

PRUDENTIAL FINANCIAL INC

Form 10-Q

November 07, 2013

[Table of Contents](#)

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

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended September 30, 2013

OR

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

For the Transition Period from            to

Commission File Number 001-16707

# Prudential Financial, Inc.

(Exact Name of Registrant as Specified in its Charter)

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

Incorporation or Organization)

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

Identification Number)

**751 Broad Street**

**Newark, New Jersey 07102**

**(973) 802-6000**

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

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

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

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

As of October 31, 2013, 461 million shares of the registrant's Common Stock (par value \$0.01) were outstanding. In addition, 2 million shares of the registrant's Class B Stock, for which there is no established public trading market, were outstanding.



**Table of Contents****TABLE OF CONTENTS**

|  | <b>Page<br/>Number</b> |
|--|------------------------|
| <b><u>PART I FINANCIAL INFORMATION</u></b>   |                        |
| Item 1. <u>Financial Statements:</u>   |                        |
| <u>Unaudited Interim Consolidated Statements of Financial Position as of September 30, 2013 and December 31, 2012</u>                    | 1                      |
| <u>Unaudited Interim Consolidated Statements of Operations for the three and nine months ended September 30, 2013 and 2012</u>           | 2                      |
| <u>Unaudited Interim Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2013 and 2012</u> | 3                      |
| <u>Unaudited Interim Consolidated Statements of Equity for the nine months ended September 30, 2013 and 2012</u>                         | 4                      |
| <u>Unaudited Interim Consolidated Statements of Cash Flows for the nine months ended September 30, 2013 and 2012</u>                     | 5                      |
| <u>Notes to Unaudited Interim Consolidated Financial Statements</u>  | 6                      |
| Unaudited Interim Supplemental Combining Financial Information:  |                        |
| <u>Unaudited Interim Supplemental Combining Statements of Financial Position as of September 30, 2013 and December 31, 2012</u>          | 114                    |
| <u>Unaudited Interim Supplemental Combining Statements of Operations for the three months ended September 30, 2013 and 2012</u>          | 115                    |
| <u>Unaudited Interim Supplemental Combining Statements of Operations for the nine months ended September 30, 2013 and 2012</u>           | 116                    |
| <u>Notes to Unaudited Interim Supplemental Combining Financial Information</u>   | 117                    |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                                     | 119                    |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>  | 230                    |
| Item 4. <u>Controls and Procedures</u>   | 231                    |
| <b><u>PART II OTHER INFORMATION</u></b>  |                        |
| Item 1. <u>Legal Proceedings</u>   | 232                    |
| Item 1A. <u>Risk Factors</u>   | 232                    |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>   | 233                    |
| Item 6. <u>Exhibits</u>  | 233                    |
| <b><u>SIGNATURES</u></b>   | 235                    |

---

**Table of Contents**

**Forward-Looking Statements**

Certain of the statements included in this Quarterly Report on Form 10-Q, including but not limited to those in Management's Discussion and Analysis of Financial Condition and Results of Operations, constitute forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. Words such as expects, believes, anticipates, includes, plans, assumes, estimates, projects, should, will, shall or variations of such words are generally part of forward-looking statements. Forward-looking statements are made based on management's current expectations and beliefs concerning future developments and their potential effects upon Prudential Financial, Inc. and its subsidiaries. There can be no assurance that future developments affecting Prudential Financial, Inc. and its subsidiaries will be those anticipated by management. These forward-looking statements are not a guarantee of future performance and involve risks and uncertainties, and there are certain important factors that could cause actual results to differ, possibly materially, from expectations or estimates reflected in such forward-looking statements, including, among others: (1) general economic, market and political conditions, including the performance and fluctuations of fixed income, equity, real estate and other financial markets; (2) the availability and cost of additional debt or equity capital or external financing for our operations; (3) interest rate fluctuations or prolonged periods of low interest rates; (4) the degree to which we choose not to hedge risks, or the potential ineffectiveness or insufficiency of hedging or risk management strategies we do implement, with regard to variable annuity or other product guarantees; (5) any inability to access our credit facilities; (6) reestimates of our reserves for future policy benefits and claims; (7) differences between actual experience regarding mortality, longevity, morbidity, persistency, surrender experience, interest rates or market returns and the assumptions we use in pricing our products, establishing liabilities and reserves or for other purposes; (8) changes in our assumptions related to deferred policy acquisition costs, value of business acquired or goodwill; (9) changes in assumptions for retirement expense; (10) changes in our financial strength or credit ratings; (11) statutory reserve requirements associated with term and universal life insurance policies under Regulation XXX and Guideline AXXX; (12) investment losses, defaults and counterparty non-performance; (13) competition in our product lines and for personnel; (14) difficulties in marketing and distributing products through current or future distribution channels; (15) changes in tax law; (16) economic, political, currency and other risks relating to our international operations; (17) fluctuations in foreign currency exchange rates and foreign securities markets; (18) regulatory or legislative changes, including the Dodd-Frank Wall Street Reform and Consumer Protection Act; (19) inability to protect our intellectual property rights or claims of infringement of the intellectual property rights of others; (20) adverse determinations in litigation or regulatory matters and our exposure to contingent liabilities, including in connection with our divestiture or winding down of businesses; (21) domestic or international military actions, natural or man-made disasters including terrorist activities or pandemic disease, or other events resulting in catastrophic loss of life; (22) ineffectiveness of risk management policies and procedures in identifying, monitoring and managing risks; (23) effects of acquisitions, divestitures and restructurings, including possible difficulties in integrating and realizing projected results of acquisitions; (24) interruption in telecommunication, information technology or other operational systems or failure to maintain the security, confidentiality or privacy of sensitive data on such systems; (25) changes in statutory or U.S. GAAP accounting principles, practices or policies; (26) Prudential Financial, Inc.'s primary reliance, as a holding company, on dividends or distributions from its subsidiaries to meet debt payment obligations and the ability of the subsidiaries to pay such dividends or distributions in light of our ratings objectives and/or applicable regulatory restrictions; and (27) risks due to the lack of legal separation between our Financial Services Businesses and our Closed Block Business. Prudential Financial, Inc. does not intend, and is under no obligation, to update any particular forward-looking statement included in this document. See Risk Factors herein and in the Annual Report on Form 10-K for the year ended December 31, 2012 for discussion of certain risks relating to our businesses and investment in our securities.

**Table of Contents**

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

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

September 30, 2013 and December 31, 2012 (in millions, except share amounts)

|  | September<br>30,<br>2013 | December<br>31,<br>2012 |
|--|--------------------------|-------------------------|
| <b>ASSETS</b>  |                          |                         |
| Fixed maturities, available-for-sale, at fair value (amortized cost: 2013-\$272,399; 2012- \$277,654)(1)   | \$ 288,766               | \$ 301,336              |
| Fixed maturities, held-to-maturity, at amortized cost (fair value: 2013-\$3,872; 2012- \$4,511)(1)   | 3,629                    | 4,268                   |
| Trading account assets supporting insurance liabilities, at fair value(1)  | 21,131                   | 20,590                  |
| Other trading account assets, at fair value(1)   | 6,403                    | 6,328                   |
| Equity securities, available-for-sale, at fair value (cost: 2013-\$6,684; 2012-\$6,759)  | 8,984                    | 8,277                   |
| Commercial mortgage and other loans (includes \$117 and \$162 measured at fair value under the fair value option at September 30, 2013 and December 31, 2012, respectively)(1) | 39,497                   | 36,733                  |
| Policy loans   | 11,863                   | 11,575                  |
| Other long-term investments (includes \$508 and \$465 measured at fair value under the fair value option at September 30, 2013 and December 31, 2012, respectively)(1)         | 9,869                    | 10,028                  |
| Short-term investments   | 8,497                    | 6,447                   |
| Total investments  | 398,639                  | 405,582                 |
| Cash and cash equivalents(1)   | 12,650                   | 18,100                  |
| Accrued investment income(1)   | 3,157                    | 3,127                   |
| Deferred policy acquisition costs  | 16,228                   | 14,100                  |
| Value of business acquired   | 3,837                    | 3,248                   |
| Other assets(1)  | 13,524                   | 11,887                  |
| Separate account assets  | 275,091                  | 253,254                 |
| <b>TOTAL ASSETS</b>  | <b>\$ 723,126</b>        | <b>\$ 709,298</b>       |
| <b>LIABILITIES AND EQUITY</b>  |                          |                         |
| <b>LIABILITIES</b>   |                          |                         |
| Future policy benefits   | \$ 209,177               | \$ 216,050              |
| Policyholders' account balances(1)   | 137,573                  | 134,413                 |
| Policyholders' dividends   | 5,607                    | 7,507                   |
| Securities sold under agreements to repurchase   | 7,158                    | 5,818                   |
| Cash collateral for loaned securities  | 5,955                    | 3,941                   |
| Income taxes   | 4,943                    | 8,551                   |
| Short-term debt  | 3,118                    | 2,484                   |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|  |                   |                   |
|--|-------------------|-------------------|
| Long-term debt   | 23,642            | 24,729            |
| Other liabilities(1)   | 13,323            | 11,683            |
| Notes issued by consolidated variable interest entities (includes \$2,330 and \$1,406 measured at fair value under the fair value option at September 30, 2013 and December 31, 2012, respectively)(1) | 2,423             | 1,577             |
| Separate account liabilities   | 275,091           | 253,254           |
| Total liabilities  | 688,010           | 670,007           |
| <b>COMMITMENTS AND CONTINGENT LIABILITIES (See Note 15)</b>  |                   |                   |
| <b>EQUITY</b>  |                   |                   |
| Preferred Stock (\$.01 par value; 10,000,000 shares authorized; none issued)   | 0                 | 0                 |
| Common Stock (\$.01 par value; 1,500,000,000 shares authorized; 660,111,307 and 660,111,307 shares issued at September 30, 2013 and December 31, 2012, respectively)                                   | 6                 | 6                 |
| Class B Stock (\$.01 par value; 10,000,000 shares authorized; 2,000,000 shares issued and outstanding at September 30, 2013 and December 31, 2012, respectively)                                       | 0                 | 0                 |
| Additional paid-in capital   | 24,413            | 24,380            |
| Common Stock held in treasury, at cost (198,224,292 and 197,077,940 shares at September 30, 2013 and December 31, 2012, respectively)  | (12,295)          | (12,163)          |
| Accumulated other comprehensive income (loss)  | 6,899             | 10,214            |
| Retained earnings  | 15,335            | 16,138            |
| Total Prudential Financial, Inc. equity  | 34,358            | 38,575            |
| Noncontrolling interests   | 758               | 716               |
| Total equity   | 35,116            | 39,291            |
| <b>TOTAL LIABILITIES AND EQUITY</b>  | <b>\$ 723,126</b> | <b>\$ 709,298</b> |

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

*See Notes to Unaudited Interim Consolidated Financial Statements*

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Consolidated Statements of Operations****Three and Nine Months Ended September 30, 2013 and 2012 (in millions, except per share amounts)**

|  | <b>Three Months Ended<br/>September 30,</b> |                 | <b>Nine Months Ended<br/>September 30,</b> |               |
|--|---|-----------------|--|---------------|
|  | <b>2013</b>                                 | <b>2012</b>     | <b>2013</b>                                | <b>2012</b>   |
| <b>REVENUES</b>  |   |                 |  |               |
| Premiums   | \$ 6,141                                    | \$ 9,027        | \$ 20,147                                  | \$ 23,356     |
| Policy charges and fee income  | 1,257                                       | 1,224           | 3,988                                      | 3,335         |
| Net investment income  | 3,650                                       | 3,433           | 10,999                                     | 10,111        |
| Asset management fees and other income   | 2,405                                       | 905             | 295  | 3,167         |
| Realized investment gains (losses), net:   |   |                 |  |               |
| Other-than-temporary impairments on fixed maturity securities  | (359)                                       | (426)           | (847)                                      | (1,345)       |
| Other-than-temporary impairments on fixed maturity securities transferred to Other Comprehensive Income                | 316   | 331             | 701  | 1,045         |
| Other realized investment gains (losses), net  | (2,067)                                     | (1,350)         | (3,711)                                    | (766)         |
| Total realized investment gains (losses), net  | (2,110)                                     | (1,445)         | (3,857)                                    | (1,066)       |
| Total revenues   | 11,343                                      | 13,144          | 31,572                                     | 38,903        |
| <b>BENEFITS AND EXPENSES</b>   |   |                 |  |               |
| Policyholders' benefits  | 6,237                                       | 9,576           | 20,480                                     | 23,446        |
| Interest credited to policyholders' account balances   | 759   | 1,057           | 2,203                                      | 3,270         |
| Dividends to policyholders   | 582   | 517             | 1,587                                      | 1,563         |
| Amortization of deferred policy acquisition costs  | (452)                                       | 182             | (14)                                       | 1,194         |
| General and administrative expenses  | 2,658                                       | 2,742           | 8,068                                      | 8,154         |
| Total benefits and expenses  | 9,784                                       | 14,074          | 32,324                                     | 37,627        |
| <b>INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES</b> | <b>1,559</b>                                | <b>(930)</b>    | <b>(752)</b>                               | <b>1,276</b>  |
| Income tax expense (benefit)   | 509   | (328)           | (595)                                      | 594           |
| <b>INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES</b>                  | <b>1,050</b>                                | <b>(602)</b>    | <b>(157)</b>                               | <b>682</b>    |
| Equity in earnings of operating joint ventures, net of taxes   | 3   | 45              | 57   | 58            |
| <b>INCOME (LOSS) FROM CONTINUING OPERATIONS</b>  | <b>1,053</b>                                | <b>(557)</b>    | <b>(100)</b>                               | <b>740</b>    |
| Income (loss) from discontinued operations, net of taxes   | 8   | (2)             | 11   | 12            |
| <b>NET INCOME (LOSS)</b>   | <b>1,061</b>                                | <b>(559)</b>    | <b>(89)</b>                                | <b>752</b>    |
| Less: Income (loss) attributable to noncontrolling interests   | 19  | 25              | 96   | 51            |
| <b>NET INCOME (LOSS) ATTRIBUTABLE TO PRUDENTIAL FINANCIAL, INC.</b>  | <b>\$ 1,042</b>                             | <b>\$ (584)</b> | <b>\$ (185)</b>                            | <b>\$ 701</b> |
| <b>EARNINGS PER SHARE (See Note 8)</b>   |   |                 |  |               |
| <b>Financial Services Businesses</b>   |   |                 |  |               |
| <b>Basic earnings per share-Common Stock:</b>  |   |                 |  |               |
| Income (loss) from continuing operations attributable to Prudential Financial, Inc.                                    | \$ 2.09                                     | \$ (1.34)       | \$ (0.59)                                  | \$ 1.38       |
| Income (loss) from discontinued operations, net of taxes   | 0.02  | 0.00            | 0.02                                       | 0.03          |



## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|  |         |           |           |         |
|--|---------|-----------|-----------|---------|
| Net income (loss) attributable to Prudential Financial, Inc. | \$ 2.11 | \$ (1.34) | \$ (0.57) | \$ 1.41 |
|--|---------|-----------|-----------|---------|

**Diluted earnings per share-Common Stock:**

|   |         |           |           |         |
|---|---------|-----------|-----------|---------|
| Income (loss) from continuing operations attributable to Prudential Financial, Inc. | \$ 2.06 | \$ (1.34) | \$ (0.59) | \$ 1.37 |
| Income (loss) from discontinued operations, net of taxes                            | 0.01    | 0.00      | 0.02      | 0.03    |

|  |         |           |           |         |
|--|---------|-----------|-----------|---------|
| Net income (loss) attributable to Prudential Financial, Inc. | \$ 2.07 | \$ (1.34) | \$ (0.57) | \$ 1.40 |
|--|---------|-----------|-----------|---------|

|  |         |  |         |  |
|--|---------|--|---------|--|
| Dividends declared per share of Common Stock | \$ 0.40 |  | \$ 1.20 |  |
|--|---------|--|---------|--|

**Closed Block Business**

**Basic and Diluted earnings per share-Class B Stock:**

|   |          |          |          |          |
|---|----------|----------|----------|----------|
| Income (loss) from continuing operations attributable to Prudential Financial, Inc. | \$ 29.50 | \$ 20.00 | \$ 36.00 | \$ 20.50 |
| Income (loss) from discontinued operations, net of taxes                            | 0.00     | (0.50)   | 0.00     | (1.00)   |

|  |          |          |          |          |
|--|----------|----------|----------|----------|
| Net income (loss) attributable to Prudential Financial, Inc. | \$ 29.50 | \$ 19.50 | \$ 36.00 | \$ 19.50 |
|--|----------|----------|----------|----------|

|   |         |  |         |  |
|---|---------|--|---------|--|
| Dividends declared per share of Class B Stock | \$ 2.41 |  | \$ 7.22 |  |
|---|---------|--|---------|--|

*See Notes to Unaudited Interim Consolidated Financial Statements*

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Consolidated Statements of Comprehensive Income****Three and Nine Months Ended September 30, 2013 and 2012 (in millions)**

|   | <b>Three Months Ended<br/>September 30,</b> |               | <b>Nine Months Ended<br/>September 30,</b> |                 |
|---|---|---------------|--|-----------------|
|   | <b>2013</b>                                 | <b>2012</b>   | <b>2013</b>                                | <b>2012</b>     |
| <b>NET INCOME (LOSS)</b>  | \$ 1,061                                    | \$ (559)      | \$ (89)                                    | \$ 752          |
| Other comprehensive income (loss), before tax:                                |   |               |  |                 |
| Foreign currency translation adjustments:                                     |   |               |  |                 |
| Foreign currency translation adjustments for the period                       | 224   | 139           | (1,182)                                    | 236             |
| <b>Total</b>  | <b>224</b>                                  | <b>139</b>    | <b>(1,182)</b>                             | <b>236</b>      |
| Net unrealized investment gains (losses):                                     |   |               |  |                 |
| Unrealized investment gains (losses) for the period                           | (2,126)                                     | 1,740         | (2,754)                                    | 5,909           |
| Reclassification adjustment for (gains) losses included in net income (loss)  | (541)                                       | 19            | (1,065)                                    | 168             |
| <b>Total</b>  | <b>(2,667)</b>                              | <b>1,759</b>  | <b>(3,819)</b>                             | <b>6,077</b>    |
| Defined benefit pension and postretirement unrecognized net periodic benefit: |   |               |  |                 |
| Impact of foreign currency changes and other                                  | (4)   | 5             | 26   | 19              |
| Amortization included in net income (loss)                                    | 31  | 24            | 94   | 74              |
| <b>Total</b>  | <b>27</b>                                   | <b>29</b>     | <b>120</b>                                 | <b>93</b>       |
| Other comprehensive income (loss), before tax                                 | (2,416)                                     | 1,927         | (4,881)                                    | 6,406           |
| Less: Income tax expense (benefit) related to:                                |   |               |  |                 |
| Foreign currency translation adjustments                                      | 73  | 31            | (328)                                      | 90              |
| Net unrealized investment gains (losses)                                      | (917)                                       | 557           | (1,259)                                    | 2,077           |
| Defined benefit pension and postretirement unrecognized net periodic benefit  | 10  | 10            | 43   | 25              |
| <b>Total</b>  | <b>(834)</b>                                | <b>598</b>    | <b>(1,544)</b>                             | <b>2,192</b>    |
| Other comprehensive income (loss), net of taxes                               | (1,582)                                     | 1,329         | (3,337)                                    | 4,214           |
| Comprehensive income (loss)   | (521)                                       | 770           | (3,426)                                    | 4,966           |
| Less: Comprehensive income (loss) attributable to noncontrolling interests    | (13)  | 4             | 74   | 63              |
| <b>Comprehensive income (loss) attributable to Prudential Financial, Inc.</b> | <b>\$ (508)</b>                             | <b>\$ 766</b> | <b>\$ (3,500)</b>                          | <b>\$ 4,903</b> |

*See Notes to Unaudited Interim Consolidated Financial Statements*

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Consolidated Statements of Equity(1)****Nine Months Ended September 30, 2013 and 2012 (in millions)**

|   | Prudential Financial, Inc. Equity |                                  |                      |  |   |  |                             |                 |
|---|-----------------------------------|----------------------------------|----------------------|--|---|--|-----------------------------|-----------------|
|   | Common<br>Stock                   | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Common<br>Stock<br>Held In<br>Treasury | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total<br>Prudential<br>Financial, Inc.<br>Equity | Noncontrolling<br>Interests | Total<br>Equity |
| <b>Balance December 31, 2012</b>                            | \$ 6                              | \$ 24,380                        | \$ 16,138            | \$ (12,163)                            | \$ 10,214   | \$ 38,575  | \$ 716                      | \$ 39,291       |
| Common Stock acquired                                       |                                   |                                  |                      | (500)                                  |   | (500)  |                             | (500)           |
| Contributions from noncontrolling interests                 |                                   |                                  |                      |  |   | 0  | 1                           | 1               |
| Distributions to noncontrolling interests                   |                                   |                                  |                      |  |   | 0  | (78)                        | (78)            |
| Consolidations/deconsolidations of noncontrolling interests |                                   |                                  |                      |  |   | 0  | 45                          | 45              |
| Stock-based compensation programs                           |                                   | 33                               | (41)                 | 368                                    |   | 360  |                             | 360             |
| Dividends declared on Common Stock                          |                                   |                                  | (563)                |  |   | (563)  |                             | (563)           |
| Dividends declared on Class B Stock                         |                                   |                                  | (14)                 |  |   | (14)   |                             | (14)            |
| Comprehensive income:                                       |                                   |                                  |                      |  |   |  |                             |                 |
| Net income  |                                   |                                  | (185)                |  |   | (185)  | 96                          | (89)            |
| Other comprehensive income, net of tax                      |                                   |                                  |                      |  | (3,315)   | (3,315)  | (22)                        | (3,337)         |
| Total comprehensive income (loss)                           |                                   |                                  |                      |  |   | (3,500)  | 74                          | (3,426)         |
| <b>Balance, September 30, 2013</b>                          | \$ 6                              | \$ 24,413                        | \$ 15,335            | \$ (12,295)                            | \$ 6,899  | \$ 34,358  | \$ 758                      | \$ 35,116       |

|   | Prudential Financial, Inc. Equity |                                  |                      |  |   |  |                             |                 |
|---|-----------------------------------|----------------------------------|----------------------|--|---|--|-----------------------------|-----------------|
|   | Common<br>Stock                   | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Common<br>Stock<br>Held In<br>Treasury | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Total<br>Prudential<br>Financial, Inc.<br>Equity | Noncontrolling<br>Interests | Total<br>Equity |
| <b>Balance, December 31, 2011</b>                           | \$ 6                              | \$ 24,293                        | \$ 16,629            | \$ (11,920)                            | \$ 5,245  | \$ 34,253  | \$ 588                      | \$ 34,841       |
| Common Stock acquired                                       |                                   |                                  |                      | (650)                                  |   | (650)  |                             | (650)           |
| Contributions from noncontrolling interests                 |                                   |                                  |                      |  |   |  | 2                           | 2               |
| Distributions to noncontrolling interests                   |                                   |                                  |                      |  |   |  | (78)                        | (78)            |
| Consolidations/deconsolidations of noncontrolling interests |                                   |                                  |                      |  |   |  | 116                         | 116             |
| Stock-based compensation programs                           |                                   | 55                               | (173)                | 345                                    |   | 227  |                             | 227             |
| Dividends declared on Common Stock                          |                                   |                                  |                      |  |   |  |                             | 0               |
| Dividends declared on Class B Stock                         |                                   |                                  |                      |  |   |  |                             | 0               |
| Comprehensive income:                                       |                                   |                                  |                      |  |   |  |                             |                 |
| Net income  |                                   |                                  | 701                  |  |   | 701  | 51                          | 752             |
| Other comprehensive income, net of tax                      |                                   |                                  |                      |  | 4,202   | 4,202  | 12                          | 4,214           |
| Total comprehensive income                                  |                                   |                                  |                      |  |   | 4,903  | 63                          | 4,966           |
| <b>Balance, September 30, 2012</b>                          | \$ 6                              | \$ 24,348                        | \$ 17,157            | \$ (12,225)                            | \$ 9,447  | \$ 38,733  | \$ 691                      | \$ 39,424       |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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

*See Notes to Unaudited Interim Consolidated Financial Statements*

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Consolidated Statements of Cash Flows****Nine Months Ended September 30, 2013 and 2012 (in millions)**

|  | <b>2013</b>     | <b>2012</b>     |
|--|-----------------|-----------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>  |                 |                 |
| Net income (loss)  | \$ (89)         | \$ 752          |
| Adjustments to reconcile net income to net cash provided by operating activities:                      |                 |                 |
| Realized investment (gains) losses, net  | 3,857           | 1,066           |
| Policy charges and fee income  | (1,192)         | (1,080)         |
| Interest credited to policyholders' account balances   | 2,203           | 3,269           |
| Depreciation and amortization  | 338             | 230             |
| Gains on trading account assets supporting insurance liabilities, net                                  | 275             | (503)           |
| Change in:   |                 |                 |
| Deferred policy acquisition costs  | (2,230)         | (1,438)         |
| Future policy benefits and other insurance liabilities   | 6,211           | 11,336          |
| Other trading account assets   | (34)            | 4               |
| Income taxes   | (1,962)         | 879             |
| Other, net   | (1,894)         | (2,766)         |
| <b>Cash flows from operating activities</b>  | <b>5,483</b>    | <b>11,749</b>   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>  |                 |                 |
| Proceeds from the sale/maturity/prepayment of:   |                 |                 |
| Fixed maturities, available-for-sale   | 40,389          | 28,302          |
| Fixed maturities, held-to-maturity   | 397             | 377             |
| Trading account assets supporting insurance liabilities and other trading account assets               | 16,339          | 10,230          |
| Equity securities, available-for-sale  | 3,472           | 3,245           |
| Commercial mortgage and other loans  | 4,700           | 3,528           |
| Policy loans   | 1,702           | 1,698           |
| Other long-term investments  | 1,312           | 1,105           |
| Short-term investments   | 39,449          | 20,985          |
| Payments for the purchase/origination of:  |                 |                 |
| Fixed maturities, available-for-sale   | (45,215)        | (38,848)        |
| Fixed maturities, held-to-maturity   | (170)           | (18)            |
| Trading account assets supporting insurance liabilities and other trading account assets               | (18,830)        | (10,190)        |
| Equity securities, available-for-sale  | (3,233)         | (2,897)         |
| Commercial mortgage and other loans  | (7,068)         | (5,348)         |
| Policy loans   | (1,366)         | (1,527)         |
| Other long-term investments  | (1,938)         | (1,316)         |
| Short-term investments   | (41,437)        | (20,905)        |
| Acquisition of business, net of cash acquired  | (488)           | 0               |
| Other, net   | (291)           | 167             |
| <b>Cash flows used in investing activities</b>   | <b>(12,276)</b> | <b>(11,412)</b> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>  |                 |                 |
| Policyholders' account deposits  | 18,588          | 17,095          |
| Policyholders' account withdrawals   | (19,091)        | (17,935)        |
| Net change in securities sold under agreements to repurchase and cash collateral for loaned securities | 3,371           | 2,222           |
| Cash dividends paid on Common Stock  | (585)           | (53)            |
| Cash dividends paid on Class B Stock   | (14)            | 0               |
| Net change in financing arrangements (maturities 90 days or less)                                      | 269             | (74)            |
| Common Stock acquired  | (487)           | (650)           |
| Common Stock reissued for exercise of stock options  | 226             | 117             |
| Proceeds from the issuance of debt (maturities longer than 90 days)                                    | 2,695           | 2,396           |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|  |                  |                  |
|--|------------------|------------------|
| Repayments of debt (maturities longer than 90 days)                | (3,428)          | (2,384)          |
| Excess tax benefits from share-based payment arrangements          | 21               | 53               |
| Change in bank deposits  | 0                | (1,730)          |
| Other, net   | 587              | 274              |
| <b>Cash flows from (used in) financing activities</b>              | <b>2,152</b>     | <b>(669)</b>     |
| Effect of foreign exchange rate changes on cash balances           | (809)            | (13)             |
| <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>        | <b>(5,450)</b>   | <b>(345)</b>     |
| <b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>                | <b>18,100</b>    | <b>14,251</b>    |
| <b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>                    | <b>\$ 12,650</b> | <b>\$ 13,906</b> |
| <b>NON-CASH TRANSACTIONS DURING THE PERIOD</b>                     |                  |                  |
| Treasury Stock shares issued for stock-based compensation programs | \$ 104           | \$ 209           |

*See Notes to Unaudited Interim Consolidated Financial Statements*

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

**Notes to Unaudited Interim Consolidated Financial Statements**

**1. BUSINESS AND BASIS OF PRESENTATION**

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

***Basis of Presentation***

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

In the opinion of management, all adjustments necessary for a fair statement of the financial position and results of operations have been made including adjustments described below under Out of Period Adjustments. Interim results are not necessarily indicative of the results that may be expected for the full year. These financial statements should be read in conjunction with the Company's Audited Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

The Company's Gibraltar Life Insurance Company, Ltd. ( Gibraltar Life ) consolidated operations use a November 30 fiscal year end for purposes of inclusion in the Company's Consolidated Financial Statements. Therefore, the Unaudited Interim Consolidated Financial Statements as of September 30, 2013, include the assets and liabilities of Gibraltar Life as of August 31, 2013 and the results of operations for Gibraltar Life for the three and nine months ended August 31, 2013.

***Use of Estimates***

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



**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

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

***Reclassifications***

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

***Out of Period Adjustments***

In the second quarter of 2012, the Company recorded two out of period adjustments resulting in a decrease of \$122 million to Income from continuing operations before income taxes and equity in earnings of operating joint ventures for the nine months ended September 30, 2012. These adjustments were related to a decline in the value of a real estate-related investment and an increase in reserves for estimated payments to deceased policy and contract holders. For additional information regarding these out of period adjustments, see Notes 1 and 24 to the Company's Consolidated Financial Statements included in its 2012 Annual Report on Form 10-K.

**2. SIGNIFICANT ACCOUNTING POLICIES AND PRONOUNCEMENTS**

***Investments in Debt and Equity Securities and Commercial Mortgage and Other Loans***

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

Fixed maturities are comprised of bonds, notes and redeemable preferred stock. Fixed maturities classified as available-for-sale are carried at fair value. See Note 13 for additional information regarding the determination of fair value. Fixed maturities that the Company has both the positive intent and ability to hold to maturity are carried at amortized cost and classified as held-to-maturity. The amortized cost of fixed maturities is adjusted for amortization of premiums and accretion of discounts to maturity. Interest income, as well as the related amortization of premium and accretion of discount, is included in Net investment income under the effective yield method. For mortgage-backed and asset-backed securities, the effective yield is based on estimated cash flows, including interest rate and prepayment assumptions based on data from widely

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

accepted third-party data sources or internal estimates. In addition to interest rate and prepayment assumptions, cash flow estimates also vary based on other assumptions regarding the underlying collateral, including default rates and changes in value. These assumptions can significantly impact income recognition and the amount of other-than-temporary impairments recognized in earnings and other comprehensive income. For high credit quality mortgage-backed and asset-backed securities (those rated AA or above), cash flows are provided quarterly, and the amortized cost and effective yield of the security are adjusted as necessary to reflect historical prepayment experience and changes in estimated future prepayments. The adjustments to amortized cost are recorded as a charge or credit to net investment income in accordance with the retrospective method. For mortgage-backed and asset-backed securities rated below AA or those for which an other than temporary impairment has been recorded, the effective yield is adjusted prospectively for any changes in estimated cash flows. See the discussion below on realized investment gains and losses for a description of the accounting for impairments. Unrealized gains and losses on fixed maturities classified as available-for-sale, net of tax, and the effect on deferred policy acquisition costs, value of business acquired, deferred sales inducements, future policy benefits and policyholders' dividends that would result from the realization of unrealized gains and losses, are included in Accumulated other comprehensive income (loss) (AOCI).

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

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

Other trading account assets, at fair value consist primarily of fixed maturities, equity securities, including certain perpetual preferred stock, and certain derivatives. Realized and unrealized gains and losses on these investments are reported in Asset management fees and other income. Interest and dividend income from these investments is reported in Net investment income. See Derivative Financial Instruments below for additional information regarding the accounting for derivatives.

Equity securities available-for-sale are comprised of common stock, mutual fund shares, non-redeemable preferred stock, and certain perpetual preferred stock, and are carried at fair value. The associated unrealized gains and losses, net of tax, and the effect on deferred policy acquisition costs, value of business acquired, deferred sales inducements, future policy benefits and policyholders' dividends that would result from the realization of unrealized gains and losses, are included in AOCI. The cost of equity securities is written down to fair value when a decline in value is considered to be other-than-temporary. See the discussion below on realized investment gains and losses for a description of the accounting for impairments. Dividends from these investments are recognized in Net investment income when earned.

Commercial mortgage and other loans consist of commercial mortgage loans, agricultural loans, loans backed by residential properties, as well as certain other collateralized and uncollateralized loans. Loans backed by residential properties primarily include recourse loans held by the Company's international insurance businesses. Other collateralized loans primarily include senior loans made by the Company's international insurance businesses and loans made to the Company's former real estate franchisees. Uncollateralized loans primarily represent reverse dual currency loans and corporate loans held by the Company's international insurance businesses.

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

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

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

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

The Company reviews the performance and credit quality of the commercial mortgage and other loan portfolio on an on-going basis. Loans are placed on watch list status based on a predefined set of criteria and are assigned one of three categories. Loans are placed on early warning status in cases where, based on the Company's analysis of the loan's collateral, the financial situation of the borrower or tenants or other market factors, it is believed a loss of principal or interest could occur. Loans are classified as closely monitored when it is determined that there is a collateral deficiency or other credit events that may lead to a potential loss of principal or interest. Loans not in good standing are those loans where the Company has concluded that there is a high probability of loss of principal, such as when the loan is delinquent or in the process of foreclosure. As described below, in determining the allowance for losses, the Company evaluates each loan on the watch list to determine if it is probable that amounts due will not be collected according to the contractual terms of the loan agreement.

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

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

For those loans not reported at fair value, the allowance for losses includes a loan specific reserve for each impaired loan that has a specifically identified loss and a portfolio reserve for probable incurred but not



**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

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

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

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

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

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

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

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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

Short-term investments primarily consist of highly liquid debt instruments with a maturity of twelve months or less and greater than three months when purchased, other than those debt instruments meeting this



**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

definition that are included in Trading account assets supporting insurance liabilities, at fair value. These investments are generally carried at fair value and include certain money market investments, short-term debt securities issued by government sponsored entities and other highly liquid debt instruments. Short-term investments held in the Company's former broker-dealer operations were marked-to-market through Income from discontinued operations, net of taxes.

Realized investment gains (losses) are computed using the specific identification method with the exception of some of the Company's International Insurance businesses' portfolios, where the average cost method is used. Realized investment gains and losses are generated from numerous sources, including the sale of fixed maturity securities, equity securities, investments in joint ventures and limited partnerships and other types of investments, as well as adjustments to the cost basis of investments for net other-than-temporary impairments recognized in earnings. Realized investment gains and losses are also generated from prepayment premiums received on private fixed maturity securities, allowance for losses on commercial mortgage and other loans, fair value changes on commercial mortgage loans carried at fair value, and fair value changes on embedded derivatives and free-standing derivatives that do not qualify for hedge accounting treatment. See Derivative Financial Instruments below for additional information regarding the accounting for derivatives.

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

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

When an other-than-temporary impairment of a debt security has occurred, the amount of the other-than-temporary impairment recognized in earnings depends on whether the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis. If the debt security meets either of these two criteria or the unrealized losses due to changes in foreign currency exchange rates are not expected to be recovered before maturity, the other-than-temporary impairment recognized in earnings is equal to the entire difference between the security's amortized cost basis and its fair value at the impairment measurement date. For other-than-temporary impairments of debt securities that do not meet these criteria, the net amount recognized in earnings is equal to the difference between the amortized cost of the debt



**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

security and its net present value calculated as described above. Any difference between the fair value and the net present value of the debt security at the impairment measurement date is recorded in Other comprehensive income (loss). Unrealized gains or losses on securities for which an other-than-temporary impairment has been recognized in earnings is tracked as a separate component of AOCI.

For debt securities, the split between the amount of an other-than-temporary impairment recognized in other comprehensive income and the net amount recognized in earnings is driven principally by assumptions regarding the amount and timing of projected cash flows. For mortgage-backed and asset-backed securities, cash flow estimates consider the payment terms of the underlying assets backing a particular security, including interest rate and prepayment assumptions, based on data from widely accepted third-party data sources or internal estimates. In addition to interest rate and prepayment assumptions, cash flow estimates also include other assumptions regarding the underlying collateral including default rates and recoveries, which vary based on the asset type and geographic location, as well as the vintage year of the security. For structured securities, the payment priority within the tranche structure is also considered. For all other debt securities, cash flow estimates are driven by assumptions regarding probability of default and estimates regarding timing and amount of recoveries associated with a default. The Company has developed these estimates using information based on its historical experience as well as using market observable data, such as industry analyst reports and forecasts, sector credit ratings and other data relevant to the collectability of a security, such as the general payment terms of the security and the security's position within the capital structure of the issuer.

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

***Derivative Financial Instruments***

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

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

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Derivatives are recorded either as assets, within Other trading account assets, at fair value or Other long-term investments, or as liabilities, within Other liabilities, except for embedded derivatives which are

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

recorded with the associated host contract. The Company nets the fair value of all derivative financial instruments with counterparties for which a master netting arrangement has been executed.

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

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

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

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

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

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

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

If it is determined that a derivative no longer qualifies as an effective fair value or cash flow hedge or management removes the hedge designation, the derivative will continue to be carried on the balance sheet at its fair value, with changes in fair value recognized currently in

Realized investment gains (losses), net. In this scenario, the hedged asset or liability under a fair value hedge will no longer be adjusted for changes in fair value and the existing basis adjustment is amortized to the income statement line associated with the asset or liability. The component of AOCI related to discontinued cash flow hedges is reclassified to the income statement line associated with the hedged cash flows consistent with the earnings impact of the original hedged cash flows.

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

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

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

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

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

***Adoption of New Accounting Pronouncements***

In December 2011 and January 2013, the Financial Accounting Standards Board ( FASB ) issued updated guidance regarding the disclosure of recognized derivative instruments (including bifurcated embedded derivatives), repurchase agreements and securities borrowing/lending transactions that are offset in the statement of financial position or are subject to an enforceable master netting arrangement or similar agreement (irrespective of whether they are offset in the statement of financial position). This new guidance requires an entity to disclose information on both a gross and net basis about instruments and transactions within the scope of this guidance. This new guidance is effective for interim or annual reporting periods beginning on or after January 1, 2013, and should be applied retrospectively for all comparative periods presented. The disclosures required by this guidance are included in Note 14.

In February 2013, the FASB issued updated guidance regarding the presentation of comprehensive income. Under the guidance, an entity is required to separately present information about significant items reclassified out of accumulated other comprehensive income by component as well as changes in accumulated other comprehensive income balances by component in either the financial statements or the notes to the financial statements. The guidance does not change the items that are reported in other comprehensive income, does not change when an item of other comprehensive income must be reclassified to net income, and does not amend any existing requirements for reporting net income or other comprehensive income. The guidance is effective for the first interim or annual reporting period beginning after December 15, 2012 and should be applied prospectively. The disclosures required by this guidance are included in Note 7.

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

In July 2013, the FASB issued new guidance regarding derivatives. The guidance permits the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) to be used as a U.S. benchmark interest rate for hedge accounting, in addition to the United States Treasury rate and London Inter-Bank Offered Rate ( LIBOR ). The guidance also removes the restriction on using different benchmark rates for similar hedges. The guidance is effective for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013 and



**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

should be applied prospectively. Adoption of the guidance did not have a significant effect on the Company's consolidated financial position, results of operations, and financial statement disclosures.

***Future Adoption of New Accounting Pronouncements***

In March 2013, the FASB issued updated guidance regarding the recognition in net income of the cumulative translation adjustment upon the sale or loss of control of a business or group of assets residing in a foreign subsidiary, or a loss of control of a foreign investment. The guidance is effective for the first interim or annual reporting period beginning after December 15, 2013 and should be applied prospectively. This guidance is not expected to have a significant effect on the Company's consolidated financial position, results of operations, and financial statement disclosures.

In June 2013, the FASB issued updated guidance clarifying the characteristics of an investment company and requiring new disclosures. Under the guidance, all entities regulated under the Investment Company Act of 1940 automatically qualify as investment companies, while all other entities need to consider both the fundamental and typical characteristics of an investment company in determining whether they qualify as investment companies. This new guidance is effective for interim or annual reporting periods that begin after December 15, 2013, and should be applied prospectively. This guidance is not expected to have a significant effect on the Company's consolidated financial position, results of operations, and financial statement disclosures.

In July 2013, the FASB issued updated guidance regarding the presentation of unrecognized tax benefits when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist. This new guidance is effective for interim or annual reporting periods that begin after December 15, 2013, and should be applied prospectively, with early application permitted. This guidance is not expected to have a significant effect on the Company's consolidated financial position, results of operations, and financial statement disclosures.

**3. ACQUISITIONS AND DISPOSITIONS**

***Acquisition of The Hartford's Individual Life Insurance Business***

On January 2, 2013, the Company acquired The Hartford's individual life insurance business through a reinsurance transaction. Under the agreement, the Company paid The Hartford cash consideration of \$615 million, primarily in the form of a ceding commission to provide reinsurance for approximately 700,000 life insurance policies with net retained face amount in force of approximately \$141 billion. The acquisition increases the Company's scale in the U.S. individual life insurance market, particularly universal life products, and provides complementary distribution opportunities through expanded wirehouse and bank distribution channels.

The assets and liabilities assumed have been included in the Company's Consolidated Financial Statements as of the acquisition date. Total assets assumed were \$11.3 billion, which includes \$1.3 billion of value of business acquired and \$0.1 billion of cash, and total liabilities assumed were \$10.7 billion. There is no goodwill, including tax deductible goodwill, associated with the acquisition.

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

On February 1, 2011, Prudential Financial completed the acquisition from American International Group, Inc. ( AIG ) of AIG Star Life Insurance Co., Ltd. ( Star ), AIG Edison Life Insurance Company ( Edison ), AIG Financial Assurance Japan K.K., and AIG Edison Service Co., Ltd. (collectively, the Star and Edison Businesses ) pursuant to the stock purchase agreement dated September 30, 2010 between Prudential Financial

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

and AIG. The total purchase price was \$4,709 million, comprised of \$4,213 million in cash and \$496 million in assumed third party debt, substantially all of which is expected to be repaid, over time, with excess capital of the acquired entities. The acquisition of these businesses included the purchase by the Company of all of the shares of these entities, which became indirect wholly-owned subsidiaries of the Company. All acquired entities were Japanese corporations and their businesses were in Japan, increasing the Company's scale in the Japanese insurance market. On January 1, 2012, Star and Edison were merged into Gibraltar Life.

***Sale of Wealth Management Solutions Business***

In April 2013, the Company signed a definitive agreement to sell its wealth management solutions business to Envestnet Inc. The transaction, which does not have a material impact to the Company's financial results, closed on July 1, 2013. Due to the existence of an ongoing contractual relationship between the Company and these operations, this disposition did not qualify for discontinued operations treatment under U.S. GAAP. See Note 11 for additional information.

***Acquisition of UniAsia Life Assurance***

On August 15, 2013, the Company reached agreement to acquire UniAsia Life Assurance Berhad, an established life insurance company in Malaysia, through the formation of a joint venture with Bank Simpanan Nasional (BSN), a bank owned by the Malaysian government. The joint venture will pay cash consideration of approximately \$160 million, 70% of which will be provided by Prudential Insurance and 30% of which will be provided by BSN. This acquisition is part of the Company's strategic initiative to further expand its business in Southeast Asian markets. The transaction may close as early as the fourth quarter of 2013, subject to regulatory approvals and customary closing conditions.

***Discontinued Operations***

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

|   | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|---|---------------------------|-------------|--------------------------|-------------|
|   | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|   | <b>2013</b>               | <b>2012</b> | <b>2013</b>              | <b>2012</b> |
|   | <b>(in millions)</b>      |             |                          |             |
| Real estate investments sold or held for sale(1)        | \$ 13                     | \$ (3)      | \$ 15                    | \$ 19       |
| Global commodities business                             | (1)                       | 0           | 1                        | 0           |
| Income from discontinued operations before income taxes | 12                        | (3)         | 16                       | 19          |

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|   |      |        |       |       |
|---|------|--------|-------|-------|
| Income tax expense                                | 4    | (1)    | 5     | 7     |
| Income from discontinued operations, net of taxes | \$ 8 | \$ (2) | \$ 11 | \$ 12 |

(1) Reflects the income from discontinued real estate investments.

