

PRUDENTIAL FINANCIAL INC

Form 10-Q/A

February 15, 2006

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q/A**  
**AMENDMENT NO. 1**

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

For the quarterly period ended March 31, 2005

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

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**Prudential Financial, Inc.**

(Exact Name of Registrant as Specified in its Charter)

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**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)**

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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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

As of April 29, 2005, 520 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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**EXPLANATORY NOTE**

This Amendment No. 1 on Form 10-Q/A is being filed for the purpose of amending Items 1 and 4 of Part I of the Quarterly Report on Form 10-Q for the quarter ended March 31, 2005 of Prudential Financial, Inc. ( "Prudential Financial" ) to reflect the restatement of Prudential Financial's Unaudited Interim Consolidated Statements of Cash Flows for the three months ended March 31, 2005 and 2004, as described in Footnote 1 to the Unaudited Interim Consolidated Financial Statements included in this Form 10-Q/A. All other Items of the original filing on Form 10-Q made on May 5, 2005 are unaffected by the changes to the Unaudited Interim Consolidated Statements of Cash Flows and such Items have not been included in this Amendment. Information in this Form 10-Q/A is generally stated as of March 31, 2005 and does not reflect any subsequent information or events other than the restatement of the Unaudited Interim Consolidated Statements of Cash Flows. More current information with respect to Prudential Financial is contained within its Quarterly Report on Form 10-Q for the quarter ended September 30, 2005, and other filings with the Securities and Exchange Commission.

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Throughout this Quarterly Report on Form 10-Q/A, *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, 2005 and December 31, 2004 (in millions, except share amounts)

	March 31, 2005	December 31, 2004
<b>ASSETS</b>		
Fixed maturities:		
Available for sale, at fair value (amortized cost: 2005 \$147,745; 2004 \$143,156)	\$ 154,034	\$ 150,968
Held to maturity, at amortized cost (fair value: 2005 \$3,412; 2004 \$2,765)	3,389	2,747
Trading account assets supporting insurance liabilities, at fair value	13,239	12,964
Other trading account assets, at fair value	1,488	1,547
Equity securities, available for sale, at fair value (cost: 2005 \$3,824; 2004 \$3,589)	4,456	4,283
Commercial loans	23,814	24,389
Policy loans	8,372	8,373
Securities purchased under agreements to resell	171	127
Other long-term investments	5,639	5,981
Short-term investments	4,852	5,245
<b>Total investments</b>	<b>219,454</b>	<b>216,624</b>
Cash and cash equivalents	8,497	8,072
Accrued investment income	2,149	2,028
Reinsurance recoverables	3,767	32,790
Deferred policy acquisition costs	9,051	8,847
Other assets	17,682	17,129
Separate account assets	142,568	115,568
<b>TOTAL ASSETS</b>	<b>\$ 403,168</b>	<b>\$ 401,058</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>LIABILITIES</b>		
Future policy benefits	\$ 101,968	\$ 102,033
Policyholders' account balances	75,847	75,497
Unpaid claims and claim adjustment expenses	1,839	1,807

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Policyholders dividends	4,697	5,350
Reinsurance payables	3,345	32,386
Securities sold under agreements to repurchase	12,058	8,958
Cash collateral for loaned securities	6,111	7,269
Income taxes payable	2,642	2,681
Securities sold but not yet purchased	466	427
Short-term debt	7,010	4,044
Long-term debt	7,731	7,627
Other liabilities	14,467	15,067
Separate account liabilities	142,568	115,568
	<hr/>	<hr/>
Total liabilities	380,749	378,714
	<hr/>	<hr/>

**COMMITMENTS AND CONTINGENCIES (See Note 9)**

**STOCKHOLDERS EQUITY**

Preferred Stock (\$.01 par value; 10,000,000 shares authorized; none issued)		
Common Stock (\$.01 par value; 1,500,000,000 shares authorized; 604,896,123 and 604,894,558 shares issued as of March 31, 2005 and December 31, 2004, respectively)	6	6
Class B Stock (\$.01 par value; 10,000,000 shares authorized; 2,000,000 shares issued and outstanding as of March 31, 2005 and December 31, 2004, respectively)		
Additional paid-in capital	20,454	20,354
Common Stock held in treasury, at cost (82,603,670 and 77,549,848 shares as of March 31, 2005 and December 31, 2004, respectively)	(3,277)	(2,967)
Deferred compensation	(147)	(91)
Accumulated other comprehensive income	1,610	2,191
Retained earnings	3,773	2,851
	<hr/>	<hr/>
Total stockholders equity	22,419	22,344
	<hr/>	<hr/>
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 403,168</b>	<b>\$ 401,058</b>
	<hr/>	<hr/>

*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, 2005 and 2004 (in millions, except per share amounts)**

	<b>Three Months Ended March 31,</b>	
	<b>2005</b>	<b>2004</b>
<b>REVENUES</b>		
Premiums	\$ 3,376	\$ 3,081
Policy charges and fee income	623	557
Net investment income	2,424	2,124
Realized investment gains (losses), net	430	197
Commissions and other income	925	792
<b>Total revenues</b>	<b>7,778</b>	<b>6,751</b>
<b>BENEFITS AND EXPENSES</b>		
Policyholders' benefits	3,474	3,240
Interest credited to policyholders' account balances	553	512
Dividends to policyholders	608	641
General and administrative expenses	1,834	1,652
<b>Total benefits and expenses</b>	<b>6,469</b>	<b>6,045</b>
<b>INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND CUMULATIVE EFFECT OF ACCOUNTING CHANGE</b>	<b>1,309</b>	<b>706</b>
Income tax expense	388	220
<b>INCOME FROM CONTINUING OPERATIONS BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE</b>	<b>921</b>	<b>486</b>
Income (loss) from discontinued operations, net of taxes	8	(6)
Cumulative effect of accounting change, net of taxes		(79)
<b>NET INCOME</b>	<b>\$ 929</b>	<b>\$ 401</b>
<b>EARNINGS PER SHARE (See Note 6)</b>		
<b>Financial Services Businesses</b>		
<b>Basic:</b>		
Income from continuing operations before cumulative effect of accounting change per share of Common Stock	\$ 1.49	\$ 0.74
Income (loss) from discontinued operations, net of taxes	0.02	(0.01)
Cumulative effect of accounting change, net of taxes		(0.15)

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Net income per share of Common Stock	\$ 1.51	\$ 0.58
	<u>          </u>	<u>          </u>
<b>Diluted:</b>		
Income from continuing operations before cumulative effect of accounting change per share of Common Stock	\$ 1.47	\$ 0.73
Income (loss) from discontinued operations, net of taxes	0.02	(0.01)
Cumulative effect of accounting change, net of taxes		(0.15)
	<u>          </u>	<u>          </u>
Net income per share of Common Stock	\$ 1.49	\$ 0.57
	<u>          </u>	<u>          </u>
<b>Closed Block Business</b>		
Net income per share of Class B Stock basic and diluted	\$ 70.50	\$ 46.00
	<u>          </u>	<u>          </u>

*See Notes to Unaudited Interim Consolidated Financial Statements*

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## PRUDENTIAL FINANCIAL, INC.

