact of adoption of FSP FAS 115-2 and FAS 124-2, net of taxes				664		(664)			
Comprehensive income:									
Net income				177			177	6	183
Other comprehensive income (loss), net of tax						3,005	3,005	(25)	2,980
Total comprehensive income (loss)							3,182	(19)	3,163
Balance, June 30, 2009	$ 6	$	$ 23,325	$ 11,238	$ (11,494)	$ (5,002)	$ 18,073	$ 602	$ 18,675

	Prudential Financial, Inc. Equity								
	Common Stock	**Class B Stock**	**Additional Paid-in Capital**	**Retained Earnings**	**Common Stock Held in Treasury**	**Accumulated Other Comprehensive Loss**	**Total Prudential Financial, Inc. Equity**	**Noncontrolling Interests**	**Total Equity**
Balance, December 31, 2007	$ 6	$	$ 20,945	$ 11,809	$ (9,693)	$ 447	$ 23,514	$ 409	$ 23,923
Common Stock acquired					(1,750)		(1,750)		(1,750)
Contributions from noncontrolling interests								5	5
Distributions to noncontrolling interests								(152)	(152)
Stock-based compensation programs				(13)	128		115		115
Impact of Company s investment in Wachovia Securities due to addition of AG Edwards business, net of tax			977				977		977
Cumulative effect of changes in accounting principles, net of taxes				3			3		3
Comprehensive income:									
Net income				641			641	32	673
Other comprehensive loss, net of tax						(1,892)	(1,892)	(1)	(1,893)
Total comprehensive income (loss)							(1,251)	31	(1,220)
Balance, June 30, 2008	$ 6	$	$ 21,922	$ 12,440	$ (11,315)	$ (1,445)	$ 21,608	$ 293	$ 21,901

See Notes to Unaudited Interim Consolidated Financial Statements

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PRUDENTIAL FINANCIAL, INC.

Unaudited Interim Consolidated Statements of Cash Flows

Six Months Ended June 30, 2009 and 2008 (in millions)

	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 183	$ 673
Adjustments to reconcile net income to net cash provided by operating activities:		
Realized investment (gains) losses, net	2,130	1,810
Policy charges and fee income	(786)	(537)
Interest credited to policyholders account balances	2,268	1,382
Depreciation and amortization	192	208
(Gains) losses on trading account assets supporting insurance liabilities, net	(840)	375
Change in:		
Deferred policy acquisition costs	(133)	(513)
Future policy benefits and other insurance liabilities	(1,033)	1,751
Other trading account assets	1,977	302
Income taxes	(152)	(465)
Other, net	(47)	(1,364)
Cash flows from operating activities	3,759	3,622
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from the sale/maturity/prepayment of:		
Fixed maturities, available for sale	25,410	46,923
Fixed maturities, held to maturity	168	111
Trading account assets supporting insurance liabilities and other trading account assets	14,969	11,952
Equity securities, available for sale	840	1,899
Commercial mortgage and other loans	1,628	1,162
Policy loans	844	716
Other long-term investments	672	525
Short-term investments	12,887	16,159
Payments for the purchase/origination of:		
Fixed maturities, available for sale	(22,270)	(45,610)
Fixed maturities, held to maturity	(952)	(24)
Trading account assets supporting insurance liabilities and other trading account assets	(16,243)	(13,148)
Equity securities, available for sale	(326)	(2,151)
Commercial mortgage and other loans	(1,609)	(3,404)
Policy loans	(785)	(737)
Other long-term investments	(905)	(1,477)
Short-term investments	(14,295)	(17,807)
Other, net	158	(84)
Cash flows from (used in) investing activities	191	(4,995)
CASH FLOWS FROM FINANCING ACTIVITIES		
Policyholders account deposits	15,513	16,995
Policyholders account withdrawals	(15,273)	(11,013)
Net change in securities sold under agreements to repurchase and cash collateral for loaned securities	(974)	(4,838)
Proceeds from the issuance of Common Stock	1,391	
Cash dividends paid on Common Stock	(37)	(83)
Net change in financing arrangements (maturities 90 days or less)	(3,386)	(1,244)
Common Stock acquired		(1,717)
Common Stock reissued for exercise of stock options	22	56
Proceeds from the issuance of debt (maturities longer than 90 days)	2,868	5,788
Repayments of debt (maturities longer than 90 days)	(5,494)	(3,444)
Excess tax benefits from share-based payment arrangements		15
Other, net	(64)	(276)

Cash flows from (used in) financing activities	(5,434)	239
Effect of foreign exchange rate changes on cash balances	(53)	17
NET DECREASE IN CASH AND CASH EQUIVALENTS	(1,537)	(1,117)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	15,028	11,060
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 13,491	$ 9,943
NON-CASH TRANSACTIONS DURING THE PERIOD		
Impact on Company s investment in Wachovia Securities due to addition of A.G. Edwards business, net of tax	$	$ 977
Treasury Stock shares issued for stock-based compensation programs	$ 97	$ 87

See Notes to Unaudited Interim Consolidated Financial Statements

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, investment management, and real estate services. 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 and Investments. The Company s real estate and relocation services business as well as businesses that are not sufficiently material to warrant separate disclosure and businesses to be divested, including the Company s investment in the retail securities brokerage joint venture Wachovia Securities Financial Holdings, LLC (Wachovia Securities), 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. 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. The Company has evaluated subsequent events through August 7, 2009, the date these financial statements were issued as part of this Quarterly Report on Form 10-Q.