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

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

|                   | September 30,<br>2013 | December 31,<br>2012 |
|-------------------|-----------------------|----------------------|
|                   | (in millions)         |                      |
| Total assets      | \$ 32                 | \$ 13                |
| Total liabilities | \$ 7                  | \$ 0                 |

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)****4. INVESTMENTS***Fixed Maturities and Equity Securities*

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

|  | September 30, 2013 |                              |  |                   |   |
|--|--------------------|------------------------------|--|-------------------|---|
|  | Amortized<br>Cost  | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses<br>(in millions) | Fair Value        | Other-than-<br>temporary<br>Impairments<br>in AOCI(3) |
| <b>Fixed maturities, available-for-sale</b>  |                    |                              |  |                   |   |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | \$ 11,496          | \$ 1,985                     | \$ 154   | \$ 13,327         | \$ 0  |
| Obligations of U.S. states and their political subdivisions                          | 3,511              | 261                          | 138  | 3,634             | 0   |
| Foreign government bonds   | 76,007             | 6,849                        | 298  | 82,558            | 1   |
| Corporate securities   | 149,942            | 11,576                       | 4,171  | 157,347           | (6)   |
| Asset-backed securities(1)   | 11,328             | 232                          | 374  | 11,186            | (779)   |
| Commercial mortgage-backed securities  | 13,263             | 447                          | 166  | 13,544            | 0   |
| Residential mortgage-backed securities(2)  | 6,852              | 379                          | 61   | 7,170             | (10)  |
| <b>Total fixed maturities, available-for-sale</b>                                    | <b>\$ 272,399</b>  | <b>\$ 21,729</b>             | <b>\$ 5,362</b>                                | <b>\$ 288,766</b> | <b>\$ (794)</b>                                       |
| <b>Equity securities, available-for-sale</b>   | <b>\$ 6,684</b>    | <b>\$ 2,341</b>              | <b>\$ 41</b>                                   | <b>\$ 8,984</b>   |   |

|   | September 30, 2013 |                              |  |               |  |
|---|--------------------|------------------------------|--|---------------|--|
|   | Amortized<br>Cost  | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses<br>(in millions) | Fair<br>Value | Other-than-<br>temporary<br>Impairments<br>in<br>AOCI(3) |
| <b>Fixed maturities, held-to-maturity</b> |                    |                              |  |               |  |
| Foreign government bonds                  | \$ 1,005           | \$ 129                       | \$ 0   | \$ 1,134      | \$ 0   |
| Corporate securities(4)                   | 1,004              | 43                           | 31   | 1,016         | 0  |
| Asset-backed securities(1)                | 758                | 46                           | 1  | 803           | 0  |
| Commercial mortgage-backed securities     | 219                | 24                           | 0  | 243           | 0  |
| Residential mortgage-backed securities(2) | 643                | 33                           | 0  | 676           | 0  |

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|   |          |        |       |          |      |
|---|----------|--------|-------|----------|------|
| Total fixed maturities, held-to-maturity(4) | \$ 3,629 | \$ 275 | \$ 32 | \$ 3,872 | \$ 0 |
|---|----------|--------|-------|----------|------|

- (1) Includes credit-tranched securities collateralized by sub-prime mortgages, auto loans, credit cards, education loans and other asset types.
- (2) Includes publicly traded agency pass-through securities and collateralized mortgage obligations.
- (3) Represents the amount of other-than-temporary impairment losses in AOCI which were not included in earnings. Amount excludes \$831 million of net unrealized gains on impaired available-for-sale securities relating to changes in the value of such securities subsequent to the impairment measurement date.
- (4) Excludes notes with amortized cost of \$1,250 million (fair value, \$1,314 million) which have been offset with the associated payables under a netting agreement.

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

|  | December 31, 2012 |                        |                                       |                   | Other-than-temporary Impairments in AOCI(3) |
|--|-------------------|------------------------|---------------------------------------|-------------------|---|
|  | Amortized Cost    | Gross Unrealized Gains | Gross Unrealized Losses (in millions) | Fair Value        |   |
| <b>Fixed maturities, available-for-sale</b>  |                   |                        |                                       |                   |   |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | \$ 13,973         | \$ 3,448               | \$ 35                                 | \$ 17,386         | \$ 0  |
| Obligations of U.S. states and their political subdivisions                          | 2,952             | 505                    | 5                                     | 3,452             | 0   |
| Foreign government bonds   | 81,578            | 6,778                  | 66                                    | 88,290            | 1   |
| Corporate securities   | 146,924           | 13,996                 | 1,589                                 | 159,331           | (2)   |
| Asset-backed securities(1)   | 11,846            | 221                    | 731                                   | 11,336            | (964)                                       |
| Commercial mortgage-backed securities  | 11,228            | 726                    | 17                                    | 11,937            | 5   |
| Residential mortgage-backed securities(2)  | 9,153             | 484                    | 33                                    | 9,604             | (11)  |
| <b>Total fixed maturities, available-for-sale</b>                                    | <b>\$ 277,654</b> | <b>\$ 26,158</b>       | <b>\$ 2,476</b>                       | <b>\$ 301,336</b> | <b>\$ (971)</b>                             |
| <b>Equity securities, available-for-sale</b>   | <b>\$ 6,759</b>   | <b>\$ 1,573</b>        | <b>\$ 55</b>                          | <b>\$ 8,277</b>   |   |

|  | December 31, 2012 |                        |                                       |                 | Other-than-temporary Impairments in AOCI(3) |
|--|-------------------|------------------------|---------------------------------------|-----------------|---|
|  | Amortized Cost    | Gross Unrealized Gains | Gross Unrealized Losses (in millions) | Fair Value      |   |
| <b>Fixed maturities, held-to-maturity</b>          |                   |                        |                                       |                 |   |
| Foreign government bonds                           | \$ 1,142          | \$ 108                 | \$ 0                                  | \$ 1,250        | \$ 0  |
| Corporate securities(4)                            | 1,065             | 37                     | 67                                    | 1,035           | 0   |
| Asset-backed securities(1)                         | 1,001             | 66                     | 0                                     | 1,067           | 0   |
| Commercial mortgage-backed securities              | 302               | 49                     | 0                                     | 351             | 0   |
| Residential mortgage-backed securities(2)          | 758               | 50                     | 0                                     | 808             | 0   |
| <b>Total fixed maturities, held-to-maturity(4)</b> | <b>\$ 4,268</b>   | <b>\$ 310</b>          | <b>\$ 67</b>                          | <b>\$ 4,511</b> | <b>\$ 0</b>                                 |

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

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

(3) Represents the amount of other-than-temporary impairment losses in AOCI, which were not included in earnings. Amount excludes \$778 million of net unrealized gains on impaired available-for-sale securities and \$1 million of net unrealized gains on impaired held-to-maturity securities relating to changes in the value of such securities subsequent to the impairment measurement date.

(4) Excludes notes with amortized cost of \$1,500 million (fair value, \$1,660 million) which have been offset with the associated payables under a netting agreement.

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

The amortized cost and fair value of fixed maturities by contractual maturities at September 30, 2013, are as follows:

|  | Available-for-Sale |            | Held-to-Maturity |            |
|--|--------------------|------------|------------------|------------|
|  | Amortized Cost     | Fair Value | Amortized Cost   | Fair Value |
| (in millions)                          |                    |            |                  |            |
| Due in one year or less                | \$ 11,469          | \$ 11,933  | \$ 0             | \$ 0       |
| Due after one year through five years  | 46,803             | 50,763     | 59               | 60         |
| Due after five years through ten years | 58,812             | 63,160     | 397              | 406        |
| Due after ten years(1)                 | 123,872            | 131,010    | 1,553            | 1,684      |
| Asset-backed securities                | 11,328             | 11,186     | 758              | 803        |
| Commercial mortgage-backed securities  | 13,263             | 13,544     | 219              | 243        |
| Residential mortgage-backed securities | 6,852              | 7,170      | 643              | 676        |
| Total                                  | \$ 272,399         | \$ 288,766 | \$ 3,629         | \$ 3,872   |

(1) Excludes notes with amortized cost of \$1,250 million (fair value, \$1,314 million) which have been offset with the associated payables under a netting agreement.

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

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

|  | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |           |
|--|-------------------------------------|----------|------------------------------------|-----------|
|  | 2013                                | 2012     | 2013                               | 2012      |
| (in millions)  |                                     |          |                                    |           |
| <b>Fixed maturities, available-for-sale</b>                    |                                     |          |                                    |           |
| Proceeds from sales  | \$ 7,603                            | \$ 2,682 | \$ 22,237                          | \$ 12,140 |
| Proceeds from maturities/repayments                            | 5,976                               | 5,509    | 18,420                             | 15,794    |
| Gross investment gains from sales, prepayments, and maturities | 607                                 | 129      | 1,249                              | 397       |
| Gross investment losses from sales and maturities              | (197)                               | (87)     | (391)                              | (245)     |
| <b>Fixed maturities, held-to-maturity</b>                      |                                     |          |                                    |           |
| Gross investment gains from prepayments                        | \$ 0                                | \$ 0     | \$ 0                               | \$ 0      |
| Proceeds from maturities/repayments                            | 122                                 | 132      | 395                                | 379       |
| <b>Equity securities, available-for-sale</b>                   |                                     |          |                                    |           |



Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|   |          |          |          |          |
|---|----------|----------|----------|----------|
| Proceeds from sales   | \$ 1,290 | \$ 1,101 | \$ 3,475 | \$ 3,251 |
| Gross investment gains from sales   | 222      | 125      | 453      | 339      |
| Gross investment losses from sales  | (22)     | (61)     | (72)     | (222)    |
| <b>Fixed maturity and equity security impairments</b>   |          |          |          |          |
| Net writedowns for other-than-temporary impairment losses on fixed maturities recognized in earnings(1) | \$ (43)  | \$ (95)  | \$ (146) | \$ (300) |
| Writedowns for impairments on equity securities   | (3)      | (24)     | (11)     | (114)    |

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

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

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

**Credit losses recognized in earnings on fixed maturity securities held by the Company for which a portion of the OTTI loss was recognized in OCI**

|  | Three<br>Months<br>Ended<br>September 30, 2013 | Nine Months<br>Ended<br>September<br>30, 2013 |
|--|--|---|
|  | (in millions)                                  |   |
| Balance, beginning of period   | \$ 1,080                                       | \$ 1,166                                      |
| Credit loss impairments previously recognized on securities which matured, paid down, prepaid or were sold during the period | (113)  | (263)   |
| Credit loss impairments previously recognized on securities impaired to fair value during the period(1)                      | (1)  | (1)   |
| Credit loss impairment recognized in the current period on securities not previously impaired                                | 1  | 9   |
| Additional credit loss impairments recognized in the current period on securities previously impaired                        | 27   | 66  |
| Increases due to the passage of time on previously recorded credit losses  | 14   | 40  |
| Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected         | (3)  | (12)  |
| Balance, end of period   | \$ 1,005                                       | \$ 1,005                                      |

**Credit losses recognized in earnings on fixed maturity securities held by the Company for which a portion of the OTTI loss was recognized in OCI**

|  | Three<br>Months<br>Ended<br>September 30, 2012 | Nine Months<br>Ended<br>September 30, 2012 |
|--|--|--|
|  | (in millions)                                  |  |
| Balance, beginning of period   | \$ 1,433                                       | \$ 1,475                                   |
| Credit loss impairments previously recognized on securities which matured, paid down, prepaid or were sold during the period | (48)   | (133)                                      |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|  |          |          |
|--|----------|----------|
| Credit loss impairments previously recognized on securities impaired to fair value during the period(1)              | (10)     | (69)     |
| Credit loss impairment recognized in the current period on securities not previously impaired                        | 1        | 31       |
| Additional credit loss impairments recognized in the current period on securities previously impaired                | 22       | 80       |
| Increases due to the passage of time on previously recorded credit losses  | 16       | 45       |
| Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected | (8)      | (23)     |
| Balance, end of period   | \$ 1,406 | \$ 1,406 |

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

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

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

|   | September 30, 2013 |               | December 31, 2012 |               |
|---|--------------------|---------------|-------------------|---------------|
|   | Amortized<br>Cost  | Fair<br>Value | Amortized<br>Cost | Fair<br>Value |
|   | (in millions)      |               |                   |               |
| Short-term investments and cash equivalents                             | \$ 1,119           | \$ 1,119      | \$ 938            | \$ 938        |
| Fixed maturities:   |                    |               |                   |               |
| Corporate securities  | 11,991             | 12,566        | 11,076            | 12,107        |
| Commercial mortgage-backed securities                                   | 2,382              | 2,420         | 2,096             | 2,229         |
| Residential mortgage-backed securities(1)                               | 1,731              | 1,729         | 1,965             | 2,026         |
| Asset-backed securities(2)  | 1,177              | 1,187         | 1,179             | 1,116         |
| Foreign government bonds  | 613                | 627           | 683               | 708           |
| U.S. government authorities and agencies and obligations of U.S. states | 308                | 344           | 369               | 426           |
| Total fixed maturities  | 18,202             | 18,873        | 17,368            | 18,612        |
| Equity securities   | 899                | 1,139         | 943               | 1,040         |
| Total trading account assets supporting insurance liabilities           | \$ 20,220          | \$ 21,131     | \$ 19,249         | \$ 20,590     |

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

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

The net change in unrealized gains (losses) from trading account assets supporting insurance liabilities still held at period end, recorded within Asset management fees and other income, was \$63 million and \$288 million during the three months ended September 30, 2013 and 2012, respectively, and (\$430) million and \$568 million during the nine months ended September 30, 2013 and 2012, respectively.

**Other Trading Account Assets**

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

September 30, 2013

December 31, 2012

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|   | Amortized<br>Cost | Fair<br>Value<br>(in millions) | Amortized<br>Cost | Fair<br>Value   |
|---|-------------------|--------------------------------|-------------------|-----------------|
| Short-term investments and cash equivalents | \$ 79             | \$ 80                          | \$ 42             | \$ 42           |
| Fixed maturities                            | 3,810             | 3,822                          | 2,196             | 2,132           |
| Equity securities                           | 1,038             | 1,146                          | 1,363             | 1,437           |
| Other                                       | 3                 | 7                              | 3                 | 6               |
| <b>Subtotal</b>                             | <b>4,930</b>      | <b>5,055</b>                   | <b>3,604</b>      | <b>3,617</b>    |
| Derivative instruments                      |                   | 1,348                          |                   | 2,711           |
| <b>Total other trading account assets</b>   | <b>\$ 4,930</b>   | <b>\$ 6,403</b>                | <b>\$ 3,604</b>   | <b>\$ 6,328</b> |

The net change in unrealized gains (losses) from other trading account assets, excluding derivative instruments, still held at period end, recorded within Asset management fees and other income was \$25 million and \$62 million during the three months ended September 30, 2013 and 2012, respectively, and \$112 million and \$149 million during the nine months ended September 30, 2013 and 2012, respectively.

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

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

As of both September 30, 2013 and December 31, 2012, the Company's exposure to concentrations of credit risk of single issuers greater than 10% of the Company's stockholders' equity included securities of the U.S. government, certain U.S. government agencies and certain securities guaranteed by the U.S. government, as well as the securities disclosed below.

|   | September 30, 2013 |               | December 31, 2012 |               |
|---|--------------------|---------------|-------------------|---------------|
|   | Amortized<br>Cost  | Fair<br>Value | Amortized<br>Cost | Fair<br>Value |
|   | (in millions)      |               |                   |               |
| <b>Investments in Japanese government and government agency securities:</b> |                    |               |                   |               |
| Fixed maturities, available-for-sale  | \$ 60,680          | \$ 65,782     | \$ 66,590         | \$ 70,997     |
| Fixed maturities, held-to-maturity  | 982                | 1,110         | 1,118             | 1,223         |
| Trading account assets supporting insurance liabilities                     | 484                | 489           | 513               | 524           |
| Other trading account assets  | 39                 | 39            | 39                | 40            |
| Short-term investments  | 0                  | 0             | 0                 | 0             |
| Cash equivalents  | 1,243              | 1,243         | 1,637             | 1,637         |
| Total   | \$ 63,428          | \$ 68,663     | \$ 69,897         | \$ 74,421     |

|   | September 30, 2013 |               | December 31, 2012 |               |
|---|--------------------|---------------|-------------------|---------------|
|   | Amortized<br>Cost  | Fair<br>Value | Amortized<br>Cost | Fair<br>Value |
|   | (in millions)      |               |                   |               |
| <b>Investments in South Korean government and government agency securities:</b> |                    |               |                   |               |
| Fixed maturities, available-for-sale  | \$ 6,323           | \$ 7,049      | \$ 5,837          | \$ 6,883      |
| Fixed maturities, held-to-maturity  | 0                  | 0             | 0                 | 0             |
| Trading account assets supporting insurance liabilities                         | 62                 | 61            | 62                | 63            |
| Other trading account assets  | 0                  | 0             | 2                 | 2             |
| Short-term investments  | 0                  | 0             | 0                 | 0             |
| Cash equivalents  | 0                  | 0             | 0                 | 0             |
| Total   | \$ 6,385           | \$ 7,110      | \$ 5,901          | \$ 6,948      |

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

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

|   | September 30, 2013      |               | December 31, 2012       |               |
|---|-------------------------|---------------|-------------------------|---------------|
|   | Amount<br>(in millions) | % of<br>Total | Amount<br>(in millions) | % of<br>Total |
| <b>Commercial and agricultural mortgage loans by property type:</b>   |                         |               |                         |               |
| Office  | \$ 7,841                | 20.8%         | \$ 6,890                | 20.1%         |
| Retail  | 8,691                   | 23.1          | 8,190                   | 23.9          |
| Apartments/Multi-Family   | 6,555                   | 17.4          | 5,235                   | 15.3          |
| Industrial  | 7,467                   | 19.8          | 7,636                   | 22.3          |
| Hospitality   | 1,941                   | 5.2           | 1,322                   | 3.9           |
| Other   | 2,992                   | 8.0           | 2,841                   | 8.3           |
| Total commercial mortgage loans                                       | 35,487                  | 94.3          | 32,114                  | 93.8          |
| Agricultural property loans   | 2,139                   | 5.7           | 2,122                   | 6.2           |
| Total commercial and agricultural mortgage loans by property type     | 37,626                  | 100.0%        | 34,236                  | 100.0%        |
| Valuation allowance   | (187)                   |               | (229)                   |               |
| Total net commercial and agricultural mortgage loans by property type | 37,439                  |               | 34,007                  |               |
| <b>Other loans</b>  |                         |               |                         |               |
| Uncollateralized loans  | 1,439                   |               | 1,836                   |               |
| Residential property loans  | 600                     |               | 790                     |               |
| Other collateralized loans  | 40                      |               | 140                     |               |
| Total other loans   | 2,079                   |               | 2,766                   |               |
| Valuation allowance   | (21)                    |               | (40)                    |               |
| Total net other loans   | 2,058                   |               | 2,726                   |               |
| Total commercial mortgage and other loans(1)                          | \$ 39,497               |               | \$ 36,733               |               |

(1) Includes loans held at fair value.

The commercial mortgage and agricultural property loans are geographically dispersed throughout the United States, Canada and Asia with the largest concentrations in California (26%), New York (10%), and Texas (9%) at September 30, 2013.





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

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

|  | Commercial<br>Mortgage<br>Loans | Agricultural<br>Property<br>Loans | September 30, 2013               |                                  |               | Uncollateralized<br>Loans | Total |
|--|---------------------------------|-----------------------------------|----------------------------------|----------------------------------|---------------|---------------------------|-------|
|  |                                 |                                   | Residential<br>Property<br>Loans | Other<br>Collateralized<br>Loans | (in millions) |                           |       |
| Allowance for losses, beginning of year        | \$ 209                          | \$ 20                             | \$ 11                            | \$ 12                            | \$ 17         | \$ 269                    |       |
| Addition to / (release of) allowance of losses | 2                               | (6)                               | (3)                              | (10)                             | (2)           | (19)                      |       |
| Charge-offs, net of recoveries                 | (32)                            | (6)                               | 0                                | 0                                | 0             | (38)                      |       |
| Change in foreign exchange                     | 0                               | 0                                 | (1)                              | 0                                | (3)           | (4)                       |       |
| <b>Total ending balance</b>                    | <b>\$ 179</b>                   | <b>\$ 8</b>                       | <b>\$ 7</b>                      | <b>\$ 2</b>                      | <b>\$ 12</b>  | <b>\$ 208</b>             |       |

|  | Commercial<br>Mortgage<br>Loans | Agricultural<br>Property<br>Loans | December 31, 2012                |                                  |               | Uncollateralized<br>Loans | Total |
|--|---------------------------------|-----------------------------------|----------------------------------|----------------------------------|---------------|---------------------------|-------|
|  |                                 |                                   | Residential<br>Property<br>Loans | Other<br>Collateralized<br>Loans | (in millions) |                           |       |
| Allowance for losses, beginning of year        | \$ 294                          | \$ 19                             | \$ 16                            | \$ 18                            | \$ 20         | \$ 367                    |       |
| Addition to / (release of) allowance of losses | (20)                            | 1                                 | (4)                              | (6)                              | (2)           | (31)                      |       |
| Charge-offs, net of recoveries                 | (65)                            | 0                                 | 0                                | 0                                | 0             | (65)                      |       |
| Change in foreign exchange                     | 0                               | 0                                 | (1)                              | 0                                | (1)           | (2)                       |       |
| <b>Total ending balance</b>                    | <b>\$ 209</b>                   | <b>\$ 20</b>                      | <b>\$ 11</b>                     | <b>\$ 12</b>                     | <b>\$ 17</b>  | <b>\$ 269</b>             |       |

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

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

|   | September 30, 2013              |                                   |                                  |                                  |                           |                  |
|---|---------------------------------|-----------------------------------|----------------------------------|----------------------------------|---------------------------|------------------|
|   | Commercial<br>Mortgage<br>Loans | Agricultural<br>Property<br>Loans | Residential<br>Property<br>Loans | Other<br>Collateralized<br>Loans | Uncollateralized<br>Loans | Total            |
|   | (in millions)                   |                                   |                                  |                                  |                           |                  |
| <b>Allowance for Credit Losses:</b>   |                                 |                                   |                                  |                                  |                           |                  |
| Ending balance: individually evaluated for impairment                             | \$ 16                           | \$ 0                              | \$ 0                             | \$ 2                             | \$ 0                      | \$ 18            |
| Ending balance: collectively evaluated for impairment                             | 163                             | 8                                 | 7                                | 0                                | 12                        | 190              |
| Ending balance: loans acquired with deteriorated credit quality                   | 0                               | 0                                 | 0                                | 0                                | 0                         | 0                |
| <b>Total ending balance</b>   | <b>\$ 179</b>                   | <b>\$ 8</b>                       | <b>\$ 7</b>                      | <b>\$ 2</b>                      | <b>\$ 12</b>              | <b>\$ 208</b>    |
| <b>Recorded Investment:(1)</b>  |                                 |                                   |                                  |                                  |                           |                  |
| Ending balance gross of reserves: individually evaluated for impairment           | \$ 482                          | \$ 5                              | \$ 0                             | \$ 8                             | \$ 2                      | \$ 497           |
| Ending balance gross of reserves: collectively evaluated for impairment           | 35,005                          | 2,134                             | 600                              | 32                               | 1,437                     | 39,208           |
| Ending balance gross of reserves: loans acquired with deteriorated credit quality | 0                               | 0                                 | 0                                | 0                                | 0                         | 0                |
| <b>Total ending balance, gross of reserves</b>                                    | <b>\$ 35,487</b>                | <b>\$ 2,139</b>                   | <b>\$ 600</b>                    | <b>\$ 40</b>                     | <b>\$ 1,439</b>           | <b>\$ 39,705</b> |

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

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

|   | December 31, 2012               |                                   |                                  |                                  |                           |                  |
|---|---------------------------------|-----------------------------------|----------------------------------|----------------------------------|---------------------------|------------------|
|   | Commercial<br>Mortgage<br>Loans | Agricultural<br>Property<br>Loans | Residential<br>Property<br>Loans | Other<br>Collateralized<br>Loans | Uncollateralized<br>Loans | Total            |
|   | (in millions)                   |                                   |                                  |                                  |                           |                  |
| <b>Allowance for Credit Losses:</b>   |                                 |                                   |                                  |                                  |                           |                  |
| Ending balance: individually evaluated for impairment                             | \$ 49                           | \$ 12                             | \$ 0                             | \$ 12                            | \$ 0                      | \$ 73            |
| Ending balance: collectively evaluated for impairment                             | 160                             | 8                                 | 11                               | 0                                | 17                        | 196              |
| Ending balance: loans acquired with deteriorated credit quality                   | 0                               | 0                                 | 0                                | 0                                | 0                         | 0                |
| <b>Total ending balance</b>   | <b>\$ 209</b>                   | <b>\$ 20</b>                      | <b>\$ 11</b>                     | <b>\$ 12</b>                     | <b>\$ 17</b>              | <b>\$ 269</b>    |
| <b>Recorded Investment:(1)</b>  |                                 |                                   |                                  |                                  |                           |                  |
| Ending balance gross of reserves: individually evaluated for impairment           | \$ 1,011                        | \$ 49                             | \$ 0                             | \$ 93                            | \$ 3                      | \$ 1,156         |
| Ending balance gross of reserves: collectively evaluated for impairment           | 31,103                          | 2,073                             | 790                              | 47                               | 1,833                     | 35,846           |
| Ending balance gross of reserves: loans acquired with deteriorated credit quality | 0                               | 0                                 | 0                                | 0                                | 0                         | 0                |
| <b>Total ending balance, gross of reserves</b>                                    | <b>\$ 32,114</b>                | <b>\$ 2,122</b>                   | <b>\$ 790</b>                    | <b>\$ 140</b>                    | <b>\$ 1,836</b>           | <b>\$ 37,002</b> |

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

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

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

|  | September 30, 2013        |                                |                                       |   |                                     |
|--|---------------------------|--------------------------------|---------------------------------------|---|-------------------------------------|
|  | Recorded<br>Investment(1) | Unpaid<br>Principal<br>Balance | Related<br>Allowance<br>(in millions) | Average<br>Recorded<br>Investment<br>Before<br>Allowance(2) | Interest<br>Income<br>Recognized(3) |
| <b>With no related allowance recorded:</b> |                           |                                |                                       |   |                                     |
| Commercial mortgage loans                  | \$ 27                     | \$ 27                          | \$ 0                                  | \$ 30   | \$ 1                                |
| Agricultural property loans                | 5                         | 0                              | 0                                     | 1   | 0                                   |
| Residential property loans                 | 0                         | 0                              | 0                                     | 0   | 0                                   |
| Other collateralized loans                 | 0                         | 0                              | 0                                     | 0   | 0                                   |
| Uncollateralized loans                     | 0                         | 2                              | 0                                     | 0   | 0                                   |
| <b>Total with no related allowance</b>     | <b>\$ 32</b>              | <b>\$ 29</b>                   | <b>\$ 0</b>                           | <b>\$ 31</b>  | <b>\$ 1</b>                         |
| <b>With an allowance recorded:</b>         |                           |                                |                                       |   |                                     |
| Commercial mortgage loans                  | \$ 90                     | \$ 90                          | \$ 16                                 | \$ 138  | \$ 2                                |
| Agricultural property loans                | 0                         | 0                              | 0                                     | 13  | 0                                   |
| Residential property loans                 | 0                         | 0                              | 0                                     | 0   | 0                                   |
| Other collateralized loans                 | 5                         | 5                              | 2                                     | 9   | 3                                   |
| Uncollateralized loans                     | 0                         | 0                              | 0                                     | 0   | 0                                   |
| <b>Total with related allowance</b>        | <b>\$ 95</b>              | <b>\$ 95</b>                   | <b>\$ 18</b>                          | <b>\$ 160</b>   | <b>\$ 5</b>                         |
| <b>Total:</b>                              |                           |                                |                                       |   |                                     |
| Commercial mortgage loans                  | \$ 117                    | \$ 117                         | \$ 16                                 | \$ 168  | \$ 3                                |
| Agricultural property loans                | 5                         | 0                              | 0                                     | 14  | 0                                   |
| Residential property loans                 | 0                         | 0                              | 0                                     | 0   | 0                                   |
| Other collateralized loans                 | 5                         | 5                              | 2                                     | 9   | 3                                   |
| Uncollateralized loans                     | 0                         | 2                              | 0                                     | 0   | 0                                   |
| <b>Total</b>                               | <b>\$ 127</b>             | <b>\$ 124</b>                  | <b>\$ 18</b>                          | <b>\$ 191</b>   | <b>\$ 6</b>                         |

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

(2) Average recorded investment represents the average of the beginning-of-period and all subsequent quarterly end-of-period balances.

(3) The interest income recognized is for the year-to-date income regardless of when the impairments occurred.



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

|  | December 31, 2012         |                                |                                       |   |                                     |
|--|---------------------------|--------------------------------|---------------------------------------|---|-------------------------------------|
|  | Recorded<br>Investment(1) | Unpaid<br>Principal<br>Balance | Related<br>Allowance<br>(in millions) | Average<br>Recorded<br>Investment<br>Before<br>Allowance(2) | Interest<br>Income<br>Recognized(3) |
| <b>With no related allowance recorded:</b> |                           |                                |                                       |   |                                     |
| Commercial mortgage loans(4)               | \$ 27                     | \$ 166                         | \$ 0                                  | \$ 54   | \$ 4                                |
| Agricultural property loans                | 0                         | 0                              | 0                                     | 0   | 0                                   |
| Residential property loans                 | 0                         | 0                              | 0                                     | 0   | 0                                   |
| Other collateralized loans                 | 0                         | 0                              | 0                                     | 0   | 0                                   |
| Uncollateralized loans                     | 0                         | 2                              | 0                                     | 4   | 0                                   |
| <b>Total with no related allowance</b>     | <b>\$ 27</b>              | <b>\$ 168</b>                  | <b>\$ 0</b>                           | <b>\$ 58</b>  | <b>\$ 4</b>                         |
| <b>With an allowance recorded:</b>         |                           |                                |                                       |   |                                     |
| Commercial mortgage loans                  | \$ 185                    | \$ 185                         | \$ 50                                 | \$ 351  | \$ 8                                |
| Agricultural property loans                | 17                        | 17                             | 12                                    | 16  | 0                                   |
| Residential property loans                 | 0                         | 0                              | 0                                     | 0   | 0                                   |
| Other collateralized loans                 | 17                        | 17                             | 11                                    | 19  | 0                                   |
| Uncollateralized loans                     | 0                         | 0                              | 0                                     | 0   | 0                                   |
| <b>Total with related allowance</b>        | <b>\$ 219</b>             | <b>\$ 219</b>                  | <b>\$ 73</b>                          | <b>\$ 386</b>   | <b>\$ 8</b>                         |
| <b>Total:</b>                              |                           |                                |                                       |   |                                     |
| Commercial mortgage loans(4)               | \$ 212                    | \$ 351                         | \$ 50                                 | \$ 405  | \$ 12                               |
| Agricultural property loans                | 17                        | 17                             | 12                                    | 16  | 0                                   |
| Residential property loans                 | 0                         | 0                              | 0                                     | 0   | 0                                   |
| Other collateralized loans                 | 17                        | 17                             | 11                                    | 19  | 0                                   |
| Uncollateralized loans                     | 0                         | 2                              | 0                                     | 4   | 0                                   |
| <b>Total</b>                               | <b>\$ 246</b>             | <b>\$ 387</b>                  | <b>\$ 73</b>                          | <b>\$ 444</b>   | <b>\$ 12</b>                        |

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

(2) Average recorded investment represents the average of the beginning-of-period and all subsequent quarterly end-of-period balances.

(3) The interest income recognized is for the year-to-date income regardless of when the impairments occurred.

(4) Includes the impact of loans acquired from the Star Business for which the balance sheet carrying value had been previously written down.

The net carrying value of commercial and other loans held for sale by the Company as of September 30, 2013 and December 31, 2012 was \$93 million and \$114 million, respectively. In all of these transactions, the Company pre-arranges that it will sell the loan to an investor. As of September 30, 2013 and December 31, 2012, all of the Company's commercial and other loans held for sale were collateralized, with collateral primarily consisting of office buildings, retail properties, apartment complexes and industrial buildings.



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

The following tables set forth the credit quality indicators as of September 30, 2013, based upon the recorded investment gross of allowance for credit losses.

**Commercial mortgage loans**

|                                 | Debt Service Coverage Ratio September 30, 2013 |                                |                   | Total     |
|---------------------------------|--|--------------------------------|-------------------|-----------|
|                                 | Greater than<br>1.2X                           | 1.0X to <1.2X<br>(in millions) | Less than<br>1.0X |           |
| <b>Loan-to-Value Ratio</b>      |  |                                |                   |           |
| 0%-59.99%                       | \$ 17,511                                      | \$ 648                         | \$ 243            | \$ 18,402 |
| 60%-69.99%                      | 11,009   | 447                            | 108               | 11,564    |
| 70%-79.99%                      | 3,705  | 773                            | 228               | 4,706     |
| Greater than 80%                | 284  | 185                            | 346               | 815       |
| Total commercial mortgage loans | \$ 32,509                                      | \$ 2,053                       | \$ 925            | \$ 35,487 |

**Agricultural property loans**

|                                   | Debt Service Coverage Ratio September 30, 2013 |                                |                   | Total    |
|-----------------------------------|--|--------------------------------|-------------------|----------|
|                                   | Greater than<br>1.2X                           | 1.0X to <1.2X<br>(in millions) | Less than<br>1.0X |          |
| <b>Loan-to-Value Ratio</b>        |  |                                |                   |          |
| 0%-59.99%                         | \$ 1,758                                       | \$ 176                         | \$ 13             | \$ 1,947 |
| 60%-69.99%                        | 192  | 0                              | 0                 | 192      |
| 70%-79.99%                        | 0  | 0                              | 0                 | 0        |
| Greater than 80%                  | 0  | 0                              | 0                 | 0        |
| Total agricultural property loans | \$ 1,950                                       | \$ 176                         | \$ 13             | \$ 2,139 |

**Total commercial and agricultural mortgage loans**

|  | Debt Service Coverage Ratio September 30, 2013 |               |                   | Total |
|--|--|---------------|-------------------|-------|
|  | Greater than<br>1.2X                           | 1.0X to <1.2X | Less than<br>1.0X |       |



Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|  | (in millions) |        |           |        |           |               |
|--|---------------|--------|-----------|--------|-----------|---------------|
| <b>Loan-to-Value Ratio</b>                           |               |        |           |        |           |               |
| 0%-59.99%  | \$ 19,269     | \$     | 824       | \$ 256 | \$ 20,349 |               |
| 60%-69.99%   | 11,201        |        | 447       | 108    | 11,756    |               |
| 70%-79.99%   | 3,705         |        | 773       | 228    | 4,706     |               |
| Greater than 80%                                     | 284           |        | 185       | 346    | 815       |               |
| <br>Total commercial and agricultural mortgage loans | <br>\$ 34,459 | <br>\$ | <br>2,229 | <br>\$ | <br>938   | <br>\$ 37,626 |

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

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

**Commercial mortgage loans**

|                                 | Debt Service Coverage Ratio December 31, 2012 |               |                   | Total     |
|---------------------------------|---|---------------|-------------------|-----------|
|                                 | Greater than<br>1.2X                          | 1.0X to <1.2X | Less than<br>1.0X |           |
|                                 | (in millions)                                 |               |                   |           |
| <b>Loan-to-Value Ratio</b>      |   |               |                   |           |
| 0%-59.99%                       | \$ 15,089                                     | \$ 487        | \$ 188            | \$ 15,764 |
| 60%-69.99%                      | 9,263   | 801           | 36                | 10,100    |
| 70%-79.99%                      | 3,689   | 776           | 217               | 4,682     |
| Greater than 80%                | 219   | 770           | 579               | 1,568     |
| Total commercial mortgage loans | \$ 28,260                                     | \$ 2,834      | \$ 1,020          | \$ 32,114 |

**Agricultural property loans**

|                                   | Debt Service Coverage Ratio December 31, 2012 |               |                   | Total    |
|-----------------------------------|---|---------------|-------------------|----------|
|                                   | Greater than<br>1.2X                          | 1.0X to <1.2X | Less than<br>1.0X |          |
|                                   | (in millions)                                 |               |                   |          |
| <b>Loan-to-Value Ratio</b>        |   |               |                   |          |
| 0%-59.99%                         | \$ 1,635                                      | \$ 186        | \$ 44             | \$ 1,865 |
| 60%-69.99%                        | 213   | 0             | 0                 | 213      |
| 70%-79.99%                        | 0   | 0             | 0                 | 0        |
| Greater than 80%                  | 0   | 0             | 44                | 44       |
| Total agricultural property loans | \$ 1,848                                      | \$ 186        | \$ 88             | \$ 2,122 |

**Total commercial and agricultural mortgage loans**

|  | Debt Service Coverage Ratio December 31, 2012 |               |                   | Total |
|--|---|---------------|-------------------|-------|
|  | Greater than<br>1.2X                          | 1.0X to <1.2X | Less than<br>1.0X |       |
|  | (in millions)                                 |               |                   |       |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|  | (in millions) |              |              |               |
|--|---------------|--------------|--------------|---------------|
| <b>Loan-to-Value Ratio</b>                           |               |              |              |               |
| 0%-59.99%  | \$ 16,724     | \$ 673       | \$ 232       | \$ 17,629     |
| 60%-69.99%   | 9,476         | 801          | 36           | 10,313        |
| 70%-79.99%   | 3,689         | 776          | 217          | 4,682         |
| Greater than 80%                                     | 219           | 770          | 623          | 1,612         |
| <br>Total commercial and agricultural mortgage loans | <br>\$ 30,108 | <br>\$ 3,020 | <br>\$ 1,108 | <br>\$ 34,236 |

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

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

|                             | September 30, 2013 |                           |                           |   |  |                   | Total Commercial<br>Mortgage<br>and Other<br>Loans | Non<br>Accrual<br>Status |
|-----------------------------|--------------------|---------------------------|---------------------------|---|--|-------------------|--|--------------------------|
|                             | Current            | 30-59 Days<br>Past<br>Due | 60-89 Days<br>Past<br>Due | Greater<br>Than<br>90<br>Days -<br>Accruing | Greater<br>Than 90<br>Days - Not<br>Accruing | Total Past<br>Due |  |                          |
| Commercial mortgage loans   | \$ 35,448          | \$ 19                     | \$ 0                      | \$ 0  | \$ 20  | \$ 39             | \$ 35,487  | \$ 113                   |
| Agricultural property loans | 2,137              | 0                         | 0                         | 0   | 2  | 2                 | 2,139  | 2                        |
| Residential property loans  | 579                | 6                         | 2                         | 0   | 13   | 21                | 600  | 13                       |
| Other collateralized loans  | 38                 | 0                         | 0                         | 0   | 2  | 2                 | 40   | 5                        |
| Uncollateralized loans      | 1,439              | 0                         | 0                         | 0   | 0  | 0                 | 1,439  | 3                        |
| Total                       | \$ 39,641          | \$ 25                     | \$ 2                      | \$ 0  | \$ 37  | \$ 64             | \$ 39,705  | \$ 136                   |

|                             | December 31, 2012 |                           |                           |   |  |                   | Total Commercial<br>Mortgage<br>and Other<br>Loans | Non<br>Accrual<br>Status |
|-----------------------------|-------------------|---------------------------|---------------------------|---|--|-------------------|--|--------------------------|
|                             | Current           | 30-59 Days<br>Past<br>Due | 60-89 Days<br>Past<br>Due | Greater<br>Than<br>90<br>Days -<br>Accruing | Greater<br>Than 90<br>Days - Not<br>Accruing | Total Past<br>Due |  |                          |
| Commercial mortgage loans   | \$ 31,943         | \$ 43                     | \$ 91                     | \$ 0  | \$ 37  | \$ 171            | \$ 32,114  | \$ 190                   |
| Agricultural property loans | 2,077             | 0                         | 0                         | 0   | 45   | 45                | 2,122  | 49                       |
| Residential property loans  | 759               | 12                        | 5                         | 0   | 14   | 31                | 790  | 14                       |
| Other collateralized loans  | 139               | 0                         | 0                         | 0   | 1  | 1                 | 140  | 17                       |
| Uncollateralized loans      | 1,836             | 0                         | 0                         | 0   | 0  | 0                 | 1,836  | 3                        |
| Total                       | \$ 36,754         | \$ 55                     | \$ 96                     | \$ 0  | \$ 97  | \$ 248            | \$ 37,002  | \$ 273                   |

See Note 2 for further discussion regarding nonaccrual status loans.

For the three months ended September 30, 2013 and 2012, there were no commercial mortgage and other loans acquired, other than those through direct origination and no new commercial mortgage and other loans sold, other than those classified as held-for-sale.

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

The Company's commercial mortgage and other loans may occasionally be involved in a troubled debt restructuring. As of both September 30, 2013 and December 31, 2012, the Company had no significant commitments to fund to borrowers that have been involved in a troubled debt restructuring. During the three months and nine months ended September 30, 2013, there were adjusted pre-modification outstanding recorded investments of \$7 million and \$107 million, respectively, and post-modification outstanding recorded investments of \$8 million and \$107 million, respectively, related to commercial mortgage loans. No payment defaults on commercial mortgage and other loans were modified as a troubled debt restructuring within the 12 months preceding each respective period. See Note 2 for additional information relating to the accounting for troubled debt restructurings.

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

Net investment income for the three and nine months ended September 30, 2013 and 2012, was from the following sources:

|   | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |           |
|---|-------------------------------------|----------|------------------------------------|-----------|
|   | 2013                                | 2012     | 2013                               | 2012      |
|   | (in millions)                       |          |                                    |           |
| Fixed maturities, available-for-sale        | \$ 2,618                            | \$ 2,427 | \$ 7,910                           | \$ 7,244  |
| Fixed maturities, held-to-maturity          | 31                                  | 34       | 92                                 | 102       |
| Equity securities, available-for-sale       | 93                                  | 85       | 265                                | 247       |
| Trading account assets                      | 243                                 | 215      | 715                                | 666       |
| Commercial mortgage and other loans         | 498                                 | 516      | 1,480                              | 1,487     |
| Policy loans                                | 159                                 | 148      | 457                                | 443       |
| Short-term investments and cash equivalents | 9                                   | 11       | 30                                 | 35        |
| Other long-term investments                 | 145                                 | 100      | 477                                | 211       |
| Gross investment income                     | 3,796                               | 3,536    | 11,426                             | 10,435    |
| Less: investment expenses                   | (146)                               | (103)    | (427)                              | (324)     |
| Net investment income                       | \$ 3,650                            | \$ 3,433 | \$ 10,999                          | \$ 10,111 |

**Realized Investment Gains (Losses), Net**

Realized investment gains (losses), net, for the three and nine months ended September 30, 2013 and 2012, were from the following sources:

|   | Three Months Ended<br>September 30, |         | Nine Months Ended<br>September 30, |          |
|---|-------------------------------------|---------|------------------------------------|----------|
|   | 2013                                | 2012    | 2013                               | 2012     |
|   | (in millions)                       |         |                                    |          |
| Fixed maturities                        | \$ 368                              | \$ (53) | \$ 712                             | \$ (148) |
| Equity securities                       | 198                                 | 40      | 369                                | 3        |
| Commercial mortgage and other loans     | 31                                  | 28      | 68                                 | 49       |
| Investment real-estate                  | 2                                   | 4       | 2                                  | (63)     |
| Joint ventures and limited partnerships | 16                                  | (3)     | 10                                 | (1)      |
| Derivatives(1)                          | (2,730)                             | (1,458) | (5,030)                            | (903)    |
| Other                                   | 5                                   | (3)     | 12                                 | (3)      |

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|   |            |            |            |            |
|---|------------|------------|------------|------------|
| Realized investment gains (losses), net | \$ (2,110) | \$ (1,445) | \$ (3,857) | \$ (1,066) |
|---|------------|------------|------------|------------|

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

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)****Net Unrealized Gains (Losses) on Investments by Asset Class**

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

|   | September 30,<br>2013 | December 31,<br>2012 |
|---|-----------------------|----------------------|
|   | (in millions)         |                      |
| Fixed maturity securities on which an OTTI loss has been recognized | \$ 37                 | \$ (194)             |
| Fixed maturity securities, available-for-sale all other             | 16,330                | 23,876               |
| Equity securities, available-for-sale                               | 2,300                 | 1,518                |
| Derivatives designated as cash flow hedges(1)                       | (355)                 | (257)                |
| Other investments(2)  | (11)                  | 14                   |
| Net unrealized gains (losses) on investments                        | \$ 18,301             | \$ 24,957            |

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

(2) As of September 30, 2013, includes \$26 million of net unrealized losses on held-to-maturity securities that were previously transferred from available-for-sale. Also includes net unrealized gains on certain joint ventures that are included in Other assets.