## Unaudited Interim Consolidated Statement of Stockholders Equity

Three Months Ended March 31, 2005 (in millions)

	<u>Common Stock</u>		Class B Stock	Additional Paid-in Capital	Retained Earnings	Common Stock Held In Treasury	Deferred Compensation	Accumulated Other Comprehensive Income	Total Stockholders Equity
	Shares	Amount							
<b>Balance, December 31, 2004</b>	527.3	\$ 6	\$	\$ 20,354	\$ 2,851	\$ (2,967)	\$ (91)	\$ 2,191	\$ 22,344
Common Stock acquired	(6.5)					(367)			(367)
Stock-based compensation programs	1.5			100	(7)	57	(56)		94
Comprehensive income (loss):									
Net income					929				929
Other comprehensive loss, net of tax								(581)	(581)
<b>Total comprehensive income</b>									<b>348</b>
<b>Balance, March 31, 2005</b>	<b>522.3</b>	<b>\$ 6</b>	<b>\$</b>	<b>\$ 20,454</b>	<b>\$ 3,773</b>	<b>\$ (3,277)</b>	<b>\$ (147)</b>	<b>\$ 1,610</b>	<b>\$ 22,419</b>

*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, 2005 and 2004 (in millions)**

	2005	2004
	(Restated)	(Restated)
	<u>          </u>	<u>          </u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 929	\$ 401
Adjustments to reconcile net income to net cash provided by operating activities:		
Realized investment (gains) losses, net	(430)	(197)
Policy charges and fee income	(235)	(174)
Interest credited to policyholders' account balances	553	512
Depreciation and amortization, including premiums and discounts	119	131
Change in:		
Deferred policy acquisition costs	(152)	(153)
Future policy benefits and other insurance liabilities	723	567
Trading account assets supporting insurance liabilities and other trading account assets	(59)	(644)
Income taxes payable	63	323
Securities sold but not yet purchased	39	788
Other, net	(1,011)	(86)
	<u>          </u>	<u>          </u>
<b>Cash flows from operating activities</b>	<b>539</b>	<b>1,468</b>
	<u>          </u>	<u>          </u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from the sale/maturity/prepayment of:		
Fixed maturities, available for sale	20,927	14,797
Fixed maturities, held to maturity	117	137
Equity securities, available for sale	752	252
Commercial loans	1,413	1,634
Other long-term investments	650	(416)
Short-term investments	4,005	8,454
Payments for the purchase of:		
Fixed maturities, available for sale	(26,800)	(18,737)
Fixed maturities, held to maturity	(803)	
Equity securities, available for sale	(877)	(182)
Commercial loans	(892)	(830)
Other long-term investments	(457)	(228)
Short-term investments	(3,742)	(5,988)
Acquisition of subsidiaries, net of cash acquired.		(91)
Proceeds from sale of subsidiaries, net of cash disposed		(69)
Net change in policy loans	53	6
	<u>          </u>	<u>          </u>
<b>Cash flows used in investing activities</b>	<b>(5,654)</b>	<b>(1,261)</b>
	<u>          </u>	<u>          </u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Policyholders' account deposits	4,419	2,510
Policyholders' account withdrawals	(4,152)	(2,718)
Net change in securities sold under agreements to repurchase and cash collateral for loaned securities	1,956	801
Cash dividends paid on Common Stock	(37)	(38)
Net change in financing arrangements (maturities 90 days or less)	3,670	(226)
Common Stock acquired	(366)	(359)
Common Stock reissued for exercise of stock options	49	34
Proceeds from the issuance of debt (maturities longer than 90 days)	323	493

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Repayments of debt (maturities longer than 90 days)	(545)	(582)
Cash payments to or in respect of eligible policyholders	(91)	(4)
Other, net	261	(17)
<b>Cash flows from (used in) financing activities</b>	<b>5,487</b>	<b>(106)</b>
Effect of foreign exchange rate changes on cash balances	53	8
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>425</b>	<b>109</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<b>8,072</b>	<b>7,949</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$ 8,497</b>	<b>\$ 8,058</b>

*See Notes to Unaudited Interim Consolidated Financial Statements*

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**PRUDENTIAL FINANCIAL, INC.**

**Notes to Unaudited Interim Consolidated Financial Statements**

**1. BUSINESS AND BASIS OF PRESENTATION**

Prudential Financial, Inc. ( Prudential Financial ) and its subsidiaries (collectively, Prudential or the Company ) provide a wide range of insurance, investment management, and other financial products and services to both retail and institutional customers throughout the United States and in many other countries. Principal products and services provided include life insurance, annuities, mutual funds, pension and retirement related investments and administration, and asset management. In addition, the Company provides securities brokerage services indirectly through a minority ownership in a joint venture. 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: Insurance, Investment, and International Insurance and Investments. Businesses that are not sufficiently material to warrant separate disclosure and businesses to be divested are included in Corporate and Other operations within the Financial Services Businesses. The Closed Block Business, which includes the Closed Block (see Note 4), 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 policyholder 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 has ceased offering these participating products.

***Restatement of Unaudited Interim Consolidated Statements of Cash Flows***

The Unaudited Interim Consolidated Statements of Cash Flows for the three months ended March 31, 2005 and 2004 have been restated to reflect the following:

1. Changes in the net receivable/payable from unsettled investment purchases and sales, previously classified within adjustments to reconcile net income to cash provided by operating activities, have been reclassified to cash flows from investing activities, to the extent such balances pertained to investments classified as either available for sale or held to maturity.
2. The net change in the policy loans receivable, previously reported in cash flows from operating activities, is now reported as a component of cash flows of investing activities.
3. Changes in the presentation of bank overdrafts, certain commercial loans, proprietary investments, certain variable product investments, and various other items.

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

As a result of the restatements, previously reported cash flows from operating activities, cash flows used in investing activities and cash flows from (used in) financing activities were increased or reduced for the three months ended March 31, 2005, and 2004 as follows:

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2005</b>	<b>2004</b>
<b>Cash flows from operating activities:</b>		
As originally reported	\$ 1,035	\$ 878
Impact of restatements	(496)	590
	<u>          </u>	<u>          </u>
Revised for restatements	<u>\$ 539</u>	<u>\$ 1,468</u>
<b>Cash flows used in investing activities:</b>		
As originally reported	\$ (5,499)	\$ (617)
Impact of restatements	(155)	(644)
	<u>          </u>	<u>          </u>
Revised for restatements	<u>\$ (5,654)</u>	<u>\$ (1,261)</u>
<b>Cash flows from (used in) financing activities:</b>		
As originally reported	\$ 4,835	\$ (158)
Impact of restatements	652	52
	<u>          </u>	<u>          </u>
Revised for restatements	<u>\$ 5,487</u>	<u>\$ (106)</u>

The restatements had no impact on the total change in cash and cash equivalents within the Unaudited Interim Consolidated Statements of Cash Flows or on the Unaudited Interim Consolidated Statements of Operations or Unaudited Interim Consolidated Statements of Financial Position.

***Basis of Presentation***

The Unaudited Interim Consolidated Financial Statements include the accounts of Prudential Financial, its majority-owned subsidiaries, as well as variable interest entities in which the Company is considered the primary beneficiary, and those partnerships and joint ventures in which the Company has a majority financial interest, except for those partnerships and joint ventures where the Company cannot exercise control because the minority owners have substantive participating rights in the operating and capital decisions of the entity. The Unaudited Interim Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America ( 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. Intercompany balances and transactions have been eliminated.

*Use of Estimates*

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, in particular deferred policy acquisition costs, valuation of business acquired, investments, future policy benefits, provision for income taxes, disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

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

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**PRUDENTIAL FINANCIAL, INC.**

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

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/A for the year ended December 31, 2004.

***Reclassifications***

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

**2. ACCOUNTING POLICIES AND PRONOUNCEMENTS**

***Adoption of SOP 03-1***

In July 2003, the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA) issued Statement of Position (SOP) 03-1, Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts. AcSEC issued this SOP to address the need for interpretive guidance in three areas: separate account presentation and valuation; the classification and valuation of certain long-duration contract liabilities; and the accounting recognition given sales inducements (bonus interest, bonus credits and persistency bonuses).

The Company adopted SOP 03-1 effective January 1, 2004. One element of this guidance addressed the accounting for liabilities related to insurance products that provide contractholders with a return based on a contractually referenced pool of investments. Effective with the adoption of SOP 03-1, the contractholder liabilities associated with these products are required to be adjusted for changes in the fair value of the related pool of investments. These products pass the economics related to the referenced pool of investments to the contractholder.