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. 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, 2008.

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.

The most significant estimates include those used in determining deferred policy acquisition costs and related amortization; measurement of goodwill and any related impairment; valuation of business acquired and its amortization; valuation of investments including derivatives and the recognition of other-than-temporary

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

impairments; future policy benefits including guarantees; pension and other postretirement benefits; provision for income taxes and valuation of deferred tax assets; 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.

2. ACCOUNTING POLICIES AND PRONOUNCEMENTS

Share-Based Payments

The Company issues employee share-based compensation awards, under a plan authorized by the Board of Directors, that are subject to specific vesting conditions. Generally the awards vest ratably over a three-year period, the nominal vesting period, or at the date the employee retires (as defined by the plan), if earlier. The Company accounts for those awards granted between (a) the adoption of the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123 Accounting for Stock Based Compensation on January 1, 2003, and (b) the adoption on January 1, 2006 of SFAS No. 123(R) which specify that an employee vests in the award upon retirement, using the nominal vesting period approach. Under this approach, the Company records compensation expense over the nominal vesting period. If the employee retires before the end of the nominal vesting period, any remaining unrecognized compensation cost is recognized at the date of retirement.

Upon the adoption of SFAS No. 123(R), the Company revised its approach to the recognition of compensation costs for awards granted to retirement-eligible employees and awards that vest when an employee becomes retirement-eligible to apply the non-substantive vesting period approach to all new share-based compensation awards granted after January 1, 2006. Under this approach, all compensation cost is recognized on the date of grant for awards issued to retirement-eligible employees, or over the period from the grant date to the date retirement eligibility is achieved, if that is expected to occur during the nominal vesting period.

If the Company had accounted for all share-based compensation awards granted after January 1, 2003 under the non-substantive vesting period approach, net income of the Financial Services Businesses for the three and six months ended June 30, 2008 would have been increased by $0.2 million and $1 million, respectively, with no reportable impact to the earnings per share of Common Stock, on both a basic and diluted basis. There is no impact to net income for 2009, as all compensation expense relating to share-based compensation awards accounted for under the nominal vesting period approach had been recognized in net income by December 31, 2008.

Investments in Debt and Equity Securities

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 12 for additional information regarding the determination of fair value. Fixed maturities that the Company has both the positive intent and ability to hold to maturity are carried at amortized cost and classified as held to maturity. The amortized cost of fixed maturities is adjusted for amortization of premiums and accretion of discounts to maturity. Interest income, as well as the related amortization of premium and accretion of discount is included in Net investment income under the effective yield method. For mortgage-backed and asset-backed securities, the effective yield is based on estimated cash flows, including prepayment assumptions based on data from widely accepted third-party data sources or internal estimates. In addition to prepayment assumptions, cash flow estimates vary based on assumptions regarding the underlying collateral including default rates and changes in value. These assumptions

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

can significantly impact income recognition and the amount of other-than-temporary impairments recognized in 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 mortgage-backed securities rated below AA, 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 as well as the impact of the Company s adoption of FASB Staff Position (FSP) FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments. Unrealized gains and losses on fixed maturities classified as available for sale, net of tax, and the effect on deferred policy acquisition costs, valuation of business acquired, 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 investments and certain derivatives used by the Company either in its capacity as a broker-dealer or for asset and liability management activities. These instruments are carried at fair value. Realized and unrealized gains and losses on other trading account assets are reported in Asset management fees and other income. Interest and dividend income from these investments is reported in Net investment income.

Equity securities available for sale are comprised of common stock, mutual fund shares, non-redeemable preferred stock, and 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, valuation of business acquired, future policy benefits and policyholders dividends that would result from the realization of unrealized gains and losses, are included in Accumulated other comprehensive income (loss). The cost of equity securities is written down to fair value when a decline in value is considered to be other-than-temporary. See the discussion below on realized investment gains and losses for a description of the accounting for impairments. Dividends from these investments are recognized in Net investment income when declared.

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 money market investments, short-term debt securities issued by government sponsored entities and other highly liquid debt instruments.

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, recoveries of principal on previously impaired securities, provisions for losses

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

on commercial mortgage and other loans, fair value changes on commercial mortgage loans carried at fair value, gains on commercial mortgage loans in connection with securitization transactions, and fair value changes on embedded derivatives and 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.

In addition, in April 2009, the Financial Accounting Standards Board (FASB) issued FSP FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments. The Company early adopted this guidance on January 1, 2009. This guidance indicates that 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. Prior to the adoption of this guidance the Company was required to record an other-than-temporary impairment for a debt security unless it could assert that it had both the intent and ability to hold the security for a period of time sufficient to allow for a recovery in its fair value to its amortized cost basis. For all debt securities in unrealized loss positions that do not meet either of these two criteria, FSP FAS 115-2 and FAS 124-2 requires that the Company analyze its ability to recover the amortized cost by comparing the net present value of projected future cash flows with the amortized cost of the security. The net present value is calculated by discounting the Company s best estimate of projected future cash flows at the effective interest rate implicit in the debt security prior to impairment. The Company may use the estimated fair value of collateral as a proxy for the net present value if it believes that the security is dependent on the liquidation of collateral for recovery of its investment. If the net present value is less than the amortized cost of the investment, an other-than-temporary impairment is recorded.