**Duration of Gross Unrealized Loss Positions for Fixed Maturities and Equity Securities**

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

|  | Less than twelve months |                               | September 30, 2013<br>Twelve months or more |                               | Total      |                               |
|--|-------------------------|-------------------------------|---|-------------------------------|------------|-------------------------------|
|  | Fair Value              | Gross<br>Unrealized<br>Losses | Fair Value                                  | Gross<br>Unrealized<br>Losses | Fair Value | Gross<br>Unrealized<br>Losses |
|  | (in millions)           |                               |   |                               |            |                               |
| <b>Fixed maturities(1)</b>   |                         |                               |   |                               |            |                               |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | \$ 1,424                | \$ 141                        | \$ 49                                       | \$ 13                         | \$ 1,473   | \$ 154                        |
| Obligations of U.S. states and their political subdivisions                          | 1,198                   | 135                           | 16  | 3                             | 1,214      | 138                           |
| Foreign government bonds   | 5,241                   | 289                           | 54  | 9                             | 5,295      | 298                           |
| Corporate securities   | 44,459                  | 3,783                         | 3,882                                       | 420                           | 48,341     | 4,203                         |



Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|  |                  |                 |                 |               |                  |                 |
|--|------------------|-----------------|-----------------|---------------|------------------|-----------------|
| Commercial mortgage-backed securities        | 3,864            | 164             | 58              | 2             | 3,922            | 166             |
| Asset-backed securities                      | 2,363            | 15              | 2,661           | 359           | 5,024            | 374             |
| Residential mortgage-backed securities       | 1,825            | 51              | 204             | 10            | 2,029            | 61              |
| <b>Total</b>                                 | <b>\$ 60,374</b> | <b>\$ 4,578</b> | <b>\$ 6,924</b> | <b>\$ 816</b> | <b>\$ 67,298</b> | <b>\$ 5,394</b> |
| <b>Equity securities, available-for-sale</b> | <b>\$ 826</b>    | <b>\$ 41</b>    | <b>\$ 1</b>     | <b>\$ 0</b>   | <b>\$ 827</b>    | <b>\$ 41</b>    |

(1) Includes \$233 million of fair value and \$32 million of gross unrealized losses at September 30, 2013, on securities classified as held-to-maturity, a portion of which is not reflected in AOCI.

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

|  | Less than twelve months |                               | December 31, 2012<br>Twelve months or more |                               | Total            |                               |
|--|-------------------------|-------------------------------|--|-------------------------------|------------------|-------------------------------|
|  | Fair Value              | Gross<br>Unrealized<br>Losses | Fair Value<br>(in millions)                | Gross<br>Unrealized<br>Losses | Fair Value       | Gross<br>Unrealized<br>Losses |
| <b>Fixed maturities(1)</b>   |                         |                               |  |                               |                  |                               |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | \$ 2,191                | \$ 33                         | \$ 42                                      | \$ 2                          | \$ 2,233         | \$ 35                         |
| Obligations of U.S. states and their political subdivisions                          | 343                     | 5                             | 5  | 0                             | 348              | 5                             |
| Foreign government bonds   | 5,426                   | 55                            | 167  | 11                            | 5,593            | 66                            |
| Corporate securities   | 25,051                  | 599                           | 7,961                                      | 1,057                         | 33,012           | 1,656                         |
| Commercial mortgage-backed securities  | 525                     | 3                             | 185  | 14                            | 710              | 17                            |
| Asset-backed securities  | 911                     | 11                            | 3,545                                      | 720                           | 4,456            | 731                           |
| Residential mortgage-backed securities   | 773                     | 4                             | 259  | 29                            | 1,032            | 33                            |
| <b>Total</b>   | <b>\$ 35,220</b>        | <b>\$ 710</b>                 | <b>\$ 12,164</b>                           | <b>\$ 1,833</b>               | <b>\$ 47,384</b> | <b>\$ 2,543</b>               |
| <b>Equity securities, available-for-sale</b>   | <b>\$ 961</b>           | <b>\$ 55</b>                  | <b>\$ 0</b>                                | <b>\$ 0</b>                   | <b>\$ 961</b>    | <b>\$ 55</b>                  |

(1) Includes \$526 million of fair value and \$67 million of gross unrealized losses at December 31, 2012, on securities classified as held-to-maturity, a portion of which is not reflected in AOCI.

The gross unrealized losses at September 30, 2013 and December 31, 2012, are composed of \$4,959 million and \$1,866 million, respectively, related to high or highest quality securities based on NAIC or equivalent rating and \$434 million and \$677 million, respectively, related to other than high or highest quality securities based on NAIC or equivalent rating. At September 30, 2013, the \$816 million of gross unrealized losses of twelve months or more were concentrated in the utility, finance, and consumer non-cyclical sectors of the Company's corporate securities. At December 31, 2012, the \$1,833 million of gross unrealized losses of twelve months or more were concentrated in asset-backed securities, and in the finance, and consumer cyclical sectors of the Company's corporate securities. In accordance with its policy described in Note 2, the Company concluded that an adjustment to earnings for other-than-temporary impairments for these securities was not warranted at September 30, 2013 or December 31, 2012. These conclusions are based on a detailed analysis of the underlying credit and cash flows on each security. The gross unrealized losses are primarily attributable to foreign currency movements, credit spread widening and increased liquidity discounts. At September 30, 2013, the Company does not intend to sell these securities and it is not more likely than not that the Company will be required to sell these securities before the anticipated recovery of their remaining amortized cost bases.

At September 30, 2013, \$1 million of the gross unrealized losses represented declines in value of greater than 20%, all of which had been in that position for less than six months. At December 31, 2012, \$6 million of the gross unrealized losses represented declines in value of greater than 20%, \$4 million of which had been in that position for less than six months. In accordance with its policy described in Note 2, the Company concluded that an adjustment for other-than-temporary impairments for these equity securities was not warranted at September 30, 2013 or December 31, 2012.



---

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

**5. VARIABLE INTEREST ENTITIES**

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

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

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

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

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



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

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

|  | September 30,<br>2013 | December 31,<br>2012 |
|--|-----------------------|----------------------|
|  | (in millions)         |                      |
| Fixed maturities, available-for-sale   | \$ 81                 | \$ 87                |
| Other trading account assets           | 2,793                 | 1,409                |
| Commercial mortgage and other loans    | 65                    | 127                  |
| Other long-term investments            | 0                     | 22                   |
| Cash and cash equivalents              | 150                   | 9                    |
| Accrued investment income              | 14                    | 0                    |
| Other assets                           | 92                    | 1                    |
| <br>                                   |                       |                      |
| Total assets of consolidated VIEs      | \$ 3,195              | \$ 1,655             |
| <br>                                   |                       |                      |
| Notes issued by consolidated VIEs      | \$ 2,423              | \$ 1,577             |
| Other liabilities                      | 208                   | 0                    |
| <br>                                   |                       |                      |
| Total liabilities of consolidated VIEs | \$ 2,631              | \$ 1,577             |

As included in the table above, notes issued by consolidated VIEs are reported on the Consolidated Statements of Financial Position within Notes issued by consolidated VIEs. Recourse is limited to the assets of the respective VIE and does not extend to the general credit of Prudential Financial. As of September 30, 2013, the maturities of these obligations were over five years.

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

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

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

|   | September 30,<br>2013 | December 31,<br>2012 |
|---|-----------------------|----------------------|
|   | (in millions)         |                      |
| Fixed maturities, available-for-sale                    | \$ 116                | \$ 115               |
| Fixed maturities, held-to-maturity                      | 933                   | 1,059                |
| Trading account assets supporting insurance liabilities | 11                    | 8                    |
| Other long-term investments                             | 64                    | 53                   |
| Accrued investment income                               | 4                     | 3                    |
| <br>Total assets of consolidated VIEs                   | <br>\$ 1,128          | <br>\$ 1,238         |
| <br>Other liabilities                                   | <br>\$ 1              | <br>\$ 1             |
| <br>Total liabilities of consolidated VIEs              | <br>\$ 1              | <br>\$ 1             |

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

The funding agreements represent an intercompany transaction that is eliminated upon consolidation. However, in recognition of the security interest in such funding agreements, the trust's medium-term note liability, including accrued interest, of \$2,057 million and \$1,780 million at September 30, 2013 and December 31, 2012, respectively, is classified within Policyholders' account balances. Creditors of the trust have recourse to Prudential Insurance if the trust fails to make contractual payments on the medium-term notes. The Company has not provided material financial or other support to the trust that was not contractually required.

*Unconsolidated Variable Interest Entities*

The Company has determined that it is not the primary beneficiary of certain VIEs for which it is the investment manager, including certain CDOs and other investment structures, as it does not have both (1) the power to direct the activities of the VIE that most significantly impact the economic performance of the entity and (2) the obligation to absorb losses of the entity that could be potentially significant to the VIE or the right to receive benefits from the entity that could be potentially significant. The Company's maximum exposure to loss resulting from its relationship with unconsolidated VIEs for which it is the investment manager is limited to its investment in the VIEs, which was \$530 million and \$602 million at September 30, 2013 and December 31, 2012, respectively. These investments are reflected in Fixed maturities, available-for-sale, Other trading



**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

account assets, at fair value and Other long-term investments. The fair value of assets held within these unconsolidated VIEs was \$9,059 million and \$9,240 million as of September 30, 2013 and December 31, 2012, respectively. The Company provided a guarantee to an unconsolidated VIE under which it was exposed to potential losses in the amount of \$64 million as of December 31, 2012. As of July 10, 2013, the Company is no longer providing this guarantee. There are no liabilities associated with these unconsolidated VIEs on the Company's balance sheet.

In the normal course of its activities, the Company invests in joint ventures and limited partnerships. These ventures primarily include hedge funds, private equity funds and real estate-related funds and may or may not be VIEs. The Company's maximum exposure to loss on these investments, both VIEs and non-VIEs, is limited to the amount of its investment. The Company has determined that it is not required to consolidate these entities because either (1) it does not control them or (2) it does not have the obligation to absorb losses of the entities that could be potentially significant to the entities or the right to receive benefits from the entities that could be potentially significant. The Company classifies these investments as Other long-term investments and its maximum exposure to loss associated with these entities was \$6,870 million and \$6,873 million as of September 30, 2013 and December 31, 2012, respectively.

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

Included among these structured investments are asset-backed securities issued by VIEs that manage investments in the European market. In addition to a stated coupon, each investment provides a return based on the VIE's portfolio of assets and related investment activity. The market value of these VIEs was approximately \$2.0 billion and \$2.1 billion as of September 30, 2013 and December 31, 2012, respectively, and these VIEs were financed primarily through the issuance of notes similar to those purchased by the Company. The Company generally accounts for these investments as available-for-sale fixed maturities containing embedded derivatives that are bifurcated and marked-to-market through

Realized investment gains (losses), net, based upon the change in value of the underlying portfolio. The Company's variable interest in each of these VIEs represents less than 50% of the only class of variable interests issued by the VIE. The Company's maximum exposure to loss from these interests was \$323 million and \$314 million at September 30, 2013 and December 31, 2012, respectively, which includes the fair value of the embedded derivatives.

**6. CLOSED BLOCK**

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

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

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

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

As of September 30, 2013 and December 31, 2012, the Company recognized a policyholder dividend obligation of \$955 million and \$885 million, respectively, to Closed Block policyholders for the excess of actual cumulative earnings over the expected cumulative earnings. Additionally, accumulated net unrealized investment gains that have arisen subsequent to the establishment of the Closed Block were reflected as a policyholder dividend obligation of \$3,641 million and \$5,478 million at September 30, 2013 and December 31, 2012, respectively, to be paid to Closed Block policyholders unless offset by future experience, with an offsetting amount reported in AOCI. See the table below for changes in the components of the policyholder dividend obligation for the nine months ended September 30, 2013.

**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:

|   | September 30,<br>2013 | December 31,<br>2012 |
|---|-----------------------|----------------------|
|   | (in millions)         |                      |
| <b>Closed Block Liabilities</b>   |                       |                      |
| Future policy benefits  | \$ 50,321             | \$ 50,839            |
| Policyholders dividends payable   | 923                   | 887                  |
| Policyholders dividend obligation   | 4,596                 | 6,363                |
| Policyholders account balances  | 5,370                 | 5,426                |
| Other Closed Block liabilities  | 4,586                 | 3,366                |
| <b>Total Closed Block Liabilities</b>   | <b>65,796</b>         | <b>66,881</b>        |
| <b>Closed Block Assets</b>  |                       |                      |
| Fixed maturities, available-for-sale, at fair value   | 39,714                | 41,980               |
| Other trading account assets, at fair value   | 231                   | 224                  |
| Equity securities, available-for-sale, at fair value  | 3,496                 | 3,225                |
| Commercial mortgage and other loans   | 8,874                 | 8,747                |
| Policy loans  | 5,036                 | 5,120                |
| Other long-term investments   | 2,037                 | 2,094                |
| Short-term investments  | 1,993                 | 1,194                |
| <b>Total investments</b>  | <b>61,381</b>         | <b>62,584</b>        |
| Cash and cash equivalents   | 480                   | 511                  |
| Accrued investment income   | 576                   | 550                  |
| Other Closed Block assets   | 411                   | 262                  |
| <b>Total Closed Block Assets</b>  | <b>62,848</b>         | <b>63,907</b>        |
| <b>Excess of reported Closed Block Liabilities over Closed Block Assets</b>                   | <b>2,948</b>          | <b>2,974</b>         |
| Portion of above representing accumulated other comprehensive income:                         |                       |                      |
| Net unrealized investment gains (losses)  | 3,640                 | 5,467                |
| Allocated to policyholder dividend obligation   | (3,641)               | (5,478)              |
| <b>Future earnings to be recognized from Closed Block Assets and Closed Block Liabilities</b> | <b>\$ 2,947</b>       | <b>\$ 2,963</b>      |

Information regarding the policyholder dividend obligation is as follows:

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|  | Nine Months Ended<br>September 30,<br>2013<br>(in millions) |
|--|---|
| Balance, January 1   | \$ 6,363  |
| Impact from earnings allocable to policyholder dividend obligation                               | 70  |
| Change in net unrealized investment gains (losses) allocated to policyholder dividend obligation | (1,837)   |
| Balance, September 30  | \$ 4,596  |

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

Closed Block revenues and benefits and expenses for the three and nine months ended September 30, 2013 and 2012 were as follows:

|   | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |          |
|---|-------------------------------------|--------|------------------------------------|----------|
|   | 2013                                | 2012   | 2013                               | 2012     |
|   | (in millions)                       |        |                                    |          |
| <b>Revenues</b>   |                                     |        |                                    |          |
| Premiums  | \$ 629                              | \$ 646 | \$ 1,987                           | \$ 2,060 |
| Net investment income   | 678                                 | 710    | 2,099                              | 2,177    |
| Realized investment gains (losses), net   | 208                                 | 74     | 284                                | 220      |
| Other income  | 25                                  | 15     | 40                                 | 14       |
| Total Closed Block revenues   | 1,540                               | 1,445  | 4,410                              | 4,471    |
| <b>Benefits and Expenses</b>  |                                     |        |                                    |          |
| Policyholders' benefits   | 774                                 | 776    | 2,459                              | 2,565    |
| Interest credited to policyholders' account balances  | 34                                  | 34     | 102                                | 103      |
| Dividends to policyholders  | 557                                 | 478    | 1,468                              | 1,454    |
| General and administrative expenses   | 116                                 | 122    | 353                                | 372      |
| Total Closed Block benefits and expenses  | 1,481                               | 1,410  | 4,382                              | 4,494    |
| Closed Block revenues, net of Closed Block benefits and expenses, before income taxes and discontinued operations | 59                                  | 35     | 28                                 | (23)     |
| Income tax benefit  | 53                                  | 29     | 12                                 | (36)     |
| Closed Block revenues, net of Closed Block benefits and expenses and income taxes, before discontinued operations | 6                                   | 6      | 16                                 | 13       |
| Income (loss) from discontinued operations, net of taxes  | 0                                   | (1)    | 0                                  | (2)      |
| Closed Block revenues, net of Closed Block benefits and expenses, income taxes and discontinued operations        | \$ 6                                | \$ 5   | \$ 16                              | \$ 11    |

**7. EQUITY**

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

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|                                      | Issued | Common Stock<br>Held In<br>Treasury | Outstanding<br>(in millions) | Class B Stock<br>Issued and<br>Outstanding |
|--------------------------------------|--------|-------------------------------------|------------------------------|--|
| Balance, December 31, 2012           | 660.1  | 197.1                               | 463.0                        | 2.0  |
| Common Stock issued                  | 0.0    | 0.0                                 | 0.0                          | 0.0  |
| Common Stock acquired                | 0.0    | 7.1                                 | (7.1)                        | 0.0  |
| Stock-based compensation programs(1) | 0.0    | (6.0)                               | 6.0                          | 0.0  |
| Balance, September 30, 2013          | 660.1  | 198.2                               | 461.9                        | 2.0  |

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

In June 2012, Prudential Financial's Board of Directors authorized the Company to repurchase at management's discretion up to \$1.0 billion of its outstanding Common Stock through June 2013. Under this

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

authorization, 6.6 million shares of the Company's common stock were repurchased at a total cost of \$400 million, of which 3.9 million shares were repurchased in the first six months of 2013 at a total cost of \$250 million.

In June 2013, Prudential Financial's Board of Directors authorized the Company to repurchase at management's discretion up to \$1.0 billion of its outstanding Common Stock from July 1, 2013 through June 30, 2014. As of September 30, 2013, 3.2 million shares of the Company's Common Stock were repurchased under this authorization at a total cost of \$250 million. The timing and amount of share repurchases are determined by management based upon market conditions and other considerations, and repurchases may be effected in the open market, through derivative, accelerated repurchase and other negotiated transactions and through prearranged trading plans complying with Rule 10b5-1(c) under the Exchange Act. Numerous factors could affect the timing and amount of any future repurchases under the share repurchase authorization, including increased capital needs of the Company due to changes in regulatory capital requirements, opportunities for growth and acquisitions, and the effect of adverse market conditions on the segments.

**Accumulated Other Comprehensive Income (Loss)**

The balance of and changes in each component of Accumulated other comprehensive income (loss) attributable to Prudential Financial, Inc. for the nine months ended September 30, 2013 and 2012 are as follows:

| <b>Accumulated Other Comprehensive Income (Loss) Attributable to Prudential<br/>Financial, Inc.</b> |  |  |  |  |
|---|--|--|--|--|
|   | <b>Foreign Currency<br/>Translation<br/>Adjustment</b> | <b>Net Unrealized<br/>Investment<br/>Gains (Losses)(1)</b> | <b>Pension and<br/>Postretirement<br/>Unrecognized Net<br/>Periodic<br/>Benefit<br/>(Cost)</b> | <b>Total<br/>Accumulated<br/>Other<br/>Comprehensive<br/>Income<br/>(Loss)</b> |
|   | (in millions)  |  |  |  |
| Balance, December 31, 2012  | \$ 928   | \$ 11,402  | \$ (2,116)   | \$ 10,214  |
| Change in other comprehensive income before reclassifications                                       | (1,160)  | (2,754)  | 26   | (3,888)  |
| Amounts reclassified from AOCI  | 0  | (1,065)  | 94   | (971)  |
| Income tax benefit (expense)  | 328  | 1,259  | (43)   | 1,544  |
| Balance, September 30, 2013   | \$ 96  | \$ 8,842   | \$ (2,039)   | \$ 6,899   |

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



Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|                                      |               |          | Periodic<br>Benefit<br>(Cost) | Comprehensive<br>Income<br>(Loss) |
|--------------------------------------|---------------|----------|-------------------------------|-----------------------------------|
|                                      | (in millions) |          |                               |                                   |
| Balance, December 31, 2011           | \$ 1,107      | \$ 5,805 | \$ (1,667)                    | \$ 5,245                          |
| Change in component during period(2) | 134           | 4,000    | 68                            | 4,202                             |
| Balance, September 30, 2012          | \$ 1,241      | \$ 9,805 | \$ (1,599)                    | \$ 9,447                          |

(1) Includes cash flow hedges of \$(355) million and \$(257) million as of September 30, 2013 and December 31, 2012, respectively, and \$(126) million and \$(86) million as of September 30, 2012 and December 31, 2011, respectively.

(2) Net of taxes.

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

|  | Three<br>Months<br>Ended<br>September 30, 2013 | Nine Months<br>Ended<br>September 30, 2013<br>(in millions) | Affected line item in Consolidated<br>Statements of Operations |
|--|--|---|--|
| <b>Amounts reclassified from AOCI(1)(2):</b>                                 |  |   |  |
| Foreign currency translation adjustment:                                     |  |   |  |
| Foreign currency translation adjustment                                      | \$ 0   | \$ 0  | Realized investment gains (losses), net                        |
| Foreign currency translation adjustment                                      | 0  | 0   | Other income   |
| Total foreign currency translation adjustment                                | 0  | 0   |  |
| Net unrealized investment gains (losses):                                    |  |   |  |
| Cash flow hedges Interest Rate   | (6)  | (18)  | (3)  |
| Cash flow hedges Currency/Interest rate                                      | (21)   | (65)  | (3)  |
| Net unrealized investment gains (losses) on<br>available-for-sale securities | 568  | 1,082   |  |
| Net unrealized investment gains (losses) all other                           | 0  | 66  |  |
| Total net unrealized investment gains (losses)                               | 541  | 1,065   | (4)  |
| Amortization of defined benefit pension items:                               |  |   |  |
| Prior service cost   | 6  | 17  | (5)  |
| Actuarial gain (loss)  | (37)   | (111)   | (5)  |
| Transition obligation  | 0  | 0   | (5)  |
| Total amortization of defined benefit pension<br>items                       | (31)   | (94)  |  |
| Total reclassifications for the period                                       | \$ 510   | \$ 971  |  |

(1) All amounts are shown before tax.

(2) Positive amounts indicate gains/benefits reclassified out of AOCI. Negative amounts indicate losses/costs reclassified out of AOCI.

(3) See Note 14 for additional information on cash flow hedges.

(4) See table below for additional information on unrealized investment gains (losses), including the impact on deferred policy acquisition and other costs, future policy benefits and policyholders' dividends.

(5) See Note 10 for information on employee benefit plans.

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

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

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

|  | Net Unrealized<br>Gains (Losses) on<br>Investments | Deferred Policy<br>Acquisition<br>Costs,<br>Deferred<br>Sales<br>Inducements,<br>and Value<br>of<br>Business<br>Acquired | Future<br>Policy<br>Benefits | Policyholders<br>Dividends | Deferred<br>Income Tax<br>(Liability)<br>Benefit | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss)<br>Related To<br>Net<br>Unrealized<br>Investment<br>Gains<br>(Losses) |
|--|--|--|------------------------------|----------------------------|--|---|
|  | (in millions)                                      |  |                              |                            |  |   |
| Balance, December 31, 2012   | \$ (194)   | \$ 3   | \$ 3                         | \$ 139                     | \$ 18  | \$ (31)   |
| Net investment gains (losses) on<br>investments arising during the period  | 192  |  |                              |                            | (67)   | 125   |
| Reclassification adjustment for (gains)<br>losses included in net income   | 46   |  |                              |                            | (16)   | 30  |
| Reclassification adjustment for OTTI<br>losses excluded from net income(1)   | (7)  |  |                              |                            | 2  | (5)   |
| Impact of net unrealized investment<br>(gains) losses on deferred policy<br>acquisition costs, deferred sales<br>inducements and value of business<br>acquired |  | (5)  |                              |                            | 2  | (3)   |
| Impact of net unrealized investment<br>(gains) losses on future policy benefits  |  |  | 0                            |                            | 0  | 0   |
| Impact of net unrealized investment<br>(gains) losses on policyholders' dividends  |  |  |                              | (97)                       | 34   | (63)  |
| Balance, September 30, 2013  | \$ 37  | \$ (2)   | \$ 3                         | \$ 42                      | \$ (27)  | \$ 53   |

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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

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

|   | Net Unrealized<br>Gains (Losses) on<br>Investments(1) | Deferred Policy<br>Acquisition<br>Costs, Deferred<br>Sales<br>Inducements,<br>and Value of<br>Business<br>Acquired | Future<br>Policy<br>Benefits | Policyholders<br>Dividends | Deferred<br>Income Tax<br>(Liability)<br>Benefit | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss)<br>Related To<br>Net<br>Unrealized<br>Investment<br>Gains<br>(Losses) |
|---|---|--|------------------------------|----------------------------|--|---|
|   | (in millions)   |  |                              |                            |  |   |
| Balance, December 31, 2012  | \$ 25,151   | \$ (1,228)   | \$ (1,144)                   | \$ (5,627)                 | \$ (5,719)                                       | \$ 11,433   |
| Net investment gains (losses) on<br>investments arising during the period   | (5,783)   |  |                              |                            | 1,947  | (3,836)   |
| Reclassification adjustment for (gains)<br>losses included in net income  | (1,111)   |  |                              |                            | 389  | (722)   |
| Reclassification adjustment for OTTI losses<br>excluded from net income(2)  | 7   |  |                              |                            | (2)  | 5   |
| Impact of net unrealized investment (gains)<br>losses on deferred policy acquisition costs,<br>deferred sales inducements and value of<br>business acquired |   | 638  |                              |                            | (223)  | 415   |
| Impact of net unrealized investment (gains)<br>losses on future policy benefits   |   |  | 363                          |                            | (128)  | 235   |
| Impact of net unrealized investment (gains)<br>losses on policyholders dividends  |   |  |                              | 1,936                      | (677)  | 1,259   |
| Balance, September 30, 2013   | \$ 18,264   | \$ (590)   | \$ (781)                     | \$ (3,691)                 | \$ (4,413)                                       | \$ 8,789  |

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

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

**8. EARNINGS PER SHARE**

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

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

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

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

**Common Stock**

A reconciliation of the numerators and denominators of the basic and diluted per share computations is as follows:

|  | Income | Three Months Ended September 30,      |                     | Income   | 2012<br>Weighted<br>Average<br>Shares | Per Share<br>Amount |
|--|--------|---------------------------------------|---------------------|----------|---------------------------------------|---------------------|
|  |        | 2013<br>Weighted<br>Average<br>Shares | Per Share<br>Amount |          |                                       |                     |
| <b>Basic earnings per share</b>  |        |                                       |                     |          |                                       |                     |
| Income (loss) from continuing operations attributable to the Financial Services Businesses   | \$ 992 |                                       |                     | \$ (601) |                                       |                     |
| Direct equity adjustment   | 2      |                                       |                     | 4        |                                       |                     |
| Less: Income attributable to noncontrolling interests  | 19     |                                       |                     | 25       |                                       |                     |
| Less: Dividends and undistributed earnings allocated to participating unvested share-based payment awards  | 9      |                                       |                     | 0        |                                       |                     |
| Income (loss) from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment | \$ 966 | 462.6                                 | \$ 2.09             | \$ (622) | 464.4                                 | \$ (1.34)           |
| <b>Effect of dilutive securities and compensation programs(1)</b>  |        |                                       |                     |          |                                       |                     |
| Add: Dividends and undistributed earnings allocated to participating unvested share-based payment awards Basic   | \$ 9   |                                       |                     | \$ 0     |                                       |                     |
| Less: Dividends and undistributed earnings allocated to participating unvested share-based payment awards Diluted  | 9      |                                       |                     | 0        |                                       |                     |
| Stock options  |        | 3.4                                   |                     |          | 0.0                                   |                     |
| Deferred and long-term compensation programs   |        | 0.7                                   |                     |          | 0.0                                   |                     |
| Exchangeable Surplus Notes   | 4      | 5.3                                   |                     | 0        | 0.0                                   |                     |
| <b>Diluted earnings per share(1)</b>   |        |                                       |                     |          |                                       |                     |
| Income (loss) from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment | \$ 970 | 472.0                                 | \$ 2.06             | \$ (622) | 464.4                                 | \$ (1.34)           |

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

|  | Nine Months Ended September 30,         |                                       |                     |        |                                       |                     |
|--|---|---------------------------------------|---------------------|--------|---------------------------------------|---------------------|
|  | Income                                  | 2013<br>Weighted<br>Average<br>Shares | Per Share<br>Amount | Income | 2012<br>Weighted<br>Average<br>Shares | Per Share<br>Amount |
|  | (in millions, except per share amounts) |                                       |                     |        |                                       |                     |
| <b>Basic earnings per share</b>  |   |                                       |                     |        |                                       |                     |
| Income (loss) from continuing operations attributable to the Financial Services Businesses   | \$ (179)                                |                                       |                     | \$ 679 |                                       |                     |
| Direct equity adjustment   | 7                                       |                                       |                     | 20     |                                       |                     |
| Less: Income attributable to noncontrolling interests  | 96                                      |                                       |                     | 51     |                                       |                     |
| Less: Dividends and undistributed earnings allocated to participating unvested share-based payment awards  | 6                                       |                                       |                     | 6      |                                       |                     |
| Income (loss) from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment | \$ (274)                                | 463.7                                 | \$ (0.59)           | \$ 642 | 466.6                                 | \$ 1.38             |
| <b>Effect of dilutive securities and compensation programs(1)(2)</b>   |   |                                       |                     |        |                                       |                     |
| Add: Dividends and undistributed earnings allocated to participating unvested share-based payment awards Basic   | \$ 6                                    |                                       |                     | \$ 6   |                                       |                     |
| Less: Dividends and undistributed earnings allocated to participating unvested share-based payment awards Diluted  | 6                                       |                                       |                     | 6      |                                       |                     |
| Stock options  |   | 0.0                                   |                     |        | 2.1                                   |                     |
| Deferred and long-term compensation programs   |   | 0.0                                   |                     |        | 0.5                                   |                     |
| Exchangeable Surplus Notes   | 0                                       | 0.0                                   |                     | 0      | 0.0                                   |                     |
| <b>Diluted earnings per share(1)(2)</b>  |   |                                       |                     |        |                                       |                     |
| Income (loss) from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment | \$ (274)                                | 463.7                                 | \$ (0.59)           | \$ 642 | 469.2                                 | \$ 1.37             |

- (1) For the three months ended September 30, 2012 and the nine months ended September 30, 2013, weighted average shares for basic earnings per share is also used for calculating diluted earnings per share because dilutive shares and dilutive earnings per share are not applicable when a loss from continuing operations is reported. As a result of the loss from continuing operations available to holders of Common Stock after direct equity adjustment for the three months ended September 30, 2012 and the nine months ended September 30, 2013, all potential stock options and compensation programs were considered antidilutive.
- (2) For the nine months ended September 30, 2012, weighted average shares used for calculating diluted earnings per share excludes the potential shares that would be issued related to the exchangeable surplus notes since the hypothetical impact of these shares was antidilutive. In calculating diluted earnings per share under the if-converted method, the potential shares that would be issued related to the exchangeable surplus notes assuming a hypothetical exchange, weighted for the period the notes are outstanding, is added to the denominator, and interest expense, net of tax, is added to the numerator, if the overall effect is dilutive.

Unvested share-based payment awards that contain nonforfeitable rights to dividends are participating securities and included in the computation of earnings per share pursuant to the two-class method. Under this





**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

method, earnings of the Financial Services Businesses attributable to Prudential Financial, Inc. are allocated between Common Stock and the participating awards, as if the awards were a second class of stock. For the three months ended September 30, 2012 and the nine months ended September 30, 2013, undistributed earnings were not allocated to participating unvested share-based payment awards as these awards do not participate in losses. Undistributed earnings allocated to participating unvested share-based payment awards for the three months ended September 30, 2013 were based on 4.4 million and the nine months ended September 30, 2012 were based on 4.7 million of such awards, respectively, weighted for the period they were outstanding. The computation of earnings per share of Common Stock excludes the dilutive impact of participating unvested share-based awards based on the application of the two-class method.

Options and shares related to deferred and long-term compensation programs that are considered antidilutive are excluded from the computation of dilutive earnings per share. For the three months ended September 30, 2013, 2.2 million options, with a weighted average exercise price of \$88.63 per share were considered antidilutive. For the nine months ended September 30, 2013, 19.6 million options and 5.2 million shares related to deferred and long-term compensation programs, weighted for the portion of the period they were outstanding, were considered antidilutive, of which 11.4 million options and 5.2 million shares were antidilutive due to the loss from continuing operations available to holders of Common Stock after direct equity adjustment. The remaining 8.2 million options, with a weighted average exercise price of \$72.33 per share were considered antidilutive based on application of the treasury stock method. For the three months ended September 30, 2012, 20.1 million options and 5.1 million shares related to deferred and long-term compensation programs, weighted for the portion of the period they were outstanding, were considered antidilutive, of which 6.1 million options and 5.1 million shares are antidilutive due to the loss from continuing operations available to holders of Common Stock after direct equity adjustment. The remaining 14.0 million options, with a weighted average exercise price of \$68.97 per share were considered antidilutive based on application of the treasury stock method. For the nine months ended September 30, 2012, 13.1 million options, with a weighted average exercise price of \$70.11 per share were considered antidilutive based on application of the treasury stock method.

In September 2009, the Company issued \$500 million of surplus notes with an interest rate of 5.36% per annum which are exchangeable at the option of the note holders for shares of Common Stock. The initial exchange rate for the surplus notes was 10.1235 shares of Common Stock per each \$1,000 principal amount of surplus notes, which represents an initial exchange price per share of Common Stock of \$98.78; however, the exchange rate is subject to customary anti-dilution adjustments. In calculating diluted earnings per share under the if-converted method, the potential shares that would be issued assuming a hypothetical exchange, weighted for the period the notes are outstanding, are added to the denominator, and interest expense, net of tax, is added to the numerator, if the overall effect is dilutive.

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

Income from continuing operations per share of Class B Stock for the three and nine months ended September 30 are presented below. There are no potentially dilutive shares associated with the Class B Stock.

|   | Three Months Ended September 30, |                                       |                     |        |                                       |                     |
|---|----------------------------------|---------------------------------------|---------------------|--------|---------------------------------------|---------------------|
|   | Income                           | 2013<br>Weighted<br>Average<br>Shares | Per Share<br>Amount | Income | 2012<br>Weighted<br>Average<br>Shares | Per Share<br>Amount |
| (in millions, except per share amounts)   |                                  |                                       |                     |        |                                       |                     |
| <b>Basic earnings per share</b>   |                                  |                                       |                     |        |                                       |                     |
| Income (loss) from continuing operations attributable to the Closed Block Business  | \$ 61                            |                                       |                     | \$ 44  |                                       |                     |
| Less: Direct equity adjustment  | 2                                |                                       |                     | 4      |                                       |                     |
| Income (loss) from continuing operations attributable to the Closed Block Business available to holders of Class B Stock after direct equity adjustment | \$ 59                            | 2.0                                   | \$ 29.50            | \$ 40  | 2.0                                   | \$ 20.00            |

|   | Nine Months Ended September 30, |                                       |                     |        |                                       |                     |
|---|---------------------------------|---------------------------------------|---------------------|--------|---------------------------------------|---------------------|
|   | Income                          | 2013<br>Weighted<br>Average<br>Shares | Per Share<br>Amount | Income | 2012<br>Weighted<br>Average<br>Shares | Per Share<br>Amount |
| (in millions, except per share amounts)   |                                 |                                       |                     |        |                                       |                     |
| <b>Basic earnings per share</b>   |                                 |                                       |                     |        |                                       |                     |
| Income (loss) from continuing operations attributable to the Closed Block Business  | \$ 79                           |                                       |                     | \$ 61  |                                       |                     |
| Less: Direct equity adjustment  | 7                               |                                       |                     | 20     |                                       |                     |
| Income (loss) from continuing operations attributable to the Closed Block Business available to holders of Class B Stock after direct equity adjustment | \$ 72                           | 2.0                                   | \$ 36.00            | \$ 41  | 2.0                                   | \$ 20.50            |

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)****9. SHORT-TERM AND LONG-TERM DEBT*****Short-term Debt***

The table below presents the Company's short-term debt as of the dates indicated:

|  | September 30,<br>2013 | December 31,<br>2012 |
|--|-----------------------|----------------------|
|  | (in millions)         |                      |
| Commercial paper:  |                       |                      |
| Prudential Financial   | \$ 185                | \$ 113               |
| Prudential Funding, LLC  | 804                   | 359                  |
| Subtotal commercial paper  | 989                   | 472                  |
| Other notes payable(1)   | 100                   | 100                  |
| Current portion of long-term debt(2)                               | 2,029                 | 1,912                |
| <b>Total short-term debt(3)</b>                                    | <b>\$ 3,118</b>       | <b>\$ 2,484</b>      |
| <b><u>Supplemental short-term debt information:</u></b>            |                       |                      |
| Portion of commercial paper borrowings due overnight               | \$ 319                | \$ 156               |
| Daily average commercial paper outstanding                         | \$ 1,291              | \$ 1,194             |
| Weighted average maturity of outstanding commercial paper, in days | 27                    | 21                   |
| Weighted average interest rate on outstanding short-term debt(4)   | 0.19%                 | 0.28%                |

- (1) Includes collateralized borrowings from the Federal Home Loan Bank of New York of \$100 million at both September 30, 2013 and December 31, 2012, discussed in more detail below.
- (2) Includes limited and non-recourse borrowings of Prudential Holdings, LLC attributable to the Closed Block Business of \$75 million at both September 30, 2013 and December 31, 2012.
- (3) Includes Prudential Financial debt of \$1,704 million and \$1,847 million at September 30, 2013 and December 31, 2012, respectively.
- (4) Excludes the current portion of long-term debt.

***Commercial Paper***

Prudential Financial has a commercial paper program with an authorized capacity of \$3.0 billion. Prudential Financial commercial paper borrowings generally have been used to fund the working capital needs of Prudential Financial and its subsidiaries.

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Prudential Funding, LLC ( Prudential Funding ), a wholly-owned subsidiary of Prudential Insurance, has a commercial paper program with an authorized capacity of \$7.0 billion. Prudential Funding commercial paper borrowings generally have served as an additional source of financing to meet the working capital needs of Prudential Insurance and its subsidiaries. Prudential Funding also lends to other subsidiaries of Prudential Financial up to limits agreed with the New Jersey Department of Banking and Insurance, or NJDOBI. Prudential Funding maintains a support agreement with Prudential Insurance whereby Prudential Insurance has agreed to maintain Prudential Funding 's tangible net worth at a positive level. Additionally, Prudential Financial has issued a subordinated guarantee covering Prudential Funding 's commercial paper program.

### *Federal Home Loan Bank of New York*

Prudential Insurance is a member of the Federal Home Loan Bank of New York or FHLBNY. Membership allows Prudential Insurance access to the FHLBNY 's financial services, including the ability to obtain collateralized loans and to issue collateralized funding agreements. Under applicable law, the funding agreements

---

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

issued to the FHLBNY have priority claim status above debt holders of Prudential Insurance. FHLBNY borrowings and funding agreements are collateralized by qualifying mortgage-related assets or U.S. Treasury securities, the fair value of which must be maintained at certain specified levels relative to outstanding borrowings. FHLBNY membership requires Prudential Insurance to own member stock and borrowings require the purchase of activity-based stock in an amount equal to 4.5% of outstanding borrowings. Under FHLBNY guidelines, if Prudential Insurance's financial strength ratings decline below A/A2/A Stable by S&P/Moody's/Fitch, respectively, and the FHLBNY does not receive written assurances from the NJDOBI regarding Prudential Insurance's solvency, new borrowings from the FHLBNY would be limited to a term of 90 days or less. Currently there are no restrictions on the term of borrowings from the FHLBNY.

NJDOBI permits Prudential Insurance to pledge collateral to the FHLBNY in an amount of up to 5% of its prior year-end statutory net admitted assets, excluding separate account assets. Based on Prudential Insurance's statutory net admitted assets as of December 31, 2012, the 5% limitation equates to a maximum amount of pledged assets of \$8.1 billion and an estimated maximum borrowing capacity (after taking into account required collateralization levels and purchases of activity-based stock) of approximately \$6.7 billion, of which \$2.3 billion was outstanding. Nevertheless, FHLBNY borrowings are subject to the FHLBNY's discretion and to the availability of qualifying assets at Prudential Insurance.

As of September 30, 2013, Prudential Insurance had pledged qualifying assets with a fair value of \$2.8 billion that supported outstanding collateralized advances and collateralized funding agreements. As of September 30, 2013, \$100 million of the FHLBNY outstanding advances is reflected in Short-term debt and matures in December 2013 and \$280 million is in Long-term debt and matures in December 2015. Outstanding collateralized funding agreements, which totaled \$1,947 million at September 30, 2013, are included in Policyholders' account balances. The fair value of qualifying assets that were available to Prudential Insurance but not pledged amounted to \$3.0 billion as of September 30, 2013.

*Federal Home Loan Bank of Boston*

Prudential Retirement Insurance and Annuity Company, or PRIAC, is a member of the Federal Home Loan Bank of Boston or FHLBB. Membership allows PRIAC access to collateralized advances which will be classified in Short-term debt or Long-term debt, depending on the maturity date of the obligation. PRIAC's membership in FHLBB requires the ownership of member stock and borrowings from FHLBB require the purchase of activity-based stock in an amount between 3.0% and 4.5% of outstanding borrowings depending on the maturity date of the obligation. As of September 30, 2013, PRIAC had no advances outstanding under the FHLBB facility.

The Connecticut Department of Insurance, or CTDOI, permits PRIAC to pledge up to \$2.2 billion in qualifying assets to secure FHLBB borrowings through December 31, 2013. PRIAC must seek re-approval from CTDOI prior to borrowing additional funds after that date. Based on available eligible assets as of September 30, 2013, PRIAC had an estimated maximum borrowing capacity, after taking into consideration required collateralization levels and required purchases of activity-based FHLBB stock, of approximately \$1.6 billion.

*Credit Facilities*

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

As of September 30, 2013, Prudential Financial and Prudential Funding maintained an aggregate of \$3,750 million of unsecured committed credit facilities consisting of a \$2,000 million five-year facility expiring in December 2016 that has Prudential Financial as borrower and a \$1,750 million three-year facility expiring in December 2014 that has both Prudential Financial and Prudential Funding as borrowers. Each of the facilities

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

may be used for general corporate purposes, including as backup liquidity for the Company's commercial paper programs discussed above. As of September 30, 2013, there were no outstanding borrowings under either credit facility. Prudential Financial expects that it may continue to borrow under the five-year credit facility from time to time to fund its working capital needs and those of its subsidiaries. In addition, up to \$300 million of the five-year facility may be drawn in the form of standby letters of credit that can be used to meet the Company's operating needs.

The credit facilities contain representations and warranties, covenants and events of default that are customary for facilities of this type; however, borrowings under the facilities are not contingent on the Company's credit ratings nor subject to material adverse change clauses. Borrowings under the credit facilities are conditioned on the continued satisfaction of other customary conditions, including the maintenance at all times of consolidated net worth, relating to the Company's Financial Services Businesses only, of at least \$18.985 billion, which for this purpose is calculated as U.S. GAAP equity, excluding AOCI and excluding equity of noncontrolling interests. As of September 30, 2013, the consolidated net worth of the Company's Financial Services Businesses exceeded the minimum amount required to borrow under the credit facilities.

***Long-term Debt******Surplus Notes***

During 2011 and 2012, a captive reinsurance subsidiary of Prudential Insurance entered into agreements providing for the issuance and sale of up to \$1.5 billion of ten-year fixed rate surplus notes. At September 30, 2013, \$1,250 million of surplus notes were outstanding under these agreements, an increase of \$250 million from December 31, 2012. Under these agreements, the subsidiary received debt securities, with a principal amounts equal to the surplus notes issued. Because valid rights of set-off exist, interest and principal payments on the surplus notes and on the debt securities are settled on a net basis, and the surplus notes are reflected in the Company's total consolidated borrowings on a net basis.

***Senior Notes***

***Medium-term notes.*** Prudential Financial maintains a Medium-term Notes, Series D program under its shelf registration statement with an authorized issuance capacity of \$20 billion. As of September 30, 2013, the outstanding balance of medium-term notes under this program was \$12.7 billion, a decrease of \$0.5 billion from December 31, 2012, due to maturities of \$1.6 billion offset by \$1.1 billion of issuances, as presented in the following table.

| Issue Date | Principal<br>Amount<br>(in millions) | Interest Rate | Maturity Date |
|------------|--------------------------------------|---------------|---------------|
|------------|--------------------------------------|---------------|---------------|



## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|                 |    |     |               |                 |
|-----------------|----|-----|---------------|-----------------|
| August 15, 2013 | \$ | 350 | 2.300%        | August 15, 2018 |
| August 15, 2013 | \$ | 350 | LIBOR + 0.78% | August 15, 2018 |
| August 15, 2013 | \$ | 350 | 5.100%        | August 15, 2043 |

*Retail medium-term notes.* Prudential Financial maintains a retail medium-term notes program, including the InterNotes® program, under its shelf registration statement with an authorized issuance capacity of \$5.0 billion. As of September 30, 2013, the outstanding balance of retail notes was \$294 million. This represents a decrease of \$613 million from December 31, 2012, primarily due to the Company's redemption of \$462 million of notes during the second quarter with an average interest rate of approximately 6.0%.