The effect of adopting SOP 03-1 was a charge of \$79 million, net of \$44 million of taxes, which was reported as a Cumulative effect of accounting change, net of taxes in the results of operations for the three months ended March 31, 2004. This charge reflects the net impact of converting large group annuity contracts and certain individual market value adjusted annuity contracts from separate account accounting treatment to general account accounting treatment, including carrying the related liabilities at accreted value, and the effect of establishing reserves for guaranteed minimum death benefit provisions of the Company's variable annuity and variable life contracts. The Company also recognized a cumulative effect of accounting change related to unrealized investment gains within Other comprehensive income, net of taxes of \$73 million, net of \$42 million of taxes, for the three months ended March 31, 2004. Upon adoption of SOP 03-1, \$3.3 billion in Separate account assets were reclassified resulting in a \$2.8 billion increase in Fixed maturities, available for sale and a \$0.6 billion increase in Trading account assets supporting insurance liabilities, at fair value, as well as changes in other non-separate account assets. Similarly, upon adoption, \$3.3 billion in Separate account liabilities were reclassified resulting in increases in Policyholders' account balances and Future policy benefits, as well as changes in other non-separate account liabilities.

In June 2004, the Financial Accounting Standards Board ( FASB ) issued FASB Staff Position ( FSP ) No. 97-1, Situations in Which Paragraphs 17(b) and 20 of FASB Statement No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments, Permit or Require Accrual of an Unearned Revenue Liability. FSP 97-1 clarifies the accounting for unearned revenue liabilities of certain universal-life type contracts under SOP 03-1. The Company's adoption of FSP 97-1 on July 1, 2004 did not change the accounting for unearned revenue liabilities and, therefore, had no impact on the Company's consolidated financial position or results of operations. In September 2004, the AICPA SOP 03-1 Implementation Task Force issued a Technical Practice Aid ( TPA ) to clarify certain aspects of SOP 03-1. The Company is currently evaluating the effect of the implementation of this TPA in its international insurance operations on the Company's consolidated financial position or results of operations.

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Effective January 1, 2003, the Company changed its accounting for employee stock options to adopt the fair value recognition provisions of Statement of Financial Accounting Standards ( SFAS ) No. 123, Accounting for Stock-Based Compensation, as amended, prospectively for all new awards granted to employees on or after January 1, 2003. Prior to January 1, 2003, the Company accounted for employee stock options using the intrinsic value method of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. Under this method, the Company did not recognize any stock-based compensation expense for employee stock options as all options granted had an exercise price equal to the market value of the underlying Common Stock on the date of grant. If the Company had accounted for all employee stock options granted prior to January 1, 2003 under the fair value based accounting method of SFAS No. 123 for the three months ended March 31, 2005 and 2004, net income and earnings per share would have been as follows:

	Three Months Ended		Three Months Ended	
	March 31, 2005		March 31, 2004	
	Financial	Closed	Financial	Closed
	Services	Block	Services	Block
	Businesses	Business	Businesses	Business
	(in millions, except per share amounts)			
Net income, as reported	\$ 766	\$ 163	\$ 290	\$ 111
Add: Total employee stock option compensation expense included in reported net income, net of taxes	6		3	
Deduct: Total employee stock option compensation expense determined under the fair value based method for all awards, net of taxes	(11)		(10)	
Pro forma net income	\$ 761	\$ 163	\$ 283	\$ 111
Earnings per share:				
Basic as reported	\$ 1.51	\$ 70.50	\$ 0.58	\$ 46.00
Basic pro forma	\$ 1.50	\$ 70.50	\$ 0.57	\$ 46.00
Diluted as reported	\$ 1.49	\$ 70.50	\$ 0.57	\$ 46.00
Diluted pro forma	\$ 1.48	\$ 70.50	\$ 0.56	\$ 46.00



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In December 2004, the FASB issued SFAS No. 123(R), Share-Based Payment, which replaces FASB Statement No. 123, Accounting for Stock-Based Compensation. SFAS No. 123(R) requires all entities to apply the fair value based measurement method in accounting for share-based payment transactions with employees except for equity instruments held by employee share ownership plans. Under this method, compensation costs of awards to employees, such as stock options, are measured at fair value and expensed over the period during which an employee is required to provide service in exchange for the award (the vesting period). The Company had previously adopted the fair value recognition provisions of the original SFAS No. 123, prospectively for all new stock options issued to employees on or after January 1, 2003. As issued, SFAS No. 123(R) is effective for interim and annual periods beginning after June 15, 2005. However, the SEC has recently deferred the effective date and as a result the Company will adopt SFAS No. 123(R) on January 1, 2006. By that date, there will be no unvested stock options issued prior to January 1, 2003.

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**PRUDENTIAL FINANCIAL, INC.**

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

The fair value of each option issued prior to January 1, 2003 for purposes of the pro forma information presented above was estimated on the date of grant using a Black-Scholes option-pricing model. For options issued on or after January 1, 2003, the fair value of each option was estimated on the date of grant using a binomial option-pricing model.

The Company accounts for non-employee stock options using the fair value method of SFAS No. 123 in accordance with Emerging Issue Task Force No. 96-18 Accounting for Equity Instruments That Are Issued to Other Than Employees and related interpretations in accounting for its non-employee stock options.

**3. ACQUISITIONS AND DISPOSITIONS**

***Acquisition of Aoba Life Insurance Company, Ltd.***

On November 1, 2004, the Company acquired Aoba Life Insurance Company, Ltd. ( Aoba Life ) for \$191 million of total consideration from Tawa S.A., a subsidiary of Artemis S.A. Aoba Life is a Japanese life insurer with a run-off book of insurance and is not selling new policies. In recording the transaction \$6.4 billion was allocated to assets acquired and \$6.2 billion to liabilities assumed. Aoba Life initially adopted an October 31 fiscal year end for purposes of inclusion in the Company's Consolidated Financial Statements. During the three months ended March 31, 2005, Aoba Life was merged with and into our existing Japanese insurance operations, other than Gibraltar Life, and as a result changed to a December 31 fiscal year end for purposes of inclusion in the Company's Unaudited Interim Consolidated Financial Statements. Accordingly, results for the three months ended March 31, 2005 include five months of results from Aoba Life. Results of Aoba Life for the five months ended March 31, 2005 reflect total revenues of \$145 million, total benefits and expenses of \$110 million and income from continuing operations before cumulative effect of accounting change of \$35 million. Pro forma information for this acquisition is omitted as the impact is not material.

***Acquisition of CIGNA Corporation's Retirement Business***

On April 1, 2004, the Company purchased the retirement business of CIGNA Corporation ( CIGNA ) for \$2.1 billion, including \$2.1 billion of cash consideration and \$20 million of transaction costs. The assets acquired and liabilities assumed and the results of operations have been included in the Company's consolidated financial statements as of that date. The acquisition of this business included the purchase by the Company of all the shares of CIGNA Life Insurance Company ( CIGNA Life ), which became an indirect wholly owned subsidiary of the Company. Prior to the acquisition, CIGNA Life entered into reinsurance arrangements with CIGNA to effect the transfer of the retirement business included in the transaction to CIGNA Life. Subsequent to its acquisition, the Company changed the name of CIGNA Life to Prudential Retirement Insurance and Annuity Company ( PRIAC ).

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The reinsurance arrangements between PRIAC and CIGNA include coinsurance-with-assumption, modified-coinsurance-with-assumption, and modified-coinsurance-without-assumption.