Under FSP FAS 115-2 and FAS 124-2, 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, 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 two 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). Prior to the adoption of FSP FAS 115-2 and FAS 124-2, an other-than-temporary impairment recognized in earnings for debt securities was equal to the total difference between amortized cost and fair value at the time of impairment.

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

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the amount and timing of projected cash flows. For mortgage-backed and asset-backed securities, cash flow estimates including prepayment assumptions, are based on data from widely accepted third-party data sources or internal estimates. In addition to prepayment assumptions, cash flow estimates vary based on assumptions regarding the underlying collateral including default rates, recoveries and changes in value. 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.

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 based on prospective changes in cash flow estimates, to reflect adjustments to the effective yield.

Goodwill

The Company tests goodwill for impairment annually as of December 31 and more frequently if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. A reporting unit is an operating segment or a unit one level below the operating segment.

The Company did not evaluate goodwill for impairment as of June 30, 2009, as no events occurred or circumstances changed that would have more likely than not reduced the fair value of a reporting unit below its carrying amount during the second quarter of 2009. The carrying value of goodwill was $706 million as of June 30, 2009.

Derivative Financial Instruments

Derivatives are financial instruments whose values are derived from interest rates, foreign exchange rates, financial indices or the values of securities or commodities. 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. Values can be affected by changes in interest rates, foreign exchange rates, financial indices, values of securities or commodities, credit spreads, market volatility, expected returns and liquidity. Values can also be affected by changes in estimates and assumptions, including those related to counterparty behavior, used in valuation models.

Derivatives are used in a non-dealer capacity in insurance, investment and international businesses as well as treasury operations to manage the characteristics of the Company s asset/liability mix, to manage the interest rate and currency characteristics of assets or liabilities and to mitigate the risk of a diminution, upon translation to U.S. dollars, of expected non-U.S. earnings and net investments in foreign operations resulting from unfavorable 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-dealer related derivatives, with the exception of the effective portion of cash flow hedges and effective hedges of net investments in foreign operations, are recorded in current earnings. Cash flows from these derivatives are reported in the operating, investing, or financing activities sections in the Consolidated Statements of Cash Flows.

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Derivatives are also used in a derivative dealer or broker capacity in the Company s securities operations to meet the needs of clients by structuring transactions that allow clients to manage their exposure to interest rates, foreign exchange rates, indices or prices of securities and commodities and similarly in a dealer or broker capacity through the operation of certain hedge portfolios. Realized and unrealized changes in fair value of derivatives used in these dealer related operations are included in Asset management fees and other income in the periods in which the changes occur. Cash flows from such derivatives are reported in the operating activities section of the Consolidated Statements of Cash Flows.

Derivatives are recorded either as assets, within Other trading account assets, or Other long-term investments, or as liabilities, within Other liabilities, in the Consolidated Statements of Financial Position, except for embedded derivatives which are recorded in the Consolidated Statements of Financial Position 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 pursuant to FASB Interpretation (FIN) No. 39 and FSP No. 39-1.

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

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

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

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

When a derivative is designated as a cash flow hedge and is determined to be highly effective, changes in its fair value are recorded in Accumulated other comprehensive income (loss) 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 in either current period earnings or Accumulated other comprehensive

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income (loss), depending on whether the hedge transaction is a fair value hedge (e.g., a hedge of a recognized foreign currency asset or liability) or 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. The 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 amortized 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 derivative are clearly and closely related to the economic characteristics of the remaining component of the financial instrument (i.e., the host contract) and whether a separate instrument with the same terms as the embedded instrument would meet the definition of a derivative instrument. When it is determined that (1) the embedded derivative possesses economic characteristics that are not clearly and closely related to the economic characteristics of the host contract, and (2) a separate instrument with the same terms would qualify as a derivative instrument, the embedded derivative 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.

Income Taxes

The Company s liability for income taxes includes the liability for unrecognized tax benefits and interest and penalties which relate to tax years still subject to review by the Internal Revenue Service (IRS) or other taxing jurisdictions. 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

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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 2002 tax year expired on April 30, 2009. The statute of limitations for the 2003 tax year expired on July 31, 2009. The statute of limitations for the 2004 and 2005 tax years is set to expire in June 2010. Tax years 2006 through 2008 are still open for IRS examination. The Company does not anticipate any significant changes within the next 12 months to its total unrecognized tax benefits related to tax years for which the statute of limitations has not expired.

As discussed above, 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. As such, the second quarter of 2009 benefited from a reduction to the liability for unrecognized tax benefits and interest of $147 million primarily related to tax years prior to 2002 as a result of the expiration of the statute of limitations for the 2002 tax year, additional interest on a tax refund received related to the 1997 through 2001 tax years, and changes in estimates. Also as discussed above, the statute of limitations for the 2003 tax year expired on July 31, 2009. As a result, the Company s income tax provision for the third quarter of 2009 will include a reduction to the liability for unrecognized tax benefits and interest of approximately $165 million related to tax years prior to 2002.