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

Prudential Financial's junior subordinated notes outstanding are considered hybrid securities that receive enhanced equity treatment from the rating agencies. Junior subordinated notes outstanding, along with their key terms, are as follows:

| Issue Date    | Principal Amount<br>(in millions) | Initial Interest Rate | Investor Type | Optional Redemption Date(1) | Interest Rate Subsequent to Optional Redemption Date | Scheduled Maturity Date | Final Maturity Date |
|---------------|-----------------------------------|-----------------------|---------------|-----------------------------|--|-------------------------|---------------------|
| June 2008     | \$ 600                            | 8.875%                | Institutional | 6/15/18                     | LIBOR + 5.00%  | 6/15/38                 | 6/15/68             |
| August 2012   | \$ 1,000                          | 5.875%                | Institutional | 9/15/22                     | LIBOR + 4.175%                                       | n/a                     | 9/15/42             |
| November 2012 | \$ 1,500                          | 5.625%                | Institutional | 6/15/23                     | LIBOR + 3.920%                                       | n/a                     | 6/15/43             |
| December 2012 | \$ 575                            | 5.750%                | Retail        | 12/4/17                     | 5.750%   | n/a                     | 12/15/52            |
| March 2013    | \$ 710                            | 5.700%                | Retail        | 3/15/18                     | 5.700%   | n/a                     | 3/15/53             |
| March 2013    | \$ 500                            | 5.200%                | Institutional | 3/15/24                     | LIBOR + 3.040%                                       | n/a                     | 3/15/44             |

(1) Represents the initial date on which the notes can be redeemed at par solely at the option of the Company, subject in the case of the 8.875% notes to compliance with the replacement capital covenant described below.

Prudential Financial has the right to defer interest payments on these notes for specified periods, typically 5-10 years without resulting in a default, during which time interest will be compounded. On or after the optional redemption dates, Prudential Financial may redeem the notes at par plus accrued and unpaid interest. Prior to those optional redemption dates, redemptions generally are subject to a make-whole price; however, the Company may redeem the notes prior to these dates at par upon the occurrence of certain events, such as, for the notes issued in 2012 and 2013, a future change in the regulatory capital treatment of the notes with respect to the Company. In June 2013, Prudential Financial redeemed all of its \$920 million 9.0% Junior Subordinated Notes due 2068.

As of September 30, 2013, the Company was in compliance with all debt covenants related to its short-term and long-term debt.

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

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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

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

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

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

|  | <b>Three Months Ended September 30,</b> |             |                                      |             |
|--|---|-------------|--------------------------------------|-------------|
|  | <b>Pension Benefits</b>                 |             | <b>Other Postretirement Benefits</b> |             |
|  | <b>2013</b>                             | <b>2012</b> | <b>2013</b>                          | <b>2012</b> |
|  | (in millions)                           |             |                                      |             |
| <b>Components of net periodic (benefit) cost</b> |   |             |                                      |             |
| Service cost                                     | \$ 62                                   | \$ 61       | \$ 4                                 | \$ 4        |
| Interest cost                                    | 109                                     | 118         | 23                                   | 25          |
| Expected return on plan assets                   | (192)                                   | (203)       | (22)                                 | (22)        |
| Amortization of prior service cost               | (3)                                     | 3           | (3)                                  | (3)         |
| Amortization of actuarial (gain) loss, net       | 23                                      | 12          | 14                                   | 14          |
| Special termination benefits                     | 0                                       | 5           | 0                                    | 0           |
| Net periodic (benefit) cost                      | \$ (1)                                  | \$ (4)      | \$ 16                                | \$ 18       |

|  | <b>Nine Months Ended September 30,</b> |             |                                      |             |
|--|--|-------------|--------------------------------------|-------------|
|  | <b>Pension Benefits</b>                |             | <b>Other Postretirement Benefits</b> |             |
|  | <b>2013</b>                            | <b>2012</b> | <b>2013</b>                          | <b>2012</b> |
|  | (in millions)                          |             |                                      |             |
| <b>Components of net periodic (benefit) cost</b> |  |             |                                      |             |
| Service cost                                     | \$ 189                                 | \$ 182      | \$ 12                                | \$ 11       |
| Interest cost                                    | 328                                    | 355         | 67                                   | 76          |
| Expected return on plan assets                   | (576)                                  | (607)       | (64)                                 | (66)        |
| Amortization of prior service cost               | (8)                                    | 10          | (9)                                  | (9)         |
| Amortization of actuarial (gain) loss, net       | 69                                     | 34          | 42                                   | 41          |
| Special termination benefits                     | 2                                      | 7           | 0                                    | 0           |
| Net periodic (benefit) cost                      | \$ 4                                   | \$ (19)     | \$ 48                                | \$ 53       |

During the nine months ended September 30, 2013, the Company made cash contributions of \$160 million to the pension plans and anticipates making an additional \$20 million of cash contributions during the remainder of 2013.

**11. SEGMENT INFORMATION****Segments**

The Company has organized its principal operations into the Financial Services Businesses and the Closed Block Business. Within the Financial Services Businesses, the Company operates through three divisions, which together encompass six reportable segments. Businesses that are not sufficiently material to warrant separate disclosure and divested businesses are included in Corporate and Other operations within the Financial Services Businesses. Collectively, the businesses that comprise the three operating divisions and Corporate and Other are referred to as the Financial Services Businesses.

### **Adjusted Operating Income**

In managing the Financial Services Businesses, the Company analyzes the operating performance of each segment using adjusted operating income. Adjusted operating income does not equate to income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures or net income as

---

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

determined in accordance with U.S. GAAP but is the measure of segment profit or loss used by the Company to evaluate segment performance and allocate resources, and consistent with authoritative guidance, is the measure of segment performance presented below. Adjusted operating income is calculated by adjusting each segment's income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures for the following items, which are described in greater detail below:

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

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

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

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

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

As discussed in Note 1, the Company recorded out of period adjustments in the second quarter of 2012 that resulted in a decrease in adjusted operating income of \$61 million to the Asset Management segment and \$45 million to Corporate and Other operations for the nine months ended September 30, 2012. For additional information regarding these out of period adjustments, see Notes 1 and 24 to the Company's Consolidated Financial Statements included in its 2012 Annual Report on Form 10-K.

**Realized investment gains (losses), net, and related charges and adjustments**

***Realized investment gains (losses), net***

Adjusted operating income excludes Realized investment gains (losses), net, except for certain items described below. Significant activity excluded from adjusted operating income includes impairments and credit-related gains and losses from sales of securities, the timing of which depends largely on market credit cycles and can vary considerably across periods, and interest rate-related gains and losses from sales of

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

securities, which are largely subject to the Company's discretion and influenced by market opportunities, as well as the Company's tax and capital profile. Additionally, certain gains and losses pertaining to derivative contracts that do not qualify for hedge accounting treatment are also excluded from adjusted operating income. Trends in the underlying profitability of the Company's businesses can be more clearly identified without the fluctuating effects of these transactions.

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

The following table sets forth the components of Realized investment gains (losses), net that are included in adjusted operating income and, as a result, are reflected as adjustments to Realized investment gains (losses), net for purposes of calculating adjusted operating income:

|  | Three Months Ended |         | Nine Months Ended |         |
|--|--------------------|---------|-------------------|---------|
|  | September 30,      |         | September 30,     |         |
|  | 2013               | 2012    | 2013              | 2012    |
|  | (in millions)      |         |                   |         |
| Net gains (losses) from:                       |                    |         |                   |         |
| Terminated hedges of foreign currency earnings | \$ 72              | \$ (20) | \$ 175            | \$ (68) |
| Current period yield adjustments               | \$ 118             | \$ 85   | \$ 323            | \$ 231  |
| Principal source of earnings                   | \$ 27              | \$ 30   | \$ 96             | \$ 7    |

*Terminated Hedges of Foreign Currency Earnings.* The amounts shown in the table above primarily reflect the impact of an intercompany arrangement between Corporate and Other operations and the International Insurance segment, pursuant to which the non-U.S. dollar-denominated earnings in all countries for a particular year, including its interim reporting periods, are translated at fixed currency exchange rates. The fixed rates are determined in connection with a currency hedging program designed to mitigate the risk that unfavorable rate changes will reduce the segment's U.S. dollar equivalent earnings. Pursuant to this program, the Company's Corporate and Other operations may execute forward currency contracts with third parties to sell the net exposure of projected earnings from the hedged currency in exchange for U.S. dollars at a specified exchange rate. The maturities of these contracts correspond with the future periods in which the identified non-U.S. dollar-denominated earnings are expected to be generated. These contracts do not qualify for hedge accounting under U.S. GAAP, so the resulting profits or losses are recorded 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.

*Current Period Yield Adjustments.* The Company uses interest rate and currency swaps and other derivatives to manage interest and currency exchange rate exposures arising from mismatches between assets and liabilities, including duration mismatches. For derivative contracts that do not qualify for hedge accounting treatment, the periodic swap settlements, as well as certain other derivative related yield adjustments are recorded in Realized investment gains (losses), net, and are included in adjusted operating income to reflect the after-hedge yield of the underlying instruments. In certain instances, when these derivative contracts are terminated or offset before their final maturity, the resulting realized gains or losses are recognized in adjusted operating income over periods that generally approximate the expected terms of the derivatives or underlying instruments in order for adjusted operating income to reflect the after-hedge yield of the underlying instruments. Included in the amounts shown in the table above are gains on certain derivatives contracts that were terminated or offset in prior periods of \$18 million and \$16 million for the three months ended September 30, 2013 and 2012, respectively, and \$54 million and \$46 million for the nine months ended September 30, 2013 and 2012, respectively. Additionally, as of September 30, 2013, there was a \$521 million deferred net gain related to certain derivative contracts that were terminated or offset in prior periods, primarily in the International Insurance segment.

*Principal Source of Earnings.* The Company conducts certain activities for which realized investment gains and losses are a principal source of earnings for its businesses and therefore included in adjusted operating income, particularly within the Company's Asset Management segment. For example, Asset Management's strategic investing business makes investments for sale or syndication to other investors or for placement or co-investment in the Company's managed funds and structured products. The realized investment gains and losses associated with the sale of these strategic investments, as well as related derivative results, are a principal activity for this business and included in adjusted operating income. In addition, the realized investment gains and losses





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

associated with loans originated by the Company's commercial mortgage operations, as well as related derivative results and retained mortgage servicing rights, are a principal activity for this business and included in adjusted operating income.

***Other items reflected as adjustments to Realized investment gains (losses), net***

The following table sets forth certain other items excluded from adjusted operating income and reflected as an adjustment to Realized investment gains (losses), net for purposes of calculating adjusted operating income:

|                                     | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|-------------------------------------|-------------------------------------|----------|------------------------------------|----------|
|                                     | 2013                                | 2012     | 2013                               | 2012     |
|                                     | (in millions)                       |          |                                    |          |
| Net gains (losses) from:            |                                     |          |                                    |          |
| Other trading account assets        | \$ 36                               | \$ 26    | \$ 121                             | \$ 59    |
| Foreign currency exchange movements | \$ 1,169                            | \$ (347) | \$ (2,856)                         | \$ (223) |
| Other activities                    | \$ 24                               | \$ (8)   | \$ 136                             | \$ 30    |

**Other Trading Account Assets.** The Company has certain investments in its general account portfolios that are classified as trading. These trading investments are carried at fair value and included in Other trading account assets, at fair value on the Company's statements of financial position. Realized and unrealized gains and losses for these investments are recorded in Asset management fees and other income. Consistent with the exclusion of realized investment gains and losses with respect to other investments managed on a consistent basis, the net gains or losses on these investments are excluded from adjusted operating income.

**Foreign Currency Exchange Movements.** The Company has certain assets and liabilities for which, under U.S. GAAP, the changes in value, including those associated with changes in foreign currency exchange rates during the period, are recorded in Asset management fees and other income. To the extent the foreign currency exposure on these assets and liabilities is economically hedged or considered part of the Company's capital funding strategies for its international subsidiaries, the change in value included in Asset management fees and other income is excluded from adjusted operating income. The amounts in the table above are largely driven by non-yen denominated insurance liabilities in the Company's Japanese insurance operations. The insurance liabilities are supported by investments denominated in corresponding currencies, including a significant portion designated as available-for-sale. While these non-yen denominated assets and liabilities are economically hedged, under U.S. GAAP, unrealized gains and losses on available-for-sale investments, including those arising from foreign currency exchange rate movements, are recorded in Accumulated other comprehensive income (loss), while the non-yen denominated liabilities are re-measured for foreign currency exchange rate movements, and the related change in value is recorded in earnings within Asset management fees and other income. Due to this non-economic volatility that is reflected in U.S. GAAP earnings, the change in value recorded within Asset management fee and other income is excluded from adjusted operating income.

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

*Other Activities.* The Company excludes certain other items from adjusted operating income that are consistent with similar adjustments described above. The significant items within other activities shown in the table above included the following:

In connection with disputes arising out of the Chapter 11 bankruptcy petition filed by Lehman Brothers Holdings Inc., the Company previously recorded losses related to a portion of its counterparty exposure on derivative transactions it had previously held with Lehman Brothers and its affiliates. The Company recorded estimated recoveries related to this matter of \$19 million and \$136 million in the three and nine months ended September 30, 2013, respectively, and \$12 million in the nine months ended September 30, 2012. These

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

recoveries are recorded within Asset management fees and other income within the Company's Corporate and Other operations. Consistent with the exclusion of credit-related losses recorded in Realized investment gains (losses), net, the impact of this estimated recovery is excluded from adjusted operating income.

The Company records an adjustment for non-performance risk that relates to the uncollateralized portion of certain derivative contracts between a subsidiary of the Company and third parties. These adjustments are recorded within Asset management fees and other income. Consistent with the exclusion of the mark-to-market on derivatives recorded in Realized investment gains (losses), net, the impact of the non-performance risk is excluded from adjusted operating income. The net impact of the non-performance risk was to exclude from adjusted operating income net gains of \$7 million and net losses of \$2 million for the three months ended September 30, 2013 and 2012, respectively, and net gains of \$9 million and \$32 million for the nine months ended September 30, 2013 and 2012, respectively.

***Related charges***

Charges that relate to realized investment gains and losses are also excluded from adjusted operating income, and include the following:

The portion of the amortization of deferred policy acquisition costs, value of business acquired, unearned revenue reserves and deferred sales inducements for certain products that is related to net realized investment gains and losses.

Policyholder dividends and interest credited to policyholders' account balances that relate to certain life policies that pass back certain realized investment gains and losses to the policyholder, and reserves for future policy benefits for certain policies where cash flows are affected by net realized investment gains and losses.

Market value adjustments paid or received upon a contractholder's surrender of certain of the Company's annuity products as these amounts mitigate the net realized investment gains or losses incurred upon the disposition of the underlying invested assets.

**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 and International Insurance segments are experience-rated in that investment results associated with these products are expected to ultimately accrue to contractholders. The majority of investments supporting these experience-rated products are classified as trading and are carried at fair value, with realized and unrealized gains and losses reported in Asset management fees and other income. To a lesser extent, these experience-rated products are also supported by derivatives and commercial mortgage and other loans. The derivatives are carried at fair value, with realized and unrealized gains and losses reported in Realized investment gains (losses), net. The commercial mortgage and other loans are carried at unpaid principal, net of unamortized discounts and an allowance for losses, with gains and

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

losses on sales and changes in the valuation allowance for commercial mortgage and other loans reported in Realized investment gains (losses), net.

Adjusted operating income excludes net investment gains and losses on trading account assets supporting insurance liabilities, which is consistent with the exclusion of realized investment gains and losses with respect to other investments supporting insurance liabilities managed on a consistent basis. In addition, to be consistent with the historical treatment of charges related to realized investment gains and losses on investments, adjusted operating income also excludes the change in contractholder liabilities due to asset value changes in the pool of investments (including changes in the fair value of commercial mortgage and other loans) supporting these

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

experience-rated contracts, which are reflected in Interest credited to policyholders account balances. These adjustments are in addition to the exclusion from adjusted operating income of net investment gains and losses on the related derivatives and commercial mortgage and other loans through *Realized investment gains (losses), net, and related charges and adjustments*, as discussed above. The result of this approach is that adjusted operating income for these products includes net fee revenue and interest spread the Company earns on these experience-rated contracts, and excludes changes in fair value of the pool of investments, both realized and unrealized, that are expected to ultimately accrue to the contractholders.

**Divested businesses**

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

On July 1, 2013, the Company sold its wealth management solutions business to Envestnet Inc. Due to the existence of an ongoing contractual relationship between the Company and these operations, this disposition did not qualify for discontinued operations treatment under U.S. GAAP. As a result, the Company has classified the results of these operations, previously reported in the Asset Management segment, as a divested business and excluded the results from adjusted operating income.

**Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests**

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

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

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

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

|  | Three Months Ended<br>September 30, |              | Nine Months Ended<br>September 30, |              |
|--|-------------------------------------|--------------|------------------------------------|--------------|
|  | 2013                                | 2012         | 2013                               | 2012         |
|  | (in millions)                       |              |                                    |              |
| Adjusted Operating Income before income taxes for Financial Services Businesses by Segment:  |                                     |              |                                    |              |
| Individual Annuities   | \$ 821                              | \$ 207       | \$ 1,593                           | \$ 735       |
| Retirement   | 237                                 | 110          | 744                                | 413          |
| Asset Management   | 200                                 | 189          | 547                                | 373          |
| <b>Total U.S. Retirement Solutions and Investment Management Division</b>  | <b>1,258</b>                        | <b>506</b>   | <b>2,884</b>                       | <b>1,521</b> |
| Individual Life  | 148                                 | 112          | 426                                | 285          |
| Group Insurance  | 68                                  | 35           | 99                                 | 28           |
| <b>Total U.S. Individual Life and Group Insurance Division</b>   | <b>216</b>                          | <b>147</b>   | <b>525</b>                         | <b>313</b>   |
| <b>International Insurance</b>   | <b>778</b>                          | <b>782</b>   | <b>2,505</b>                       | <b>2,057</b> |
| <b>Total International Insurance Division</b>  | <b>778</b>                          | <b>782</b>   | <b>2,505</b>                       | <b>2,057</b> |
| <b>Corporate Operations</b>  | <b>(312)</b>                        | <b>(414)</b> | <b>(973)</b>                       | <b>(966)</b> |
| <b>Total Corporate and Other</b>   | <b>(312)</b>                        | <b>(414)</b> | <b>(973)</b>                       | <b>(966)</b> |
| <b>Adjusted Operating Income before income taxes for Financial Services Businesses</b>   | <b>1,940</b>                        | <b>1,021</b> | <b>4,941</b>                       | <b>2,925</b> |
| Reconciling items:   |                                     |              |                                    |              |
| Realized investment gains (losses), net, and related adjustments   | (1,319)                             | (1,951)      | (7,322)                            | (1,609)      |
| Charges related to realized investment gains (losses), net   | 763                                 | 648          | 1,533                              | 498          |
| Investment gains (losses) on trading account assets supporting insurance liabilities, net  | 103                                 | 264          | (273)                              | 502          |
| Change in experience-rated contractholder liabilities due to asset value changes   | (73)                                | (254)        | 255                                | (446)        |
| Divested businesses  | 43                                  | (687)        | (12)                               | (664)        |
| Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests   | 17                                  | (40)         | 18                                 | (27)         |
| <b>Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures for Financial Services Businesses</b> | <b>1,474</b>                        | <b>(999)</b> | <b>(860)</b>                       | <b>1,179</b> |
| Income from continuing operations before income taxes and equity in earnings of operating joint ventures for Closed Block Business                       | 85                                  | 69           | 108                                | 97           |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|   |          |          |          |          |
|---|----------|----------|----------|----------|
| Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ 1,559 | \$ (930) | \$ (752) | \$ 1,276 |
|---|----------|----------|----------|----------|



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

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

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

|  | Revenue                             |          |                                    |          | Total Assets     |                 |
|--|-------------------------------------|----------|------------------------------------|----------|------------------|-----------------|
|  | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          | September<br>30, | December<br>31, |
|  | 2013                                | 2012     | 2013                               | 2012     | 2013             | 2012            |
|  | (in millions)                       |          |                                    |          |                  |                 |
| Financial Services Businesses:   |                                     |          |                                    |          |                  |                 |
| Individual Annuities   | \$ 1,120                            | \$ 1,018 | \$ 3,307                           | \$ 2,944 | \$ 156,314       | \$ 146,893      |
| Retirement   | 1,525                               | 1,162    | 4,382                              | 3,511    | 169,836          | 168,262         |
| Asset Management   | 682                                 | 641      | 2,007                              | 1,687    | 43,878           | 41,909          |
| Total U.S. Retirement Solutions and Investment Management Division                                   | 3,327                               | 2,821    | 9,696                              | 8,142    | 370,028          | 357,064         |
| Individual Life  | 1,041                               | 948      | 3,408                              | 2,527    | 62,500           | 47,371          |
| Group Insurance  | 1,342                               | 1,420    | 4,143                              | 4,203    | 37,763           | 38,754          |
| Total U.S. Individual Life and Group Insurance Division  | 2,383                               | 2,368    | 7,551                              | 6,730    | 100,263          | 86,125          |
| International Insurance  | 5,259                               | 8,154    | 17,549                             | 20,377   | 170,952          | 183,794         |
| Total International Insurance Division   | 5,259                               | 8,154    | 17,549                             | 20,377   | 170,952          | 183,794         |
| Corporate Operations   | (153)                               | (106)    | (439)                              | (301)    | 12,991           | 12,325          |
| Total Corporate and Other  | (153)                               | (106)    | (439)                              | (301)    | 12,991           | 12,325          |
| Total  | 10,816                              | 13,237   | 34,357                             | 34,948   | 654,234          | 639,308         |
| Reconciling items:   |                                     |          |                                    |          |                  |                 |
| Realized investment gains (losses), net, and related adjustments                                     | (1,320)                             | (1,954)  | (7,325)                            | (1,613)  |                  |                 |
| Charges related to realized investment gains (losses), net   | (27)                                | (27)     | (181)                              | (79)     |                  |                 |
| Investment gains (losses) on trading account assets supporting insurance liabilities, net            | 103                                 | 264      | (273)                              | 502      |                  |                 |
| Divested businesses  | 179                                 | 185      | 495                                | 566      |                  |                 |
| Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests | (3)                                 | (65)     | (79)                               | (78)     |                  |                 |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|   |           |           |           |           |            |            |
|---|-----------|-----------|-----------|-----------|------------|------------|
| Total Financial Services Businesses                           | 9,748     | 11,640    | 26,994    | 34,246    | 654,234    | 639,308    |
| Closed Block Business   | 1,595     | 1,504     | 4,578     | 4,657     | 68,892     | 69,990     |
| Total per Unaudited Interim Consolidated Financial Statements | \$ 11,343 | \$ 13,144 | \$ 31,572 | \$ 38,903 | \$ 723,126 | \$ 709,298 |

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

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

|  | Three Months Ended |        | Nine Months Ended |        |
|--|--------------------|--------|-------------------|--------|
|  | September 30,      |        | September 30,     |        |
|  | 2013               | 2012   | 2013              | 2012   |
|  | (in millions)      |        |                   |        |
| Asset Management segment intersegment revenues | \$ 151             | \$ 139 | \$ 454            | \$ 405 |

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

**12. INCOME TAXES**

The Company's liability for income taxes includes the liability for unrecognized tax benefits, interest and penalties which relate to tax years still subject to review by the Internal Revenue Service ( IRS ) or other taxing authorities. Audit periods remain open for review until the statute of limitations has passed. Generally, for tax years which produce net operating losses, capital losses or tax credit carryforwards ( tax attributes ), the statute of limitations does not close, to the extent of these tax attributes, until the expiration of the statute of limitations for the tax year in which they are fully utilized. The completion of review or the expiration of the statute of limitations for a given audit period could result in an adjustment to the liability for income taxes. The statute of limitations for the 2004 through 2006 tax years will expire in March 2014, unless extended. The statute of limitations for the 2007 through 2009 tax years will expire in December 2014, unless extended. Tax years 2010 through 2012 are still open for IRS examination.

The Company does not anticipate any significant changes within the next 12 months to its total unrecognized tax benefits related to tax years for which the statute of limitations has not expired.

The dividends received deduction ( DRD ) reduces the amount of dividend income subject to U.S. tax and is a significant component of the difference between the Company's effective tax rate and the federal statutory tax rate of 35%. The DRD for the current period was estimated using information from 2012, current year results, and was adjusted to take into account the current year's equity market performance. The actual current year DRD can vary from the estimate based on factors such as, but not limited to, changes in the amount of dividends received that are eligible for the DRD, changes in the amount of distributions received from mutual fund investments, changes in the account balances of variable life and annuity contracts, and the Company's taxable income before the DRD.

In August 2007, the IRS released Revenue Ruling 2007-54, which included, among other items, guidance on the methodology to be followed in calculating the DRD related to variable life insurance and annuity contracts. In September 2007, the IRS released Revenue Ruling 2007-61.

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Revenue Ruling 2007-61 suspended Revenue Ruling 2007-54 and informed taxpayers that the U.S. Treasury Department and the IRS intend to address through new guidance the issues considered in Revenue Ruling 2007-54, including the methodology to be followed in determining the DRD related to variable life insurance and annuity contracts. In May 2010, the IRS issued an Industry Director Directive ( IDD ) confirming that the methodology for calculating the DRD set forth in Revenue Ruling 2007-54 should not be followed. The IDD also confirmed that the IRS guidance issued before Revenue Ruling 2007-54, which guidance the Company relied upon in calculating its DRD, should be used to determine the DRD. For the last several years, the revenue proposals included in the Obama Administration's budgets included a proposal that would change the method used to determine the amount of the DRD. A change in the DRD, including the possible retroactive or prospective elimination of this deduction through guidance or legislation, could increase actual tax expense and reduce the Company's consolidated net income. These activities had no impact on the Company's results in 2012 or first nine months of 2013.

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

For tax years 2007 through 2013, the Company is participating in the IRS's Compliance Assurance Program (CAP). Under CAP, the IRS assigns an examination team to review completed transactions contemporaneously during these tax years in order to reach agreement with the Company on how they should be reported in the tax returns. If disagreements arise, accelerated resolutions programs are available to resolve the disagreements in a timely manner before the tax returns are filed. It is management's expectation this program will shorten the time period between the filing of the Company's federal income tax returns and the IRS's completion of its examination of the returns.

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

|  | <b>Prudential<br/>Gibraltar</b> | <b>Star and<br/>Edison<br/>Businesses<br/>(in millions)</b> | <b>Total</b> |
|--|---------------------------------|---|--------------|
| Opening balance sheet deferred tax assets after valuation allowance that will result in additional tax expense | \$ 56                           | \$ 678  | \$ 734       |
| Additional tax expense (benefit) recognized in the Statement of Operations:                                    |                                 |   |              |
| 2009   | 13                              | 0   | 13           |
| 2010   | 6                               | 0   | 6            |
| 2011   | (29)                            | 252   | 223          |
| 2012   | 51                              | 333   | 384          |
| Nine months 2013   | 15                              | 93  | 108          |
| Subtotal   | 56                              | 678   | 734          |
| Additional tax expense (benefit) recognized in Other Comprehensive Income                                      | 0                               | 0   | 0            |
| Unrecognized balance of additional tax expense   | \$ 0                            | \$ 0  | \$ 0         |

On January 1, 2012, the Star and Edison Businesses merged into Gibraltar Life. The majority of additional U.S. tax expense recognized in 2012 is a result of the merger. During 2013, the Company changed its repatriation assumption for Gibraltar Life and Prudential Gibraltar. As a result, the Company recorded an additional U.S. tax expense of \$108 million in the first nine months of 2013.

**13. FAIR VALUE OF ASSETS AND LIABILITIES**

**Fair Value Measurement** Fair value represents the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The authoritative fair value guidance establishes a framework for measuring fair value that includes a hierarchy used to classify the inputs used in measuring fair value. The level in the fair value hierarchy within which the

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement. The levels of the fair value hierarchy are as follows:

Level 1 Fair value is based on unadjusted quoted prices in active markets that are accessible to the Company for identical assets or liabilities. The Company's Level 1 assets and liabilities primarily include certain cash equivalents and short term investments, equity securities and derivative contracts that trade on an active exchange market.

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

Level 2 Fair value is based on significant inputs, other than quoted prices included in Level 1, that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability through corroboration with observable market data. Level 2 inputs include quoted market prices in active markets for similar assets and liabilities, quoted market prices in markets that are not active for identical or similar assets or liabilities, and other market observable inputs. The Company's Level 2 assets and liabilities include: fixed maturities (corporate public and private bonds, most government securities, certain asset-backed and mortgage-backed securities, etc.), certain equity securities (mutual funds, which do not actively trade and are priced based on a net asset value), certain commercial mortgage loans, short-term investments and certain cash equivalents (primarily commercial paper), and certain over-the-counter derivatives.

Level 3 Fair value is based on at least one or more significant unobservable inputs for the asset or liability. The assets and liabilities in this category may require significant judgment or estimation in determining the fair value. The Company's Level 3 assets and liabilities primarily include: certain private fixed maturities and equity securities, certain manually priced public equity securities and fixed maturities, certain highly structured over-the-counter derivative contracts, certain commercial mortgage loans, certain consolidated real estate funds for which the Company is the general partner, and embedded derivatives resulting from certain products with guaranteed benefits.

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

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

|  | As of September 30, 2013 |                   |                  |                   |                   |
|--|--------------------------|-------------------|------------------|-------------------|-------------------|
|  | Level 1                  | Level 2           | Level 3          | Netting(1)        | Total             |
|  | (in millions)            |                   |                  |                   |                   |
| <b>Fixed maturities, available-for-sale:</b>   |                          |                   |                  |                   |                   |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | \$ 0                     | \$ 13,327         | \$ 0             | \$                | \$ 13,327         |
| Obligations of U.S. states and their political subdivisions                          | 0                        | 3,634             | 0                |                   | 3,634             |
| Foreign government bonds   | 0                        | 82,557            | 1                |                   | 82,558            |
| Corporate securities   | 0                        | 156,149           | 1,198            |                   | 157,347           |
| Asset-backed securities  | 0                        | 7,096             | 4,090            |                   | 11,186            |
| Commercial mortgage-backed securities  | 0                        | 13,380            | 164              |                   | 13,544            |
| Residential mortgage-backed securities   | 0                        | 7,162             | 8                |                   | 7,170             |
| <b>Subtotal</b>  | <b>0</b>                 | <b>283,305</b>    | <b>5,461</b>     |                   | <b>288,766</b>    |
| <b>Trading account assets:(2)</b>  |                          |                   |                  |                   |                   |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | 0                        | 465               | 0                |                   | 465               |
| Obligations of U.S. states and their political subdivisions                          | 0                        | 190               | 0                |                   | 190               |
| Foreign government bonds   | 0                        | 686               | 0                |                   | 686               |
| Corporate securities   | 0                        | 15,739            | 85               |                   | 15,824            |
| Asset-backed securities  | 0                        | 844               | 514              |                   | 1,358             |
| Commercial mortgage-backed securities  | 0                        | 2,439             | 4                |                   | 2,443             |
| Residential mortgage-backed securities   | 0                        | 1,727             | 2                |                   | 1,729             |
| Equity securities  | 1,192                    | 215               | 878              |                   | 2,285             |
| All other(3)   | 862                      | 8,934             | 8                | (7,250)           | 2,554             |
| <b>Subtotal</b>  | <b>2,054</b>             | <b>31,239</b>     | <b>1,491</b>     | <b>(7,250)</b>    | <b>27,534</b>     |
| Equity securities, available-for-sale  | 6,238                    | 2,464             | 282              |                   | 8,984             |
| Commercial mortgage and other loans  | 0                        | 93                | 19               |                   | 112               |
| Other long-term investments  | 57                       | 200               | 1,010            | 8                 | 1,275             |
| Short-term investments   | 5,936                    | 2,008             | 0                |                   | 7,944             |
| Cash equivalents   | 2,560                    | 3,582             | 0                |                   | 6,142             |
| Other assets   | 2                        | 248               | 6                |                   | 256               |
| <b>Subtotal excluding separate account assets</b>                                    | <b>16,847</b>            | <b>323,139</b>    | <b>8,269</b>     | <b>(7,242)</b>    | <b>341,013</b>    |
| Separate account assets(4)   | 49,343                   | 203,401           | 22,347           |                   | 275,091           |
| <b>Total assets</b>  | <b>\$ 66,190</b>         | <b>\$ 526,540</b> | <b>\$ 30,616</b> | <b>\$ (7,242)</b> | <b>\$ 616,104</b> |
| Future policy benefits   | \$ 0                     | \$ 0              | \$ 1,928         | \$                | \$ 1,928          |
| Other liabilities  | 0                        | 8,311             | 6                | (7,187)           | 1,130             |
| Notes of consolidated VIEs   | 0                        | 0                 | 2,330            |                   | 2,330             |



Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|                   |    |   |    |       |    |       |    |         |    |       |
|-------------------|----|---|----|-------|----|-------|----|---------|----|-------|
| Total liabilities | \$ | 0 | \$ | 8,311 | \$ | 4,264 | \$ | (7,187) | \$ | 5,388 |
|-------------------|----|---|----|-------|----|-------|----|---------|----|-------|

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

|  | As of December 31, 2012 |            |           |             |            |
|--|-------------------------|------------|-----------|-------------|------------|
|  | Level 1                 | Level 2    | Level 3   | Netting(1)  | Total      |
|  | (in millions)           |            |           |             |            |
| Fixed maturities, available-for-sale:  |                         |            |           |             |            |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | \$ 0                    | \$ 17,386  | \$ 0      | \$          | \$ 17,386  |
| Obligations of U.S. states and their political subdivisions                          | 0                       | 3,452      | 0         |             | 3,452      |
| Foreign government bonds   | 0                       | 88,290     | 0         |             | 88,290     |
| Corporate securities   | 0                       | 157,701    | 1,630     |             | 159,331    |
| Asset-backed securities  | 0                       | 7,633      | 3,703     |             | 11,336     |
| Commercial mortgage-backed securities  | 0                       | 11,813     | 124       |             | 11,937     |
| Residential mortgage-backed securities   | 0                       | 9,593      | 11        |             | 9,604      |
| Subtotal   | 0                       | 295,868    | 5,468     |             | 301,336    |
| Trading account assets:(2)   |                         |            |           |             |            |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | 0                       | 287        | 0         |             | 287        |
| Obligations of U.S. states and their political subdivisions                          | 0                       | 259        | 0         |             | 259        |
| Foreign government bonds   | 2                       | 767        | 0         |             | 769        |
| Corporate securities   | 0                       | 13,609     | 134       |             | 13,743     |
| Asset-backed securities  | 0                       | 923        | 431       |             | 1,354      |
| Commercial mortgage-backed securities  | 0                       | 2,298      | 8         |             | 2,306      |
| Residential mortgage-backed securities   | 0                       | 2,024      | 2         |             | 2,026      |
| Equity securities  | 1,198                   | 181        | 1,098     |             | 2,477      |
| All other(3)   | 664                     | 13,371     | 25        | (10,363)    | 3,697      |
| Subtotal   | 1,864                   | 33,719     | 1,698     | (10,363)    | 26,918     |
| Equity securities, available-for-sale  | 5,518                   | 2,429      | 330       |             | 8,277      |
| Commercial mortgage and other loans  | 0                       | 114        | 48        |             | 162        |
| Other long-term investments  | (57)                    | 141        | 1,053     | 246         | 1,383      |
| Short-term investments   | 3,519                   | 2,871      | 0         |             | 6,390      |
| Cash equivalents   | 3,105                   | 10,495     | 0         |             | 13,600     |
| Other assets   | 78                      | 109        | 8         |             | 195        |
| Subtotal excluding separate account assets   | 14,027                  | 345,746    | 8,605     | (10,117)    | 358,261    |
| Separate account assets(4)   | 39,362                  | 192,760    | 21,132    |             | 253,254    |
| Total assets   | \$ 53,389               | \$ 538,506 | \$ 29,737 | \$ (10,117) | \$ 611,515 |
| Future policy benefits   | \$ 0                    | \$ 0       | \$ 3,348  | \$          | \$ 3,348   |
| Other liabilities  | 0                       | 8,121      | 0         | (8,031)     | 90         |
| Notes of consolidated VIEs   | 0                       | 0          | 1,406     |             | 1,406      |
| Total liabilities  | \$ 0                    | \$ 8,121   | \$ 4,754  | \$ (8,031)  | \$ 4,844   |

(1)

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Netting amounts represent cash collateral of \$55 million and \$2,086 million as of September 30, 2013 and December 31, 2012, respectively, and the impact of offsetting asset and liability positions held with the same counterparty.

- (2) Includes Trading Account Assets Supporting Insurance Liabilities and Other Trading Account Assets.
- (3) Level 1 represents cash equivalents and short term investments. All other amounts primarily represent derivative assets.
- (4) Separate account assets represent segregated funds that are invested for certain customers. Investment risks associated with market value changes are borne by the customers, except to the extent of minimum guarantees made by the Company with respect to certain accounts. Separate account assets classified as Level 3 consist primarily of real estate and real estate investment funds. Separate account liabilities are not included in the above table as they are reported at contract value and not fair value in the Company's Unaudited Interim Consolidated Statement of Financial Position.

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

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

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

Internally-developed valuations or indicative broker quotes are also used to determine fair value in circumstances where vendor pricing is not available, or where the Company ultimately concludes that pricing information received from the independent pricing service is not reflective of market activity. If the Company concludes the values from both pricing services and brokers are not reflective of market activity, it may over-ride the information with an internally-developed valuation. As of September 30, 2013 and December 31, 2012, over-rides on a net basis were not material. Pricing service over-rides, internally-developed valuations and indicative broker quotes are generally included in Level 3 in the fair value hierarchy.

The fair value of private fixed maturities, which are comprised of investments in private placement securities, originated by internal private asset managers, are primarily determined using a discounted cash flow model. If the fair value is determined using pricing inputs that are observable in the market, the securities have been reflected within Level 2; otherwise a Level 3 classification is used.

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

**Trading Account Assets** Trading account assets consist primarily of fixed maturity securities, equity securities and derivatives whose fair values are determined consistent with similar instruments described above under Fixed Maturity Securities and below under Equity Securities and Derivative Instruments.

**Equity Securities** Equity securities consist principally of investments in common and preferred stock of publicly traded companies, perpetual preferred stock, privately traded securities, as well as mutual fund shares. The fair values of most publicly traded equity securities are based on quoted market prices in active markets for identical assets and are classified within Level 1 in the fair value hierarchy. Estimated fair values for

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

most privately traded equity securities are determined using discounted cash flow, earnings multiple and other valuation models that require a substantial level of judgment around inputs and, therefore, are classified within Level 3. The fair values of mutual fund shares that transact regularly (but do not trade in active markets because they are not publicly available) are based on transaction prices of identical fund shares and are classified within Level 2 in the fair value hierarchy. The fair values of perpetual preferred stock are based on inputs obtained from independent pricing services that are primarily based on indicative broker quotes. As a result, the fair values of perpetual preferred stock are classified as Level 3.

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

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

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

**Other Long-Term Investments** Other long-term investments include limited partnerships which are consolidated because the Company is either deemed to exercise control or considered the primary beneficiary of a variable interest entity. These entities are considered investment companies and follow specialized industry accounting whereby their assets are carried at fair value. The investments held by these entities include various feeder fund investments in underlying master funds (whose underlying holdings generally include public fixed maturities, equity securities and mutual funds), as well as wholly-owned real estate held within other investment funds. The fair value is determined by reference to the underlying direct investments, with publicly traded equity securities based on quoted prices in active markets reflected in Level 1, and public fixed maturities and mutual funds priced via quotes from pricing services or observable data reflected in Level 2. The fair value of investments in funds that are subject to significant liquidity restrictions are reflected in Level 3.

The fair value of real estate held in consolidated investment funds is determined through an independent appraisal process. The appraisals generally utilize a discounted cash flow model, supplemented with replacement cost estimates and comparable recent sales data when available. These appraisals and the related assumptions are updated at least annually. Since many of the assumptions utilized are unobservable and are considered to be significant inputs to the valuation, the real estate investments within other long-term investments have been reflected within Level 3 in the fair value hierarchy.

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

**Derivative Instruments** Derivatives are recorded at fair value either as assets, within Other trading account assets, or Other long-term investments, or as liabilities, within Other liabilities, except for embedded derivatives which are recorded with the associated host contract. The fair values of derivative contracts can be affected by changes in interest rates, foreign exchange rates, commodity prices, credit spreads, market volatility, expected returns, non-performance risk, liquidity and other factors. Liquidity valuation adjustments are made to reflect the cost of exiting significant risk positions, and consider the bid-ask spread, maturity, complexity, and other specific attributes of the underlying derivative position.

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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

The majority of the Company's derivative positions are traded in the over-the-counter ( OTC ) derivative market and are classified within Level 2 in the fair value hierarchy. OTC derivatives classified within Level 2 are

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

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

The Company's cleared interest rate swaps and credit derivatives linked to an index are valued using models that utilize actively quoted or observable market inputs obtained from external market data providers, third-party pricing vendors and/or recent trading activity. These derivatives are classified as Level 2 in the fair value hierarchy.

The vast majority of the Company's derivative agreements are with highly rated major international financial institutions. To reflect the market's perception of its own and the counterparty's non-performance risk, the Company incorporates additional spreads over LIBOR into the discount rate used in determining the fair value of OTC derivative assets and liabilities that are not otherwise collateralized.

Derivatives classified as Level 3 include look-back equity options and other structured products. These derivatives are valued based upon models, such as Monte Carlo simulation models and other techniques, that utilize significant unobservable inputs. Level 3 methodologies are validated through periodic comparison of the Company's fair values to external broker-dealer values.

**Cash Equivalents and Short-Term Investments** Cash equivalents and short-term investments include money market instruments, commercial paper and other highly liquid debt instruments. Certain money market instruments are valued using unadjusted quoted prices in active markets that are accessible for identical assets and are primarily classified as Level 1. The remaining instruments in this category are generally fair valued based on market observable inputs and these investments have primarily been classified within Level 2.

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

**Notes of Consolidated VIEs** The fair values of these notes are based on broker quotes and classified within Level 3. See Note 5 and the Fair Value Option section below for additional information.



## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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

**Future Policy Benefits** The liability for future policy benefits primarily includes general account liabilities for the optional living benefit features of the Company's variable annuity contracts, including guaranteed minimum accumulation benefits ( GMAB ), guaranteed minimum withdrawal benefits ( GMWB ) and guaranteed minimum income and withdrawal benefits ( GMIWB ), accounted for as embedded derivatives. The fair values of the GMAB, GMWB and GMIWB liabilities are calculated as the present value of future expected benefit payments to customers less the present value of assessed rider fees attributable to the embedded derivative feature. This methodology could result in either a liability or contra-liability balance, given changing capital market conditions and various policyholder behavior assumptions. Since there is no observable active

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

market for the transfer of these obligations, the valuations are calculated using internally-developed models with option pricing techniques. The models are based on a risk neutral valuation framework and incorporate premiums for risks inherent in valuation techniques, inputs, and the general uncertainty around the timing and amount of future cash flows. The determination of these risk premiums requires the use of management judgment.

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

Capital market inputs and actual policyholders' account values are updated each quarter based on capital market conditions as of the end of the quarter, including interest rates, equity markets and implied volatility. In the risk neutral valuation, interest rates are used to both grow the policyholders' account values and discount all projected future cash flows. The Company's discount rate assumption is based on the LIBOR swap curve adjusted for an additional spread over LIBOR to reflect NPR.

Actuarial assumptions, including contractholder behavior and mortality, are reviewed at least annually, and updated based upon emerging experience, future expectations and other data, including any observable market data, such as available industry studies or market transactions such as acquisitions and reinsurance transactions. These assumptions are generally updated in the third quarter of each year unless a material change that the Company feels is indicative of a long term trend is observed in an interim period.

**Transfers between Levels 1 and 2** Periodically there are transfers between Level 1 and Level 2 for foreign common stocks held in the Company's Separate Account. In certain periods, an adjustment may be made to the fair value of these assets to reflect events that occurred between the close of foreign trading markets and the close of U.S. trading markets for the respective day. During the three months ended September 30, 2013, \$1.3 billion were transferred from Level 2 to Level 1. During the nine months ended September 30, 2013, \$0.1 billion were transferred from Level 1 to Level 2 and \$3.6 billion were transferred from Level 2 to Level 1. During the three months ended September 30, 2012, there were no transfers of separate account assets from Level 1 to Level 2 and \$2.1 billion were transferred from Level 2 to Level 1. During the nine months ended September 30, 2012, \$2.9 billion of separate account assets were transferred from Level 1 to Level 2 and \$2.1 billion were transferred from Level 2 to Level 1.