The coinsurance-with-assumption arrangement applies to the acquired general account defined contribution and defined benefit plan contracts. Prior to the acquisition, CIGNA Life assumed from CIGNA all of the insurance liabilities associated with these contracts, totaling \$15.9 billion, and received from CIGNA the related investments. PRIAC has established a trust account for the benefit of CIGNA to secure its obligations to CIGNA under the coinsurance agreement. The Company is in the process of requesting the pension plan customers to agree to substitute PRIAC for CIGNA in their respective contracts, and expects this process to be substantially complete by the end of 2005.

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**PRUDENTIAL FINANCIAL, INC.**

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

The modified-coinsurance-with-assumption arrangements apply to the majority of separate account contracts, and the general account defined benefit guaranteed-cost contracts acquired. Under the modified coinsurance arrangement associated with the separate account contracts, CIGNA retained the separate account and other assets as well as the related separate account and other liabilities until the agreed upon dates of asset transfer but, beginning on the date of acquisition, cedes all of the net profits or losses and related net cash flows associated with the contracts to PRIAC. At the date of acquisition, the statement of financial position for PRIAC included a reinsurance receivable of \$32.4 billion and reinsurance payable of \$32.4 billion established under these modified coinsurance arrangements and reflected in Reinsurance recoverables and Reinsurance payables, respectively. As of March 31, 2005, PRIAC has received from CIGNA the separate account assets and concurrently assumed the associated separate account liabilities, which are primarily included in Separate account assets and Separate account liabilities, respectively, in the Company's Unaudited Interim Consolidated Statement of Financial Position. The Company is in the process of requesting customers to agree to substitute PRIAC for CIGNA in their respective contracts.

The modified-coinsurance-with-assumption arrangement associated with the general account defined benefit guaranteed-cost contracts is similar to the arrangement associated with the separate account contracts; however, beginning two years after the acquisition, the Company may commute this modified coinsurance arrangement in exchange for cash consideration from CIGNA, at which time PRIAC would no longer have a related liability and the defined benefit guaranteed cost contracts would remain with CIGNA. If PRIAC does not commute the modified coinsurance arrangement, this arrangement will convert to a coinsurance-with-assumption arrangement. After the conversion, this coinsurance arrangement will be similar to the arrangement associated with the defined contribution and defined benefit pension plan contracts described above. At the date of acquisition, PRIAC established a reinsurance receivable of \$1.8 billion and a reinsurance payable of \$1.8 billion under the modified coinsurance arrangement, which are reflected in Reinsurance recoverables and Reinsurance payables, respectively. The net profits earned by PRIAC during the two-year period that the modified coinsurance arrangement is in effect are included in Commissions and other income.

The modified-coinsurance-without-assumption arrangement applies to the remaining separate account contracts acquired and is similar to the modified coinsurance arrangement associated with the separate account contracts described above; however, CIGNA will retain the separate account and other assets and the related liabilities while ceding the net profits or losses and the associated net cash flows to PRIAC for the remaining lives of the contracts. At the date of acquisition, PRIAC established a reinsurance receivable of \$1.0 billion and a reinsurance payable of \$1.0 billion for this modified coinsurance arrangement, which are reflected in Reinsurance recoverables and Reinsurance payables, respectively.

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

The following table presents an allocation of the purchase price to assets acquired and liabilities assumed at April 1, 2004:

	<b>(in millions)</b>
Total invested assets at fair value(1)	\$ 17,103
Cash and cash equivalents	45
Accrued investment income	181
Valuation of business acquired ( VOBA )	421
Goodwill	583
Reinsurance recoverable(2)	35,184
Other assets	176
Separate account assets	25
	<hr/>
Total assets acquired	53,718
Future policy benefits assumed	(9)
Policyholders' account balances assumed	(15,866)
Reinsurance payable(2)	(35,184)
Other liabilities	(511)
Separate account liabilities	(25)
	<hr/>
Total liabilities assumed	(51,595)
	<hr/>
Net assets acquired	\$ 2,123
	<hr/>

- (1) Total invested assets include \$11.1 billion of Trading account assets supporting insurance liabilities, which is primarily comprised of fixed maturities.
- (2) The reinsurance recoverable and reinsurance payable amounts represent amounts receivable and payable under the modified coinsurance arrangements described above.

**VOBA**

Valuation of business acquired ( VOBA ), which is established in accordance with purchase accounting guidance, represents the present value of future profits embedded in the acquired contracts. VOBA is determined by estimating the net present value of future cash flows expected to result from contracts in force at the date of the transaction. Future positive cash flows include investment spreads, and fees and other charges assessed to the contracts for as long as they remain in force, while future negative cash flows include costs to administer the contracts and taxes. Contract balances, from which the cash flows arise, are projected using assumptions for add-on deposits, participant withdrawals, contract surrenders, and investment returns. VOBA is further explicitly adjusted to reflect the cost associated with the capital invested in the business. VOBA will be amortized over the expected life of the contracts (approximately 40 years) in proportion to estimated gross profits arising principally from fees in excess of actual expenses based upon historical and estimated future experience, which is updated periodically.



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

The following table provides estimated future amortization of VOBA relating to the acquired CIGNA retirement business from March 31, 2005 and thereafter.

	(in millions)
2005	\$ 14
2006	\$ 9
2007	\$ 5
2008	\$ 4
2009	\$ 3
2010 and thereafter	\$ 367

*Goodwill*

Goodwill is the excess of the cost of an acquired entity over the net amounts assigned to assets acquired and liabilities assumed. Goodwill resulting from the acquisition of CIGNA's retirement business amounted to \$583 million, of which the Company currently estimates 100% to be deductible for tax purposes. In accordance with GAAP, goodwill will not be amortized but rather will be tested at least annually for impairment. The goodwill associated with this acquisition is reflected as \$464 million in the Retirement segment, and as \$119 million in the Asset Management segment.

The following supplemental information presents selected unaudited pro forma information for the Company assuming the acquisition had occurred as of January 1, 2004. 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.

	<b>Three Months Ended</b>	
	<b>March 31, 2004</b>	
	(in millions, except per	
	share data)	
Total revenues	\$	7,291
Income from continuing operations before cumulative effect of accounting change		510
Net income		290
<b>Earnings per share:</b>		
<b>Financial Services Businesses:</b>		
Income from continuing operations before cumulative effect of accounting change per share of Common		
Stock:		
Basic	\$	0.79

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Diluted		0.77
Net income per share of Common Stock:		
Basic	\$	0.37
Diluted		0.37

**Closed Block Business:**

Income from continuing operations before cumulative effect of accounting change per share of Class B Stock:		
Basic and diluted	\$	46.00
Net income per share of Class B Stock:		
Basic and diluted	\$	46.00



**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)*****Acquisition of Hyundai Investment and Securities Co., Ltd.***

On February 27, 2004, the Company acquired an 80% interest in Hyundai Investment and Securities Co., Ltd. and its subsidiary Hyundai Investment Trust Management Co., Ltd., a Korean asset management firm, from the Korean Deposit Insurance Corporation ( KDIC ) an agency of the Korean government for \$301 million in cash, including \$210 million used to repay debt assumed. The Company may choose to acquire, or be required to acquire, from the KDIC the remaining 20% three to six years after closing. Subsequent to the acquisition, the Company was renamed Prudential Investment & Securities Co., Ltd. Pro forma information for this acquisition is omitted as the impact is not material.

The Company's Unaudited Interim Consolidated Statements of Operations for the three months ended March 31, 2005 and March 31, 2004, include the operating results of Prudential Investment & Securities Co., Ltd. from the date of acquisition. In connection with the acquisition Prudential Investment & Securities Co., Ltd. entered into an agreement with the Korean government related to the provision of asset management and brokerage services, which agreement extends until February 27, 2009. Commissions and other income for the three months ended March 31, 2005 includes \$6 million of fees due from the Korean government under the terms of the transaction. There were no such fees included in Prudential Investment & Securities Co., Ltd.'s results of operations for the three months ended March 31, 2004.