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 2008, 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 suspends Revenue Ruling 2007-54 and informs taxpayers that the U.S. Treasury Department and the IRS have indicated that they intend to address through new regulations 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 May 11, 2009, the Obama Administration released the General Explanations of the Administration s Revenue Proposals. Although the Administration has not released proposed statutory language, 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 regulation or legislation, could increase actual tax expense and reduce the Company s consolidated net income. These activities had no impact on the Company s 2008 or 2009 results.

In December 2006, the IRS completed all fieldwork with respect to its examination of the consolidated federal income tax returns for tax years 2002 and 2003. The final report was initially submitted to the Joint Committee on Taxation for their review in April 2007. The final report was resubmitted in March 2008 and again in April 2008. The Joint Committee returned the report to the IRS for additional review of an industry issue regarding the methodology for calculating the DRD related to variable life insurance and annuity contracts. The IRS completed its review of the issue and proposed an adjustment with respect to the calculation of the DRD. In order to expedite receipt of an income tax refund related to the 2002 and 2003 tax years, the Company has agreed to such adjustment. The report, with the adjustment to the DRD, was submitted to the Joint Committee on Taxation in October 2008. The Company was advised on January 2, 2009 that the Joint Committee completed its

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consideration of the report and has taken no exception to the conclusions reached by the IRS. Accordingly, the final report was processed and a $157 million refund was received in February 2009. The Company believes that its return position with respect to the calculation of the DRD is technically correct. Therefore, the Company intends to file a protective refund claim within six months of the expiration of the respective statutes of limitations to recover the taxes associated with the agreed upon adjustment and to pursue such other actions as appropriate. These activities had no impact on the Company s 2008 or 2009 results.

In January 2007, the IRS began an examination of tax years 2004 through 2006. For tax years 2007, 2008 and 2009, the Company participated 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.

The Company s affiliates in Japan file separate tax returns and are subject to audits by the local taxing authority. The general statute of limitations is 5 years from when the return is filed. During 2009, the Tokyo Regional Taxation Bureau concluded a routine tax audit of the tax returns of Prudential Life Insurance Company Ltd. for its tax years ending March 31, 2004 to March 31, 2008. These activities had no material impact on the Company s 2008 and 2009 results.

Accounting Pronouncements Adopted

In May 2009, the FASB issued SFAS No. 165, Subsequent Events. This statement addresses the accounting for and disclosure of subsequent events not addressed in other applicable GAAP, including disclosure of the date through which subsequent events have been evaluated. This guidance is effective for interim or annual periods ending after June 15, 2009. The Company s adoption of this guidance effective with the interim period ending June 30, 2009 did not have a material effect on the Company s consolidated financial position or results of operations. The required disclosure of the date through which subsequent events have been evaluated is provided in Note 1.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments. This FSP requires disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. This FSP also amends the disclosure requirements. This FSP is effective for interim reporting periods ending after June 15, 2009. The Company adopted this guidance effective with the interim period ending June 30, 2009. The required disclosures are provided in Note 12.

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments. This FSP amends the other-than-temporary impairment guidance for debt securities and expands the presentation and disclosure requirements of other-than-temporary impairments on debt and equity securities in the financial statements. This FSP also requires that the required annual disclosures for debt and equity securities be made for interim reporting periods. This FSP does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. This FSP is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Company early adopted this guidance effective

January 1, 2009, which resulted in a net after-tax increase to retained earnings and decrease to Accumulated other comprehensive income (loss) of $664 million. The disclosures required by this FSP are provided in Note 4. See Investments in Debt and Equity Securities above for more information.

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In April 2009, the FASB issued FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly. This FSP amends FASB Statement No. 157, Fair Value Measurements , to provide guidance on (1) estimating the fair value of an asset or liability if there was a significant decrease in the volume and level of trading activity for these assets or liabilities, and (2) identifying transactions that are not orderly. Further, FSP 157-4 requires additional disclosures about fair value measurements in interim and annual periods and supersedes FSP FAS 157-3, Determining the Fair Value of a Financial Asset in a Market That Is Not Active . This FSP is effective for interim and annual reporting periods ending after June 15, 2009, and shall be applied prospectively. Early adoption is permitted for periods ending after March 15, 2009. The Company s early adoption of this guidance effective January 1, 2009 did not have a material effect on the Company s consolidated financial position or results of operations. The disclosures required by this FSP are provided in Note 12.

In April 2009, the FASB issued FSP FAS 141(R)-1, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies. This FSP requires an asset acquired or liability assumed in a business combination that arises from a contingency to be recognized at fair value at the acquisition date, if the acquisition date fair value of that asset or liability can be determined during the measurement period. If the acquisition date fair value of an asset acquired or liability assumed in a business combination that arises from a contingency cannot be determined during the measurement period, the asset or liability shall be recognized at the acquisition date using the guidance in SFAS No. 5, Accounting for Contingencies. This FSP also amends disclosure requirements. This FSP is effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is on or after January 1, 2009. The Company s adoption of this guidance effective January 1, 2009 did not have a material effect on the Company s consolidated financial position or results of operations.