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

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

|   | As of September 30, 2013 |                              |           |
|---|--------------------------|------------------------------|-----------|
|   | Internal(1)              | External(2)<br>(in millions) | Total     |
| Foreign government bonds                      | \$ 0                     | \$ 1                         | \$ 1      |
| Corporate securities                          | 564                      | 719                          | 1,283     |
| Asset-backed securities                       | 282                      | 4,322                        | 4,604     |
| Commercial mortgage-backed securities         | 17                       | 151                          | 168       |
| Residential mortgage-backed securities        | 3                        | 7                            | 10        |
| Equity securities                             | 114                      | 1,046                        | 1,160     |
| Commercial mortgage and other loans           | 19                       | 0                            | 19        |
| Other long-term investments                   | 10                       | 1,000                        | 1,010     |
| Other assets                                  | 14                       | 0                            | 14        |
| Subtotal excluding separate account assets(3) | 1,023                    | 7,246                        | 8,269     |
| Separate account assets                       | 21,402                   | 945                          | 22,347    |
| Total assets                                  | \$ 22,425                | \$ 8,191                     | \$ 30,616 |
| Future policy benefits                        | \$ 1,928                 | \$ 0                         | \$ 1,928  |
| Other liabilities                             | 0                        | 6                            | 6         |
| Notes of consolidated VIEs                    | 0                        | 2,330                        | 2,330     |
| Total liabilities                             | \$ 1,928                 | \$ 2,336                     | \$ 4,264  |

|   | As of December 31, 2012 |                              |           |
|---|-------------------------|------------------------------|-----------|
|   | Internal(1)             | External(2)<br>(in millions) | Total     |
| Corporate securities                          | \$ 889                  | \$ 875                       | \$ 1,764  |
| Asset-backed securities                       | 338                     | 3,796                        | 4,134     |
| Commercial mortgage-backed securities         | 68                      | 64                           | 132       |
| Residential mortgage-backed securities        | 3                       | 10                           | 13        |
| Equity securities                             | 101                     | 1,327                        | 1,428     |
| Commercial mortgage and other loans           | 48                      | 0                            | 48        |
| Other long-term investments                   | 9                       | 1,044                        | 1,053     |
| Other assets                                  | 33                      | 0                            | 33        |
| Subtotal excluding separate account assets(3) | 1,489                   | 7,116                        | 8,605     |
| Separate account assets                       | 20,422                  | 710                          | 21,132    |
| Total assets                                  | \$ 21,911               | \$ 7,826                     | \$ 29,737 |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|                            |          |          |          |
|----------------------------|----------|----------|----------|
| Future policy benefits     | \$ 3,348 | \$ 0     | \$ 3,348 |
| Notes of consolidated VIEs | 0        | 1,406    | 1,406    |
| Total liabilities          | \$ 3,348 | \$ 1,406 | \$ 4,754 |

- (1) Represents valuations which could incorporate internally-derived and market inputs. See below for additional information related to internally-developed valuation for significant items in the above table.
- (2) Represents unadjusted prices from independent pricing services and independent non-binding broker quotes where pricing inputs are not readily available.
- (3) Includes assets classified as fixed maturities available-for-sale, trading account assets supporting insurance liabilities and other trading account assets.

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

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

As of September 30, 2013

|                           | Fair Value<br>(in millions) | Valuation<br>Techniques | Unobservable Inputs        | Minimum | Maximum  | Weighted<br>Average | Impact of<br>Increase in<br>Input on<br>Fair<br>Value(1) |
|---------------------------|-----------------------------|-------------------------|----------------------------|---------|----------|---------------------|--|
| <b>Assets:</b>            |                             |                         |                            |         |          |                     |  |
| Corporate securities      | \$ 564                      | Discounted cash flow    | Discount rate              | 1.30%   | - 15%    | 7.71%               | Decrease   |
|                           |                             | Market comparables      | EBITDA multiples(2)        | 5.0X    | - 8.0X   | 5.96X               | Increase   |
|                           |                             | Liquidation             | Liquidation value          | 21.85%  | - 100.0% | 62.94%              | Increase   |
| Asset-backed securities   | \$ 282                      | Discounted cash flow    | Prepayment rate(3)         | 2.82%   | - 27.41% | 9.62%               | Increase   |
|                           |                             |                         | Default rate(3)            | 0.49%   | - 28.51% | 2.82%               | Decrease   |
|                           |                             |                         | Loss severity(3)           | 15.96%  | - 45.00% | 32.76%              | Decrease   |
|                           |                             |                         | Liquidity premium          | 1.00%   | - 2.00%  | 1.86%               | Decrease   |
|                           |                             |                         | Average life (years)       | 0.64    | - 14.53  | 5.4                 | Increase   |
|                           |                             |                         | Comparable spreads         | 0.17%   | - 24.87% | 3.47%               | Decrease   |
|                           |                             |                         | Comparable security yields | 4.21%   | - 12.34% | 7.13%               | Decrease   |
| <b>Liabilities:</b>       |                             |                         |                            |         |          |                     |  |
| Future policy benefits(4) | \$ 1,928                    | Discounted cash flow    | Lapse rate(5)              | 0%      | - 11%    |                     | Decrease   |
|                           |                             |                         | NPR spread(6)              | 0.08%   | - 1.32%  |                     | Decrease   |
|                           |                             |                         | Utilization rate(7)        | 70%     | - 94%    |                     | Increase   |
|                           |                             |                         | Withdrawal rate(8)         | 86%     | - 100%   |                     | Increase   |
|                           |                             |                         | Mortality rate(9)          | 0%      | - 13%    |                     | Decrease   |
|                           |                             |                         | Equity volatility curve    | 16%     | - 28%    |                     | Increase   |

As of December 31, 2012

|                           | Fair<br>Value<br>(in millions) | Valuation<br>Techniques | Unobservable Inputs        | Minimum | Maximum  | Weighted<br>Average | Impact of<br>Increase in<br>Input on<br>Fair<br>Value(1) |
|---------------------------|--------------------------------|-------------------------|----------------------------|---------|----------|---------------------|--|
| <b>Assets:</b>            |                                |                         |                            |         |          |                     |  |
| Corporate securities      | \$ 889                         | Discounted cash flow    | Discount rate              | 1.7%    | - 17.5%  | 9.92%               | Decrease   |
|                           |                                | Market comparables      | EBITDA multiples(2)        | 5.0X    | - 8.5X   | 6.2X                | Increase   |
|                           |                                | Cap at call price       | Call price                 | 100%    | - 101%   | 100.24%             | Increase   |
|                           |                                | Liquidation             | Liquidation value          | 49%     | - 100.0% | 83.06%              | Increase   |
| Asset-backed securities   | \$ 338                         | Discounted cash flow    | Prepayment rate(3)         | 2.8%    | - 29.0%  | 9.84%               | Increase   |
|                           |                                |                         | Default rate(3)            | 0.5%    | - 2.52%  | 0.84%               | Decrease   |
|                           |                                |                         | Loss severity(3)           | 35%     | - 43.88% | 35.76%              | Decrease   |
|                           |                                |                         | Liquidity premium          | 1.0%    | - 2.50%  | 1.83%               | Decrease   |
|                           |                                |                         | Average life (years)       | 0.1     | - 15     | 5.61                | Increase   |
|                           |                                |                         | Comparable spreads         | 0.1%    | - 20%    | 2.81%               | Decrease   |
|                           |                                |                         | Comparable security yields | 0.4%    | - 15%    | 7.59%               | Decrease   |
| <b>Liabilities:</b>       |                                |                         |                            |         |          |                     |  |
| Future policy benefits(4) | \$ 3,348                       | Discounted cash flow    | Lapse rate(5)              | 0%      | - 14%    |                     | Decrease   |
|                           |                                |                         | NPR spread(6)              | 0.20%   | - 1.60%  |                     | Decrease   |
|                           |                                |                         | Utilization rate(7)        | 70%     | - 94%    |                     | Increase   |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|                         |     |   |      |          |
|-------------------------|-----|---|------|----------|
| Withdrawal rate(8)      | 85% | - | 100% | Increase |
| Mortality rate(9)       | 0%  | - | 13%  | Decrease |
| Equity volatility curve | 19% | - | 34%  | Increase |

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

- (1) Conversely, the impact of a decrease in input would have the opposite impact for the fair value as that presented in the table.
- (2) EBITDA multiples represent multiples of earnings before interest, taxes, depreciation and amortization, and are amounts used when the reporting entity has determined that market participants would use such multiples when pricing the investments.
- (3) In isolation, an increase in prepayment rate or a decrease in default rate or loss severity would generally result in an increase in fair value, although the interrelationships between these inputs depend on specific market conditions.
- (4) Future policy benefits primarily represent general account liabilities for the optional living benefit features of the Company's variable annuity contracts which are accounted for as embedded derivatives. Since the valuation methodology for these liabilities uses a range of inputs that vary at the contract level over the cash flow projection period, presenting a range, rather than weighted average, is a more meaningful representation of the unobservable inputs used in the valuation.
- (5) Base lapse rates are adjusted at the contract level based on a comparison of the benefit amount and the current policyholder account value as well as other factors, such as the applicability of any surrender charges. A dynamic lapse adjustment reduces the base lapse rate when the benefit amount is greater than the account value, as in-the-money contracts are less likely to lapse. Lapse rates are also generally assumed to be lower for the period where surrender charges apply.
- (6) To reflect NPR, the Company incorporates an additional spread over LIBOR into the discount rate used in the valuation of individual living benefit contracts in a liability position and generally not to those in a contra-liability position. In determining the NPR spread, the Company reflects the financial strength ratings of the Company's insurance subsidiaries as these are insurance liabilities and senior to debt. The additional spread over LIBOR is determined by utilizing the credit spreads associated with issuing funding agreements, adjusted for any illiquidity risk premium.
- (7) The utilization rate assumption estimates the percentage of contracts that will utilize the benefit during the contract duration, and begin lifetime withdrawals at various time intervals from contract inception. The remaining contractholders are assumed to either begin lifetime withdrawals immediately or never utilizing the benefit. These assumptions vary based on the product type, the age of the contractholder and the age of the contract. The impact of changes in these assumptions is highly dependent on the contract type and age of the contractholder at the time of the sale and the timing of the first lifetime income withdrawal.
- (8) The withdrawal rate assumption estimates the magnitude of annual contractholder withdrawals relative to the maximum allowable amount under the contract. The fair value of the liability will generally increase the closer the withdrawal rate is to 100%.
- (9) Range reflects the mortality rate for the vast majority of business with living benefits, with policyholders ranging from 35 to 90 years old. While the majority of living benefits have a minimum age requirement, certain benefits do not have an age restriction. This results in contractholders for certain benefits with mortality rates approaching 0%. Based on historical experience, the Company applies a set of age and duration specific mortality rate adjustments compared to standard industry tables. A mortality improvement assumption is also incorporated into the overall mortality table.

**Interrelationships Between Unobservable Inputs** In addition to the sensitivities of fair value measurements to changes in each unobservable input in isolation, as reflected in the table above, interrelationships between these inputs may also exist, such that a change in one unobservable input may give rise to a change in another, or multiple inputs. Examples of such interrelationships for significant internally-priced Level 3 assets and liabilities are as follows:

*Corporate Securities* The rate used to discount future cash flows reflects current risk-free rates plus credit and liquidity spread requirements that market participants would use to value an asset. The discount rate may be influenced by many factors, including market cycles, expectations of default, collateral, term, and asset complexity. Each of these factors can influence discount rates, either in isolation, or in response to other factors.

*Asset-Backed Securities* Interrelationships may exist between the prepayment rate, the default rate and/or loss severity, depending on specific market conditions. In stronger business cycles, prepayment rates are generally driven by overall market interest rates, and accompanied by lower default rates and loss severity. During weaker cycles, prepayments may decline, as default rates and loss severity increase. Additionally, the impact of these factors on average life varies with the structure and subordination.

*Future Policy Benefits* The unobservable contractholder behavior inputs related to the liability for the optional living benefit features of the Company's variable annuity contracts included in future policy benefits are generally based on emerging experience, future expectations and other data. While experience for these products is still emerging, the Company expects efficient benefit utilization and withdrawal rates to generally be correlated



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

with lapse rates. However, behavior is generally highly dependent on the facts and circumstances surrounding the individual contractholder, such as their liquidity needs or tax situation, which could drive lapse behavior independent of other contractholder behavior assumptions. The dynamic lapse adjustment assumes lower lapses when the benefit amount is greater than the account value, as in-the-money contracts are less likely to lapse. Therefore, to the extent more efficient contractholder behavior results in greater in-the-moneyness at the contract level, the dynamic lapse function will reduce lapse rates for those contracts. Similarly, to the extent that increases in equity volatility are correlated with overall declines in the capital markets, the dynamic lapse function will lower overall lapse rates as contracts become more in-the-money.

**Separate Account Assets** In addition to the significant internally-priced Level 3 assets and liabilities presented and described above, the Company also has internally-priced separate account assets reported within Level 3. Changes in the fair value of separate account assets are borne by customers and thus are offset by changes in separate account liabilities on the Company's Consolidated Statement of Financial Position. As a result, changes in value associated with these investments do not impact the Company's Consolidated Statement of Operations. In addition, fees earned by the Company related to the management of most separate account assets classified as Level 3 do not change due to changes in the fair value of these investments. Quantitative information about significant internally-priced Level 3 separate account assets is as follows:

*Real Estate and Other Invested Assets* Separate account assets include \$20,559 million and \$19,518 million of investments in real estate as of September 30, 2013 and December 31, 2012, respectively, that are classified as Level 3 and reported at fair value. In general, these fair value estimates are based on property appraisal reports prepared by independent real estate appraisers. Key inputs and assumptions to the appraisal process include rental income and expense amounts, related growth rates, discount rates and capitalization rates. In cases where real estate investments are made through indirect investments, fair value is generally determined by the Company's equity in net assets of the entities. The debt associated with real estate, other invested assets and the Company's equity position in entities are externally valued. Because of the subjective nature of inputs and the judgment involved in the appraisal process, real estate investments and their corresponding debt are typically included in the Level 3 classification. Key unobservable inputs to real estate valuation include capitalization rates, which ranged from 4.50% to 11.0% (6.41% weighted average) as of September 30, 2013 and 4.75% to 10.5% (6.49% weighted average) as of December 31, 2012 and discount rates, which ranged from 6.25% to 11.25% (7.83% weighted average) as of September 30, 2013 and 6.25% to 15.0% (7.92% weighted average) as of December 31, 2012. Key unobservable inputs to real estate debt valuation include yield to maturity, which ranged from 1.24% to 6.84% (4.33% weighted average) as of September 30, 2013 and 3.59% to 7.62% (4.74% weighted average) as of December 31, 2012 and market spread over base rate, which ranged from 1.75% to 2.80% (2.18% weighted average) as of September 30, 2013 and 1.67% to 4.48% (3.22% weighted average) as of December 31, 2012.

*Commercial Mortgage Loans* Separate account assets include \$791 million and \$833 million of commercial mortgage loans as of September 30, 2013 and December 31, 2012 respectively that are classified as Level 3 and reported at fair value. Commercial mortgage loans are primarily valued internally using discounted cash flow techniques, as described further under Fair Value of Financial Instruments. The primary unobservable input used is the spread to discount cash flows, which ranged from 1.50% to 2.06% (1.63% weighted average) as of September 30, 2013 and 1.65% to 4.15% (1.87% weighted average) as of December 31, 2012. In isolation, an increase (decrease) in the value of this input would result in a lower (higher) fair value measurement.

**Valuation Process for Fair Value Measurements Categorized within Level 3** The Company has established an internal control infrastructure over the valuation of financial instruments that requires ongoing oversight by its various Business Groups. These management control functions are segregated from the trading



**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

and investing functions. For invested assets, the Company has established oversight teams, often in the form of Pricing Committees within each asset management group. The teams, which typically include representation from investment, accounting, operations, legal and other disciplines are responsible for overseeing and monitoring the pricing of the Company's investments and performing periodic due diligence reviews of independent pricing services. An actuarial valuation team oversees the valuation of optional living benefit features of the Company's variable annuity contracts.

The Company has also established policies and guidelines that require the establishment of valuation methodologies and consistent application of such methodologies. These policies and guidelines govern the use of inputs and price source hierarchies and provide controls around the valuation processes. These controls include appropriate review and analysis of investment prices against market activity or indicators of reasonableness, approval of price source changes, price overrides, methodology changes and classification of fair value hierarchy levels. For optional living benefit features of the Company's variable annuity products, the actuarial valuation unit periodically performs baseline testing of contract input data and actuarial assumptions are reviewed at least annually, and updated based upon emerging experience, future expectations and other data, including any observable market data, such as available industry studies. The valuation policies and guidelines are reviewed and updated as appropriate.

Within the trading and investing functions, the Company has established policies and procedures that relate to the approval of all new transaction types, transaction pricing sources and fair value hierarchy coding within the financial reporting system. For variable annuity product changes or new launches of optional living benefit features, the actuarial valuation unit validates input logic and new product features and agrees new input data directly to source documents.

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

**Changes in Level 3 assets and liabilities** The following tables provide summaries of the changes in fair values of Level 3 assets and liabilities as of the dates indicated, as well as the portion of gains or losses included in income attributable to unrealized gains or losses related to those assets and liabilities still held at the end of their respective periods.

**Three Months Ended September 30, 2013****Fixed Maturities Available-For-Sale**

|   | U.S.<br>Government | U.S.<br>States | Foreign<br>Government | Corporate<br>(in millions) | Asset-<br>Backed | Commercial<br>Mortgage-<br>Backed | Residential<br>Mortgage-<br>Backed |
|---|--------------------|----------------|-----------------------|----------------------------|------------------|-----------------------------------|------------------------------------|
| Fair Value, beginning of period               | \$ 0               | \$ 0           | \$ 13                 | \$ 1,383                   | \$ 4,009         | \$ 243                            | \$ 11                              |
| Total gains (losses) (realized/unrealized):   |                    |                |                       |                            |                  |                                   |                                    |
| Included in earnings:                         |                    |                |                       |                            |                  |                                   |                                    |
| Realized investment gains (losses), net       | 0                  | 0              | 0                     | (11)                       | 9                | 35                                | 0                                  |
| Included in other comprehensive income (loss) | 0                  | 0              | 0                     | (20)                       | (4)              | (16)                              | 0                                  |
| Net investment income                         | 0                  | 0              | 0                     | (6)                        | 7                | 0                                 | 0                                  |
| Purchases                                     | 0                  | 0              | 1                     | 91                         | 515              | 91                                | 0                                  |
| Sales   | 0                  | 0              | 0                     | (12)                       | (80)             | (34)                              | 0                                  |
| Issuances                                     | 0                  | 0              | 0                     | 0                          | 0                | 0                                 | 0                                  |
| Settlements                                   | 0                  | 0              | (1)                   | (158)                      | (251)            | (7)                               | (3)                                |
| Foreign currency translation                  | 0                  | 0              | 0                     | 15                         | 13               | 1                                 | 0                                  |
| Other(1)                                      | 0                  | 0              | 0                     | 0                          | (84)             | 0                                 | 0                                  |
| Transfers into Level 3(2)                     | 0                  | 0              | 0                     | 69                         | 2                | 0                                 | 0                                  |
| Transfers out of Level 3(2)                   | 0                  | 0              | (12)                  | (153)                      | (46)             | (149)                             | 0                                  |
| Fair Value, end of period                     | \$ 0               | \$ 0           | \$ 1                  | \$ 1,198                   | \$ 4,090         | \$ 164                            | \$ 8                               |

Unrealized gains (losses) for assets still held(3):

|   |      |      |      |      |      |      |      |
|---|------|------|------|------|------|------|------|
| Included in earnings:                   |      |      |      |      |      |      |      |
| Realized investment gains (losses), net | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 7 | \$ 0 | \$ 0 |

**Three Months Ended September 30, 2013****Trading Account Assets**

|   | U.S.<br>Government | Corporate | Asset-<br>Backed | Commercial<br>Mortgage-<br>Backed<br>(in millions) | Residential<br>Mortgage-<br>Backed | Equity | All<br>Other<br>Activity |
|---|--------------------|-----------|------------------|--|------------------------------------|--------|--------------------------|
| Fair Value, beginning of period             | \$ 0               | \$ 90     | \$ 424           | \$ 54  | \$ 2                               | \$ 884 | \$ 14                    |
| Total gains (losses) (realized/unrealized): |                    |           |                  |  |                                    |        |                          |
| Included in earnings:                       |                    |           |                  |  |                                    |        |                          |
| Realized investment gains (losses), net     | 0                  | 0         | 0                | 0  | 0                                  | 0      | (3)                      |
| Asset management fees and other income      | 0                  | (2)       | (1)              | (1)  | 0                                  | 5      | 1                        |
| Net investment income                       | 0                  | 0         | 2                | 0  | 0                                  | 0      | 0                        |
| Purchases                                   | 0                  | 17        | 156              | 0  | 0                                  | 7      | 0                        |
| Sales                                       | 0                  | (6)       | (1)              | 0  | 0                                  | (5)    | 0                        |
| Issuances                                   | 0                  | 0         | 0                | 0  | 0                                  | 0      | 0                        |
| Settlements                                 | 0                  | (8)       | (44)             | 0  | 0                                  | (30)   | (4)                      |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|                              |      |       |        |      |      |        |      |
|------------------------------|------|-------|--------|------|------|--------|------|
| Foreign currency translation | 0    | 0     | 1      | 0    | 0    | 17     | 0    |
| Other(1)                     | 0    | 0     | (19)   | 0    | 0    | 0      | 0    |
| Transfers into Level 3(2)    | 0    | 0     | 2      | 0    | 0    | 0      | 0    |
| Transfers out of Level 3(2)  | 0    | (6)   | (6)    | (49) | 0    | 0      | 0    |
| Fair Value, end of period    | \$ 0 | \$ 85 | \$ 514 | \$ 4 | \$ 2 | \$ 878 | \$ 8 |

Unrealized gains (losses) for assets still held(3):

Included in earnings:

|   |      |      |      |      |      |      |        |
|---|------|------|------|------|------|------|--------|
| Realized investment gains (losses), net | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ (2) |
| Asset management fees and other income  | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 9 | \$ 1   |

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

|   | Three Months Ended September 30, 2013          |  |                                   |                 |
|---|--|--|-----------------------------------|-----------------|
|   | Equity<br>Securities<br>Available-<br>For-Sale | Commercial<br>Mortgage<br>and Other<br>Loans | Other<br>Long-term<br>Investments | Other<br>Assets |
|   | (in millions)                                  |  |                                   |                 |
| Fair Value, beginning of period                     | \$ 292   | \$ 21  | \$ 1,082                          | \$ 6            |
| Total gains (losses) (realized/unrealized):         |  |  |                                   |                 |
| Included in earnings:                               |  |  |                                   |                 |
| Realized investment gains (losses), net             | 10   | (2)  | (1)                               | 0               |
| Asset management fees and other income              | 0  | 0  | 19                                | 0               |
| Included in other comprehensive income (loss)       | 2  | 0  | 0                                 | 0               |
| Net investment income                               | 0  | 0  | 1                                 | 0               |
| Purchases   | 8  | 0  | 27                                | 0               |
| Sales   | (38)   | 0  | 0                                 | 0               |
| Issuances   | 0  | 0  | 0                                 | 0               |
| Settlements   | 0  | 0  | (23)                              | 0               |
| Foreign currency translation                        | 7  | 0  | (27)                              | 0               |
| Other(1)  | 0  | 0  | (68)                              | 0               |
| Transfers into Level 3(2)                           | 1  | 0  | 0                                 | 0               |
| Transfers out of Level 3(2)                         | 0  | 0  | 0                                 | 0               |
| Fair Value, end of period                           | \$ 282   | \$ 19  | \$ 1,010                          | \$ 6            |
| Unrealized gains (losses) for assets still held(3): |  |  |                                   |                 |
| Included in earnings:                               |  |  |                                   |                 |
| Asset management fees and other income              | \$ 0   | \$ 0   | \$ 20                             | \$ 0            |

|  | Three Months Ended September 30, 2013 |                              |                      |                                  |
|--|---------------------------------------|------------------------------|----------------------|----------------------------------|
|  | Separate<br>Account<br>Assets(4)      | Future<br>Policy<br>Benefits | Other<br>Liabilities | Notes of<br>consolidated<br>VIEs |
|  | (in millions)                         |                              |                      |                                  |
| Fair Value, beginning of period                      | \$ 21,672                             | \$ (365)                     | \$ (6)               | \$ (2,055)                       |
| Total gains (losses) (realized/unrealized):          |                                       |                              |                      |                                  |
| Included in earnings:                                |                                       |                              |                      |                                  |
| Realized investment gains (losses), net              | 0                                     | (1,351)                      | 1                    | 30                               |
| Interest credited to policyholders' account balances | 736                                   | 0                            | 0                    | 0                                |
| Purchases  | 528                                   | 0                            | 0                    | 0                                |
| Sales  | (166)                                 | 0                            | 0                    | 0                                |
| Issuances  | 0                                     | (212)                        | 0                    | (292)                            |
| Settlements  | (372)                                 | 0                            | 0                    | (13)                             |
| Other(1)   | 0                                     | 0                            | (1)                  | 0                                |
| Transfers into Level 3(2)                            | 3                                     | 0                            | 0                    | 0                                |
| Transfers out of Level 3(2)                          | (54)                                  | 0                            | 0                    | 0                                |
| Fair Value, end of period                            | \$ 22,347                             | \$ (1,928)                   | \$ (6)               | \$ (2,330)                       |

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Unrealized gains (losses) for assets/liabilities still held(3):

Included in earnings:

|  |    |     |    |         |    |   |    |    |
|--|----|-----|----|---------|----|---|----|----|
| Realized investment gains (losses), net    | \$ | 0   | \$ | (1,359) | \$ | 0 | \$ | 29 |
| Interest credited to policyholders account | \$ | 464 | \$ | 0       | \$ | 0 | \$ | 0  |

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)****Nine Months Ended September 30, 2013  
Fixed Maturities Available-For-Sale**

|   | U.S.<br>Government | U.S.<br>States | Foreign<br>Government | Corporate | Asset-<br>Backed<br>(in millions) | Commercial<br>Mortgage-<br>Backed | Residential<br>Mortgage-<br>Backed |
|---|--------------------|----------------|-----------------------|-----------|-----------------------------------|-----------------------------------|------------------------------------|
| Fair Value, beginning of period                     | \$ 0               | \$ 0           | \$ 0                  | \$ 1,630  | \$ 3,703                          | \$ 124                            | \$ 11                              |
| Total gains (losses) (realized/unrealized):         |                    |                |                       |           |                                   |                                   |                                    |
| Included in earnings:                               |                    |                |                       |           |                                   |                                   |                                    |
| Realized investment gains (losses), net             | 0                  | 0              | 0                     | (5)       | 20                                | 36                                | 0                                  |
| Included in other comprehensive income (loss)       | 0                  | 0              | (1)                   | (8)       | (5)                               | (17)                              | 0                                  |
| Net investment income                               | 0                  | 0              | 0                     | (4)       | 28                                | 0                                 | 0                                  |
| Purchases   | 0                  | 0              | 5                     | 393       | 1,898                             | 328                               | 0                                  |
| Sales   | 0                  | 0              | (1)                   | (72)      | (306)                             | (37)                              | 0                                  |
| Issuances   | 0                  | 0              | 0                     | 0         | 0                                 | 0                                 | 0                                  |
| Settlements   | 0                  | 0              | (3)                   | (555)     | (1,036)                           | (38)                              | (3)                                |
| Foreign currency translation                        | 0                  | 0              | 0                     | (96)      | (92)                              | (8)                               | 0                                  |
| Other(1)  | 0                  | 0              | 0                     | 0         | (84)                              | 0                                 | 0                                  |
| Transfers into Level 3(2)                           | 0                  | 0              | 13                    | 302       | 10                                | 0                                 | 0                                  |
| Transfers out of Level 3(2)                         | 0                  | 0              | (12)                  | (387)     | (46)                              | (224)                             | 0                                  |
| Fair Value, end of period                           | \$ 0               | \$ 0           | \$ 1                  | \$ 1,198  | \$ 4,090                          | \$ 164                            | \$ 8                               |
| Unrealized gains (losses) for assets still held(3): |                    |                |                       |           |                                   |                                   |                                    |
| Included in earnings:                               |                    |                |                       |           |                                   |                                   |                                    |
| Realized investment gains (losses), net             | \$ 0               | \$ 0           | \$ 0                  | \$ 0      | \$ 12                             | \$ 0                              | \$ 0                               |

**Nine Months Ended September 30, 2013  
Trading Account Assets**

|   | U.S.<br>Government | Corporate | Asset-<br>Backed | Commercial<br>Mortgage-<br>Backed<br>(in millions) | Residential<br>Mortgage-<br>Backed | Equity   | All<br>Other<br>Activity |
|---|--------------------|-----------|------------------|--|------------------------------------|----------|--------------------------|
| Fair Value, beginning of period             | \$ 0               | \$ 134    | \$ 430           | \$ 8   | \$ 2                               | \$ 1,098 | \$ 25                    |
| Total gains (losses) (realized/unrealized): |                    |           |                  |  |                                    |          |                          |
| Included in earnings:                       |                    |           |                  |  |                                    |          |                          |
| Realized investment gains (losses), net     | 0                  | 0         | 0                | 0  | 0                                  | (1)      | (15)                     |
| Asset management fees and other income      | 0                  | (3)       | 7                | (1)  | 0                                  | 45       | 2                        |
| Net investment income                       | 0                  | 0         | 4                | 0  | 0                                  | 0        | 0                        |
| Purchases                                   | 0                  | 20        | 321              | 76   | 0                                  | 10       | 0                        |
| Sales                                       | 0                  | (11)      | (2)              | (1)  | 0                                  | (108)    | 0                        |
| Issuances                                   | 0                  | 0         | 0                | 0  | 0                                  | 0        | 0                        |
| Settlements                                 | 0                  | (48)      | (216)            | (1)  | 0                                  | (43)     | (4)                      |
| Foreign currency translation                | 0                  | 0         | (7)              | (1)  | 0                                  | (123)    | 0                        |
| Other(1)                                    | 0                  | 0         | (19)             | 0  | 0                                  | 0        | 0                        |
| Transfers into Level 3(2)                   | 0                  | 3         | 4                | 0  | 0                                  | 0        | 0                        |
| Transfers out of Level 3(2)                 | 0                  | (10)      | (8)              | (76)   | 0                                  | 0        | 0                        |
| Fair Value, end of period                   | \$ 0               | \$ 85     | \$ 514           | \$ 4   | \$ 2                               | \$ 878   | \$ 8                     |



Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Unrealized gains (losses) for assets still held(3):

Included in earnings:

|   |      |        |      |      |      |       |      |         |
|---|------|--------|------|------|------|-------|------|---------|
| Realized investment gains (losses), net | \$ 0 | \$ 0   | \$ 0 | \$ 0 | \$ 0 | \$ 0  | \$ 0 | \$ (15) |
| Asset management fees and other income  | \$ 0 | \$ (3) | \$ 8 | \$ 1 | \$ 0 | \$ 41 | \$ 2 |         |

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

|   | Nine Months Ended September 30, 2013           |  |                                   |                 |
|---|--|--|-----------------------------------|-----------------|
|   | Equity<br>Securities<br>Available-<br>For-Sale | Commercial<br>Mortgage<br>and Other<br>Loans | Other<br>Long-term<br>Investments | Other<br>Assets |
|   | (in millions)                                  |  |                                   |                 |
| Fair Value, beginning of period                     | \$ 330   | \$ 48  | \$ 1,053                          | \$ 8            |
| Total gains (losses) (realized/unrealized):         |  |  |                                   |                 |
| Included in earnings:                               |  |  |                                   |                 |
| Realized investment gains (losses), net             | 11   | 0  | 0                                 | (2)             |
| Asset management fees and other income              | 0  | 0  | 103                               | 0               |
| Included in other comprehensive income (loss)       | 45   | 0  | 0                                 | 0               |
| Net investment income                               | 0  | 0  | (1)                               | 0               |
| Purchases   | 20   | 0  | 86                                | 0               |
| Sales   | (61)   | 0  | 0                                 | 0               |
| Issuances   | 0  | 0  | 6                                 | 0               |
| Settlements   | (3)  | (29)   | (121)                             | 0               |
| Foreign currency translation                        | (44)   | 0  | (8)                               | 0               |
| Other(1)  | (18)   | 0  | (108)                             | 0               |
| Transfers into Level 3(2)                           | 2  | 0  | 0                                 | 0               |
| Transfers out of Level 3(2)                         | 0  | 0  | 0                                 | 0               |
| Fair Value, end of period                           | \$ 282   | \$ 19  | \$ 1,010                          | \$ 6            |
| Unrealized gains (losses) for assets still held(3): |  |  |                                   |                 |
| Included in earnings:                               |  |  |                                   |                 |
| Realized investment gains (losses), net             | \$ 0   | \$ 0   | \$ (3)                            | \$ (2)          |
| Asset management fees and other income              | \$ 0   | \$ 0   | \$ 103                            | \$ 0            |

|  | Nine Months Ended September 30, 2013 |                              |                      |                                  |
|--|--------------------------------------|------------------------------|----------------------|----------------------------------|
|  | Separate<br>Account<br>Assets(4)     | Future<br>Policy<br>Benefits | Other<br>Liabilities | Notes of<br>consolidated<br>VIEs |
|  | (in millions)                        |                              |                      |                                  |
| Fair Value, beginning of period                      | \$ 21,132                            | \$ (3,348)                   | \$ 0                 | \$ (1,406)                       |
| Total gains (losses) (realized/unrealized):          |                                      |                              |                      |                                  |
| Included in earnings:                                |                                      |                              |                      |                                  |
| Realized investment gains (losses), net              | 0                                    | 2,037                        | (3)                  | 32                               |
| Interest credited to policyholders' account balances | 1,884                                | 0                            | 0                    | 0                                |
| Purchases  | 1,309                                | 0                            | 0                    | 0                                |
| Sales  | (483)                                | 0                            | 0                    | 0                                |
| Issuances  | 0                                    | (619)                        | 0                    | (932)                            |
| Settlements  | (1,593)                              | 0                            | 0                    | (24)                             |
| Foreign currency translation                         | 0                                    | 2                            | 0                    | 0                                |
| Other(1)   | 140                                  | 0                            | (3)                  | 0                                |
| Transfers into Level 3(2)                            | 62                                   | 0                            | 0                    | 0                                |
| Transfers out of Level 3(2)                          | (104)                                | 0                            | 0                    | 0                                |
| Fair Value, end of period                            | \$ 22,347                            | \$ (1,928)                   | \$ (6)               | \$ (2,330)                       |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|   |          |          |        |       |
|---|----------|----------|--------|-------|
| Unrealized gains (losses) for assets/liabilities still held(3): |          |          |        |       |
| Included in earnings:   |          |          |        |       |
| Realized investment gains (losses), net                         | \$ 0     | \$ 1,970 | \$ (3) | \$ 32 |
| Interest credited to policyholders' account                     | \$ 1,135 | \$ 0     | \$ 0   | \$ 0  |

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)****Three Months Ended September 30, 2012  
Fixed Maturities Available-For-Sale**

|   | U.S.<br>Government States | U.S. | Foreign<br>Government | Corporate<br>(in millions) | Asset-<br>Backed | Commercial<br>Mortgage-<br>Backed | Residential<br>Mortgage-<br>Backed |
|---|---------------------------|------|-----------------------|----------------------------|------------------|-----------------------------------|------------------------------------|
| Fair Value, beginning of period                     | \$ 66                     | \$ 0 | \$ 21                 | \$ 1,635                   | \$ 3,069         | \$ 186                            | \$ 13                              |
| Total gains (losses) (realized/unrealized):         |                           |      |                       |                            |                  |                                   |                                    |
| Included in earnings:                               |                           |      |                       |                            |                  |                                   |                                    |
| Realized investment gains (losses), net             | 0                         | 0    | 0                     | 0                          | 10               | 2                                 | 0                                  |
| Included in other comprehensive income (loss)       | 0                         | 0    | 0                     | 46                         | 22               | 7                                 | 0                                  |
| Net investment income                               | 0                         | 0    | 0                     | 2                          | 7                | 1                                 | 0                                  |
| Purchases   | 0                         | 0    | 0                     | 100                        | 793              | 10                                | 0                                  |
| Sales   | 0                         | 0    | 0                     | (91)                       | (381)            | (2)                               | 0                                  |
| Issuances   | 0                         | 0    | 0                     | 0                          | 0                | 0                                 | 0                                  |
| Settlements   | 0                         | 0    | 0                     | (42)                       | (105)            | (7)                               | (2)                                |
| Foreign currency translation                        | 0                         | 0    | 0                     | 3                          | 2                | 0                                 | 0                                  |
| Other(1)  | 0                         | 0    | (5)                   | 5                          | 0                | 0                                 | 0                                  |
| Transfers into Level 3(2)                           | 0                         | 0    | 0                     | 59                         | 35               | 0                                 | 0                                  |
| Transfers out of Level 3(2)                         | 0                         | 0    | (13)                  | (41)                       | (253)            | (14)                              | 0                                  |
| Fair Value, end of period                           | \$ 66                     | \$ 0 | \$ 3                  | \$ 1,676                   | \$ 3,199         | \$ 183                            | \$ 11                              |
| Unrealized gains (losses) for assets still held(3): |                           |      |                       |                            |                  |                                   |                                    |
| Included in earnings:                               |                           |      |                       |                            |                  |                                   |                                    |
| Realized investment gains (losses), net             | \$ 0                      | \$ 0 | \$ 0                  | \$ 0                       | \$ 3             | \$ 0                              | \$ 0                               |

**Three Months Ended September 30, 2012  
Trading Account Assets**

|   | U.S.<br>Government | Corporate | Asset-<br>Backed | Commercial<br>Mortgage-<br>Backed<br>(in millions) | Residential<br>Mortgage-<br>Backed | Equity   | All<br>Other<br>Activity |
|---|--------------------|-----------|------------------|--|------------------------------------|----------|--------------------------|
| Fair Value, beginning of period             | \$ 9               | \$ 140    | \$ 444           | \$ 68  | \$ 3                               | \$ 1,241 | \$ 45                    |
| Total gains (losses) (realized/unrealized): |                    |           |                  |  |                                    |          |                          |
| Included in earnings:                       |                    |           |                  |  |                                    |          |                          |
| Realized investment gains (losses), net     | 0                  | 0         | 0                | 0  | 0                                  | 1        | (16)                     |
| Asset management fees and other income      | 0                  | 0         | 8                | 1  | 0                                  | 20       | 1                        |
| Net investment income                       | 0                  | 0         | 1                | 0  | 0                                  | 0        | 0                        |
| Purchases                                   | 0                  | (1)       | 0                | 2  | 0                                  | 0        | 0                        |
| Sales                                       | 0                  | (2)       | (6)              | (2)  | 0                                  | (2)      | 0                        |
| Issuances                                   | 0                  | 0         | 0                | 0  | 0                                  | 0        | 0                        |
| Settlements                                 | 0                  | (5)       | (21)             | (2)  | 0                                  | (32)     | 2                        |
| Foreign currency translation                | 0                  | 0         | 0                | 0  | 0                                  | 7        | 0                        |
| Other(1)                                    | 0                  | 0         | 1                | 0  | (1)                                | 0        | 0                        |
| Transfers into Level 3(2)                   | 0                  | 2         | 3                | 43   | 0                                  | 33       | 0                        |
| Transfers out of Level 3(2)                 | 0                  | 0         | (31)             | (17)   | 0                                  | 0        | 0                        |
| Fair Value, end of period                   | \$ 9               | \$ 134    | \$ 399           | \$ 93  | \$ 2                               | \$ 1,268 | \$ 32                    |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Unrealized gains (losses) for assets still held(3):

Included in earnings:

|   |      |        |      |      |      |       |      |         |
|---|------|--------|------|------|------|-------|------|---------|
| Realized investment gains (losses), net | \$ 0 | \$ 0   | \$ 0 | \$ 0 | \$ 0 | \$ 0  | \$ 0 | \$ (16) |
| Asset management fees and other income  | \$ 0 | \$ (3) | \$ 7 | \$ 0 | \$ 0 | \$ 22 | \$ 1 |         |

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

|   | Three Months Ended September 30, 2012          |  |                                   |                           |
|---|--|--|-----------------------------------|---------------------------|
|   | Equity<br>Securities<br>Available-<br>For-Sale | Commercial<br>Mortgage<br>and Other<br>Loans | Other<br>Long-term<br>Investments | Short-term<br>Investments |
|   | (in millions)                                  |  |                                   |                           |
| Fair Value, beginning of period                                 | \$ 355   | \$ 37  | \$ 1,042                          | \$ 5                      |
| Total gains (losses) (realized/unrealized):                     |  |  |                                   |                           |
| Included in earnings:   |  |  |                                   |                           |
| Realized investment gains (losses), net                         | (1)  | 2  | 3                                 | (5)                       |
| Asset management fees and other income                          | 0  | 0  | 5                                 | 0                         |
| Included in other comprehensive income (loss)                   | (6)  | 0  | 0                                 | 0                         |
| Net investment income   | 0  | 0  | (1)                               | 0                         |
| Purchases   | 6  | 0  | 44                                | 0                         |
| Sales   | (9)  | 0  | (3)                               | 0                         |
| Issuances   | 0  | 0  | 0                                 | 0                         |
| Settlements   | 0  | 29   | (45)                              | 0                         |
| Foreign currency translation                                    | 1  | 0  | 0                                 | 0                         |
| Other(1)  | 0  | 0  | 11                                | 0                         |
| Transfers into Level 3(2)                                       | 0  | 0  | 0                                 | 0                         |
| Transfers out of Level 3(2)                                     | 0  | 0  | (42)                              | 0                         |
| Fair Value, end of period                                       | \$ 346   | \$ 68  | \$ 1,014                          | \$ 0                      |
| Unrealized gains (losses) for assets/liabilities still held(3): |  |  |                                   |                           |
| Included in earnings:   |  |  |                                   |                           |
| Realized investment gains (losses), net                         | \$ 0   | \$ 2   | \$ 0                              | \$ (5)                    |
| Asset management fees and other income                          | \$ 0   | \$ 0   | \$ 20                             | \$ 0                      |

|  | Three Months Ended September 30, 2012 |                                  |                              |                      |                                  |
|--|---------------------------------------|----------------------------------|------------------------------|----------------------|----------------------------------|
|  | Other<br>Assets                       | Separate<br>Account<br>Assets(4) | Future<br>Policy<br>Benefits | Other<br>Liabilities | Notes of<br>consolidated<br>VIEs |
|  | (in millions)                         |                                  |                              |                      |                                  |
| Fair Value, beginning of period                      | \$ 8                                  | \$ 20,698                        | \$ (3,054)                   | \$ (2)               | \$ (296)                         |
| Total gains (losses) (realized/unrealized):          |                                       |                                  |                              |                      |                                  |
| Included in earnings:                                |                                       |                                  |                              |                      |                                  |
| Realized investment gains (losses), net              | 0                                     | 0                                | (408)                        | (5)                  | (3)                              |
| Interest credited to policyholders' account balances | 0                                     | 303                              | 0                            | 0                    | 0                                |
| Purchases  | 0                                     | 310                              | 0                            | 0                    | 0                                |
| Sales  | 0                                     | (184)                            | 0                            | 0                    | 0                                |
| Issuances  | 0                                     | 0                                | (176)                        | 0                    | (390)                            |
| Settlements  | 0                                     | (592)                            | 0                            | 6                    | 295                              |
| Transfers into Level 3(2)                            | 0                                     | 29                               | 0                            | 0                    | 0                                |
| Transfers out of Level 3(2)                          | 0                                     | (225)                            | 0                            | 0                    | 0                                |
| Fair Value, end of period                            | \$ 8                                  | \$ 20,339                        | \$ (3,638)                   | \$ (1)               | \$ (394)                         |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Unrealized gains (losses) for assets/liabilities still held(3):

Included in earnings:

|   |      |        |          |        |      |
|---|------|--------|----------|--------|------|
| Realized investment gains (losses), net     | \$ 0 | \$ 0   | \$ (448) | \$ (6) | \$ 0 |
| Interest credited to policyholders' account | \$ 0 | \$ 146 | \$ 0     | \$ 0   | \$ 0 |