***Discontinued Operations***

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

	Three Months Ended	Three Months Ended
	March 31, 2005	March 31, 2004
	—	—
	(in millions)	
International securities operations	\$ (4)	\$ (23)
Healthcare operations	18	
Consumer banking operations	—	8
Income (loss) from discontinued operations before income taxes	14	(15)
Income tax expense (benefit)	6	(9)
Income (loss) from discontinued operations, net of taxes	\$ 8	\$ (6)

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The Company's Unaudited Interim Consolidated Statements of Financial Position include total assets and total liabilities related to discontinued operations of \$117 million and \$84 million, respectively, as of March 31, 2005 and \$141 million and \$114 million, respectively, as of December 31, 2004. Charges recorded in connection with the disposals of operations include estimates that are subject to subsequent adjustment. It is possible that such adjustments might be material to future results of operations of a particular quarterly or annual period.

### **4. 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 Company established a separate closed block for participating individual life insurance policies issued by the Canadian branch of Prudential Insurance. Due to the substantially smaller number of outstanding Canadian policies, this separate closed block is insignificant in size and is not included in the information presented below.

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**PRUDENTIAL FINANCIAL, INC.**

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

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 in the future 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 in the future, which would be intended to increase future actual earnings until the actual cumulative earnings equaled the expected cumulative earnings. As of March 31, 2005, the Company has not recognized a policyholder dividend obligation for the excess of actual cumulative earnings over the expected cumulative earnings. However, net unrealized investment gains that have arisen subsequent to the establishment of the Closed Block have been reflected as a policyholder dividend obligation of \$2,421 million as of March 31, 2005, to be paid to Closed Block policyholders unless otherwise offset by future experience, with an offsetting amount reported in Accumulated other comprehensive income (loss).

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

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, 2005	December 31, 2004
	(in millions)	
<b>Closed Block Liabilities</b>		
Future policy benefits	\$ 49,598	\$ 49,511
Policyholders' dividends payable	1,128	1,077
Policyholder dividend obligation	2,421	3,141
Policyholders' account balances	5,560	5,557
Other Closed Block liabilities	11,189	8,943
<b>Total Closed Block Liabilities</b>	<b>69,896</b>	<b>68,229</b>
<b>Closed Block Assets</b>		
Fixed maturities, available for sale, at fair value	46,119	44,870
Equity securities, available for sale, at fair value	2,591	2,620
Commercial loans	6,673	6,707
Policy loans	5,429	5,454
Other long-term investments	943	996
Short-term investments	1,787	1,769
<b>Total investments</b>	<b>63,542</b>	<b>62,416</b>
Cash and cash equivalents	2,121	1,800
Accrued investment income	714	668
Other Closed Block assets	506	343
<b>Total Closed Block Assets</b>	<b>66,883</b>	<b>65,227</b>
Excess of reported Closed Block Liabilities over Closed Block Assets	3,013	3,002
Portion of above representing accumulated other comprehensive income:		
Net unrealized investment gains	2,638	3,459
Allocated to policyholder dividend obligation	(2,421)	(3,141)
<b>Future earnings to be recognized from Closed Block Assets and Closed Block Liabilities</b>	<b>\$ 3,230</b>	<b>\$ 3,320</b>

Information regarding the policyholder dividend obligation is as follows:

	<b>Three Months Ended</b>
	<b>March 31, 2005</b>
	<b>(in millions)</b>
Balance, January 1, 2005	\$ 3,141
Impact on income before gains allocable to policyholder dividend obligation	
Net investment gains	
Unrealized investment gains	(720)
Balance, March 31, 2005	\$ 2,421

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

Closed Block revenues and benefits and expenses for the three months ended March 31, 2005 and 2004 were as follows:

	<b>Three Months Ended March 31,</b>	
	<b>2005</b>	<b>2004</b>
	(in millions)	
<b>Revenues</b>		
Premiums	\$ 845	\$ 888
Net investment income	849	804
Realized investment gains (losses), net	204	207
Other income	15	16
<b>Total Closed Block revenues</b>	<b>1,913</b>	<b>1,915</b>
<b>Benefits and Expenses</b>		
Policyholders' benefits	942	973
Interest credited to policyholders' account balances	36	35
Dividends to policyholders	571	616
General and administrative expenses	171	171
Other benefits and expenses	9	
<b>Total Closed Block benefits and expenses</b>	<b>1,729</b>	<b>1,795</b>
Closed Block revenues, net of Closed Block benefits and expenses, before income taxes	184	120
Income tax expense (benefit)	94	(48)
<b>Closed Block revenues, net of Closed Block benefits and expenses and income taxes</b>	<b>\$ 90</b>	<b>\$ 168</b>

**5. COMPREHENSIVE INCOME (LOSS)**

The components of comprehensive income (loss), are as follows:

<b>Three Months Ended March 31,</b>	
<b>2005</b>	<b>2004</b>

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	_____	_____
	(in millions)	
Net income	\$ 929	\$ 401
Other comprehensive income (loss), net of taxes:		
Change in foreign currency translation adjustments	(65)	91
Change in net unrealized investments gains (losses)	(514)	317
Additional pension liability adjustment	(2)	
Cumulative effect of accounting change		73
	_____	_____
Other comprehensive income (loss)(1)	(581)	481
	_____	_____
Comprehensive income	\$ 348	\$ 882
	_____	_____

(1) Amounts are net of taxes of \$(261) million and \$117 million for the three months ended March 31, 2005 and 2004, respectively.

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

The balance of and changes in each component of Accumulated other comprehensive income (loss) for the three months ended March 31, 2005 are as follows (net of taxes):

	Accumulated Other Comprehensive Income (Loss)			Total Accumulated Other Comprehensive Income (Loss)
	Foreign	Net		
	Currency	Unrealized	Pension	
	Translation	Investment	Liability	
	Adjustments	Gains (Losses)	Adjustment	
(in millions)				
Balance, December 31, 2004	\$ 326	\$ 2,021	\$ (156)	\$ 2,191
Change in component during period	(65)	(514)	(2)	(581)
Balance, March 31, 2005	\$ 261	\$ 1,507	\$ (158)	\$ 1,610

**6. 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 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 is as follows:

	Three Months Ended March 31,					
	2005			2004		
	Income	Weighted Average Shares	Per Share Amount	Income	Weighted Average Shares	Per Share Amount
(in millions, except per share amounts)						
<b>Basic earnings per share</b>						
Income from continuing operations before cumulative effect of accounting change attributable to the Financial Services Businesses	\$ 758			\$ 375		
Direct equity adjustment	22			19		
	<u>780</u>			<u>394</u>		
Income from continuing operations before cumulative effect of accounting change attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment	<u>\$ 780</u>	<u>521.8</u>	<u>\$ 1.49</u>	<u>\$ 394</u>	<u>529.7</u>	<u>\$ 0.74</u>
<b>Effect of dilutive securities and compensation programs</b>						
Stock options		5.5			3.3	
Deferred and long-term compensation programs		2.7			2.0	
Equity security units					4.9	
		<u>8.2</u>			<u>10.2</u>	
<b>Diluted earnings per share</b>						
Income from continuing operations before cumulative effect of accounting change attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment	<u>\$ 780</u>	<u>530.0</u>	<u>\$ 1.47</u>	<u>\$ 394</u>	<u>539.9</u>	<u>\$ 0.73</u>

For the three months ended March 31, 2005 and 2004, 2.3 million and 2.8 million options, respectively, weighted for the portion of the period they were outstanding, with a weighted average exercise price of \$55.71 and \$44.70 per share, respectively, were excluded from the computation of diluted earnings per share because the options, based on application of the treasury stock method, were antidilutive.