In September 2008, the FASB Emerging Issues Task Force (EITF) reached consensus on EITF Issue No. 08-5, Issuer s Accounting for Liabilities Measured at Fair Value with a Third-Party Credit Enhancement. The consensus concluded that (a) the issuer of a liability (including debt) with a third-party credit enhancement that is inseparable from the liability, shall not include the effect of the credit enhancement in the fair value measurement of the liability; (b) the issuer shall disclose the existence of any third-party credit enhancement on such liabilities, and (c) in the period of adoption the issuer shall disclose the valuation techniques used to measure the fair value of such liabilities and disclose any changes from valuation techniques used in prior periods. The Company s adoption of this guidance on a prospective basis effective January 1, 2009 did not have a material effect on the Company s consolidated financial position or results of operations.

In June 2008, the FASB EITF reached consensus on the following issues contained in EITF Issue No. 07-5, Determining Whether an Instrument (or an Embedded Feature) is Indexed to an Entity s Own Stock: (1) how an entity should evaluate whether an instrument (or embedded feature) is indexed to the entity s own stock; (2) how the currency in which the strike price of an equity-linked financial instrument (or embedded equity-linked feature) is denominated affects the determination of whether the instrument is indexed to the entity s own stock; (3) how an issuer should account for equity-linked financial instruments issued to investors for purposes of establishing a market-based measure of the grant-date fair value of employee stock options. This guidance clarifies what instruments qualify as indexed to an entity s own stock and are thereby exempt from requirements of FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, and eligible for equity classification under EITF Issue No. 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock. The Company s adoption of this guidance effective January 1, 2009 did not have a material effect on the Company s consolidated financial position or results of operations.

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In June 2008, the FASB issued FSP EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. This FSP states that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share (EPS) pursuant to the two-class method described in paragraphs 60 and 61 of FASB Statement No. 128, Earnings per Share. This FSP is effective for fiscal years and interim periods beginning after December 15, 2008, and must be applied retrospectively to all EPS data presented. The Company s adoption of this guidance effective January 1, 2009 reduced earnings per basic share of Common Stock for both the three and six months ended June 30, 2008 by $0.01 and had no reportable impact on earnings per diluted share of Common Stock for both the three and six months ended June 30, 2008. The Company s adoption of this guidance effective January 1, 2009 reduced earnings per basic share of Common Stock for the years ended December 31, 2008, 2007, 2006, 2005 and 2004 by $0.01, $0.05, $0.06, $0.06 and $0.02, respectively, and earnings per diluted share of Common Stock by $0.01, $0.01, $0.02, $0.03 and $0.01, respectively.

In May 2008, the FASB issued FSP APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement). This FSP, which is effective for fiscal years and interim periods beginning after December 15, 2008 and must be applied retrospectively, addresses the accounting for certain convertible debt instruments including those that have been issued by the Company. It requires bifurcation of the instrument into a debt component that is initially recorded at fair value and an equity component. The difference between the fair value of the debt component and the initial proceeds from issuance of the instrument is recorded as a component of equity within additional paid-in capital. The liability component of the debt instrument is accreted to par using the effective yield method, with the accretion being reported as a component of interest expense. Bond issuance costs are allocated to the debt and equity components in proportion to the debt proceeds. The Company s adoption of this guidance effective January 1, 2009 reduced net income for the three months ended June 30, 2008 by $9 million or $0.02 per share of Common Stock, on both a basic and diluted basis and reduced net income for the six months ended June 30, 2008 by $18 million or $0.04 per share of Common Stock, on both a basic and diluted basis. The Company s adoption of this guidance effective January 1, 2009 reduced net income for the years ended December 31, 2008, 2007, 2006 and 2005 by $44 million, $42 million, $36 million and $5 million, or $0.10, $0.09, $0.07 and $0.01 per share of Common Stock, on both a basic and diluted basis, respectively.

In April 2008, the FASB issued FSP FAS 142-3, Determination of the Useful Life of Intangible Assets. This FSP amends the list of factors an entity should consider in developing renewal or extension assumptions used to determine the useful life of recognized intangible assets under SFAS No. 142. This FSP is effective for fiscal years and interim periods beginning after December 15, 2008, with the guidance for determining the useful life of a recognized intangible asset being applied prospectively to intangible assets acquired after the effective date and the disclosure requirements being applied prospectively to all intangible assets recognized as of, and after, the effective date. The Company s adoption of this guidance effective January 1, 2009 did not have a material effect on the Company s consolidated financial position or results of operations.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of SFAS No. 133. This statement amends and expands the disclosure requirements for derivative instruments and hedging activities by requiring companies to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under FASB Statement No. 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. The Company s adoption of this guidance effective January 1, 2009 did not have a material effect on the Company s consolidated financial position or results of operations. The required disclosures are provided in Note 14.

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In February 2008, the FASB issued FSP FAS 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions. The FSP provides recognition and derecognition guidance for a repurchase financing transaction, which is a repurchase agreement that relates to a previously transferred financial asset between the same counterparties, that is entered into contemporaneously with or in contemplation of, the initial transfer. The FSP is effective for fiscal years beginning after November 15, 2008. The Company s adoption of this guidance on a prospective basis effective January 1, 2009 did not have a material effect on the Company s consolidated financial position or results of operations.