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

|   | Nine Months Ended September 30, 2012 |                |                       |           |                  |                                   |                                    |
|---|--------------------------------------|----------------|-----------------------|-----------|------------------|-----------------------------------|------------------------------------|
|   | Fixed Maturities Available-For-Sale  |                |                       |           |                  |                                   |                                    |
|   | U.S.<br>Government                   | U.S.<br>States | Foreign<br>Government | Corporate | Asset-<br>Backed | Commercial<br>Mortgage-<br>Backed | Residential<br>Mortgage-<br>Backed |
|   | (in millions)                        |                |                       |           |                  |                                   |                                    |
| Fair Value, beginning of period                     | \$ 66                                | \$ 0           | \$ 25                 | \$ 1,450  | \$ 2,528         | \$ 145                            | \$ 16                              |
| Total gains (losses) (realized/unrealized):         |                                      |                |                       |           |                  |                                   |                                    |
| Included in earnings:                               |                                      |                |                       |           |                  |                                   |                                    |
| Realized investment gains (losses), net             | 0                                    | 0              | 0                     | (25)      | 18               | 2                                 | 0                                  |
| Included in other comprehensive income (loss)       | 0                                    | 0              | 0                     | 176       | 52               | 18                                | 0                                  |
| Net investment income                               | 0                                    | 0              | 0                     | 6         | 22               | (2)                               | 1                                  |
| Purchases   | 0                                    | 10             | 0                     | 321       | 1,964            | 43                                | 0                                  |
| Sales   | 0                                    | 0              | 0                     | (130)     | (425)            | (2)                               | 0                                  |
| Issuances   | 0                                    | 0              | 0                     | 0         | 0                | 0                                 | 0                                  |
| Settlements   | (2)                                  | 0              | 0                     | (228)     | (450)            | (11)                              | (6)                                |
| Foreign currency translation                        | 0                                    | 0              | 0                     | (3)       | (8)              | (1)                               | 0                                  |
| Other(1)  | 2                                    | 0              | (5)                   | 3         | 0                | 0                                 | 0                                  |
| Transfers into Level 3(2)                           | 0                                    | 0              | 7                     | 276       | 35               | 37                                | 0                                  |
| Transfers out of Level 3(2)                         | 0                                    | (10)           | (24)                  | (170)     | (537)            | (46)                              | 0                                  |
| Fair Value, end of period                           | \$ 66                                | \$ 0           | \$ 3                  | \$ 1,676  | \$ 3,199         | \$ 183                            | \$ 11                              |
| Unrealized gains (losses) for assets still held(3): |                                      |                |                       |           |                  |                                   |                                    |
| Included in earnings:                               |                                      |                |                       |           |                  |                                   |                                    |
| Realized investment gains (losses), net             | \$ 0                                 | \$ 0           | \$ 0                  | \$ (1)    | \$ 9             | \$ 0                              | \$ 0                               |

|   | Nine Months Ended September 30, 2012 |           |                  |                                   |                                    |          |                          |
|---|--------------------------------------|-----------|------------------|-----------------------------------|------------------------------------|----------|--------------------------|
|   | Trading Account Assets               |           |                  |                                   |                                    |          |                          |
|   | U.S.<br>Government                   | Corporate | Asset-<br>Backed | Commercial<br>Mortgage-<br>Backed | Residential<br>Mortgage-<br>Backed | Equity   | All<br>Other<br>Activity |
|   | (in millions)                        |           |                  |                                   |                                    |          |                          |
| Fair Value, beginning of period             | \$ 9                                 | \$ 148    | \$ 416           | \$ 35                             | \$ 4                               | \$ 1,296 | \$ 93                    |
| Total gains (losses) (realized/unrealized): |                                      |           |                  |                                   |                                    |          |                          |
| Included in earnings:                       |                                      |           |                  |                                   |                                    |          |                          |
| Realized investment gains (losses), net     | 0                                    | 0         | 0                | 0                                 | 0                                  | 0        | (65)                     |
| Asset management fees and other income      | 0                                    | (5)       | 13               | 1                                 | 1                                  | 54       | 1                        |
| Net investment income                       | 0                                    | 0         | 5                | 1                                 | 0                                  | 0        | 0                        |
| Purchases                                   | 0                                    | 17        | 128              | 18                                | 0                                  | 13       | 0                        |
| Sales                                       | 0                                    | (10)      | (9)              | (4)                               | (1)                                | (31)     | 0                        |
| Issuances                                   | 0                                    | 0         | 0                | 0                                 | 0                                  | 0        | 0                        |
| Settlements                                 | (2)                                  | (15)      | (90)             | (3)                               | (1)                                | (88)     | 6                        |
| Foreign currency translation                | 0                                    | 0         | (1)              | 0                                 | 0                                  | (11)     | 0                        |
| Other(1)                                    | 2                                    | (2)       | 1                | 0                                 | (1)                                | 3        | (3)                      |
| Transfers into Level 3(2)                   | 0                                    | 5         | 3                | 82                                | 0                                  | 33       | 0                        |
| Transfers out of Level 3(2)                 | 0                                    | (4)       | (67)             | (37)                              | 0                                  | (1)      | 0                        |
| Fair Value, end of period                   | \$ 9                                 | \$ 134    | \$ 399           | \$ 93                             | \$ 2                               | \$ 1,268 | \$ 32                    |



Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Unrealized gains (losses) for assets still held(3):

Included in earnings:

|   |      |         |       |      |      |       |        |         |
|---|------|---------|-------|------|------|-------|--------|---------|
| Realized investment gains (losses), net | \$ 0 | \$ 0    | \$ 0  | \$ 0 | \$ 0 | \$ 0  | \$ (1) | \$ (65) |
| Asset management fees and other income  | \$ 0 | \$ (10) | \$ 11 | \$ 1 | \$ 0 | \$ 54 | \$ 1   |         |

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

|   | Nine Months Ended September 30, 2012           |  |                                   |                           |
|---|--|--|-----------------------------------|---------------------------|
|   | Equity<br>Securities<br>Available-<br>For-Sale | Commercial<br>Mortgage<br>and Other<br>Loans | Other<br>Long-term<br>Investments | Short-term<br>Investments |
|   | (in millions)                                  |  |                                   |                           |
| Fair Value, beginning of period                                 | \$ 360   | \$ 86  | \$ 1,110                          | \$ 0                      |
| Total gains (losses) (realized/unrealized):                     |  |  |                                   |                           |
| Included in earnings:   |  |  |                                   |                           |
| Realized investment gains (losses), net                         | 1  | 2  | 6                                 | (9)                       |
| Asset management fees and other income                          | 0  | 0  | 73                                | 0                         |
| Included in other comprehensive income (loss)                   | 21   | 0  | 0                                 | 0                         |
| Net investment income   | 0  | 0  | 5                                 | 0                         |
| Purchases   | 68   | 0  | 159                               | 9                         |
| Sales   | (17)   | 0  | (23)                              | 0                         |
| Issuances   | 0  | 0  | 0                                 | 0                         |
| Settlements   | 0  | (20)   | (261)                             | 0                         |
| Foreign currency translation                                    | (2)  | 0  | 2                                 | 0                         |
| Other(1)  | 0  | 0  | 7                                 | 0                         |
| Transfers into Level 3(2)                                       | 5  | 0  | 0                                 | 0                         |
| Transfers out of Level 3(2)                                     | (90)   | 0  | (64)                              | 0                         |
| Fair Value, end of period                                       | \$ 346   | \$ 68  | \$ 1,014                          | \$ 0                      |
| Unrealized gains (losses) for assets/liabilities still held(3): |  |  |                                   |                           |
| Included in earnings:   |  |  |                                   |                           |
| Realized investment gains (losses), net                         | \$ 0   | \$ 1   | \$ 1                              | \$ (9)                    |
| Asset management fees and other income                          | \$ 0   | \$ 0   | \$ 40                             | \$ 0                      |

|   | Nine Months Ended September 30, 2012 |                                  |                              |                      |                                  |
|---|--------------------------------------|----------------------------------|------------------------------|----------------------|----------------------------------|
|   | Other<br>Assets                      | Separate<br>Account<br>Assets(4) | Future<br>Policy<br>Benefits | Other<br>Liabilities | Notes of<br>consolidated<br>VIEs |
|   | (in millions)                        |                                  |                              |                      |                                  |
| Fair Value, beginning of period                     | \$ 9                                 | \$ 19,358                        | \$ (2,886)                   | \$ (3)               | \$ (282)                         |
| Total gains (losses) (realized/unrealized):         |                                      |                                  |                              |                      |                                  |
| Included in earnings:                               |                                      |                                  |                              |                      |                                  |
| Realized investment gains (losses), net             | 0                                    | 0                                | (255)                        | (22)                 | (3)                              |
| Asset management fees and other income              | 2                                    | 0                                | 0                            | 0                    | 0                                |
| Interest credited to policyholders account balances | 0                                    | 1,518                            | 0                            | 0                    | 0                                |
| Purchases   | 0                                    | 2,154                            | 0                            | 0                    | 0                                |
| Sales   | (3)                                  | (647)                            | 0                            | 0                    | 0                                |
| Issuances   | 0                                    | 0                                | (497)                        | 0                    | (401)                            |
| Settlements   | 0                                    | (1,617)                          | 0                            | 24                   | 295                              |
| Other(1)  | 0                                    | 0                                | 0                            | 0                    | (3)                              |
| Transfers into Level 3(2)                           | 0                                    | 245                              | 0                            | 0                    | 0                                |
| Transfers out of Level 3(2)                         | 0                                    | (672)                            | 0                            | 0                    | 0                                |
| Fair Value, end of period                           | \$ 8                                 | \$ 20,339                        | \$ (3,638)                   | \$ (1)               | \$ (394)                         |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|   |      |        |          |         |        |
|---|------|--------|----------|---------|--------|
| Unrealized gains (losses) for assets/liabilities still held(3): |      |        |          |         |        |
| Included in earnings:   |      |        |          |         |        |
| Realized investment gains (losses), net                         | \$ 0 | \$ 0   | \$ (340) | \$ (22) | \$ (3) |
| Asset management fees and other income                          | \$ 2 | \$ 0   | \$ 0     | \$ 0    | \$ 0   |
| Interest credited to policyholders account                      | \$ 0 | \$ 902 | \$ 0     | \$ 0    | \$ 0   |

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

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

**Transfers** Transfers into Level 3 are generally the result of unobservable inputs utilized within valuation methodologies and the use of indicative broker quotes for assets that were previously valued using observable inputs. Transfers out of Level 3 are generally due to the use of observable inputs in valuation methodologies as well as the utilization of pricing service information for certain assets that the Company is able to validate.

For the nine months ended September 30, 2012, the majority of the Equity Securities Available-for-Sale transfers out of Level 3 were due to the determination that the pricing inputs for certain equity securities did not have a material liquidity discount and therefore, should be classified as Level 1, not Level 3.

**Derivative Fair Value Information**

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

|                                | As of September 30, 2013 |          |         |            | Total    |
|--------------------------------|--------------------------|----------|---------|------------|----------|
|                                | Level 1                  | Level 2  | Level 3 | Netting(1) |          |
|                                | (in millions)            |          |         |            |          |
| <b>Derivative assets:</b>      |                          |          |         |            |          |
| Interest Rate                  | \$ 4                     | \$ 7,185 | \$ 7    | \$         | \$ 7,196 |
| Currency                       | 0                        | 511      | 0       |            | 511      |
| Credit                         | 0                        | 6        | 0       |            | 6        |
| Currency/Interest Rate         | 0                        | 457      | 0       |            | 457      |
| Equity                         | 50                       | 482      | 1       |            | 533      |
| Netting(1)                     |                          |          |         | (7,242)    | (7,242)  |
| Total derivative assets        | \$ 54                    | \$ 8,641 | \$ 8    | \$ (7,242) | \$ 1,461 |
| <b>Derivative liabilities:</b> |                          |          |         |            |          |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|                              |      |          |      |            |          |
|------------------------------|------|----------|------|------------|----------|
| Interest Rate                | \$ 1 | \$ 7,173 | \$ 6 | \$         | \$ 7,180 |
| Currency                     | 0    | 199      | 0    |            | 199      |
| Credit                       | 0    | 66       | 0    |            | 66       |
| Currency/Interest Rate       | 0    | 649      | 0    |            | 649      |
| Equity                       | 0    | 200      | 0    |            | 200      |
| Netting(1)                   |      |          |      | (7,187)    | (7,187)  |
| Total derivative liabilities | \$ 1 | \$ 8,287 | \$ 6 | \$ (7,187) | \$ 1,107 |

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

|                                | As of December 31, 2012 |           |         |             | Total     |
|--------------------------------|-------------------------|-----------|---------|-------------|-----------|
|                                | Level 1                 | Level 2   | Level 3 | Netting(1)  |           |
|                                | (in millions)           |           |         |             |           |
| <b>Derivative assets:</b>      |                         |           |         |             |           |
| Interest Rate                  | \$ 11                   | \$ 11,675 | \$ 5    | \$          | \$ 11,691 |
| Currency                       | 0                       | 432       | 0       |             | 432       |
| Credit                         | 0                       | 19        | 0       |             | 19        |
| Currency/Interest Rate         | 0                       | 450       | 0       |             | 450       |
| Equity                         | 63                      | 518       | 19      |             | 600       |
| Netting(1)                     |                         |           |         | (10,117)    | (10,117)  |
| Total derivative assets        | \$ 74                   | \$ 13,094 | \$ 24   | \$ (10,117) | \$ 3,075  |
| <b>Derivative liabilities:</b> |                         |           |         |             |           |
| Interest Rate                  | \$ 11                   | \$ 6,783  | \$ 2    | \$          | \$ 6,796  |
| Currency                       | 0                       | 517       | 0       |             | 517       |
| Credit                         | 0                       | 84        | 0       |             | 84        |
| Currency/Interest Rate         | 0                       | 578       | 0       |             | 578       |
| Equity                         | 165                     | 198       | 0       |             | 363       |
| Netting(1)                     |                         |           |         | (8,031)     | (8,031)   |
| Total derivative liabilities   | \$ 176                  | \$ 8,160  | \$ 2    | \$ (8,031)  | \$ 307    |

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

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

**Changes in Level 3 derivative assets and liabilities** The following tables provide a summary of the changes in fair value of Level 3 derivative assets and liabilities for the three and nine months ended September 30, 2013, as well as the portion of gains or losses included in income for the three and nine months ended September 30, 2013, attributable to unrealized gains or losses related to those assets and liabilities still held at September 30, 2013.

|  | Three Months Ended September 30, 2013 |                                  |  | Nine Months Ended September 30, 2013 |                                  |  |
|--|---------------------------------------|----------------------------------|--|--------------------------------------|----------------------------------|--|
|  | Derivative<br>Assets -<br>Equity      | Derivative<br>Assets -<br>Credit | Derivative<br>Assets -<br>Interest<br>Rate | Derivative<br>Assets -<br>Equity     | Derivative<br>Assets -<br>Credit | Derivative<br>Assets -<br>Interest<br>Rate |
| Fair Value, beginning of period  | \$ 8                                  | \$ 0                             | \$ 2                                       | \$ 19                                | \$ 0                             | \$ 3                                       |
| Total gains (losses) (realized/unrealized):  |                                       |                                  |  |                                      |                                  |  |
| Included in earnings:  |                                       |                                  |  |                                      |                                  |  |
| Realized investment gains (losses), net  | (3)                                   | 0                                | (1)  | (14)                                 | 0                                | (2)  |
| Asset management fees and other income   | 0                                     | 0                                | 0  | 0                                    | 0                                | 0  |
| Purchases  | 0                                     | 0                                | 0  | 0                                    | 0                                | 0  |
| Sales  | 0                                     | 0                                | 0  | 0                                    | 0                                | 0  |
| Issuances  | 0                                     | 0                                | 0  | 0                                    | 0                                | 0  |
| Settlements  | (4)                                   | 0                                | 0  | (4)                                  | 0                                | 0  |
| Transfers into Level 3(1)  | 0                                     | 0                                | 0  | 0                                    | 0                                | 0  |
| Transfers out of Level 3(1)  | 0                                     | 0                                | 0  | 0                                    | 0                                | 0  |
| Fair Value, end of period  | \$ 1                                  | \$ 0                             | \$ 1                                       | \$ 1                                 | \$ 0                             | \$ 1                                       |
| Unrealized gains (losses) for the period relating to those level 3 assets that were still held at the end of the period: |                                       |                                  |  |                                      |                                  |  |
| Included in earnings:  |                                       |                                  |  |                                      |                                  |  |
| Realized investment gains (losses), net  | \$ (3)                                | \$ 0                             | \$ (1)                                     | \$ (14)                              | \$ 0                             | \$ (2)                                     |
| Asset management fees and other income   | \$ 0                                  | \$ 0                             | \$ 0                                       | \$ 0                                 | \$ 0                             | \$ 0                                       |

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

|  | Three Months Ended September 30, 2012 |                                  |   | Nine Months Ended September 30, 2012 |                                  |  |
|--|---------------------------------------|----------------------------------|---|--------------------------------------|----------------------------------|--|
|  | Derivative<br>Assets -<br>Equity      | Derivative<br>Assets -<br>Credit | Derivative<br>Assets -<br>Interest<br>Rate<br><br>(in millions) | Derivative<br>Assets -<br>Equity     | Derivative<br>Assets -<br>Credit | Derivative<br>Assets -<br>Interest<br>Rate |
| Fair Value, beginning of period  | \$ 40                                 | \$ 0                             | \$ 2  | \$ 83                                | \$ 1                             | \$ (1)                                     |
| Total gains (losses) (realized/unrealized):  |                                       |                                  |   |                                      |                                  |  |
| Included in earnings:  |                                       |                                  |   |                                      |                                  |  |
| Realized investment gains (losses), net  | (15)                                  | 0                                | 5   | (63)                                 | (1)                              | 8  |
| Asset management fees and other income   | 0                                     | 0                                | 0   | 0                                    | 0                                | 0  |
| Purchases  | 1                                     | 0                                | 0   | 6                                    | 0                                | 0  |
| Sales  | 0                                     | 0                                | 0   | 0                                    | 0                                | 0  |
| Issuances  | 0                                     | 0                                | 0   | 0                                    | 0                                | 0  |
| Settlements  | 0                                     | 0                                | 0   | 0                                    | 0                                | 0  |
| Transfers into Level 3(1)  | 0                                     | 0                                | 0   | 0                                    | 0                                | 0  |
| Transfers out of Level 3(1)  | 0                                     | 0                                | 0   | 0                                    | 0                                | 0  |
| Fair Value, end of period  | \$ 26                                 | \$ 0                             | \$ 7  | \$ 26                                | \$ 0                             | \$ 7                                       |
| Unrealized gains (losses) for the period relating to those level 3 assets that were still held at the end of the period: |                                       |                                  |   |                                      |                                  |  |
| Included in earnings:  |                                       |                                  |   |                                      |                                  |  |
| Realized investment gains (losses), net  | \$ (15)                               | \$ 0                             | \$ 5  | \$ (63)                              | \$ (1)                           | \$ 8                                       |
| Asset management fees and other income   | \$ 0                                  | \$ 0                             | \$ 0  | \$ 0                                 | \$ 0                             | \$ 0                                       |

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

**Nonrecurring Fair Value Measurements** Certain assets and liabilities are measured at fair value on a nonrecurring basis. Commercial mortgage loan reserve adjustments of \$0 million and \$2 million in net gains were recorded for the three and nine months ended September 30, 2012, respectively. The reserve adjustments were based on discounted cash flows utilizing market rates and were classified as Level 3 in the hierarchy. There were no nonrecurring fair value reserve adjustments for the three and nine months ended September 30, 2013.

For real estate and property and equipment related investments, no impairments were recorded for the three months ended September 30, 2013. Impairments of \$20 million were recorded for the three months ended September 30, 2012. There were \$0 million and \$91 million of impairments recorded for the nine months ended September 30, 2013 and 2012, respectively, for real estate and property and equipment related investments classified as Level 3 in the valuation hierarchy. These impairments were based primarily on appraised value. For certain cost method investments, impairments of \$6 million and \$1 million were recorded for the three months ended September 30, 2013 and 2012, respectively, and \$15 million and \$3 million for the nine months ended September 30, 2013 and 2012, respectively. The methodologies utilized were primarily discounted estimated future cash flows and, where appropriate, valuations provided by the general partners taking into consideration deal and management fee expenses. These cost method investments are classified as Level 3 in the valuation hierarchy. For mortgage servicing rights, impairment recoveries which resulted in a gain of \$6 million and \$5 million were recorded for the three months and nine months ended September 30, 2013. Similarly an impairment of \$5 million and \$12 million were recorded for the three months and nine months ended 2012, for mortgage servicing rights. Mortgage servicing rights are valued based on internal models and classified as Level 3 in the



hierarchy.

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

There were no impairments related to intangible assets for the three and nine months ended September 30, 2013. An impairment of \$29 million was recorded for the three and nine months ended September 30, 2012 related to the write-off of an intangible asset resulting from an acquired business. The method utilized was primarily discounted cash flows based on assumptions and inputs specific to the Company, and are therefore classified as Level 3 in the hierarchy.

**Fair Value Option** The following table presents information regarding changes in fair values recorded in earnings for commercial mortgage loans, other long-term investments and notes issued by consolidated variable interest entities where the fair value option has been elected.

|  | Three Months Ended<br>September 30, |       | Nine Months Ended<br>September 30, |        |
|--|-------------------------------------|-------|------------------------------------|--------|
|  | 2013                                | 2012  | 2013                               | 2012   |
|  | (in millions)                       |       |                                    |        |
| <b>Assets:</b>   |                                     |       |                                    |        |
| Commercial mortgage loans:                               |                                     |       |                                    |        |
| Changes in instrument-specific credit risk               | \$ 0                                | \$ 0  | \$ 0                               | \$ (1) |
| Other changes in fair value                              | \$ 1                                | \$ 0  | \$ 3                               | \$ 0   |
| Other long-term investments:                             |                                     |       |                                    |        |
| Changes in fair value                                    | \$ 8                                | \$ 18 | \$ 39                              | \$ 30  |
| <b>Liabilities:</b>                                      |                                     |       |                                    |        |
| Notes issued by consolidated variable interest entities: |                                     |       |                                    |        |
| Changes in fair value                                    | \$ (30)                             | \$ 2  | \$ (32)                            | \$ (1) |

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

Interest income on commercial mortgage loans is included in net investment income. The Company recorded \$4 million for both the three months ended September 30, 2013 and 2012, respectively, and \$9 million for both the nine months ended September 30, 2013 and 2012, respectively, of interest income on fair value option loans. Interest income on these loans is recorded based on the effective interest rates as determined at the closing of the loan.

The fair values and aggregate contractual principal amounts of commercial mortgage loans, for which the fair value option has been elected, were \$117 million and \$109 million, respectively, as of September 30, 2013, and \$162 million and \$156 million, respectively, as of December 31, 2012. As of September 30, 2013, there were no loans in nonaccrual status and none of the loans are more than 90 days past due and still accruing.

The fair value of other long-term investments was \$508 million as of September 30, 2013 and \$465 million as of December 31, 2012.

The fair value and aggregate contractual principal amounts of limited recourse notes issued by consolidated variable interest entities, for which the fair value option has been elected, were \$2,330 million and \$2,364 million, respectively, as of September 30, 2013, and \$1,406 million and \$1,422 million, respectively as of December 31, 2012. Interest expense recorded for these liabilities was \$29 million and \$69 million, respectively, for the three and nine months ended September 30, 2013, respectively.

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

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

|  | September 30, 2013 |                   |                  |                   | Carrying<br>Amount(1)<br>Total | December 31, 2012      |                             |
|--|--------------------|-------------------|------------------|-------------------|--------------------------------|------------------------|-----------------------------|
|  | Level 1            | Fair Value        |                  | Total             |                                | Fair<br>Value<br>Total | Carrying<br>Amount<br>Total |
|  |                    | Level 2           | Level 3          | (in millions)     |                                |                        |                             |
| <b>Assets:</b>   |                    |                   |                  |                   |                                |                        |                             |
| Fixed maturities, held-to-maturity                       | \$ 0               | \$ 2,256          | \$ 1,616         | \$ 3,872          | \$ 3,629                       | \$ 4,511               | \$ 4,268                    |
| Commercial mortgage and other loans                      | 0                  | 626               | 40,375           | 41,001            | 39,385                         | 39,554                 | 36,570                      |
| Policy loans   | 0                  | 0                 | 14,219           | 14,219            | 11,863                         | 14,592                 | 11,575                      |
| Short-term investments                                   | 0                  | 553               | 0                | 553               | 553                            | 57                     | 57                          |
| Cash and cash equivalents                                | 4,431              | 2,077             | 0                | 6,508             | 6,508                          | 4,500                  | 4,500                       |
| Accrued investment income                                | 0                  | 3,157             | 0                | 3,157             | 3,157                          | 3,127                  | 3,127                       |
| Other assets   | 59                 | 2,252             | 322              | 2,633             | 2,633                          | 2,601                  | 2,601                       |
| <b>Total assets</b>                                      | <b>\$ 4,490</b>    | <b>\$ 10,921</b>  | <b>\$ 56,532</b> | <b>\$ 71,943</b>  | <b>\$ 67,728</b>               | <b>\$ 68,942</b>       | <b>\$ 62,698</b>            |
| <b>Liabilities:</b>                                      |                    |                   |                  |                   |                                |                        |                             |
| Policyholders' account balances<br>-investment contracts | \$ 0               | \$ 39,648         | \$ 58,177        | \$ 97,825         | \$ 96,360                      | \$ 104,200             | \$ 101,232                  |
| Securities sold under agreements to repurchase           | 0                  | 7,158             | 0                | 7,158             | 7,158                          | 5,818                  | 5,818                       |
| Cash collateral for loaned securities                    | 0                  | 5,955             | 0                | 5,955             | 5,955                          | 3,941                  | 3,941                       |
| Short-term debt  | 0                  | 3,181             | 0                | 3,181             | 3,118                          | 2,506                  | 2,484                       |
| Long-term debt   | 1,106              | 19,469            | 4,943            | 25,518            | 23,642                         | 27,497                 | 24,729                      |
| Notes of consolidated VIEs                               | 0                  | 0                 | 80               | 80                | 93                             | 149                    | 171                         |
| Other liabilities  | 0                  | 5,554             | 337              | 5,891             | 5,891                          | 6,356                  | 6,356                       |
| Separate account liabilities -investment contracts       | 0                  | 81,028            | 22,052           | 103,080           | 103,080                        | 96,561                 | 96,561                      |
| <b>Total liabilities</b>                                 | <b>\$ 1,106</b>    | <b>\$ 161,993</b> | <b>\$ 85,589</b> | <b>\$ 248,688</b> | <b>\$ 245,297</b>              | <b>\$ 247,028</b>      | <b>\$ 241,292</b>           |

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

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

*Fixed Maturities, Held-to-Maturity*

The fair values of public fixed maturity securities are generally based on prices from third-party pricing services, which are reviewed to validate reasonableness. However, for certain public fixed maturity securities and investments in private placement fixed maturity securities; this information is either not available or not reliable. For these public fixed maturity securities, the fair value is based on indicative broker quotes, if available, or determined using a discounted cash flow model or internally-developed values. For private fixed maturities, fair

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

value is determined using a discounted cash flow model. In determining the fair value of certain fixed maturity securities, the discounted cash flow model may also use unobservable inputs, which reflect the Company's own assumptions about the inputs market participants would use in pricing the security.

***Commercial Mortgage and Other Loans***

The fair value of most commercial mortgage loans is based upon the present value of the expected future cash flows discounted at the appropriate U.S. Treasury rate or foreign government bond rate (for non-U.S. dollar-denominated loans) plus an appropriate credit spread for similar quality loans. The quality ratings for these loans, a primary determinant of the credit spreads and a significant component of the pricing process, are based on an internally-developed methodology.

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

***Policy Loans***

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

***Short-Term Investments, Cash and Cash Equivalents, Accrued Investment Income and Other Assets***

The Company believes that due to the short-term nature of certain assets, the carrying value approximates fair value. These assets include: certain short-term investments which are not securities, are recorded at amortized cost and include quality loans; cash and cash equivalent instruments; accrued investment income; and other assets that meet the definition of financial instruments, including receivables, such as reinsurance recoverables, unsettled trades, accounts receivable and restricted cash.

*Policyholders Account Balances Investment Contracts*

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

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

amount estimated to be payable to the customer as of the reporting date, which is generally the carrying value. For defined contribution and defined benefit contracts and certain other products, the fair value is the market value of the assets supporting the liabilities.

***Securities Sold Under Agreements to Repurchase***

The Company receives collateral for selling securities under agreements to repurchase, or pledges collateral under agreements to resell. Repurchase and resale agreements are also generally short-term in nature, and therefore, the carrying amounts of these instruments approximate fair value.

***Cash Collateral for Loaned Securities***

Cash collateral for loaned securities represents the collateral received or paid in connection with loaning or borrowing securities, similar to the securities sold under agreement to repurchase above. For these transactions, the carrying value of the related asset or liability approximates fair value, as they equal the amount of cash collateral received/paid.

***Debt***

The fair value of short-term and long-term debt, as well as notes issued by consolidated VIEs, is generally determined by either prices obtained from independent pricing services, which are validated by the Company, or discounted cash flow models. With the exception of the notes issued by consolidated VIEs for which recourse is limited to the assets of the respective VIE and does not extend to the general credit of the Company, the fair values of these instruments consider the Company's own non-performance risk. Discounted cash flow models predominately use market observable inputs such as the borrowing rates currently available to the Company for debt and financial instruments with similar terms and remaining maturities. For commercial paper issuances and other debt with a maturity of less than 90 days, the carrying value approximates fair value.

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

***Other Liabilities***



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

*Separate Account Liabilities Investment Contracts*

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

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

**14. DERIVATIVE INSTRUMENTS**

*Types of Derivative Instruments and Derivative Strategies*

*Interest Rate Contracts*

Interest rate swaps, options, and futures are used by the Company to reduce risks from changes in interest rates, manage interest rate exposures arising from mismatches between assets and liabilities (including duration mismatches) and to hedge against changes in the value of assets it owns or anticipates acquiring or selling.

Swaps may be attributed to specific assets or liabilities or may be used on a portfolio basis. Under interest rate swaps, the Company agrees with other parties to exchange, at specified intervals, the difference between fixed-rate and floating-rate interest amounts calculated by reference to an agreed upon notional principal amount.

The Company also uses swaptions, interest rate caps, and interest rate floors to manage interest rate risk. A swaption is an option to enter into a swap with a forward starting effective date. The Company pays a premium for purchased swaptions and receives a premium for written swaptions. In an interest rate cap, the buyer receives payments at the end of each period in which the interest rate exceeds the agreed strike price. Similarly, in an interest rate floor, the buyer receives payments at the end of each period in which the interest rate is below the agreed strike price. Swaptions and interest rate caps and floors are included in interest rate options.

In exchange-traded interest rate futures transactions, the Company purchases or sells a specified number of contracts, the values of which are determined by the values of underlying referenced investments, and posts variation margins on a daily basis in an amount equal to the difference in the daily market values of those contracts. The Company enters into exchange-traded futures with regulated futures commission s merchants who are members of a trading exchange.

*Equity Contracts*

Equity index options are contracts which will settle in cash based on differentials in the underlying indices at the time of exercise and the strike price. The Company uses combinations of purchases and sales of equity index options to hedge the effects of adverse changes in equity indices within a predetermined range.

*Foreign Exchange Contracts*

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

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

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

Under currency swaps, the Company agrees with other parties to exchange, at specified intervals, the difference between one currency and another at an exchange rate and calculated by reference to an agreed principal amount. Generally, the principal amount of each currency is exchanged at the beginning and termination of the currency swap by each party.

***Credit Contracts***

The Company writes credit default swaps for which it receives a premium to insure credit risk. These are used by the Company to enhance the return on the Company's investment portfolio by creating credit exposure similar to an investment in public fixed maturity cash instruments. With these derivatives, the Company sells credit protection on an identified name, or an index of names, and in return receives a quarterly premium. This premium or credit spread generally corresponds to the difference between the yield on the referenced name's (or index reference names') public fixed maturity cash instruments and swap rates, at the time the agreement is executed. If there is an event of default by the referenced name or one of the referenced names in the index, as defined by the agreement, then the Company is obligated to pay the referenced amount of the contract to the counterparty and receive in return the referenced defaulted security or similar security or (in the case of a credit default index) pay the referenced amount less the auction recovery rate. See credit derivatives written section for further discussion of guarantees. In addition to selling credit protection the Company has purchased credit protection using credit derivatives in order to hedge specific credit exposures in the Company's investment portfolio.

***Other Contracts***

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

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

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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

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

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

**Synthetic Guarantees.** The Company sells synthetic guaranteed investment contracts, through both full service and investment-only sales channels, to qualified pension plans. The assets are owned by the trustees of such plans, who invest the assets according to the contract terms agreed to with the Company. The contracts contain a guarantee of a minimum rate of return on participant balances supported by the underlying assets, and a guarantee of liquidity to meet certain participant-initiated withdrawals from the contract. Under U.S. GAAP, these contracts are accounted for as derivatives and recorded at fair value.

The table below provides a summary of the gross notional amount and fair value of derivatives contracts used in a non-broker-dealer capacity by the primary underlying, excluding embedded derivatives which are recorded with the associated host. Many derivative instruments contain multiple underlyings. The fair value amounts below represent the gross fair value of derivative contracts prior to taking into account the netting effects of master netting agreements and cash collateral held with the same counterparty. This netting impact results in total derivative assets of \$1,461 million and \$3,075 million as of September 30, 2013 and December 31, 2012, respectively, and total derivative liabilities of \$1,107 million and \$307 million as of September 30, 2013 and December 31, 2012, respectively, reflected in the Unaudited Interim Consolidated Statement of Financial Position.

| Primary Underlying/ Instrument Type                            | September 30, 2013 |                  |                 | December 31, 2012 |                  |                 |
|--|--------------------|------------------|-----------------|-------------------|------------------|-----------------|
|  | Notional           | Gross Fair Value |                 | Notional          | Gross Fair Value |                 |
|  |                    | Assets           | Liabilities     |                   | Assets           | Liabilities     |
|  | (in millions)      |                  |                 |                   |                  |                 |
| <b>Derivatives Designated as Hedge Accounting Instruments:</b> |                    |                  |                 |                   |                  |                 |
| <b>Interest Rate</b>   |                    |                  |                 |                   |                  |                 |
| Interest Rate Swaps  | \$ 2,475           | \$ 9             | \$ (265)        | \$ 3,374          | \$ 26            | \$ (396)        |
| <b>Foreign Currency</b>  |                    |                  |                 |                   |                  |                 |
| Foreign Currency Forwards                                      | 579                | 6                | (60)            | 639               | 1                | (35)            |
| <b>Currency/Interest Rate</b>                                  |                    |                  |                 |                   |                  |                 |
| Foreign Currency Swaps   | 7,879              | 132              | (389)           | 6,373             | 128              | (342)           |
| <b>Total Qualifying Derivatives</b>                            | <b>\$ 10,933</b>   | <b>\$ 147</b>    | <b>\$ (714)</b> | <b>\$ 10,386</b>  | <b>\$ 155</b>    | <b>\$ (773)</b> |

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

| Primary Underlying/ Instrument Type                                | September 30, 2013 |                  |                   | December 31, 2012 |                  |                   |
|--|--------------------|------------------|-------------------|-------------------|------------------|-------------------|
|  | Notional           | Gross Fair Value |                   | Notional          | Gross Fair Value |                   |
|  |                    | Assets           | Liabilities       |                   | Assets           | Liabilities       |
|  | (in millions)      |                  |                   |                   |                  |                   |
| <b>Derivatives Not Qualifying as Hedge Accounting Instruments:</b> |                    |                  |                   |                   |                  |                   |
| <b>Interest Rate</b>   |                    |                  |                   |                   |                  |                   |
| Interest Rate Swaps  | \$ 112,333         | \$ 4,565         | \$ (4,490)        | \$ 108,581        | \$ 7,779         | \$ (3,301)        |
| Interest Rate Futures  | 6,116              | 3                | (1)               | 6,749             | 11               | (12)              |
| Interest Rate Options  | 25,181             | 480              | (245)             | 25,250            | 895              | (141)             |
| Interest Rate Forwards   | 1,304              | 9                | 0                 | 660               | 0                | 0                 |
| <b>Foreign Currency</b>  |                    |                  |                   |                   |                  |                   |
| Foreign Currency Forwards  | 13,925             | 497              | (129)             | 14,638            | 371              | (397)             |
| Foreign Currency Options   | 77                 | 8                | 0                 | 92                | 13               | 0                 |
| <b>Currency/Interest Rate</b>                                      |                    |                  |                   |                   |                  |                   |
| Foreign Currency Swaps   | 6,609              | 270              | (211)             | 5,304             | 239              | (152)             |
| <b>Credit</b>  |                    |                  |                   |                   |                  |                   |
| Credit Default Swaps   | 1,992              | 6                | (65)              | 3,250             | 19               | (84)              |
| <b>Equity</b>  |                    |                  |                   |                   |                  |                   |
| Equity Futures   | 601                | 3                | 0                 | 6,518             | 0                | (165)             |
| Equity Options   | 51,600             | 492              | (25)              | 42,757            | 603              | (40)              |
| Total Return Swaps   | 10,760             | 81               | (181)             | 5,779             | 8                | (158)             |
| <b>Synthetic GICs</b>  | 71,417             | 7                | 0                 | 64,359            | 6                | 0                 |
| <b>Total Non-Qualifying Derivatives(1)</b>                         | <b>\$ 301,915</b>  | <b>\$ 6,421</b>  | <b>\$ (5,347)</b> | <b>\$ 283,937</b> | <b>\$ 9,944</b>  | <b>\$ (4,450)</b> |
| <b>Total Derivatives(2)</b>  | <b>\$ 312,848</b>  | <b>\$ 6,568</b>  | <b>\$ (6,061)</b> | <b>\$ 294,323</b> | <b>\$ 10,099</b> | <b>\$ (5,223)</b> |

- (1) Based on notional amounts, most of the Company's derivatives do not qualify for hedge accounting as follows: i) derivatives that economically hedge embedded derivatives do not qualify for hedge accounting because changes in the fair value of the embedded derivatives are already recorded in net income, ii) derivatives that are utilized as macro hedges of the Company's exposure to various risks typically do not qualify for hedge accounting because they do not meet the criteria required under portfolio hedge accounting rules, and iii) synthetic guaranteed investment contracts (GICs), which are product standalone derivatives do not qualify as hedging instruments under hedge accounting rules.
- (2) Excludes embedded derivatives which contain multiple underlyings. The fair value of these embedded derivatives was a net liability of \$2,030 million as of September 30, 2013 and a net liability of \$3,438 million as of December 31, 2012, included in Future policy benefits and Fixed maturities, available-for-sale.

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

The following table presents recognized derivative instruments (including bifurcated embedded derivatives), and repurchase and reverse repurchase agreements that are offset in the balance sheet, and/or are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in the balance sheet.

|  | September 30, 2013   |   |  |   |               |
|--|--|---|--|---|---------------|
|  | Gross<br>Amounts<br>of<br>Recognized<br>Financial<br>Instruments | Gross<br>Amounts<br>Offset in the<br>Statement<br>of<br>Financial<br>Position | Net<br>Amounts<br>Presented in<br>the Statement<br>of Financial<br>Position<br>(in millions) | Financial<br>Instruments/<br>Collateral | Net<br>Amount |
| <b>Offsetting of Financial Assets:</b>         |  |   |  |   |               |
| Derivatives                                    | \$ 8,671   | \$ (7,242)  | \$ 1,429   | \$ (1,238)                              | \$ 191        |
| Securities purchased under agreement to resell | 750  | 0   | 750  | (750)                                   | 0             |
| Total Assets                                   | \$ 9,421   | \$ (7,242)  | \$ 2,179   | \$ (1,988)                              | \$ 191        |
| <b>Offsetting of Financial Liabilities:</b>    |  |   |  |   |               |
| Derivatives                                    | \$ 8,288   | \$ (7,187)  | \$ 1,101   | \$ (1,251)                              | \$ (150)      |
| Securities sold under agreement to repurchase  | 7,158  | 0   | 7,158  | (7,158)                                 | 0             |
| Total Liabilities                              | \$ 15,446  | \$ (7,187)  | \$ 8,259   | \$ (8,409)                              | \$ (150)      |

|  | December 31, 2012  |  |  |   |               |
|--|--|--|--|---|---------------|
|  | Gross<br>Amounts<br>of<br>Recognized<br>Financial<br>Instruments | Gross<br>Amounts<br>Offset in the<br>Statement<br>of Financial<br>Position | Net<br>Amounts<br>Presented in<br>the Statement<br>of Financial<br>Position<br>(in millions) | Financial<br>Instruments/<br>Collateral | Net<br>Amount |
| <b>Offsetting of Financial Assets:</b>         |  |  |  |   |               |
| Derivatives                                    | \$ 13,167  | \$ (10,117)  | \$ 3,050   | \$ (2,891)                              | \$ 159        |
| Securities purchased under agreement to resell | 990  | 0  | 990  | (990)                                   | 0             |
| Total Assets                                   | \$ 14,157  | \$ (10,117)  | \$ 4,040   | \$ (3,881)                              | \$ 159        |
| <b>Offsetting of Financial Liabilities:</b>    |  |  |  |   |               |



## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|   |           |            |          |            |        |
|---|-----------|------------|----------|------------|--------|
| Derivatives                                   | \$ 8,329  | \$ (8,031) | \$ 298   | \$ (63)    | \$ 235 |
| Securities sold under agreement to repurchase | 5,818     | 0          | 5,818    | (5,818)    | 0      |
| Total Liabilities                             | \$ 14,147 | \$ (8,031) | \$ 6,116 | \$ (5,881) | \$ 235 |

For information regarding the rights of offset associated with the derivative assets and liabilities in the table above see [Credit Risk](#) below. For securities purchased under agreements to resell and securities sold under agreements to repurchase, the Company monitors the value of the securities and maintains collateral, as appropriate, to protect against credit exposure. Where the Company has entered into repurchase and resale agreements with the same counterparty, in the event of default, the Company would generally be permitted to exercise rights of offset. For additional information on the Company's accounting policy for securities repurchase and resale agreements, see Note 2 to the Company's Consolidated Financial Statements included in its 2012 Annual Report on Form 10-K.