***Class B Stock***

Net income per share of Class B Stock was \$70.50 and \$46.00 for the three months ended March 31, 2005 and 2004, respectively. The net income attributable to the Closed Block Business available to holders of Class B Stock after direct equity adjustment for the three months ended March 31, 2005 and 2004 amounted to \$141 million and \$92 million, respectively. The direct equity adjustment resulted in a decrease in the net income attributable to the Closed Block Business applicable to holders of Class B Stock for earnings per share purposes of \$22 million and \$19 million for the three months ended March 31, 2005 and 2004, respectively. For the three months ended March 31, 2005 and 2004, the weighted average number of shares of Class B Stock used in the calculation of basic earnings per share amounted to 2 million shares. There are no potentially dilutive shares associated with the Class B Stock.

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

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

	Three Months Ended March 31,			
	Pension Benefits		Other Postretirement Benefits	
	2005	2004	2005	2004
	(in millions)			
<b>Components of net periodic (benefit) cost</b>				
Service cost	\$ 41	\$ 37	\$ 3	\$ 3
Interest cost	104	105	36	40
Expected return on plan assets	(199)	(208)	(20)	(20)
Amortization of transition amount		(6)		
Amortization of prior service cost	6	6	(1)	(2)
Amortization of actuarial loss, net	6	6	9	13
Special termination benefits	6			
<b>Net periodic (benefit) cost</b>	<b>\$ (36)</b>	<b>\$ (60)</b>	<b>\$ 27</b>	<b>\$ 34</b>

**8. 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 seven reportable segments. Businesses that are not sufficiently material to warrant separate disclosure and businesses to be divested are included in Corporate and Other operations. Collectively, the businesses that comprise the three operating divisions and Corporate and Other are referred to as the Financial Services Businesses.

*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 from continuing operations before income taxes and cumulative effect of accounting change as determined in accordance with GAAP but is the measure of segment profit or loss used by the Company to evaluate segment performance and allocate resources, and, consistent with SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, is the measure of segment performance presented below.

Adjusted operating income is calculated by adjusting each segment's income from continuing operations before income taxes and cumulative effect of accounting change to exclude the following items, which are described in greater detail below:

realized investment gains (losses), net, except as indicated below, 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; and

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 GAAP.

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**PRUDENTIAL FINANCIAL, INC.**

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

The excluded items are important to an understanding of overall results of operations. Adjusted operating income is not a substitute for net income determined in accordance with 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. A significant element of realized losses is impairments and losses from sales of credit-impaired securities, the timing of which depends largely on market credit cycles and can vary considerably across periods. The timing of other sales that would result in gains or losses is largely subject to the Company's discretion and influenced by market opportunities. 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, which are offset against net realized investment gains and losses in the schedules below, relate to policyholder dividends, amortization of deferred policy acquisition costs and VOBA, reserves for future policy benefits, payments associated with the market value adjustment features related to certain of the annuity products we sell, and minority interest in consolidated operating subsidiaries. The related charges associated with policyholder dividends include a percentage of net realized investment gains on specified Gibraltar Life assets that is required to be paid as dividends to Gibraltar Life policyholders. Deferred policy acquisition costs for certain investment-type products, as well as VOBA, are amortized based on estimated gross profits, which include net realized investment gains and losses on the underlying invested assets. The related charge for deferred policy acquisition costs and VOBA represents the portion of this amortization associated with net realized investment gains and losses. 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 our annuity products contain a market value adjustment feature that requires us to pay to the contractholder or entitles us 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 adjustments features. Minority interest expense is recorded for the earnings of consolidated subsidiaries owed to minority investors. The related charge for minority interest in consolidated operating subsidiaries represents the portion of these earnings associated with net realized investment gains and losses.

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, other than derivatives used for trading purposes, 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.

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Adjusted operating income of the International Insurance and International Investments segments reflect the impact of an intercompany arrangement with Corporate and Other operations pursuant to which those segments' results in certain 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

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

to mitigate the risk that unfavorable rate changes will reduce those segments' U.S. dollar equivalent earnings. Pursuant to this program, the Company executes forward sale contracts in 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 non-U.S. earnings are expected to be generated. These contracts do not qualify for hedge accounting under 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 (losses of \$36 million and losses of \$25 million for the three months ended March 31, 2005 and 2004, respectively). As of March 31, 2005 and 2004, the fair value of open contracts used for this purpose was a net liability of \$122 million and \$184 million, respectively.

The Company utilizes interest and currency swaps 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. Adjusted operating income includes gains of \$18 million and \$8 million for the three months ended March 31, 2005 and 2004, respectively, due to periodic settlements and yield adjustments of such contracts.

As part of the acquisition of CIGNA's retirement business, the Company entered into reinsurance agreements with CIGNA, including a modified-coinsurance-with-assumption arrangement that applies to the defined benefit guaranteed-cost contracts acquired. The net results of these contracts are recorded in Commissions and other income, as a result of the reinsurance arrangement, and such net results include realized investment gains and losses. These realized investment gains and losses are excluded from adjusted operating income as an adjustment to Realized investment gains (losses), net. For the three months ended March 31, 2005, net realized investment gains of \$12 million were excluded.

*Investment gains and losses on trading account assets supporting insurance liabilities and changes in experience-rated contractholder liabilities due to asset value changes.* Certain products included in the retirement business acquired from CIGNA, as well as certain products included in the International Insurance segment, are experience-rated in that investment results associated with these products will ultimately inure to contractholders. The investments supporting these experience-rated products, excluding mortgage loans, are classified as trading. These trading investments are reflected on the statements of financial position as Trading account assets supporting insurance liabilities, at fair value and all investment results are reported in Commissions and other income. Mortgage 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 loans.

Adjusted operating income excludes net investment gains and losses on trading account assets supporting insurance liabilities. 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, as discussed above. In addition, to be consistent with the historical treatment of charges related to realized gains and losses on available for sale securities, adjusted operating income also excludes the change in contractholder liabilities due to asset value changes in the pool of investments (including mortgage 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 only 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 inure to the contractholders.





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

*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 GAAP, are excluded from adjusted operating income as the results of divested businesses are not relevant to understanding the Company's ongoing operating results.

The summary below reconciles adjusted operating income to income from continuing operations before income taxes and cumulative effect of accounting change:

	<b>Three Months Ended March 31,</b>	
	<b>2005</b>	<b>2004</b>
(in millions)		
Adjusted Operating Income before income taxes for Financial Services Businesses by Segment:		
Individual Life and Annuities	\$ 217	\$ 185
Group Insurance	38	26
<b>Total Insurance Division</b>	<b>255</b>	<b>211</b>
Asset Management	134	58
Financial Advisory	15	(14)
Retirement	155	52
<b>Total Investment Division</b>	<b>304</b>	<b>96</b>
International Insurance	285	215
International Investments	26	6
<b>Total International Insurance and Investments Division</b>	<b>311</b>	<b>221</b>
Corporate and Other	16	22
<b>Adjusted Operating Income before income taxes for Financial Services Businesses</b>	<b>886</b>	<b>550</b>
Items excluded from Adjusted Operating Income:		
Realized investment gains (losses), net, and related adjustments	257	9
Charges related to realized investment gains (losses), net	(21)	(8)
Investment gains (losses) on trading account assets supporting insurance liabilities, net	(130)	50
Change in experience-rated contractholder liabilities due to asset value changes	86	(50)
Divested businesses	(14)	(17)

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Income from continuing operations before income taxes and cumulative effect of accounting change for Financial Services Businesses	1,064	534
	<u>          </u>	<u>          </u>
Income from continuing operations before income taxes for Closed Block Business	245	172
	<u>          </u>	<u>          </u>
Income from continuing operations before income taxes and cumulative effect of accounting change	\$ 1,309	\$ 706
	<u>          </u>	<u>          </u>

The Individual Life and Annuities segment results reflect deferred policy acquisition costs as if the individual annuity business were a stand-alone operation. 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:

	<b>Three Months Ended March 31,</b>	
	<b>2005</b>	<b>2004</b>
	(in millions)	
<b>Financial Services Businesses:</b>		
Individual Life and Annuities	\$ 972	\$ 893
Group Insurance	1,052	966
<b>Total Insurance Division</b>	<b>2,024</b>	<b>1,859</b>
Asset Management	418	347
Financial Advisory	112	106
Retirement	943	577
<b>Total Investment Division</b>	<b>1,473</b>	<b>1,030</b>
International Insurance	1,918	1,596
International Investments	126	87
<b>Total International Insurance and Investments Division</b>	<b>2,044</b>	<b>1,683</b>
Corporate and Other	90	106
<b>Total</b>	<b>5,631</b>	<b>4,678</b>
<b>Items excluded from Adjusted Operating Income:</b>		
Realized investment gains (losses), net, and related adjustments	257	9
Charges related to realized investment gains (losses), net	(3)	(10)
Investment gains (losses) on trading account assets supporting insurance liabilities, net	(130)	50
Divested businesses	42	36
<b>Total Financial Services Businesses</b>	<b>5,797</b>	<b>4,763</b>
Closed Block Business	1,981	1,988
<b>Total per Unaudited Interim Consolidated Financial Statements</b>	<b>\$ 7,778</b>	<b>\$ 6,751</b>

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The Asset Management segment revenues include intersegment revenues of \$93 million and \$77 million for the three months ended March 31, 2005 and 2004, respectively, primarily consisting of asset-based management and administration fees. Management has determined the intersegment revenues with reference to market rates. Intersegment revenues are eliminated in consolidation.

**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 periods indicated:

	<b>March 31,</b>	<b>December 31,</b>
	<b>2005</b>	<b>2004</b>
	<b>(in millions)</b>	
Individual Life and Annuities	\$ 83,907	\$ 84,498
Group Insurance	24,455	24,250
<b>Total Insurance Division</b>	<b>108,362</b>	<b>108,748</b>
Asset Management	24,602	24,795
Financial Advisory	1,510	1,151
Retirement	115,872	116,596
<b>Total Investment Division</b>	<b>141,984</b>	<b>142,542</b>
International Insurance	56,686	57,761
International Investments	4,135	4,425
<b>Total International Insurance and Investments Division</b>	<b>60,821</b>	<b>62,186</b>
Corporate and Other	18,598	16,002
<b>Total Financial Services Businesses</b>	<b>329,765</b>	<b>329,478</b>
Closed Block Business	73,403	71,580
<b>Total</b>	<b>\$ 403,168</b>	<b>\$ 401,058</b>

**9. CONTINGENCIES AND LITIGATION AND REGULATORY MATTERS****Contingencies**

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. 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.

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, 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 our businesses and operations that are specific to the Company and proceedings that are typical of the businesses in which the Company operates, including in both cases businesses that have either been 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.

*Shane v. Humana, et. al* is a nationwide class action lawsuit brought on behalf of provider physicians and physician groups alleging that Prudential Insurance and other health care companies engaged in an industry-wide conspiracy to defraud physicians by failing to pay under provider agreements and by unlawfully coercing

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**PRUDENTIAL FINANCIAL, INC.**

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

physicians to enter into agreements with unfair and unreasonable terms. On April 29, 2005, Prudential Insurance agreed in principle to a settlement of these claims. The terms of the settlement include the payment by Prudential Insurance to plaintiffs of \$22 million. This settlement is subject to court approval.

The Company's litigation is subject to many uncertainties, and given its complexity and scope, its outcome cannot be predicted. 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 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. Management believes, however, that the ultimate outcome of all pending litigation and regulatory matters, after consideration of applicable reserves, should not have a material adverse effect on the Company's financial position.

**10. SUBSEQUENT EVENTS**

On March 28, 2005, The Gibraltar Life Insurance Company, Ltd. ( Gibraltar Life ), an indirect wholly owned subsidiary of the Company, entered into a settlement with Dai Ichi Fire and Marine Insurance Company ( Dai Ichi ) with respect to the appeal by Dai Ichi of a court decision in a lawsuit relating to certain capital investments made by Gibraltar Life's predecessor, Kyoei Life Insurance Company, Ltd., in Dai Ichi. The settlement, which was approved by the Tokyo High Court on March 28, 2005, provided for the dismissal of Dai Ichi's appeal and the payment by Dai Ichi to Gibraltar Life of approximately \$93 million.

Payment of the agreed settlement amount was made to Gibraltar Life on March 31, 2005. Gibraltar Life has adopted a November 30<sup>th</sup> fiscal year-end for purposes of inclusion in the Company's Consolidated Financial Statements; therefore, the Company's first quarter 2005 results include the results of Gibraltar Life for the three months ended February 28, 2005. The Company accounted for this gain contingency and related obligations when the cash was received on March 31, 2005. Accordingly, proceeds of the settlement are not recorded as income in the Company's Unaudited Interim Consolidated Financial Statements for the three months ended March 31, 2005 but will be included as income during the second quarter of 2005. Income recorded as a result of the settlement will be included within Realized investment gains (losses), net.

As part of the reorganization plan entered into at the time of the Company's acquisition of Gibraltar Life, Gibraltar Life agreed to pay extraordinary dividends to certain eligible policyholders based on approximately 70% of net realized investment gains (net of applicable taxes), if any, over the value of certain real estate and loans subject to the reorganization plan. The settlement proceeds will be included in net realized investment gains for purposes of calculating the extraordinary dividend that will be paid later this year. Therefore, concurrent with the recognition of the settlement, the Company will record expense and an increase in the liability for policyholders' dividends equal to approximately 60% of the settlement.

Because the settlement will be included within Realized investment gains (losses), net, the income, as well as the related charge for the extraordinary dividend referred to above, will not be included in adjusted operating income (see Note 8 for a discussion of adjusted operating income).





**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Supplemental Combining Statements of Financial Position****March 31, 2005 and December 31, 2004 (in millions)**

	March 31, 2005			December 31, 2004		
	Financial	Closed		Financial	Closed	
	Services	Block		Services	Block	
	Businesses	Business	Consolidated	Businesses	Business	Consolidated
<b>ASSETS</b>						
Fixed maturities:						
Available for sale, at fair value	\$ 103,966	\$ 50,068	\$ 154,034	\$ 102,155	\$ 48,813	\$ 150,968
Held to maturity, at amortized cost	3,389		3,389	2,747		2,747
Trading account assets supporting insurance liabilities, at fair value	13,239		13,239	12,964		12,964
Other trading account assets, at fair value	1,488		1,488	1,547		1,547
Equity securities, available for sale, at fair value	1,865	2,591	4,456	1,663	2,620	4,283
Commercial loans	16,569	7,245	23,814	17,092	7,297	24,389
Policy loans	2,943	5,429	8,372	2,919	5,454	8,373
Securities purchased under agreements to resell	171		171	127		127
Other long-term investments	4,644	995	5,639	4,934	1,047	5,981
Short-term investments	2,992	1,860	4,852	3,405	1,840	5,245
<b>Total investments</b>	<b>151,266</b>	<b>68,188</b>	<b>219,454</b>	<b>149,553</b>	<b>67,071</b>	<b>216,624</b>
Cash and cash equivalents	6,291	2,206	8,497	6,164	1,908	8,072
Accrued investment income	1,375	774	2,149	1,307	721	2,028
Reinsurance recoverables	3,767		3,767	32,790		32,790
Deferred policy acquisition costs	7,854	1,197	9,051	7,624	1,223	8,847
Other assets	16,644	1,038	17,682	16,472	657	17,129
Separate account assets	142,568		142,568	115,568		115,568
<b>TOTAL ASSETS</b>	<b>\$ 329,765</b>	<b>\$ 73,403</b>	<b>\$ 403,168</b>	<b>\$ 329,478</b>	<b>\$ 71,580</b>	<b>\$ 401,058</b>
<b>LIABILITIES AND ATTRIBUTED EQUITY</b>						
<b>LIABILITIES</b>						
Future policy benefits	\$ 52,370	\$ 49,598	\$ 101,968	\$ 52,522	\$ 49,511	\$ 102,033
Policyholders' account balances	70,287	5,560	75,847	69,940	5,557	75,497
Unpaid claims and claim adjustment expenses	1,839		1,839	1,807		1,807
Policyholders' dividends	1,148	3,549	4,697	1,132	4,218	5,350
Reinsurance payables	3,345		3,345	32,386		32,386
Securities sold under agreements to repurchase	6,087	5,971	12,058	4,657	4,301	8,958
Cash collateral for loaned securities	3,246	2,865	6,111	4,248	3,021	7,269
Income taxes payable	2,508	134	2,642	2,681		2,681
Securities sold but not yet purchased	466		466	427		427
Short-term debt	6,253	757	7,010	3,896	148	4,044
Long-term debt	5,981	1,750	7,731	5,877	1,750	7,627