In February 2008, the FASB issued FSP FAS 157-2, Effective Date of FASB Statement No. 157. This FSP applies to nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). FSP FAS 157-2 delays the effective date of SFAS No. 157 for these items to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The Company s adoption of this guidance effective January 1, 2009 did not have a material effect on the Company s consolidated financial position or results of operations.

In December 2007, the FASB issued SFAS No. 141R, Business Combinations. This statement, which addresses the accounting for business acquisitions, is effective for fiscal years beginning on or after December 15, 2008, with early adoption prohibited, and generally applies to business acquisitions completed after December 31, 2008. Among other things, the new standard requires that all acquisition-related costs be expensed as incurred, and that all restructuring costs related to acquired operations be expensed as incurred. This new standard also addresses the current and subsequent accounting for assets and liabilities arising from contingencies acquired or assumed and, for acquisitions both prior and subsequent to December 31, 2008, requires the acquirer to recognize changes in the amount of its deferred tax benefits that are recognizable because of a business combination either in income from continuing operations in the period of the combination or directly in contributed capital, depending on the circumstances. The Company s adoption of this guidance effective January 1, 2009 did not have a material effect on the Company s consolidated financial position or results of operations, but may have an effect on the accounting for future business combinations.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements. SFAS No. 160 changes the accounting for minority interests, which will be recharacterized as noncontrolling interests and classified by the parent company as a component of equity. Upon adoption, SFAS No. 160 requires retroactive adoption of the presentation and disclosure requirements for existing noncontrolling interests and prospective adoption for all other requirements. The Company s adoption of this guidance effective January 1, 2009 did not have a material effect on the Company s consolidated financial position or results of operations, but did affect financial statement presentation and disclosure. Noncontrolling interests, previously reported as a liability, are now required to be reported as a separate component of equity on the balance sheet, and totaled $293 million at June 30, 2008 and totaled $351 million, $409 million, $329 million, $110 million, and $97 million at December 31, 2008, 2007, 2006, 2005 and 2004, respectively. In addition, income attributable to the noncontrolling interests, which was previously reported as an expense in General and administrative expenses and reflected within Income from Continuing Operations is now reported as a separate amount below Net Income, and totaled $8 million and $32 million for the three and six months ended June 30, 2008, respectively, and totaled $36 million, $67 million, $25 million, $21 million and $13 million for the years ended December 31, 2008, 2007, 2006, 2005 and 2004, respectively.

Recent Accounting Pronouncements

In June 2009, the FASB issued SFAS No. 168, The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162. The FASB s Codification was launched on July 1, 2009 as the source of authoritative U.S. GAAP to be applied by nongovernmental entities. The Codification is not intended to change U.S. GAAP but is a new structure which takes accounting pronouncements and organizes them by accounting topic. This statement is effective for financial statements issued for interim and annual periods ending after September 15, 2009. This statement will become effective for the Company beginning with the interim reporting period ending September 30, 2009 and will impact the way the Company references U.S. GAAP accounting standards in the financial statements.

In June 2009, the FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46(R). This statement amends the consolidation guidance for variable interest entities. It also makes certain changes to the disclosures required under FSP FAS 140-4 and FIN 46(R)-8, Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities, which the Company adopted effective December 31, 2008. This statement is effective for interim and annual reporting periods beginning after November 15, 2009. The Company will adopt this guidance effective January 1, 2010. The Company is currently assessing the impact of this statement on the Company s consolidated financial position, results of operations and financial statement disclosures.

In June 2009, the FASB issued SFAS No. 166, Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140. This statement changes the accounting for transfers of financial assets, and is effective for transfers of financial assets occurring in interim and annual reporting periods beginning after November 15, 2009. It removes the concept of a qualifying special-purpose entity (QSPE) from Statement No. 140 and removes the exception from applying FASB Interpretation No. 46, Consolidation of Variable Interest Entities, to qualifying special-purpose entities. It also defines participating interest to establish specific conditions for reporting a transfer of a portion of a financial asset as a sale. Disclosure provisions will be applied to transfers that occurred both before and after January 1, 2010. The Company will adopt this guidance effective January 1, 2010. The Company is currently assessing the impact of this statement on the Company s consolidated financial position, results of operations and financial statement disclosures.

In December 2008, the FASB issued FSP FAS 132(R)-1, Employers Disclosures about Postretirement Benefit Plan Assets , which amends the plan asset disclosures required under FAS 132(R). This FSP requires additional disclosures about the components of plan assets, investment strategies for plan assets, significant concentrations of risk within plan assets, and requires disclosures regarding the measurement of plan assets similar to those required under SFAS No. 157. This FSP is effective for fiscal years ending after December 15, 2009. The Company will provide the required disclosures in the annual reporting period ending December 31, 2009.

3. ACQUISITIONS AND DISPOSITIONS

Acquisition of Yamato Life

On May 1, 2009, the Company s Gibraltar Life operations acquired Yamato Life, a Japanese life insurance company that declared bankruptcy in October 2008. Gibraltar Life served as the reorganization sponsor for Yamato and under the reorganization agreement acquired Yamato by contributing $72 million of capital to Yamato. As of June 30, 2009, the Statement of Financial Position of Prudential Financial reflects $2.3 billion of assets and $2.3 billion of liabilities related to Yamato. Subsequent to the acquisition, the Company renamed the acquired company Prudential Financial of Japan Life Insurance Company Ltd.