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

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

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

**Three Months Ended September 30, 2013**

|  | <b>Realized<br/>Investment<br/>Gains/<br/>(Losses)</b> | <b>Net<br/>Investment<br/>Income</b> | <b>Other<br/>Income</b> | <b>Interest<br/>Expense</b> | <b>Interest<br/>Credited<br/>To<br/>Policyholders<br/>Account<br/>Balances</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Income(1)</b> |
|--|--|--------------------------------------|-------------------------|-----------------------------|--|--|
|  | (in millions)  |                                      |                         |                             |  |  |
| <b>Derivatives Designated as Hedge Accounting Instruments:</b>     |  |                                      |                         |                             |  |  |
| <b>Fair value hedges</b>   |  |                                      |                         |                             |  |  |
| Interest Rate  | \$ 8   | \$ (17)                              | \$ 0                    | \$ 0                        | \$ 6   | \$ 0   |
| Currency   | (6)  | 0                                    | 0                       | 0                           | 0  | 0  |
| <b>Total fair value hedges</b>                                     | <b>2</b>   | <b>(17)</b>                          | <b>0</b>                | <b>0</b>                    | <b>6</b>   | <b>0</b>   |
| <b>Cash flow hedges</b>  |  |                                      |                         |                             |  |  |
| Interest Rate  | 0  | 0                                    | 0                       | (6)                         | 0  | 3  |
| Currency/Interest Rate   | 0  | 1                                    | (24)                    | 0                           | 0  | (260)  |
| <b>Total cash flow hedges</b>                                      | <b>0</b>   | <b>1</b>                             | <b>(24)</b>             | <b>(6)</b>                  | <b>0</b>   | <b>(257)</b>   |
| <b>Net investment hedges</b>                                       |  |                                      |                         |                             |  |  |
| Currency(2)  | 0  | 0                                    | (4)                     | 0                           | 0  | 0  |
| Currency/Interest Rate   | 0  | 0                                    | 0                       | 0                           | 0  | (3)  |
| <b>Total net investment hedges</b>                                 | <b>0</b>   | <b>0</b>                             | <b>(4)</b>              | <b>0</b>                    | <b>0</b>   | <b>(3)</b>   |
| <b>Derivatives Not Qualifying as Hedge Accounting Instruments:</b> |  |                                      |                         |                             |  |  |
| Interest Rate  | (540)  | 0                                    | 0                       | 0                           | 0  | 0  |
| Currency   | 62   | 0                                    | 0                       | 0                           | 0  | 0  |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|                                    |                   |                |                |               |             |                 |
|------------------------------------|-------------------|----------------|----------------|---------------|-------------|-----------------|
| Currency/Interest Rate             | (215)             | 0              | (2)            | 0             | 0           | 0               |
| Credit                             | (1)               | 0              | 0              | 0             | 0           | 0               |
| Equity                             | (706)             | 0              | 0              | 0             | 0           | 0               |
| Embedded Derivatives               | (1,322)           | 0              | 0              | 0             | 0           | 0               |
| <b>Total non-qualifying hedges</b> | <b>(2,722)</b>    | <b>0</b>       | <b>(2)</b>     | <b>0</b>      | <b>0</b>    | <b>0</b>        |
| <b>Total</b>                       | <b>\$ (2,720)</b> | <b>\$ (16)</b> | <b>\$ (30)</b> | <b>\$ (6)</b> | <b>\$ 6</b> | <b>\$ (260)</b> |

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

Nine Months Ended September 30, 2013

|  | Realized<br>Investment<br>Gains/<br>(Losses) | Net<br>Investment<br>Income | Other<br>Income | Interest<br>Expense<br><br>(in millions) | Interest<br>Credited<br>To<br>Policyholders<br>Account<br>Balances | Accumulated<br>Other<br>Comprehensive<br>Income(1) |
|--|--|-----------------------------|-----------------|--|--|--|
| <b>Derivatives Designated as Hedge</b>     |  |                             |                 |  |  |  |
| <b>Accounting Instruments:</b>             |  |                             |                 |  |  |  |
| <b>Fair value hedges</b>                   |  |                             |                 |  |  |  |
| Interest Rate                              | \$ 80  | \$ (56)                     | \$ 0            | \$ 0                                     | \$ 17  | \$ 0   |
| Currency                                   | (54)   | 0                           | 0               | 0  | 0  | 0  |
| Total fair value hedges                    | 26   | (56)                        | 0               | 0  | 17   | 0  |
| <b>Cash flow hedges</b>                    |  |                             |                 |  |  |  |
| Interest Rate                              | 0  | 0                           | 0               | (17)                                     | 0  | 20   |
| Currency/Interest Rate                     | 0  | 0                           | (60)            | 0  | 0  | (118)  |
| Total cash flow hedges                     | 0  | 0                           | (60)            | (17)                                     | 0  | (98)   |
| <b>Net investment hedges</b>               |  |                             |                 |  |  |  |
| Currency(2)                                | 0  | 0                           | (4)             | 0  | 0  | 7  |
| Currency/Interest Rate                     | 0  | 0                           | 0               | 0  | 0  | 154  |
| Total net investment hedges                | 0  | 0                           | (4)             | 0  | 0  | 161  |
| <b>Derivatives Not Qualifying as Hedge</b> |  |                             |                 |  |  |  |
| <b>Accounting Instruments:</b>             |  |                             |                 |  |  |  |
| Interest Rate                              | (4,071)                                      | 0                           | 0               | 0  | 0  | 0  |
| Currency                                   | (513)  | 0                           | 0               | 0  | 0  | 0  |
| Currency/Interest Rate                     | 84   | 0                           | 0               | 0  | 0  | 0  |
| Credit                                     | (11)   | 0                           | 0               | 0  | 0  | 0  |
| Equity                                     | (2,515)                                      | 0                           | 0               | 0  | 0  | 0  |
| Embedded Derivatives                       | 2,025  | 0                           | 0               | 0  | 0  | 0  |
| Total non-qualifying hedges                | (5,001)                                      | 0                           | 0               | 0  | 0  | 0  |
| <b>Total</b>                               | <b>\$ (4,975)</b>                            | <b>\$ (56)</b>              | <b>\$ (64)</b>  | <b>\$ (17)</b>                           | <b>\$ 17</b>   | <b>\$ 63</b>                                       |

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

Three Months Ended September 30, 2012

|  | Realized<br>Investment<br>Gains/<br>(Losses) | Net<br>Investment<br>Income | Other<br>Income | Interest<br>Expense | Interest<br>Credited<br>To<br>Policyholders<br>Account<br>Balances | Accumulated<br>Other<br>Comprehensive<br>Income(1) |
|--|--|-----------------------------|-----------------|---------------------|--|--|
|  | (in millions)                                |                             |                 |                     |  |  |
| <b>Derivatives Designated as Hedge</b>     |  |                             |                 |                     |  |  |
| <b>Accounting Instruments:</b>             |  |                             |                 |                     |  |  |
| <b>Fair value hedges</b>                   |  |                             |                 |                     |  |  |
| Interest Rate                              | \$ 6   | \$ (23)                     | \$ 0            | \$ 1                | \$ 5   | \$ 0   |
| Currency                                   | 0  | (1)                         | 0               | 0                   | 0  | 0  |
| <b>Total fair value hedges</b>             | <b>6</b>                                     | <b>(24)</b>                 | <b>0</b>        | <b>1</b>            | <b>5</b>   | <b>0</b>   |
| <b>Cash flow hedges</b>                    |  |                             |                 |                     |  |  |
| Interest Rate                              | 0  | 0                           | 0               | (5)                 | 0  | 2  |
| Currency/Interest Rate                     | 0  | (1)                         | (3)             | 0                   | 0  | (119)  |
| <b>Total cash flow hedges</b>              | <b>0</b>                                     | <b>(1)</b>                  | <b>(3)</b>      | <b>(5)</b>          | <b>0</b>   | <b>(117)</b>                                       |
| <b>Net investment hedges</b>               |  |                             |                 |                     |  |  |
| Currency(2)                                | 0  | 0                           | 0               | 0                   | 0  | (6)  |
| Currency/Interest Rate                     | 0  | 0                           | 0               | 0                   | 0  | (10)   |
| <b>Total net investment hedges</b>         | <b>0</b>                                     | <b>0</b>                    | <b>0</b>        | <b>0</b>            | <b>0</b>   | <b>(16)</b>  |
| <b>Derivatives Not Qualifying as Hedge</b> |  |                             |                 |                     |  |  |
| <b>Accounting Instruments:</b>             |  |                             |                 |                     |  |  |
| Interest Rate                              | 86   | 0                           | 0               | 0                   | 0  | 0  |
| Currency                                   | (119)  | 0                           | 0               | 0                   | 0  | 0  |
| Currency/Interest Rate                     | (19)   | 0                           | 0               | 0                   | 0  | 0  |
| Credit                                     | (8)  | 0                           | 0               | 0                   | 0  | 0  |
| Equity                                     | (983)  | 0                           | 0               | 0                   | 0  | 0  |
| Embedded Derivatives                       | (418)  | 0                           | 0               | 0                   | 0  | 0  |
| <b>Total non-qualifying hedges</b>         | <b>(1,461)</b>                               | <b>0</b>                    | <b>0</b>        | <b>0</b>            | <b>0</b>   | <b>0</b>   |
| <b>Total</b>                               | <b>\$ (1,455)</b>                            | <b>\$ (25)</b>              | <b>\$ (3)</b>   | <b>\$ (4)</b>       | <b>\$ 5</b>  | <b>\$ (133)</b>                                    |

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

Nine Months Ended September 30, 2012

|  | Realized<br>Investment<br>Gains/<br>(Losses) | Net<br>Investment<br>Income | Other<br>Income | Interest<br>Expense | Interest<br>Credited<br>To<br>Policyholders<br>Account<br>Balances | Accumulated<br>Other<br>Comprehensive<br>Income(1) |
|--|--|-----------------------------|-----------------|---------------------|--|--|
|  | (in millions)                                |                             |                 |                     |  |  |
| <b>Derivatives Designated as Hedge Accounting Instruments:</b>     |  |                             |                 |                     |  |  |
| <b>Fair value hedges</b>   |  |                             |                 |                     |  |  |
| Interest Rate  | \$ (6)                                       | \$ (71)                     | \$ 0            | \$ 4                | \$ 26  | \$ 0   |
| Currency   | 2  | (3)                         | 0               | 0                   | 0  | 0  |
| Total fair value hedges  | (4)  | (74)                        | 0               | 4                   | 26   | 0  |
| <b>Cash flow hedges</b>  |  |                             |                 |                     |  |  |
| Interest Rate  | 0  | 0                           | 0               | (14)                | 0  | 8  |
| Currency/Interest Rate   | 0  | (4)                         | (5)             | 0                   | 0  | (47)   |
| Total cash flow hedges   | 0  | (4)                         | (5)             | (14)                | 0  | (39)   |
| <b>Net investment hedges</b>                                       |  |                             |                 |                     |  |  |
| Currency(2)  | 0  | 0                           | 0               | 0                   | 0  | (8)  |
| Currency/Interest Rate   | 0  | 0                           | 0               | 0                   | 0  | 78   |
| Total net investment hedges  | 0  | 0                           | 0               | 0                   | 0  | 70   |
| <b>Derivatives Not Qualifying as Hedge Accounting Instruments:</b> |  |                             |                 |                     |  |  |
| Interest Rate  | 1,303  | 0                           | 0               | 0                   | 0  | 0  |
| Currency   | (46)   | 0                           | 0               | 0                   | 0  | 0  |
| Currency/Interest Rate   | 97   | 0                           | 1               | 0                   | 0  | 0  |
| Credit   | (36)   | 0                           | 0               | 0                   | 0  | 0  |
| Equity   | (1,983)                                      | 0                           | 0               | 0                   | 0  | 0  |
| Embedded Derivatives   | (241)  | 0                           | 0               | 0                   | 0  | 0  |
| Total non-qualifying hedges  | (906)  | 0                           | 1               | 0                   | 0  | 0  |
| <b>Total</b>   | <b>\$ (910)</b>                              | <b>\$ (78)</b>              | <b>\$ (4)</b>   | <b>\$ (10)</b>      | <b>\$ 26</b>   | <b>\$ 31</b>                                       |

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

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

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

For the three and nine months ended September 30, 2013, the ineffective portion of derivatives accounted for using hedge accounting was not material to the Company's results of operations and there were no material amounts reclassified into earnings relating to instances in which the Company discontinued cash flow hedge accounting because the forecasted transaction did not occur by the anticipated date or within the additional time period permitted by the authoritative guidance for the accounting for derivatives and hedging. In addition, there were no instances in which the Company discontinued fair value hedge accounting due to a hedged firm commitment no longer qualifying as a fair value hedge.

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

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

|  | (in millions) |
|--|---------------|
| Balance, December 31, 2012   | \$ (257)      |
| Net deferred gains/(losses) on cash flow hedges from January 1 to September 30, 2013 | (181)         |
| Amount reclassified into current period earnings                                     | 83            |
| Balance, September 30, 2013  | \$ (355)      |

Using September 30, 2013 values, it is anticipated that a pre-tax loss of approximately \$16 million will be reclassified from Accumulated other comprehensive income (loss) to earnings during the subsequent twelve months ending September 30, 2014, offset by amounts pertaining to the hedged items. As of September 30, 2013, the Company does not have any qualifying cash flow hedges of forecasted transactions other than those related to the variability of the payment or receipt of interest or foreign currency amounts on existing financial instruments. The maximum length of time for which these variable cash flows are hedged is 20 years. Income amounts deferred in Accumulated other comprehensive income (loss) as a result of cash flow hedges are included in Net unrealized investment gains (losses) in the Consolidated Statements of Equity.

For effective net investment hedges, the amounts, before applicable taxes, recorded in the cumulative translation adjustment account within Accumulated other comprehensive income (loss) was \$277 million and \$117 million as of September 30, 2013 and December 31, 2012.

**Credit Derivatives Written**

The following table sets forth the Company's exposure from credit derivatives where the Company has written credit protection, by NAIC rating of the underlying credits as of September 30, 2013 and December 31, 2012. The Company's maximum amount at risk under these credit derivatives listed below assumes the value of the underlying referenced securities become worthless. These credit derivatives have maturities of less than 3 years. The table excludes a credit derivative related to surplus notes issued by a subsidiary of Prudential Insurance and embedded derivatives contained in externally-managed investments in the European market.

| NAIC Designation | Single Name |            | September 30, 2013<br>Credit Default Index |            | Total    |            |
|------------------|-------------|------------|--|------------|----------|------------|
|                  | Notional    | Fair Value | Notional                                   | Fair Value | Notional | Fair Value |
|                  |             |            | (in millions)                              |            |          |            |
| 1                | \$ 0        | \$ 0       | \$ 0                                       | \$ 0       | \$ 0     | \$ 0       |
| 2                | 5           | 0          | 0  | 0          | 5        | 0          |
| Subtotal         | 5           | 0          | 0  | 0          | 5        | 0          |



Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|          |      |      |      |      |      |      |
|----------|------|------|------|------|------|------|
| 3        | 0    | 0    | 0    | 0    | 0    | 0    |
| 4        | 0    | 0    | 0    | 0    | 0    | 0    |
| 5        | 0    | 0    | 0    | 0    | 0    | 0    |
| 6        | 0    | 0    | 0    | 0    | 0    | 0    |
| Subtotal | 0    | 0    | 0    | 0    | 0    | 0    |
| Total    | \$ 5 | \$ 0 | \$ 0 | \$ 0 | \$ 5 | \$ 0 |

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

| NAIC Designation | Single Name |            | December 31, 2012<br>Credit Default Index |            | Total    |            |  |
|------------------|-------------|------------|---|------------|----------|------------|--|
|                  | Notional    | Fair Value | Notional                                  | Fair Value | Notional | Fair Value |  |
|                  |             |            | (in millions)                             |            |          |            |  |
| 1                | \$ 275      | \$ 0       | \$ 0                                      | \$ 0       | \$ 275   | \$ 0       |  |
| 2                | 45          | 0          | 0   | 0          | 45       | 0          |  |
| Subtotal         | 320         | 0          | 0   | 0          | 320      | 0          |  |
| 3                | 0           | 0          | 750                                       | 2          | 750      | 2          |  |
| 4                | 0           | 0          | 0   | 0          | 0        | 0          |  |
| 5                | 0           | 0          | 0   | 0          | 0        | 0          |  |
| 6                | 0           | 0          | 0   | 0          | 0        | 0          |  |
| Subtotal         | 0           | 0          | 750                                       | 2          | 750      | 2          |  |
| Total            | \$ 320      | \$ 0       | \$ 750                                    | \$ 2       | \$ 1,070 | \$ 2       |  |

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

| Industry                 | September 30, 2013 |            | December 31, 2012 |            |
|--------------------------|--------------------|------------|-------------------|------------|
|                          | Notional           | Fair Value | Notional          | Fair Value |
|                          | (in millions)      |            |                   |            |
| Corporate Securities:    |                    |            |                   |            |
| Consumer Non-cyclical    | \$ 0               | \$ 0       | \$ 120            | \$ 0       |
| Capital Goods            | 0                  | 0          | 90                | 0          |
| Basic Industry           | 0                  | 0          | 40                | 0          |
| Transportation           | 0                  | 0          | 25                | 0          |
| Consumer Cyclical        | 0                  | 0          | 20                | 0          |
| Energy                   | 0                  | 0          | 20                | 0          |
| Communication            | 5                  | 0          | 5                 | 0          |
| Finance                  | 0                  | 0          | 0                 | 0          |
| Other(1)                 | 0                  | 0          | 750               | 2          |
| Total Credit Derivatives | \$ 5               | \$ 0       | \$ 1,070          | \$ 2       |

(1) Includes Credit Default Index derivative with various industry categories.

In addition to the above, the Company entered into a credit derivative that will require the Company to make certain payments in the event of deterioration in the value of the surplus notes issued by a subsidiary of Prudential Insurance. The notional amount of this credit derivative is \$500 million and the fair value as of September 30, 2013 and December 31, 2012 was a liability of \$22 million and \$32 million, respectively. No

collateral was pledged in either period.

In addition to writing credit protection, the Company has purchased credit protection using credit derivatives in order to hedge specific credit exposures in the Company's investment portfolio. As of September 30, 2013 and December 31, 2012, the Company had \$1,487 million and \$1,680 million of outstanding notional amounts, respectively, reported at fair value as a liability of \$37 million and \$35 million, respectively.

The Company holds certain externally-managed investments in the European market which contain embedded derivatives whose fair values are primarily driven by changes in credit spreads. These investments are

---

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

medium-term notes that are collateralized by investment portfolios primarily consisting of investment grade European fixed income securities, including corporate bonds and asset-backed securities, and derivatives, as well as varying degrees of leverage. The notes have a stated coupon and provide a return based on the performance of the underlying portfolios and the level of leverage. The Company invests in these notes to earn a coupon through maturity, consistent with its investment purpose for other debt securities. The notes are accounted for under U.S. GAAP as available-for-sale fixed maturity securities with bifurcated embedded derivatives (total return swaps). Changes in the value of the fixed maturity securities are reported in Equity under the heading Accumulated Other Comprehensive Income (Loss) and changes in the market value of the embedded total return swaps are included in current period earnings in Realized investment gains (losses), net. The Company's maximum exposure to loss from these investments was \$323 million and \$314 million at September 30, 2013 and December 31, 2012, respectively.

***Counterparty Credit Risk***

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

The credit exposure of the Company's OTC derivative transactions is represented by the contracts with a positive fair value (market value) at the reporting date. To reduce credit exposures, the Company seeks to (i) enter into OTC derivative transactions pursuant to master agreements that provide for a netting of payments and receipts with a single counterparty, and (ii) enter into agreements that allow the use of credit support annexes, which are bilateral rating-sensitive agreements that require collateral postings at established threshold levels. Cleared derivatives are bilateral transactions between the Company and a counterparty where the transactions are cleared through a clearinghouse, such that each derivative counterparty is only exposed to the default of the clearinghouse. These cleared transactions require initial and daily variation margin collateral postings and include certain interest rate swaps and credit default swaps entered into on or after June 10, 2013, related to new guidelines implemented under the Dodd-Frank Wall Street Reform and Consumer Protection Act. Also, the Company enters into exchange-traded futures and certain options transactions through regulated exchanges and these transactions are settled on a daily basis, thereby reducing credit risk exposure in the event of non-performance by counterparties to such financial instruments.

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

Certain of the Company's derivative agreements with some of its counterparties contain credit-rating related triggers. If the Company's credit rating were to fall below a certain level, the counterparties to the derivative instruments could request termination at the then fair value of the derivative or demand immediate full collateralization on derivative instruments in net liability positions. If a downgrade occurred and the derivative positions were terminated, the Company anticipates it would be able to replace the derivative positions with other counterparties in the normal course of business. The aggregate fair value of all derivative instruments with credit-risk-related contingent features that are in a net

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

liability position were \$323 million as of September 30, 2013. In the normal course of business the Company has posted collateral related to these instruments of \$330 million as

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

of September 30, 2013. If the credit-risk-related contingent features underlying these agreements had been triggered on September 30, 2013, the Company estimates that it would be required to post a maximum of \$8 million of additional collateral to its counterparties.

**15. COMMITMENTS AND GUARANTEES, CONTINGENT LIABILITIES AND LITIGATION AND REGULATORY MATTERS****Commitments and Guarantees***Commercial Mortgage Loan Commitments*

|   | September 30,<br>2013 | December 31,<br>2012 |
|---|-----------------------|----------------------|
|   | (in millions)         |                      |
| Total outstanding mortgage loan commitments                           | \$ 3,038              | \$ 2,552             |
| Portion of commitment where prearrangement to sell to investor exists | \$ 793                | \$ 897               |

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

*Commitments to Purchase Investments (excluding Commercial Mortgage Loans)*

|  | September 30,<br>2013 | December 31,<br>2012 |
|--|-----------------------|----------------------|
|  | (in millions)         |                      |
| Expected to be funded from the general account and other operations outside the separate accounts(1) | \$ 5,001              | \$ 3,410             |
| Expected to be funded from separate accounts   | \$ 749                | \$ 757               |
| Portion of separate account commitments with recourse to Prudential Insurance                        | \$ 0                  | \$ 7                 |

(1) Includes a remaining commitment of \$64 million and \$200 million at September 30, 2013 and December 31, 2012, respectively, related to the Company's agreement to co-invest with the Fosun Group (Fosun) in a private equity fund, managed by Fosun, for the Chinese marketplace.

The Company has other commitments to purchase or fund investments, some of which are contingent upon events or circumstances not under the Company's control, including those at the discretion of the Company's counterparties. The Company anticipates a portion of these

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

commitments will ultimately be funded from its separate accounts. Some of the separate account commitments have recourse to Prudential Insurance if the separate accounts are unable to fund the amounts when due.

### *Guarantees of Investee Debt*

|  | September 30,<br>2013 | December 31,<br>2012 |
|--|-----------------------|----------------------|
|  | (in millions)         |                      |
| Total guarantees of debt issued by entities in which the separate accounts have invested | \$ 2,533              | \$ 2,178             |
| Amount of above guarantee that is limited to separate account assets                     | \$ 2,533              | \$ 2,167             |
| Accrued liability associated with guarantee  | \$ 0                  | \$ 0                 |

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

A number of guarantees provided by the Company relate to real estate investments held in its separate accounts, in which entities that the separate account has invested in have borrowed funds, and the Company has guaranteed their obligations. The Company provides these guarantees to assist these entities in obtaining financing. The Company's maximum potential exposure under these guarantees is mostly limited to the assets of the separate account. The exposure that is not limited to the separate account assets relates mostly to guarantees limited to fraud, criminal activity or other bad acts. These guarantees generally expire at various times over the next twelve years. At September 30, 2013, the Company's assessment is that it is unlikely payments will be required. Any payments that may become required under these guarantees would either first be reduced by proceeds received by the creditor on a sale of the underlying collateral, or would provide rights to obtain the underlying collateral.

***Indemnification of Securities Lending Transactions***

|   | September 30,<br>2013 | December 31,<br>2012 |
|---|-----------------------|----------------------|
|   | (in millions)         |                      |
| Indemnification provided to mutual fund and separate account clients for securities lending | \$ 15,952             | \$ 15,454            |
| Fair value of related collateral associated with above indemnifications                     | \$ 16,405             | \$ 15,730            |
| Accrued liability associated with guarantee   | \$ 0                  | \$ 0                 |

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

***Credit Derivatives Written***

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

***Guarantees of Asset Values***



Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|  | September 30,<br>2013 | December 31,<br>2012 |
|--|-----------------------|----------------------|
|  | (in millions)         |                      |
| Guaranteed value of third parties' assets              | \$ 75,512             | \$ 64,424            |
| Fair value of collateral supporting these assets       | \$ 76,915             | \$ 67,555            |
| Asset associated with guarantee, carried at fair value | \$ 7                  | \$ 5                 |

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

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

|   | September 30,<br>2013 | December 31,<br>2012 |
|---|-----------------------|----------------------|
|   | (in millions)         |                      |
| Guarantees of credit enhancements of debt instruments associated with commercial real estate assets | \$ 166                | \$ 172               |
| Fair value of properties and associated tax credits that secure the guarantee                       | \$ 226                | \$ 215               |
| Accrued liability associated with guarantee   | \$ 0                  | \$ 0                 |

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

***Indemnification of Serviced Mortgage Loans***

|  | September 30,<br>2013 | December 31,<br>2012 |
|--|-----------------------|----------------------|
|  | (in millions)         |                      |
| Maximum exposure under indemnification agreements for mortgage loans serviced by the Company | \$ 1,205              | \$ 1,147             |
| First-loss exposure portion of above   | \$ 380                | \$ 369               |
| Accrued liability associated with guarantees   | \$ 17                 | \$ 19                |

As part of the commercial mortgage activities of the Company's Asset Management segment, the Company provides commercial mortgage origination, underwriting and servicing for certain government sponsored entities, such as Fannie Mae and Freddie Mac. The Company has agreed to indemnify the government sponsored entities for a portion of the credit risk associated with certain of the mortgages it services through a delegated authority arrangement. Under these arrangements, the Company originates multi-family mortgages for sale to the government sponsored entities based on underwriting standards they specify, and makes payments to them for a specified percentage share of losses they incur on certain loans serviced by the Company. The Company's percentage share of losses incurred generally varies from 2% to 20% of the loan balance, and is typically based on a first-loss exposure for a stated percentage of the loan balance, plus a shared exposure with the government sponsored entity for any losses in excess of the stated first-loss percentage, subject to a contractually specified maximum percentage. The Company services \$9,043 million of mortgages subject to these loss-sharing arrangements as of September 30, 2013, all of which are collateralized by first priority liens on the underlying multi-family residential properties. As of September 30, 2013, these mortgages had an average debt service coverage ratio of 1.80 times and an average loan-to-value ratio of 61%. The Company's total share of losses related to indemnifications that were settled was \$0.4 million and \$2.2 million, for the nine months ended September 30, 2013 and 2012, respectively.

***Contingent Consideration***

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|   | September 30,<br>2013 | December 31,<br>2012 |
|---|-----------------------|----------------------|
|   | (in millions)         |                      |
| Maximum potential contingent consideration associated with acquisitions | \$ 0                  | \$ 52                |

106

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

In connection with the Company's initial investment in an operating joint venture, the Company agreed to pay additional consideration in future periods, contingent upon the attainment of defined operating objectives. The arrangement was resolved in 2013 and no additional consideration is required as the joint venture did not attain the defined operating objectives.

***Other Guarantees***

|   | September 30,<br>2013 | December 31,<br>2012 |
|---|-----------------------|----------------------|
|   | (in millions)         |                      |
| Other guarantees where amount can be determined             | \$ 400                | \$ 530               |
| Accrued liability for other guarantees and indemnifications | \$ 8                  | \$ 8                 |

The Company is also subject to other financial guarantees and indemnity arrangements. The Company has provided indemnities and guarantees related to acquisitions, dispositions, investments and other transactions that are triggered by, among other things, breaches of representations, warranties or covenants provided by the Company. These obligations are typically subject to various time limitations, defined by the contract or by operation of law, such as statutes of limitation. In some cases, the maximum potential obligation is subject to contractual limitations, while in other cases such limitations are not specified or applicable. Included above are \$318 million and \$299 million as of September 30, 2013 and December 31, 2012, respectively, of yield maintenance guarantees related to certain investments the Company sold. The Company does not expect to make any payments on these guarantees and is not carrying any liabilities associated with these guarantees.

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

***Contingent Liabilities***

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

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

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

---

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

**Litigation and Regulatory Matters**

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

The Company establishes accruals for litigation and regulatory matters when it is probable that a loss has been incurred and the amount of that loss can be reasonably estimated. For litigation and regulatory matters where a loss may be reasonably possible, but not probable, or is probable but not reasonably estimable, no accrual is established but the matter, if material, is disclosed, including matters discussed below. The Company estimates that as of September 30, 2013, the aggregate range of reasonably possible losses in excess of accruals established for those litigation and regulatory matters for which such an estimate currently can be made is \$0 to approximately \$175 million. This estimate is not an indication of expected loss, if any, or the Company's maximum possible loss exposure on such matters. The Company reviews relevant information with respect to its litigation and regulatory matters on a quarterly and annual basis and updates its accruals, disclosures and estimates of reasonably possible loss based on such reviews.

**Individual Annuities, Individual Life and Group Insurance**

In January 2013, a *qui tam* action on behalf of the State of Florida, *Total Asset Recovery Services v. Met Life Inc., et al., Manulife Financial Corporation, et al., Prudential Financial, Inc., The Prudential Insurance Company of America, and Prudential Insurance Agency, LLC*, filed in the Circuit Court of Leon County, Florida, was served on the Company. The complaint alleges that the Company failed to escheat life insurance proceeds to the State of Florida in violation of the Florida False Claims Act and seeks injunctive relief, compensatory damages, civil penalties, treble damages, prejudgment interest, attorneys' fees and costs. In March 2013, the Company filed a motion to dismiss the complaint. In August 2013, the court dismissed the complaint with prejudice. In September 2013, plaintiff filed an appeal with Florida's Circuit Court of the Second Judicial Circuit in Leon County.

In September 2012, the State of West Virginia, through its State Treasurer, filed a lawsuit, *State of West Virginia ex. Rel. John D. Perdue v. Prudential Insurance Company of America*, in the Circuit Court of Putnam County, West Virginia. The complaint alleges violations of the West Virginia Uniform Unclaimed Property Fund Act by failing to properly identify and report all unclaimed insurance policy proceeds which should either be paid to beneficiaries or escheated to West Virginia. The complaint seeks to examine the records of Prudential Insurance to determine compliance with the West Virginia Uniform Unclaimed Property Fund Act, and to assess penalties and costs in an undetermined amount. In October 2012, the State of West Virginia commenced a second action, *State of West Virginia ex. Rel. John D. Perdue v. Pruco Life Insurance Company* making the same allegations stated in the action against Prudential Insurance. In April 2013, the Company filed motions to dismiss the complaints in both of the West Virginia actions.

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

In January 2012, a Global Resolution Agreement entered into by the Company and a third party auditor became effective upon its acceptance by the unclaimed property departments of 20 states and jurisdictions. Under the terms of the Global Resolution Agreement, the third party auditor acting on behalf of the signatory states will compare expanded matching criteria to the Social Security Master Death File ( SSMDF ) to identify deceased

---

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

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

The Company is one of several companies subpoenaed by the New York Attorney General regarding its unclaimed property procedures. Additionally, the New York State Department of Financial Services ( NYDFS ) has requested that 172 life insurers (including the Company) provide data to the NYDFS regarding use of the SSMDf. The New York Office of Unclaimed Funds is conducting an audit of the Company's compliance with New York's unclaimed property laws. In February 2012, the Massachusetts Office of the Attorney General requested information regarding the Company's unclaimed property procedures. In May 2013, the Company entered into a settlement agreement with the Minnesota Department of Commerce, Insurance Division, which requires the Company to take additional steps to identify deceased insureds and contract holders where a valid claim has not been made.

From July 2010 to December 2010, four purported nationwide class actions were filed challenging the use of retained asset accounts to settle death benefit claims of beneficiaries of a group life insurance contract owned by the United States Department of Veterans Affairs that covers the lives of members and veterans of the U.S. armed forces. In 2011, the cases were consolidated in the United States District Court for the District of Massachusetts by the Judicial Panel for Multi-District Litigation as *In re Prudential Insurance Company of America SGLI/VGLI Contract Litigation*. The consolidated complaint alleges that the use of the retained assets accounts that earn interest and are available to be withdrawn by the beneficiary, in whole or in part, at any time, to settle death benefit claims is in violation of federal law, and asserts claims of breach of contract, breaches of fiduciary duty and the duty of good faith and fair dealing, fraud and unjust enrichment and seeks compensatory and punitive damages, disgorgement of profits, equitable relief and pre and post-judgment interest. In March 2011, the motion to dismiss was denied. In January 2012, plaintiffs filed a motion to certify the class. In August 2012, the court denied plaintiffs' class certification motion without prejudice pending the filing of summary judgment motions on the issue of whether plaintiffs sustained an actual injury. In October 2012, the parties filed motions for summary judgment.

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



**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

In January 2011, a purported state-wide class action, *Garcia v. The Prudential Insurance Company of America* was dismissed by the Second Judicial District Court, Washoe County, Nevada. The complaint was brought on behalf of Nevada beneficiaries of individual life insurance policies for which, unless the beneficiaries elected another settlement method, death benefits were placed in retained asset accounts. The complaint alleges that by failing to disclose material information about the accounts, the Company wrongfully delayed payment and improperly retained undisclosed profits, and seeks damages, injunctive relief, attorneys' fees and pre and post-judgment interest. In February 2011, plaintiff appealed the dismissal to the Nevada Supreme Court. As previously reported, in December 2009, an earlier purported nationwide class action raising substantially similar allegations brought by the same plaintiff in the United States District Court for the District of New Jersey, *Garcia v. Prudential Insurance Company of America*, was dismissed. In December 2011, plaintiff appealed the dismissal. In January 2013, the Nevada Supreme Court affirmed the dismissal of the complaint. In May 2013, the time for the plaintiffs to appeal the dismissal expired.

In December 2010, a purported state-wide class action complaint, *Phillips v. Prudential Financial, Inc.*, was filed in state court and removed to the United States District Court for the Southern District of Illinois. The complaint makes allegations under Illinois law, substantially similar to the *Garcia* cases, on behalf of a class of Illinois residents whose death benefit claims were settled by retained assets accounts. In March 2011, the complaint was amended to drop the Company as a defendant and add Pruco Life Insurance Company as a defendant and is now captioned *Phillips v. Prudential Insurance and Pruco Life Insurance Company*. In November 2011, the complaint was dismissed. In December 2011, plaintiff appealed the dismissal. In May 2013, the United States Court of Appeals for the Seventh Circuit affirmed the dismissal of plaintiff's putative class action complaint. In August 2013, plaintiff's time to appeal the dismissal expired.

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

In February 2011, a fifth amended complaint was filed in the United States District Court for the District of New Jersey in *Clark v. Prudential Insurance Company*. The complaint brought on behalf of a purported class of California, Indiana, Ohio and Texas residents who purchased individual health insurance policies alleges that Prudential Insurance failed to disclose that it had ceased selling this type of policy in 1981 and that, as a result, premiums would increase significantly. The complaint alleges claims of fraudulent misrepresentation and omission, breach of the duty of good faith and fair dealing, and California's Unfair Competition Law and seeks compensatory and punitive damages. The matter was originally filed in 2008 and certain of the claims in the first four complaints were dismissed. In February 2012, plaintiffs filed a motion for class certification. In July 2012, Prudential Insurance moved for summary judgment on certain of plaintiffs' claims. In February 2013, the Court denied plaintiffs' motion for class certification, granted the motion by Prudential Insurance for summary judgment against two of the named plaintiffs, and denied summary judgment against two other plaintiffs. In April 2013, the Court denied plaintiffs' motions: (i) for reconsideration of the Court's order denying class certification and granting the Company partial summary judgment; and (ii) to alter or amend the order denying class certification by redefining the class and bifurcating liability and damages issues.

From November 2002 to March 2005, eleven separate complaints were filed against the Company and the law firm of Leeds Morelli & Brown in New Jersey state court and in the New Jersey Superior Court, Essex



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

County as *Lederman v. Prudential Financial, Inc., et al.* The complaints allege that an alternative dispute resolution agreement entered into among Prudential Insurance, over 235 claimants who are current and former Prudential Insurance employees, and Leeds Morelli & Brown (the law firm representing the claimants) was illegal and that Prudential Insurance conspired with Leeds Morelli & Brown to commit fraud, malpractice, breach of contract, and violate racketeering laws by advancing legal fees to the law firm with the purpose of limiting Prudential's liability to the claimants. In February 2010, the New Jersey Supreme Court assigned the cases for centralized case management to the Superior Court, Bergen County. The Company participated in a court-ordered mediation that resulted in a settlement involving 193 of the remaining 235 plaintiffs. The amounts paid to the 193 plaintiffs were within existing reserves for this matter. The remaining plaintiffs continue to pursue their individual lawsuits, and have not amended the offers of judgment that they filed in January 2012 totaling approximately \$90 million. In February 2012, the court granted summary judgment against two of the remaining plaintiffs. In June 2012, the court granted summary judgment against an additional plaintiff reducing to 39 the number of plaintiffs asserting claims against the Company. These rulings, which remain subject to appeal, have not caused the remaining plaintiffs to modify their offers of judgment.

**Other Matters**

In October 2012, a shareholder derivative lawsuit, *Stephen Silverman, Derivatively on Behalf of Prudential Financial, Inc. v. John R. Strangfeld, et al.*, was filed in the United States District Court for the District of New Jersey, alleging breaches of fiduciary duties, waste of corporate assets and unjust enrichment by certain senior officers and directors. The complaint names as defendants the Company's Chief Executive Officer, the Chief Financial Officer, the Principal Accounting Officer, certain members of the Company's Board of Directors and a former Director. The complaint alleges that the defendants made false and misleading statements regarding the Company's current and future financial condition based on, among other things, the alleged failure to disclose: (i) potential liability for benefits that should either have been paid to policyholders or their beneficiaries, or escheated to applicable states; and (ii) the extent of the Company's exposure for alleged state and federal law violations concerning the settlement of claims and the escheatment of unclaimed property. The complaint seeks an undetermined amount of damages, attorneys' fees and costs, and equitable relief including a direction for the Company to reform and to improve its corporate governance and internal procedures to comply with applicable laws.

In October 2012, the Board of Directors received a shareholder demand letter (the Demand), containing allegations of wrongdoing similar to those alleged in the *Silverman* complaint. The Demand alleges that the Company's Senior Management: (i) breached their fiduciary duties of loyalty and good faith in connection with the management, operation and oversight of the Company's business; (ii) breached their fiduciary duty of good faith to establish and maintain adequate internal controls; and (iii) breached their fiduciary duties by disseminating false, misleading and/or incomplete information, all in connection with the Company's alleged failure to use the SSDMF and to pay beneficiaries and escheat funds to states. The Demand requests that the Board of Directors: (a) undertake an independent internal investigation into Senior Management's violations of New Jersey and/or federal law; and (b) commence a civil action against each member of Senior Management to recover for the benefit of the Company the amount of damages sustained by the Company as a result of the alleged breaches described above. In response to the Demand, the Board of Directors formed a Special Litigation Committee that has retained an outside law firm to investigate the Demand's allegations. In September 2013, before the conclusion of the Special Litigation Committee's investigation, the shareholder who submitted the Demand filed a shareholder derivative lawsuit, *Paul Memo, Derivatively on Behalf of Prudential Financial, Inc. v. John R. Strangfeld, Jr. et al.*, in New Jersey Superior Court, Essex County. The complaint names as defendants the Company's Chief Executive Officer, the Vice Chairman, a former Chief Financial Officer, the Principal Accounting Officer, certain members of the Company's Board of Directors and a former Director. The



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

complaint repeats the allegations in the Demand and seeks an undetermined amount of damages, attorneys' fees and costs, and equitable relief including a direction for the Company to reform and to improve its corporate governance and internal procedures to comply with applicable laws.

In August 2012, a purported class action lawsuit, *City of Sterling Heights General Employees' Retirement System v. Prudential Financial, Inc., et al.*, was filed in the United States District Court for the District of New Jersey, alleging violations of federal securities law. The complaint names as defendants the Company's Chief Executive Officer, the Chief Financial Officer, the Principal Accounting Officer and certain members of the Company's Board of Directors. The complaint alleges that knowingly false and misleading statements were made regarding the Company's current and future financial condition based on, among other things, the alleged failure to disclose: (i) potential liability for benefits that should either have been paid to policyholders or their beneficiaries, or escheated to applicable states; and (ii) the extent of the Company's exposure for alleged state and federal law violations concerning the settlement of claims and the escheatment of unclaimed property. The complaint seeks an undetermined amount of damages, interest, attorneys' fees and costs. In May 2013, the complaint was amended to add three additional putative institutional investors as lead plaintiffs: National Shopmen Pension Fund, The Heavy & General Laborers' Locals 472 & 172 Pension & Annuity Funds, and Roofers Local No. 149 Pension Fund. In June 2013, the Company moved to dismiss the amended complaint.

In October 2006, a purported class action lawsuit, *Bouder v. Prudential Financial, Inc. and Prudential Insurance Company of America*, was filed in the United States District Court for the District of New Jersey, claiming that Prudential failed to pay overtime to insurance agents in violation of federal and Pennsylvania law, and that improper deductions were made from these agents' wages in violation of state law. The complaint sought back overtime pay and statutory damages, recovery of improper deductions, interest, and attorneys' fees. In March 2008, the court conditionally certified a nationwide class on the federal overtime claim. Separately, in March 2008, a purported nationwide class action lawsuit was filed in the United States District Court for the Southern District of California, *Wang v. Prudential Financial, Inc. and Prudential Insurance*, claiming that the Company failed to pay its agents overtime and provide other benefits in violation of California and federal law and seeking compensatory and punitive damages in unspecified amounts. In September 2008, *Wang* was transferred to the United States District Court for the District of New Jersey and consolidated with the *Bouder* matter. Subsequent amendments to the complaint resulted in additional allegations involving purported violations of an additional nine states' overtime and wage payment laws. In February 2010, Prudential moved to decertify the federal overtime class that had been conditionally certified in March 2008 and moved for summary judgment on the federal overtime claims of the named plaintiffs. In July 2010, plaintiffs filed a motion for class certification of the state law claims. In August 2010, the district court granted Prudential's motion for summary judgment, dismissing the federal overtime claims. In January 2013, the Court denied plaintiffs' motion for class certification in its entirety. In July 2013, the Court granted plaintiffs' motion for reconsideration, permitting plaintiffs to file a motion to certify a class of employee insurance agents seeking recovery under state wage and hour laws. In September 2013, plaintiffs filed a renewed motion for class certification.

Since April 2012, the Company has filed ten actions seeking to recover damages attributable to investments in residential mortgage-backed securities (RMBS). Eight actions were filed in New Jersey state court, captioned *The Prudential Insurance Company of America, et al. v. JP Morgan Chase, et al.*; *The Prudential Insurance Company of America, et al. v. Morgan Stanley, et al.*; *The Prudential Insurance Company of America, et al. v. Nomura Securities International, Inc., et al.*; *The Prudential Insurance Company of America, et al. v. Barclays Bank PLC, et al.*; *The Prudential Insurance Company of America, et al. v. Goldman Sachs & Company, et al.*; *The Prudential Insurance Company of America, et al. v. RBS Financial Products, Inc., et al.*; *The Prudential Insurance Company of America, et al. v. Countrywide Financial Corp., et al.*; and *The Prudential Insurance Company of America, et al. v. UBS Securities LLC, et al.* Additionally, two actions were filed in the United States District Court for the District of New Jersey: *The Prudential Insurance Company of America v.*



**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

*Credit Suisse Securities (USA) LLC, et al. and The Prudential Insurance Company of America v. Bank of America National Association and Merrill Lynch & Co., Inc., et al.* Among other allegations stemming from the defendants' origination, underwriting and sales of RMBS, the complaints assert claims of common law fraud, negligent misrepresentation, and breaches of the New Jersey Civil RICO statute. The complaints seek unspecified damages.

Seven of the defendants (*J.P. Morgan, Barclays, Nomura, RBS, Goldman Sachs, Countrywide, and UBS*) removed the lawsuits from New Jersey state court to the United States District Court for the District of New Jersey. The *Countrywide* defendants also made an application to the Judicial Panel on Multi-District Litigation to transfer that case to the United States District Court for the Central District of California. In August 2013, that application was granted. Except for the *Nomura* and *Goldman Sachs* actions, the Company filed motions to remand the lawsuit to New Jersey state court. The *J.P. Morgan* and *Barclays* lawsuits were remanded to New Jersey state court. The motions to remand in *RBS* and *UBS* remain pending.

Each of the *Goldman Sachs, Morgan Stanley, Nomura, Credit Suisse, Barclays, Bank of America/Merrill Lynch* and *J.P. Morgan* defendants filed motions to dismiss the complaints against them. The motions to dismiss filed by *Goldman Sachs, J.P. Morgan, Morgan Stanley, and Credit Suisse* have been denied, and the motions to dismiss filed by *Nomura, Barclays, and Bank of America/Merrill Lynch* are pending.