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Other liabilities	12,423	2,044	14,467	13,128	1,939	15,067
Separate account liabilities	142,568		142,568	115,568		115,568
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total liabilities	308,521	72,228	380,749	308,269	70,445	378,714
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<b>COMMITMENTS AND CONTINGENCIES</b>						
<b>ATTRIBUTED EQUITY</b>						
Accumulated other comprehensive income	1,337	273	1,610	1,817	374	2,191
Other attributed equity	19,907	902	20,809	19,392	761	20,153
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Total attributed equity	21,244	1,175	22,419	21,209	1,135	22,344
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
<b>TOTAL LIABILITIES AND ATTRIBUTED EQUITY</b>	<b>\$ 329,765</b>	<b>\$ 73,403</b>	<b>\$ 403,168</b>	<b>\$ 329,478</b>	<b>\$ 71,580</b>	<b>\$ 401,058</b>
	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>

*See Notes to Unaudited Interim Supplemental Combining Financial Information*

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Supplemental Combining Statements of Operations****For the three months ended March 31, 2005 and 2004 (in millions)**

	Three Months Ended March 31,					
	2005			2004		
	Financial	Closed	Consolidated	Financial	Closed	Consolidated
	Services	Block		Services	Block	
	Businesses	Business		Businesses	Business	
<b>REVENUES</b>						
Premiums	\$ 2,531	\$ 845	\$ 3,376	\$ 2,193	\$ 888	\$ 3,081
Policy charges and fee income	623		623	557		557
Net investment income	1,506	918	2,424	1,245	879	2,124
Realized investment gains (losses), net	227	203	430	(8)	205	197
Commissions and other income	910	15	925	776	16	792
<b>Total revenues</b>	<b>5,797</b>	<b>1,981</b>	<b>7,778</b>	<b>4,763</b>	<b>1,988</b>	<b>6,751</b>
<b>BENEFITS AND EXPENSES</b>						
Policyholders' benefits	2,532	942	3,474	2,267	973	3,240
Interest credited to policyholders' account balances	517	36	553	477	35	512
Dividends to policyholders	37	571	608	25	616	641
General and administrative expenses	1,647	187	1,834	1,460	192	1,652
<b>Total benefits and expenses</b>	<b>4,733</b>	<b>1,736</b>	<b>6,469</b>	<b>4,229</b>	<b>1,816</b>	<b>6,045</b>
<b>INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND CUMULATIVE EFFECT OF ACCOUNTING CHANGE</b>						
	1,064	245	1,309	534	172	706
Income tax expense	306	82	388	159	61	220
<b>INCOME FROM CONTINUING OPERATIONS BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE</b>						
	758	163	921	375	111	486
Income (loss) from discontinued operations, net of taxes	8		8	(6)		(6)
Cumulative effect of accounting change, net of taxes				(79)		(79)
<b>NET INCOME</b>	<b>\$ 766</b>	<b>\$ 163</b>	<b>\$ 929</b>	<b>\$ 290</b>	<b>\$ 111</b>	<b>\$ 401</b>



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**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 Unaudited Interim 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 4 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 in Note 2 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 Insurance, Investment, and International Insurance and Investments 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 each 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 based on the general and administrative expenses of each business as a percentage of total general and administrative expenses for all businesses.

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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.

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**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.

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**Item 4. Controls and Procedures**

In order to ensure that the information we must disclose in our filings with the Securities and Exchange Commission is recorded, processed, summarized, and reported on a timely basis, the Company's management, including our Chief Executive Officer and Chief Financial Officer, previously reviewed and evaluated the effectiveness of our disclosure controls and procedures, as defined in Exchange Act Rule 13a-15(e), as of March 31, 2005. Based on such evaluation, the Chief Executive Officer and Chief Financial Officer previously concluded that, as of March 31, 2005, our disclosure controls and procedures were effective in timely alerting them to material information relating to us (and our consolidated subsidiaries) required to be included in our periodic SEC filings. No change in our internal control over financial reporting, as defined in Exchange Act Rule 13a-15(f), occurred during the quarter ended March 31, 2005, that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. These conclusions are not affected by the misclassifications in the Company's Consolidated Statements of Cash Flows discussed in the following paragraph, which were identified subsequent to the filing of the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2005.

As reported in a Current Report on Form 8-K filed by the Company on February 6, 2006, management of the Company concluded that certain amounts were incorrectly classified in the Company's audited Consolidated Statements of Cash Flows for the years ended December 31, 2004, 2003 and 2002 included in the Company's 2004 Annual Report on Form 10-K (the 2004 Form 10-K) and in the Company's unaudited Consolidated Statements of Cash Flows for the periods ended March 31 and June 30, 2005 and 2004 included in the Company's Quarterly Reports on Form 10-Q for the quarters ended March 31 and June 30, 2005 (the 2005 Forms 10-Q). In connection with the preparation of the Company's consolidated financial statements for the year ended December 31, 2005, management of the Company concluded on February 1, 2006 that the Company should file a Form 10-K/A and Forms 10-Q/A, including this Form 10-Q/A, restating the Consolidated Statements of Cash Flows included in the 2004 Form 10-K and in the 2005 Forms 10-Q. The restatements are limited in scope, relating to the classification of data collected and not to the collection of data or to the numerical accuracy of data collected. The Company has implemented enhancements to its internal control over financial reporting, primarily with respect to the periodic analysis and review of statements of cash flows, designed to provide reasonable assurance that errors of this type in the Company's Consolidated Statements of Cash Flows will not recur.



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**PART II OTHER INFORMATION**

**Item 6. Exhibits**

- 31.1 Section 302 Certification of the Chief Executive Officer.
- 31.2 Section 302 Certification of the Chief Financial Officer.
- 32.1 Section 906 Certification of the Chief Executive Officer.
- 32.2 Section 906 Certification of the Chief Financial Officer.

Prudential Financial, Inc. will furnish upon request a copy of any exhibit listed above upon the payment of a reasonable fee covering the expense of furnishing the copy. Requests should be directed to:

Shareholder Services

Prudential Financial, Inc.

751 Broad Street, 22nd Floor

Newark, NJ 07102

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PRUDENTIAL FINANCIAL, INC.

By:                     /s/ RICHARD J. CARBONE                    

**Richard J. Carbone**

**Senior Vice President and Chief Financial Officer**

**(Authorized signatory and principal financial officer)**

Date: February 15, 2006

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**Exhibit Index**

***Exhibit Number and Description***

- 31.1 Section 302 Certification of the Chief Executive Officer.
- 31.2 Section 302 Certification of the Chief Financial Officer.
- 32.1 Section 906 Certification of the Chief Executive Officer.
- 32.2 Section 906 Certification of the Chief Financial Officer.