Acquisition of Hyundai Investment and Securities Co., Ltd.

In 2004, the Company acquired an 80 percent interest in Hyundai Investment and Securities Co., Ltd., a Korean asset management firm, from an agency of the Korean government, for $301 million in cash, including

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Notes to Unaudited Interim Consolidated Financial Statements (Continued)

$210 million used to repay debt assumed. Subsequent to the acquisition, the company was renamed Prudential Investment & Securities Co., Ltd. On January 25, 2008, the Company acquired the remaining 20 percent for $90 million.

Additional Investment in UBI Pramerica

On January 18, 2008, the Company made an additional investment of $154 million in its UBI Pramerica operating joint venture in Italy, which is accounted for under the equity method. This additional investment was necessary to maintain the Company s ownership interest at 35 percent and was a result of the merger of the Company s joint venture partner with another Italian bank, and the subsequent consolidation of their asset management companies into the UBI Pramerica joint venture.

Discontinued Operations

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(in millions)			
Real estate investments sold or held for sale	$ 26	$	$ 28	$ 1
Equity sales, trading and research operations	1	(1)	1	(2)
International securities operations	1	(3)	1	(2)
Mexican asset management operations	(1)		(1)	1
Income (loss) from discontinued operations before income taxes	27	(4)	29	(2)
Income tax expense (benefit)	6	(1)	7	(1)
Income (loss) from discontinued operations, net of taxes	$ 21	$ (3)	$ 22	$ (1)

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

The Company s Unaudited Interim Consolidated Statements of Financial Position include total assets and total liabilities related to discontinued businesses of $157 million and $93 million, respectively, as of June 30, 2009 and $218 million and $149 million, respectively, as of December 31, 2008. Charges recorded in connection with the disposals of businesses include estimates that are subject to subsequent adjustment. It is possible that such adjustments might be material to future net results of operations of a particular quarterly or annual period.

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Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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:

	June 30, 2009				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (in millions)	Fair Value	Other-than-temporary impairments in AOCI(3)
Fixed maturities, available for sale					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	$ 6,260	$ 483	$ 180	$ 6,563	$
Obligations of U.S. states and their political subdivisions	714	36	2	748	
Foreign government bonds	34,772	1,135	160	35,747	
Corporate securities	86,436	2,120	5,707	82,849	(99)
Asset-backed securities(1)	14,516	117	4,125	10,508	(1,748)
Commercial mortgage-backed securities	11,355	44	1,148	10,251	19
Residential mortgage-backed securities(2)	12,022	410	185	12,247	(11)
Total fixed maturities, available for sale	$ 166,075	$ 4,345	$ 11,507	$ 158,913	$ (1,839)
Equity securities, available for sale	$ 6,019	$ 557	$ 659	$ 5,917	

(1) Includes credit tranched 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, from January 1, 2009, were not included in earnings under FSP FAS 115-2 and FAS 124-2. Amount excludes $113 million of net unrealized gains on impaired securities relating to changes in the value of such securities subsequent to the impairment measurement date.

	June 30, 2009				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (in millions)	Fair Value	Other-than-temporary impairments in AOCI(3)
Fixed maturities, held to maturity					
Foreign government bonds	$ 1,022	$ 35	$ 1	$ 1,056	$
Corporate securities	835		123	712	

Asset-backed securities(1)	902	9	6	905	
Commercial mortgage-backed securities	446	64		510	
Residential mortgage-backed securities(2)	1,730	31	6	1,755	
Total fixed maturities, held to maturity	$ 4,935	$ 139	$ 136	$ 4,938	$

(1) Includes credit tranched 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, from January 1, 2009, were not included in earnings under FSP FAS 115-2 and FAS 124-2.

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Notes to Unaudited Interim Consolidated Financial Statements (Continued)

	December 31, 2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in millions)			
Fixed maturities, available for sale				
U.S. Treasury securities and obligations of U.S. government authorities and agencies	$ 6,236	$ 1,355	$ 13	$ 7,578
Obligations of U.S. states and their political subdivisions	891	32	12	911
Foreign government bonds	32,585	2,266	112	34,739
Corporate securities	87,028	1,630	9,604	79,054
Asset-backed securities	16,057	109	4,174	11,992
Commercial mortgage-backed securities	12,381	5	2,334	10,052
Residential mortgage-backed securities	13,513	450	233	13,730
Total fixed maturities, available for sale	$ 168,691	$ 5,847	$ 16,482	$ 158,056
Equity securities, available for sale	$ 7,288	$ 259	$ 1,482	$ 6,065

	December 31, 2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in millions)			
Fixed maturities, held to maturity				
Foreign government bonds	$ 1,093	$ 115	$	$ 1,208
Corporate securities	867	9	128	748
Asset-backed securities	782	25	1	806
Commercial mortgage-backed securities	11			11
Residential mortgage-backed securities	1,055	8	4	1,059
Total fixed maturities, held to maturity	$ 3,808	$ 157	$ 133	$ 3,832

The amortized cost and fair value of fixed maturities by contractual maturities at June 30, 2009, are as follows:

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(in millions)		(in millions)	
Due in one year or less	$ 7,711	$ 7,702	$ 10	$ 10
Due after one year through five years	32,998	32,492		
Due after five years through ten years	32,516	31,169	22	22
Due after ten years	54,957	54,544	1,825	1,736
Asset-backed securities	14,516	10,508	902	905
Commercial mortgage-backed securities	11,355	10,251	446	510
Residential mortgage-backed securities	12,022	12,247	1,730	1,755

Total	$ 166,075	$ 158,913	$ 4,935	$ 4,938

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.

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Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(in millions)			
Fixed maturities, available for sale:				
Proceeds from sales	$ 8,000	$ 18,616	$ 16,643	$ 36,437
Proceeds from maturities/repayments	4,401	4,314	8,426	10,195
Gross investment gains from sales, prepayments and maturities	266	194	629	491
Gross investment losses from sales and maturities	(259)	(210)	(376)	(394)
Fixed maturities, held to maturity:				
Proceeds from maturities/repayments	$ 106	$ 62	$ 168	$ 111
Gross investment gains from prepayments				
Fixed maturity and equity security impairments:				
Total writedowns for other-than-temporary impairment losses on fixed maturities	$ (1,312)	$ (661)	$ (3,167)	$ (1,200)
Portion of loss recognized in other comprehensive income (before taxes)	813		2,063	
Net writedowns for other-than-temporary impairment losses on fixed maturities recognized in earnings	$ (499)	$ (661)	$ (1,104)	$ (1,200)
Writedowns for other-than-temporary impairment losses on equity securities	$ (263)	$ (230)	$ (756)	$ (330)

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

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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

	Six Months Ended June 30, 2009 (in millions)
Balance, December 31, 2008	$
Credit losses remaining in retained earnings related to adoption of FSP FAS 115-2 and FAS 124-2	658
Credit loss impairments previously recognized on securities which matured, paid down, prepaid or were sold during the period	(91)
Credit loss impairments previously recognized on securities impaired to fair value during the period(1)	(6)
Credit loss impairment recognized in the current period on securities not previously impaired	558
Additional credit loss impairments recognized in the current period on securities previously impaired	394
Increases due to the passage of time on previously recorded credit losses	16
Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected	(7)
Balance, June 30, 2009	$ 1,522

(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.

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 June 30, 2009 (in millions)
Balance, March 31, 2009	$ 1,207
Credit loss impairments previously recognized on securities which matured, paid down, prepaid or were sold during the period	(90)
Credit loss impairments previously recognized on securities impaired to fair value during the period(1)	(6)
Credit loss impairment recognized in the current period on securities not previously impaired	164
Additional credit loss impairments recognized in the current period on securities previously impaired	239
Increases due to the passage of time on previously recorded credit losses	14
Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected	(6)
Balance, June 30, 2009	$ 1,522

(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.

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Notes to Unaudited Interim Consolidated Financial Statements (Continued)

Trading Account Assets Supporting Insurance Liabilities

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

	June 30, 2009		December 31, 2008	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(in millions)		(in millions)	
Short-term investments and cash equivalents	$ 553	$ 553	$ 1,232	$ 1,232
Fixed maturities:				
Corporate securities	8,870	8,612	8,814	7,971
Commercial mortgage-backed securities	2,235	2,132	2,335	2,092
Residential mortgage-backed securities	1,399	1,381	708	684
Asset-backed securities	930	692	915	635
Foreign government bonds	474	479	416	420
U.S. government authorities and agencies and obligations of U.S. states	121	114	147	143
Total fixed maturities	14,029	13,410	13,335	11,945
Equity securities	953	803	1,074	698
Total trading account assets supporting insurance liabilities	$ 15,535	$ 14,766	$ 15,641	$ 13,875

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 $752 million and $(80) million during the three months ended June 30, 2009 and 2008, respectively, and $997 million and $(336) million during the six months ended June 30, 2009 and 2008, respectively.

Other Trading Account Assets

The following table sets forth the composition of the Company s other trading account assets as of the dates indicated:

	June 30, 2009		December 31, 2008	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(in millions)		(in millions)	
Short-term investments and cash equivalents	$ 6	$ 6	$ 7	$ 7
Fixed maturities:				
Asset-backed securities	1,695	1,622	423	308

Residential mortgage-backed securities	260	118	278	150
Corporate securities	257	244	230	204
Commercial mortgage-backed securities	213	120	217	136
U.S. government authorities and agencies and obligations of U.S. states	56	59	102	106
Foreign government bonds	32	33	32	33
Total fixed maturities	2,513	2,196	1,282	937
Derivative instruments and other	1,196	1,410	2,949	3,250
Equity securities	99	103	144	142
Total other trading account assets	$ 3,814	$ 3,715	$ 4,382	$ 4,336

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Notes to Unaudited Interim Consolidated Financial Statements (Continued)

The net change in unrealized gains (losses) from other trading account assets still held at period end, recorded within Asset management fees and other income was $(24) million and $236 million during the three months ended June 30, 2009 and 2008, respectively, and $(53) million and $(105) million during the six months ended June 30, 2009 and 2008, respectively.

Net Investment Income

Net investment income for the three and six months ended June 30, 2009 and 2008 was from the following sources:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	**2008**	**2009**	**2008**
		(in millions)		
Fixed maturities, available for sale	$ 2,024	$ 2,104		