**Summary**

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

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Supplemental Combining Statements of Financial Position****September 30, 2013 and December 31, 2012 (in millions)**

|  | September 30, 2013                  |                             |                   | December 31, 2012                   |                             |                   |
|--|-------------------------------------|-----------------------------|-------------------|-------------------------------------|-----------------------------|-------------------|
|  | Financial<br>Services<br>Businesses | Closed<br>Block<br>Business | Consolidated      | Financial<br>Services<br>Businesses | Closed<br>Block<br>Business | Consolidated      |
| <b>ASSETS</b>  |                                     |                             |                   |                                     |                             |                   |
| Fixed maturities, available-for-sale, at fair value                    | \$ 245,032                          | \$ 43,734                   | \$ 288,766        | \$ 254,917                          | \$ 46,419                   | \$ 301,336        |
| Fixed maturities, held-to-maturity, at amortized cost                  | 3,629                               | 0                           | 3,629             | 4,268                               | 0                           | 4,268             |
| Trading account assets supporting insurance liabilities, at fair value | 21,131                              | 0                           | 21,131            | 20,590                              | 0                           | 20,590            |
| Other trading account assets, at fair value                            | 6,121                               | 282                         | 6,403             | 6,053                               | 275                         | 6,328             |
| Equity securities, available-for-sale, at fair value                   | 5,488                               | 3,496                       | 8,984             | 5,052                               | 3,225                       | 8,277             |
| Commercial mortgage and other loans                                    | 29,709                              | 9,788                       | 39,497            | 27,125                              | 9,608                       | 36,733            |
| Policy loans   | 6,827                               | 5,036                       | 11,863            | 6,455                               | 5,120                       | 11,575            |
| Other long-term investments  | 7,904                               | 1,965                       | 9,869             | 8,016                               | 2,012                       | 10,028            |
| Short-term investments   | 6,404                               | 2,093                       | 8,497             | 5,186                               | 1,261                       | 6,447             |
| Total investments  | 332,245                             | 66,394                      | 398,639           | 337,662                             | 67,920                      | 405,582           |
| Cash and cash equivalents  | 11,950                              | 700                         | 12,650            | 17,546                              | 554                         | 18,100            |
| Accrued investment income  | 2,533                               | 624                         | 3,157             | 2,534                               | 593                         | 3,127             |
| Deferred policy acquisition costs                                      | 15,812                              | 416                         | 16,228            | 13,688                              | 412                         | 14,100            |
| Value of business acquired   | 3,837                               | 0                           | 3,837             | 3,248                               | 0                           | 3,248             |
| Other assets   | 12,766                              | 758                         | 13,524            | 11,376                              | 511                         | 11,887            |
| Separate account assets  | 275,091                             | 0                           | 275,091           | 253,254                             | 0                           | 253,254           |
| <b>TOTAL ASSETS</b>  | <b>\$ 654,234</b>                   | <b>\$ 68,892</b>            | <b>\$ 723,126</b> | <b>\$ 639,308</b>                   | <b>\$ 69,990</b>            | <b>\$ 709,298</b> |
| <b>LIABILITIES AND EQUITY</b>  |                                     |                             |                   |                                     |                             |                   |
| <b>LIABILITIES</b>   |                                     |                             |                   |                                     |                             |                   |
| Future policy benefits   | \$ 158,857                          | \$ 50,320                   | \$ 209,177        | \$ 165,212                          | \$ 50,838                   | \$ 216,050        |
| Policyholders' account balances  | 132,202                             | 5,371                       | 137,573           | 128,987                             | 5,426                       | 134,413           |
| Policyholders' dividends   | 88                                  | 5,519                       | 5,607             | 257                                 | 7,250                       | 7,507             |
| Securities sold under agreements to repurchase                         | 3,530                               | 3,628                       | 7,158             | 3,436                               | 2,382                       | 5,818             |
| Cash collateral for loaned securities                                  | 4,988                               | 967                         | 5,955             | 2,864                               | 1,077                       | 3,941             |
| Income taxes   | 5,417                               | (474)                       | 4,943             | 9,058                               | (507)                       | 8,551             |
| Short-term debt  | 3,043                               | 75                          | 3,118             | 2,409                               | 75                          | 2,484             |
| Long-term debt   | 21,967                              | 1,675                       | 23,642            | 23,054                              | 1,675                       | 24,729            |
| Other liabilities  | 12,958                              | 365                         | 13,323            | 11,406                              | 277                         | 11,683            |
| Notes issued by consolidated variable interest entities                | 2,423                               | 0                           | 2,423             | 1,577                               | 0                           | 1,577             |
| Separate account liabilities   | 275,091                             | 0                           | 275,091           | 253,254                             | 0                           | 253,254           |
| Total liabilities  | 620,564                             | 67,446                      | 688,010           | 601,514                             | 68,493                      | 670,007           |
| <b>COMMITMENTS AND CONTINGENT LIABILITIES</b>                          |                                     |                             |                   |                                     |                             |                   |
| <b>EQUITY</b>  |                                     |                             |                   |                                     |                             |                   |
| Accumulated other comprehensive income                                 | 6,784                               | 115                         | 6,899             | 9,990                               | 224                         | 10,214            |
| Other attributed equity  | 26,128                              | 1,331                       | 27,459            | 27,088                              | 1,273                       | 28,361            |



Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|                                     |            |           |            |            |           |            |
|-------------------------------------|------------|-----------|------------|------------|-----------|------------|
| Total attributed equity             | 32,912     | 1,446     | 34,358     | 37,078     | 1,497     | 38,575     |
| Noncontrolling interests            | 758        | 0         | 758        | 716        | 0         | 716        |
| Total equity                        | 33,670     | 1,446     | 35,116     | 37,794     | 1,497     | 39,291     |
| <b>TOTAL LIABILITIES AND EQUITY</b> | \$ 654,234 | \$ 68,892 | \$ 723,126 | \$ 639,308 | \$ 69,990 | \$ 709,298 |

*See Notes to Unaudited Interim Supplemental Combining Financial Information*

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Supplemental Combining Statements of Operations****Three Months Ended September 30, 2013 and 2012 (in millions)**

|  | Three Months Ended September 30,    |                                     |              |                                     |                                     |              |
|--|-------------------------------------|-------------------------------------|--------------|-------------------------------------|-------------------------------------|--------------|
|  | Financial<br>Services<br>Businesses | 2013<br>Closed<br>Block<br>Business | Consolidated | Financial<br>Services<br>Businesses | 2012<br>Closed<br>Block<br>Business | Consolidated |
| <b>REVENUES</b>  |                                     |                                     |              |                                     |                                     |              |
| Premiums   | \$ 5,512                            | \$ 629                              | \$ 6,141     | \$ 8,382                            | \$ 645                              | \$ 9,027     |
| Policy charges and fee income  | 1,257                               | 0                                   | 1,257        | 1,224                               | 0                                   | 1,224        |
| Net investment income  | 2,917                               | 733                                 | 3,650        | 2,665                               | 768                                 | 3,433        |
| Asset management fees and other income   | 2,381                               | 24                                  | 2,405        | 888                                 | 17                                  | 905          |
| Realized investment gains (losses), net:   |                                     |                                     |              |                                     |                                     |              |
| Other-than-temporary impairments on fixed maturity securities  | (197)                               | (162)                               | (359)        | (267)                               | (159)                               | (426)        |
| Other-than-temporary impairments on fixed maturity securities transferred to Other Comprehensive Income                | 169                                 | 147                                 | 316          | 185                                 | 146                                 | 331          |
| Other realized investment gains (losses), net  | (2,291)                             | 224                                 | (2,067)      | (1,437)                             | 87                                  | (1,350)      |
| Total realized investment gains (losses), net  | (2,319)                             | 209                                 | (2,110)      | (1,519)                             | 74                                  | (1,445)      |
| Total revenues   | 9,748                               | 1,595                               | 11,343       | 11,640                              | 1,504                               | 13,144       |
| <b>BENEFITS AND EXPENSES</b>   |                                     |                                     |              |                                     |                                     |              |
| Policyholders' benefits  | 5,463                               | 774                                 | 6,237        | 8,800                               | 776                                 | 9,576        |
| Interest credited to policyholders' account balances   | 725                                 | 34                                  | 759          | 1,023                               | 34                                  | 1,057        |
| Dividends to policyholders   | 25                                  | 557                                 | 582          | 39                                  | 478                                 | 517          |
| Amortization of deferred policy acquisition costs  | (461)                               | 9                                   | (452)        | 173                                 | 9                                   | 182          |
| General and administrative expenses  | 2,522                               | 136                                 | 2,658        | 2,604                               | 138                                 | 2,742        |
| Total benefits and expenses  | 8,274                               | 1,510                               | 9,784        | 12,639                              | 1,435                               | 14,074       |
| <b>INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES</b> |                                     |                                     |              |                                     |                                     |              |
|  | 1,474                               | 85                                  | 1,559        | (999)                               | 69                                  | (930)        |
| Income tax expense (benefit)   | 485                                 | 24                                  | 509          | (353)                               | 25                                  | (328)        |
| <b>INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES</b>                  |                                     |                                     |              |                                     |                                     |              |
|  | 989                                 | 61                                  | 1,050        | (646)                               | 44                                  | (602)        |
| Equity in earnings of operating joint ventures, net of taxes   | 3                                   | 0                                   | 3            | 45                                  | 0                                   | 45           |
| <b>INCOME (LOSS) FROM CONTINUING OPERATIONS</b>  |                                     |                                     |              |                                     |                                     |              |
|  | 992                                 | 61                                  | 1,053        | (601)                               | 44                                  | (557)        |
| Income (loss) from discontinued operations, net of taxes   | 8                                   | 0                                   | 8            | (1)                                 | (1)                                 | (2)          |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|   |        |       |          |          |       |          |
|---|--------|-------|----------|----------|-------|----------|
| <b>NET INCOME (LOSS)</b>  | 1,000  | 61    | 1,061    | (602)    | 43    | (559)    |
| Less: Income (loss) attributable to noncontrolling interests        | 19     | 0     | 19       | 25       | 0     | 25       |
| <b>NET INCOME (LOSS) ATTRIBUTABLE TO PRUDENTIAL FINANCIAL, INC.</b> | \$ 981 | \$ 61 | \$ 1,042 | \$ (627) | \$ 43 | \$ (584) |

*See Notes to Unaudited Interim Supplemental Combining Financial Information*

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Supplemental Combining Statements of Operations****Nine Months Ended September 30, 2013 and 2012 (in millions)**

|  | Nine Months Ended September 30,     |                                     |              |                                     |                                     |              |
|--|-------------------------------------|-------------------------------------|--------------|-------------------------------------|-------------------------------------|--------------|
|  | Financial<br>Services<br>Businesses | 2013<br>Closed<br>Block<br>Business | Consolidated | Financial<br>Services<br>Businesses | 2012<br>Closed<br>Block<br>Business | Consolidated |
| <b>REVENUES</b>  |                                     |                                     |              |                                     |                                     |              |
| Premiums   | \$ 18,160                           | \$ 1,987                            | \$ 20,147    | \$ 21,297                           | \$ 2,059                            | \$ 23,356    |
| Policy charges and fee income  | 3,988                               | 0                                   | 3,988        | 3,335                               | 0                                   | 3,335        |
| Net investment income  | 8,733                               | 2,266                               | 10,999       | 7,757                               | 2,354                               | 10,111       |
| Asset management fees and other income   | 254                                 | 41                                  | 295          | 3,141                               | 26                                  | 3,167        |
| Realized investment gains (losses), net:   |                                     |                                     |              |                                     |                                     |              |
| Other-than-temporary impairments on fixed maturity securities  | (531)                               | (316)                               | (847)        | (799)                               | (546)                               | (1,345)      |
| Other-than-temporary impairments on fixed maturity securities transferred to Other Comprehensive Income                | 421                                 | 280                                 | 701          | 561                                 | 484                                 | 1,045        |
| Other realized investment gains (losses), net  | (4,031)                             | 320                                 | (3,711)      | (1,046)                             | 280                                 | (766)        |
| Total realized investment gains (losses), net  | (4,141)                             | 284                                 | (3,857)      | (1,284)                             | 218                                 | (1,066)      |
| Total revenues   | 26,994                              | 4,578                               | 31,572       | 34,246                              | 4,657                               | 38,903       |
| <b>BENEFITS AND EXPENSES</b>   |                                     |                                     |              |                                     |                                     |              |
| Policyholders' benefits  | 18,021                              | 2,459                               | 20,480       | 20,881                              | 2,565                               | 23,446       |
| Interest credited to policyholders' account balances   | 2,101                               | 102                                 | 2,203        | 3,167                               | 103                                 | 3,270        |
| Dividends to policyholders   | 119                                 | 1,468                               | 1,587        | 109                                 | 1,454                               | 1,563        |
| Amortization of deferred policy acquisition  | (43)                                | 29                                  | (14)         | 1,165                               | 29                                  | 1,194        |
| General and administrative expenses  | 7,656                               | 412                                 | 8,068        | 7,745                               | 409                                 | 8,154        |
| Total benefits and expenses  | 27,854                              | 4,470                               | 32,324       | 33,067                              | 4,560                               | 37,627       |
| <b>INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES</b> |                                     |                                     |              |                                     |                                     |              |
|  | (860)                               | 108                                 | (752)        | 1,179                               | 97                                  | 1,276        |
| Income tax expense   | (624)                               | 29                                  | (595)        | 558                                 | 36                                  | 594          |
| <b>INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES</b>                  |                                     |                                     |              |                                     |                                     |              |
|  | (236)                               | 79                                  | (157)        | 621                                 | 61                                  | 682          |
| Equity in earnings of operating joint ventures, net of taxes   | 57                                  | 0                                   | 57           | 58                                  | 0                                   | 58           |
| <b>INCOME (LOSS) FROM CONTINUING OPERATIONS</b>  |                                     |                                     |              |                                     |                                     |              |
|  | (179)                               | 79                                  | (100)        | 679                                 | 61                                  | 740          |
| Income (loss) from discontinued operations, net of taxes   | 11                                  | 0                                   | 11           | 14                                  | (2)                                 | 12           |
| <b>NET INCOME (LOSS)</b>   |                                     |                                     |              |                                     |                                     |              |
|  | (168)                               | 79                                  | (89)         | 693                                 | 59                                  | 752          |
| Less: Income (loss) attributable to noncontrolling interests   | 96                                  | 0                                   | 96           | 51                                  | 0                                   | 51           |

|   |    |       |    |    |    |       |    |     |    |    |    |     |
|---|----|-------|----|----|----|-------|----|-----|----|----|----|-----|
| <b>NET INCOME (LOSS) ATTRIBUTABLE TO PRUDENTIAL FINANCIAL, INC.</b> | \$ | (264) | \$ | 79 | \$ | (185) | \$ | 642 | \$ | 59 | \$ | 701 |
|---|----|-------|----|----|----|-------|----|-----|----|----|----|-----|

*See Notes to Unaudited Interim Supplemental Combining Financial Information*

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

**Notes to Unaudited Interim Supplemental Combining Financial Information**

**1. BASIS OF PRESENTATION**

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

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

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

**2. ALLOCATION OF RESULTS**

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

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

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

**Notes to Unaudited Interim Supplemental Combining Financial Information (Continued)**

Income taxes are allocated between the Financial Services Businesses and the Closed Block Business as if they were separate companies based on the taxable income or losses and other tax characterizations of each business. If the Financial Services Businesses generate tax 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. However, if the Closed Block Business generates tax benefits, it will receive the full benefit in cash, and the Financial Services Businesses will subsequently recover the payment at the time the benefits are actually utilized on a consolidated basis.

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

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

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



## **Table of Contents**

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

*Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ) addresses the consolidated financial condition of Prudential Financial as of September 30, 2013, compared with December 31, 2012, and its consolidated results of operations for the three and nine months ended September 30, 2013 and 2012. You should read the following analysis of our consolidated financial condition and results of operations in conjunction with the MD&A, the Risk Factors section, and the audited Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012, as well as the statements under Forward-Looking Statements, Risk Factors and the Unaudited Interim Consolidated Financial Statements included elsewhere in this Quarterly Report on Form 10-Q.*

#### **Overview**

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

#### **Financial Services Businesses**

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

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

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

#### **Closed Block Business**

In connection with demutualization, we ceased offering domestic participating products. The liabilities for our traditional domestic in force participating products were segregated, together with assets, in a regulatory mechanism referred to as the Closed Block. The Closed Block is designed generally to provide for reasonable expectations for future policy dividends after demutualization of holders of participating individual

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

life insurance policies and annuities included in the Closed Block by allocating assets that will be used exclusively for payment of benefits, including policyholder dividends, expenses and taxes with respect to these products. See Note 6 to the Unaudited Interim Consolidated Financial Statements and Business Demutualization and Separation of the Businesses in our 2012 Annual Report on Form 10-K for more information on the Closed Block.

## **Table of Contents**

### **Executive Summary**

Prudential Financial, a financial services leader with approximately \$1.076 trillion of assets under management as of September 30, 2013, has operations in the United States, Asia, Europe and Latin America. Through our subsidiaries and affiliates, we offer a wide array of financial products and services, including life insurance, annuities, retirement-related services, mutual funds and investment management. We offer these products and services to individual and institutional customers through one of the largest distribution networks in the financial services industry.

On January 2, 2013, we completed the acquisition of The Hartford's individual life insurance business ( Hartford Life Business ) through a reinsurance transaction. The total cash consideration was \$615 million consisting primarily of a ceding commission to provide reinsurance for approximately 700,000 life insurance policies with net retained face amount in force of approximately \$141 billion.

On each of February 12, 2013, May 14, 2013 and August 15, 2013, Prudential Financial's Board of Directors declared a cash dividend of \$0.40 per share of Common Stock.

On June 11, 2013, Prudential Financial's Board of Directors authorized the Company to repurchase at management's discretion up to \$1.0 billion of its outstanding Common Stock during the period from July 1, 2013 through June 30, 2014. We purchased 3.2 million shares in the third quarter of 2013 under this authorization at a total cost of \$250 million. The timing and amount of any share repurchases will be determined by management based upon market conditions and other considerations, and such repurchases may be effected in the open market, through derivative, accelerated repurchase and negotiated transactions and through prearranged trading plans designed to comply with Rule 10b5-1(c) under the Exchange Act. We purchased 6.6 million shares under the prior twelve-month \$1.0 billion authorization that expired on June 30, 2013 for a total cost of \$400 million, including 3.9 million shares purchased in the first six months of 2013 at a total cost of \$250 million.

On August 15, 2013, we reached agreement to acquire UniAsia Life Assurance Berhad, an established life insurance company in Malaysia, through the formation of a joint venture with Bank Simpanan Nasional ( BSN ), a bank owned by the Malaysian government. The joint venture will pay cash consideration of approximately \$160 million, 70% of which will be provided by Prudential Insurance and 30% of which will be provided by BSN. We expect the transaction to close as early as the fourth quarter of 2013, subject to regulatory approvals and customary closing conditions.

### **Regulatory Developments**

On September 19, 2013, the Financial Stability Oversight Council (the Council ) made a final determination that Prudential Financial should be subject to stricter prudential regulatory standards and supervision by the Board of Governors of the Federal Reserve System (as a Covered Company ) pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act. On October 18, 2013, the Company confirmed that it would not seek to rescind the final determination of the Council. As a Covered Company under the Dodd-Frank Act, Prudential Financial is now subject to supervision and examination by the Federal Reserve Bank of Boston and to stricter prudential regulatory standards, which include or will include requirements (some of which are subject to future rulemaking) regarding risk-based capital, leverage, liquidity, stress-testing, overall risk management, resolution plans, early remediation and credit concentration; and may also include additional standards regarding capital, public disclosure, short-term debt limits and other related subjects as appropriate. The Company must also seek pre-approval from the Federal Reserve for acquisition of certain companies engaged in financial activities. See Business Regulation and Risk Factors included in our 2012 Annual Report on Form 10-K for more information regarding the potential impact of the Dodd-Frank Act on the Company, including as a result of these stricter prudential standards.

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

On July 18, 2013, the Financial Stability Board (the FSB ), consisting of representatives of national financial authorities of the G20 nations, identified the Company as a global systemically important insurer

## **Table of Contents**

( G-SII ). U.S. financial regulators are thereby expected to enhance their regulation of the Company to achieve a number of regulatory objectives, including enhanced group-wide supervision, enhanced capital standards (including backstop capital and higher loss absorption capacity requirements), and development of a risk management plan (expected to be completed within 12 months of G-SII designation) and recovery and resolution plans ( RRP plans ; expected to be developed and agreed by the end of 2014). Higher loss absorption capacity requirements are expected to begin to be implemented in 2019.

At the direction of the FSB, the International Association of Insurance Supervisors (the IAIS ) is developing a model framework ( ComFrame ) for the supervision of internationally active insurance groups ( IAIGs ) that contemplates group wide supervision across national boundaries. Prudential Financial qualifies as an IAIG. In October 2013, the IAIS announced that it expects to develop a risk-based global insurance capital standard applicable to IAIGs by 2016, with full implementation scheduled to begin in 2019. In addition, the IAIS seeks to promote the financial stability of IAIGs by endorsing: uniform standards for insurer corporate governance and enterprise risk management; group-wide supervision of IAIGs; a framework for group capital adequacy assessment that accounts for group-wide risks; additional regulatory and disclosure requirements for insurance groups; and the establishment of ongoing supervisory colleges. In October 2013, several of the Company's domestic and foreign insurance regulators convened a supervisory college. The purpose of the supervisory college is to promote ongoing supervisory coordination, facilitate the sharing of information among regulators and to enhance each regulator's understanding of the Company's risk profile.

ComFrame also requires each IAIG to conduct its own risk and solvency assessment ( ORSA ) to monitor and manage its overall solvency. In addition, state insurance regulators have focused attention on U.S. insurance solvency regulation pursuant to the NAIC's Solvency Modernization Initiative. This initiative has resulted in the recent adoption of the NAIC Risk Management and ORSA model act which, following enactment at the state level, will require a large insurer beginning in 2015 to at least annually assess the adequacy of its and its group's risk management and current and future solvency position.

At this time we cannot predict the final outcome of the above regulatory developments, including what additional capital and liquidity requirements, compliance and regulatory costs, or other implications that may affect the Company.

In addition, the NAIC, the New York State Department of Financial Services and other regulators have increased their focus on life insurers' use of captive reinsurance companies. We cannot predict what, if any, changes may result from these reviews. If applicable insurance laws are changed in a way that impairs the use of captive reinsurance companies, our ability to write certain products and efficiently manage their associated risks could be adversely affected and we may need to increase prices on certain products, modify certain products or find alternate financing sources, any of which could adversely affect our competitiveness, capital and financial position and results of operations.

## **Impact of Low Interest Rate Environment**

### *Domestic Financial Services Businesses*

As interest rates in the U.S. remain lower than historical levels, our current reinvestment yields are consequently lower than the overall portfolio income yield, primarily for our investments in fixed maturity securities and commercial mortgage loans. With the Federal Reserve Board's stated intention to keep interest rates low through at least 2014, our overall portfolio income yields are expected to continue to decline throughout these future periods; however, the recent increase in interest rates, if sustained, will mitigate the impact of new investment purchases on our overall portfolio income yields.

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

For the domestic Financial Services Businesses general account, we expect annual scheduled payments and prepayments to be approximately 10% of the total fixed maturity securities and commercial mortgage loans through 2014. The domestic Financial Services Businesses general account has approximately \$156 billion of

**Table of Contents**

such assets (based on net carrying value) as of September 30, 2013. As these assets mature, the current average portfolio income yield for fixed maturities and commercial mortgage loans of approximately 4.5% is expected to decline due to reinvesting in a lower interest rate environment. Included in the \$156 billion of fixed maturity securities and commercial mortgage loans are approximately \$63 billion that are subject to call or redemption features at the issuer's option, which have a weighted average interest rate of approximately 5%. As of September 30, 2013, approximately 80% of these assets contain prepayment penalties.

The reinvestment of scheduled payments and prepayments at rates below the current portfolio yield, including in some cases, at rates below those guaranteed under our insurance contracts, will impact future operating results to the extent we do not, or are unable to, reduce crediting rates on in-force blocks of business, or effectively utilize other asset-liability management strategies described below, in order to maintain current net interest margins. As of September 30, 2013, our domestic Financial Services Businesses have approximately \$151 billion of insurance liabilities and policyholder account balances. Of this amount, approximately \$49 billion represents contracts with crediting rates that may be adjusted over the life of the contract, subject to guaranteed minimums. The following table sets forth the related account values by range of guaranteed minimum crediting rates and the related range of the difference, in basis points (bps), between rates being credited to contractholders as of September 30, 2013, and the respective guaranteed minimums.

|   | Account Values with Crediting Rates: |                                     |                                      |  |   | Total          |
|---|--------------------------------------|-------------------------------------|--------------------------------------|--|---|----------------|
|   | At guaranteed minimum                | 1 - 49 bps above guaranteed minimum | 50 - 99 bps above guaranteed minimum | 100 - 150 bps above guaranteed minimum | Greater than 150 bps above guaranteed minimum |                |
| <b>Range of Guaranteed Minimum Crediting Rates:</b> |                                      |                                     |                                      |  |   |                |
| Less than 1%  | \$ 0.5                               | \$ 0.0                              | \$ 0.0                               | \$ 0.0                                 | \$ 0.0  | \$ 0.5         |
| 1% - 1.99%  | 1.4                                  | 1.3                                 | 10.1                                 | 2.9                                    | 0.2   | 15.9           |
| 2% - 2.99%  | 2.5                                  | 0.0                                 | 0.1                                  | 0.5                                    | 1.4   | 4.5            |
| 3% - 4.00%  | 23.0                                 | 1.4                                 | 1.7                                  | 0.5                                    | 0.0   | 26.6           |
| Greater than 4%                                     | 1.2                                  | 0.0                                 | 0.0                                  | 0.0                                    | 0.0   | 1.2            |
| <b>Total</b>  | <b>\$ 28.6</b>                       | <b>\$ 2.7</b>                       | <b>\$ 11.9</b>                       | <b>\$ 3.9</b>                          | <b>\$ 1.6</b>                                 | <b>\$ 48.7</b> |
| Percentage of total                                 | 59%                                  | 6%                                  | 24%                                  | 8%                                     | 3%  | 100%           |

Although we may have the ability to lower crediting rates for those contracts above guaranteed minimum crediting rates, our willingness to do so may be limited by competitive pressures.

Our domestic Financial Services Businesses also have approximately \$14 billion of insurance liabilities and policyholder account balances representing participating contracts for which the investment income risk is expected to ultimately accrue to contractholders. The crediting rates for these contracts are periodically adjusted based on the yield earned on the related assets. The remaining \$88 billion of the \$151 billion of insurance liabilities and policyholder account balances in our domestic Financial Services Businesses represents long duration products such as group annuities, structured settlements and other insurance products that have fixed and guaranteed terms, for which underlying assets may have to be reinvested at interest rates that are lower than portfolio rates. We seek to mitigate the impact of a prolonged low interest rate environment on these contracts through asset-liability management, as discussed further below.

For the domestic Financial Services Businesses' general account, assuming a hypothetical scenario where the average 10-year U.S. Treasury rate is 2.50% for the period from October 1, 2013 through December 31, 2014, and credit spreads remain unchanged from levels as of September 30,

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

2013, we estimate that the unfavorable impact to net interest margins included in pre-tax adjusted operating income of reinvesting in such an environment, compared to reinvesting at current average portfolio income yields, would be approximately \$1 million in the fourth quarter of 2013 and \$30 million in 2014. This impact is most significant in the Retirement



## **Table of Contents**

and Individual Annuities segments. This hypothetical scenario only reflects the impact related to the approximately \$49 billion of contracts shown in the table above, and does not reflect: i) any benefit from potential changes to the crediting rates on the corresponding contractholder liabilities where the Company has the contractual ability to do so, or other potential mitigants such as changes in investment mix that we may implement as funds are reinvested; ii) any impact related to assets that do not directly support our liabilities; iii) any impact from other factors, including but not limited to, new business, contractholder behavior, changes in competitive conditions, and changes in capital markets; and/or iv) any impact from other factors described below.

In order to mitigate the unfavorable impact that the current interest rate environment has on our net interest margins, we employ a proactive asset-liability management program, which includes strategic asset allocation and derivative strategies within a disciplined risk management framework. These strategies seek to match the characteristics of our products, and to closely approximate the interest rate sensitivity of the assets with the estimated interest rate sensitivity of the product liabilities. Our asset-liability management program also helps manage duration gaps, currency and other risks between assets and liabilities through the use of derivatives. We adjust this dynamic process as products change, as customer behavior changes and as changes in the market environment occur. As a result, our asset-liability management process has permitted us to manage interest-sensitive products successfully through several market cycles. Our interest rate exposure is also mitigated by our business mix, which includes lines of business for which fee-based earnings play a more prominent role in product profitability.

### *Japanese Insurance Operations*

Our Japanese insurance operations have experienced a low interest rate environment for many years. As of September 30, 2013, these operations have \$129 billion of insurance liabilities and policyholder account balances, which are predominantly comprised of long duration insurance products that have fixed and guaranteed terms, for which underlying assets may have to be reinvested at interest rates that are lower than portfolio rates. Also included in the \$129 billion are approximately \$7 billion of insurance liabilities and policyholder account balances with crediting rates that may be adjusted over the life of the contract, subject to guaranteed minimums; however, for these contracts, most of the current crediting rates are substantially at or near contractual minimums. Although we have the ability to lower crediting rates in some cases for those contracts above guaranteed minimum crediting rates, the majority of this business has credited interest rates which are determined by formula. Our Japanese insurance operations employ a proactive asset-liability management program in order to mitigate the unfavorable impact that the current interest rate environment has on our net interest margins, and includes strategies similar to those described for the domestic Financial Services Businesses above.

### **Results of Operations**

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

**Table of Contents**

Shown below are the contributions of each segment and Corporate and Other operations to our adjusted operating income for the three and nine months ended September 30, 2013 and 2012 and a reconciliation of adjusted operating income of our segments and Corporate and Other operations to income from continuing operations before income taxes and equity in earnings of operating joint ventures.

|   | Three Months Ended<br>September 30, |                 | Nine Months Ended<br>September 30, |                 |
|---|-------------------------------------|-----------------|------------------------------------|-----------------|
|   | 2013                                | 2012            | 2013                               | 2012            |
|   | (in millions)                       |                 |                                    |                 |
| Adjusted operating income before income taxes for segments of the Financial Services Businesses:  |                                     |                 |                                    |                 |
| Individual Annuities  | \$ 821                              | \$ 207          | \$ 1,593                           | \$ 735          |
| Retirement  | 237                                 | 110             | 744                                | 413             |
| Asset Management  | 200                                 | 189             | 547                                | 373             |
| <b>Total U.S. Retirement Solutions and Investment Management Division</b>   | <b>1,258</b>                        | <b>506</b>      | <b>2,884</b>                       | <b>1,521</b>    |
| Individual Life   | 148                                 | 112             | 426                                | 285             |
| Group Insurance   | 68                                  | 35              | 99                                 | 28              |
| <b>Total U.S. Individual Life and Group Insurance Division</b>  | <b>216</b>                          | <b>147</b>      | <b>525</b>                         | <b>313</b>      |
| International Insurance   | 778                                 | 782             | 2,505                              | 2,057           |
| <b>Total International Insurance Division</b>   | <b>778</b>                          | <b>782</b>      | <b>2,505</b>                       | <b>2,057</b>    |
| Corporate and Other   | (312)                               | (414)           | (973)                              | (966)           |
| Adjusted operating income before income taxes for the Financial Services Businesses   | 1,940                               | 1,021           | 4,941                              | 2,925           |
| Reconciling Items:  |                                     |                 |                                    |                 |
| Realized investment gains (losses), net, and related adjustments(1)   | (1,319)                             | (1,951)         | (7,322)                            | (1,609)         |
| Charges related to realized investment gains (losses), net(2)   | 763                                 | 648             | 1,533                              | 498             |
| Investment gains on trading account assets supporting insurance liabilities, net(3)   | 103                                 | 264             | (273)                              | 502             |
| Change in experience-rated contractholder liabilities due to asset value changes(4)   | (73)                                | (254)           | 255                                | (446)           |
| Divested businesses(5)  | 43                                  | (687)           | (12)                               | (664)           |
| Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests(6)   | 17                                  | (40)            | 18                                 | (27)            |
| Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures for Financial Services Businesses | 1,474                               | (999)           | (860)                              | 1,179           |
| Income (loss) from continuing operations before income taxes for Closed Block Business  | 85                                  | 69              | 108                                | 97              |
| <b>Consolidated income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures</b>               | <b>\$ 1,559</b>                     | <b>\$ (930)</b> | <b>\$ (752)</b>                    | <b>\$ 1,276</b> |

(1) Represents Realized investment gains (losses), net, and related adjustments. See Realized Investment Gains and Losses and Note 11 to our Unaudited Interim Consolidated Financial Statements for additional information.

(2) Includes charges that represent the impact of realized investment gains (losses), net, on the amortization of deferred policy acquisition costs, and other costs. Also includes charges resulting from payments related to market value adjustment features of certain of our annuity products and the impact of realized investment gains (losses), net, on the amortization of unearned revenue reserves.

(3)

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Represents net investment gains and losses on trading account assets supporting insurance liabilities. See Experience-Rated Contractholder Liabilities, Trading Account Assets Supporting Insurance Liabilities and Other Related Investments.

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

---

**Table of Contents**

- (6) Equity in earnings of operating joint ventures are included in adjusted operating income but excluded from income from continuing operations before income taxes and equity in earnings of operating joint ventures as they are reflected on a U.S. GAAP basis on an after-tax basis as a separate line in our Consolidated Statements of Operations. Earnings attributable to noncontrolling interests are excluded from adjusted operating income but included in income from continuing operations before taxes and equity earnings of operating joint ventures as they are reflected on a U.S. GAAP basis as a separate line in our Consolidated Statements of Operations. Earnings attributable to noncontrolling interests represent the portion of earnings from consolidated entities that relates to the equity interests of minority investors.

Results for the periods presented above reflect the following:

*Individual Annuities.* Results for the third quarter and first nine months of 2013 increased in comparison to the prior year periods. The increases reflect higher asset-based fee income, driven by higher average variable annuity account values, net of a related increase in asset-based commissions. The increases for both periods also include favorable comparative impacts from changes in the estimated profitability of the business, including those resulting from annual reviews and updates of assumptions performed in the third quarter of each year.

*Retirement.* Results for the third quarter and first nine months of 2013 increased in comparison to the prior year periods. The increases for both periods reflect higher net investment spread results and higher asset-based fee income resulting from increased account values, as well as a more favorable reserve impact from case experience, primarily driven by significant pension risk transfer transactions that closed in the fourth quarter of 2012. In addition, results reflect the absence of a charge in the third quarter of 2012 resulting from the write off of an intangible asset related to an acquired business and favorable comparative impacts from changes in the estimated profitability of the business, including those resulting from annual reviews and updates of assumptions.

*Asset Management.* Results for the third quarter and first nine months of 2013 increased in comparison to the prior year periods. The increases for both periods include higher asset management fees, reflecting growth in assets under management, net of expenses, and improved contributions from the segment's performance-based incentive fees. Results for the current quarter reflect lower contributions from strategic investing activities primarily due to less favorable market appreciation on certain real estate-related investments, while the results for the first nine months of 2013 benefited from improved strategic investing activities as the prior year reflected a charge for an impairment of a real estate-related investment.

*Individual Life.* Results for the third quarter and first nine months of 2013 increased in comparison to the prior year periods. The increases for both periods reflect earnings from the in force business acquired from The Hartford in January 2013 and a favorable comparative impact from our annual reviews and updates of assumptions. In addition, the nine month comparison reflects improved mortality experience.

*Group Insurance.* Results for the third quarter and first nine months of 2013 increased in comparison to the prior year periods. The increases for both periods include more favorable impacts resulting from annual reviews and updates of assumptions. Excluding these impacts, results for the third quarter of 2013 decreased in comparison to the prior year period, reflecting declines in net investment spread income and higher operating expenses, which more than offset favorable comparative underwriting results in our group life business. Results for the first nine months of 2013 increased in comparison to the prior year period, reflecting more favorable underwriting results in both our group life and group disability businesses, partially offset by higher operating expenses.

*International Insurance.* Results for the third quarter of 2013 were essentially unchanged from the prior year period as the benefits of business growth, additional synergies and lower integration costs associated with our acquisition of the former Star and Edison businesses, and other items were offset by the impact from our annual reviews and updates of assumptions and the absence of a gain in the year ago quarter from the partial sale of our investment in China Pacific Group. Results for the first nine months of 2013 increased in comparison to the prior year period reflecting business growth, additional synergies and lower integration costs associated with our acquisition of the former Star and Edison

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

businesses, favorable results from non-coupon investments and more favorable foreign currency exchange rates, including the impact of our currency hedging programs, partly offset by the impact from our annual reviews and updates of assumptions.

**Table of Contents**

*Corporate and Other operations.* Results for the third quarter of 2013 improved compared to the prior year period primarily driven by lower levels of charges in other corporate activities, including the impact of our annual reviews and updates of assumptions on certain reserves. Results for the first nine months compared to the prior year period reflect an increased loss primarily driven by greater interest expense including the impact of debt prefunding activities.

*Closed Block Business.* Income from continuing operations before income taxes for the third quarter and first nine months of 2013 increased in comparison to the prior year periods reflecting an increase in net realized investment gains, largely offset by a corresponding increase in the policyholder dividend obligation.

**Consolidated Results of Operations**

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

|   | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|---|-------------------------------------|-----------|------------------------------------|-----------|
|   | 2013                                | 2012      | 2013                               | 2012      |
|   | (in millions)                       |           |                                    |           |
| <b>Financial Services Businesses:</b>   |                                     |           |                                    |           |
| Revenues  | \$ 9,748                            | \$ 11,640 | \$ 26,994                          | \$ 34,246 |
| Benefits and expenses   | 8,274                               | 12,639    | 27,854                             | 33,067    |
| Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures for Financial Services Businesses | 1,474                               | (999)     | (860)                              | 1,179     |
| Income tax expense (benefit)  | 485                                 | (353)     | (624)                              | 558       |
| Income (loss) from continuing operations before equity in earnings of operating joint ventures for Financial Services Businesses                  | 989                                 | (646)     | (236)                              | 621       |
| Equity in earnings of operating joint ventures, net of taxes  | 3                                   | 45        | 57                                 | 58        |
| Income (loss) from continuing operations for Financial Services Businesses  | 992                                 | (601)     | (179)                              | 679       |
| Income (loss) from discontinued operations, net of taxes  | 8                                   | (1)       | 11                                 | 14        |
| Net income (loss) Financial Services Businesses   | 1,000                               | (602)     | (168)                              | 693       |
| Less: Income attributable to noncontrolling interests   | 19                                  | 25        | 96                                 | 51        |
| Net income (loss) of Financial Services Businesses attributable to Prudential Financial, Inc.   | \$ 981                              | \$ (627)  | \$ (264)                           | \$ 642    |
| <b>Closed Block Business:</b>   |                                     |           |                                    |           |
| Revenues  | \$ 1,595                            | \$ 1,504  | \$ 4,578                           | \$ 4,657  |
| Benefits and expenses   | 1,510                               | 1,435     | 4,470                              | 4,560     |
| Income (loss) from continuing operations before income taxes for Closed Block Business  | 85                                  | 69        | 108                                | 97        |
| Income tax expense  | 24                                  | 25        | 29                                 | 36        |
| Income (loss) from continuing operations for Closed Block Business  | 61                                  | 44        | 79                                 | 61        |
| Income (loss) from discontinued operations, net of taxes  | 0                                   | (1)       | 0                                  | (2)       |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|   |    |    |    |    |
|---|----|----|----|----|
| Net income (loss) Closed Block Business               | 61 | 43 | 79 | 59 |
| Less: Income attributable to noncontrolling interests | 0  | 0  | 0  | 0  |

Net income (loss) of Closed Block Business attributable to Prudential Financial, Inc.      \$ 61      \$ 43      \$ 79      \$ 59

**Consolidated:**

Net income (loss) attributable to Prudential Financial, Inc.      \$ 1,042      \$ (584)      \$ (185)      \$ 701

**Table of Contents**

**Results of Operations Financial Services Businesses**

*2013 to 2012 Three Month Comparison.* Income (loss) from continuing operations for the Financial Services Businesses increased \$1,593 million, from a loss of \$601 million in the third quarter of 2012 to income of \$992 million in the third quarter of 2013. Results for the current quarter compared to the year ago quarter reflect the following:

Higher net pre-tax earnings of \$1,563 million resulting from the impact of foreign currency exchange rate movements on certain non-yen denominated assets and liabilities within our Japanese insurance operations which are economically matched and offset in AOCI, driven by the strengthening of the Japanese yen during the current quarter (see Results of Operations for Financial Services Businesses by Segment International Insurance Division Impact of foreign currency exchange rate movements on earnings U.S. GAAP earnings impact of products denominated in non-local currencies for additional information);

A \$1,350 million favorable variance, before taxes, from adjustments to deferred policy acquisition and other costs as well as reserves, reflecting updates to the estimated profitability of our businesses primarily driven by the impact of our annual reviews and updates of assumptions performed in the third quarter of each year. This includes the absence of a \$698 million net charge in the year ago quarter associated with long-term care products, which are included in Divested Businesses, but excludes the impact associated with the variable annuity hedging program discussed below (see Results of Operations for Financial Services Businesses by Segment and Divested Businesses for additional information);

More favorable results of \$216 million, on a pre-tax basis, associated with our Capital Protection Framework, driven by an increase in interest rates, reflecting our decision to manage interest rate risk through this framework (see Results of Operations for Financial Services Businesses by Segment Corporate and Other Capital Protection Framework for additional information); and

\$209 million higher net pre-tax realized gains (losses), excluding the impact of the variable annuity hedging described below, primarily reflecting trading gains on fixed maturities (see Realized Investment Gains and Losses for additional information).

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

A \$1,123 million unfavorable variance, before income taxes, reflecting the net impact from market value changes on our embedded derivatives and related hedge positions associated with certain variable annuities, including the impacts from our annual reviews and updates of assumptions performed in the third quarter (see Results of Operations for Financial Services Businesses by Segment U.S. Retirement Solutions and Investment Management Division Individual Annuities Variable Annuity Living Benefits Hedging Program Results for additional information); and

An \$838 million increase in income tax expense reflecting the increase in pre-tax income from continuing operations.

In addition to the items above, several of our segment's earnings benefited from business growth, including the impact from higher account values, particularly within our U.S. Retirement Solutions and Investment Management Division, growth of in force in our International Insurance Division, and contributions from our recent acquisition of the Hartford Life Business (see Results of Operations for Financial Services Businesses by Segment for additional information).



## **Table of Contents**

*2013 to 2012 Nine Month Comparison.* Income from continuing operations for the Financial Services Businesses decreased \$858 million, from income of \$679 million in the first nine months of 2012 to a loss of \$179 million in the first nine months of 2013. Results for the current period compared to the year ago reflect the following:

A \$2,811 million unfavorable variance, before income taxes, reflecting the net impact from market value changes on our embedded derivatives and related hedge positions associated with certain variable annuities, including the impacts from our annual reviews and updates of assumptions performed in the third quarter;

Lower net pre-tax earnings of \$2,568 million resulting from the impact of foreign currency exchange rate movements on certain non-yen denominated assets and liabilities within our Japanese insurance operations which are economically matched and offset in AOCI, driven by the weakening of the Japanese yen; and

\$755 million lower net pre-tax realized gains (losses), excluding the impact of the hedging program associated with certain variable annuities described above, primarily reflecting changes in the market value of derivatives due to increased interest rates as well as foreign currency exchange rate movements primarily driven by the weakening of the Japanese yen, partially offset by higher trading gains on fixed maturities.

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

More favorable results of \$1,666 million, on a pre-tax basis, associated with our Capital Protection Framework, driven by an increase in interest rates, reflecting our decision to manage interest rate risk through this framework;

A \$1,415 million favorable variance, before taxes, from adjustments to deferred policy acquisition and other costs as well as reserves, reflecting updates to the estimated profitability of our businesses primarily driven by the impact of our annual reviews and updates of assumptions performed in the third quarter of each year. This includes the absence of a \$698 million net charge in the year ago period associated with long-term care products, which are included in Divested Businesses, but excludes the impact associated with the variable annuity hedging program discussed above; and

A \$1,182 million decrease in income tax expense reflecting a decrease in pre-tax income from continuing operations as well as the impact from a tax limitation applied to the 2013 period, partly offset by the effect of a double tax recognized for U.S. GAAP purposes (see [Income Taxes](#) for additional information).

In addition to the items above, our segment's earnings benefited from business growth, including the impact from higher account values, particularly within our U.S. Retirement Solutions and Investment Management Division, growth of in force in our International Insurance Division, contributions from our recent acquisition of the Hartford Life Business, and higher income from alternative investments (see [Results of Operations for Financial Services Businesses by Segment](#) for additional information).

## **Results of Operations - Closed Block Business**

For a discussion of the results of operations for the Closed Block Business, see [Results of Operations of Closed Block Business](#), below.

**Segment Measures**

*Adjusted Operating Income.* In managing our business, we analyze operating performance separately for our Financial Services Businesses and our Closed Block Business. For the Financial Services Businesses, we analyze our segments' operating performance using adjusted operating income. Results of the Closed Block Business for all periods are evaluated and presented only in accordance with U.S. GAAP. Adjusted operating income does not equate to income (loss) from continuing operations before income taxes and equity in earnings of operating

## **Table of Contents**

joint ventures or net income as determined in accordance with U.S. GAAP but is the measure of segment profit or loss we use to evaluate segment performance and allocate resources, and consistent with authoritative guidance, is our measure of segment performance. The adjustments to derive adjusted operating income are important to an understanding of our overall results of operations. Adjusted operating income is not a substitute for income determined in accordance with U.S. GAAP, and our definition of adjusted operating income may differ from that used by other companies. However, we believe that the presentation of adjusted operating income as we measure it for management purposes enhances understanding of our results of operations by highlighting the results from ongoing operations and the underlying profitability of the Financial Services Businesses.

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

*Annualized New Business Premiums.* In managing certain of our businesses, we analyze annualized new business premiums, which do not correspond to revenues under U.S. GAAP. Annualized new business premiums measure the current sales performance of the business, while revenues primarily reflect the renewal persistency of policies written in prior years and net investment income, in addition to current sales. Annualized new business premiums include 10% of first year premiums or deposits from single pay products. No other adjustments are made for limited pay contracts.

*Assets Under Management.* In managing our Asset Management business, we analyze assets under management, which do not correspond to U.S. GAAP assets, because the principal source of revenues is fees based on assets under management. Assets under management represents the fair market value or account value of assets which we manage directly for institutional clients, retail clients, and for our general account, as well as assets invested in our products that are managed by third party managers.

*Account Values.* For our Individual Annuity and Retirement businesses, assets are reported at account value, which do not correspond to U.S. GAAP assets. Net sales (redemptions) in our Individual Annuity business and net additions (withdrawals) in our Retirement business do not correspond to revenues under U.S. GAAP, but are used as relevant measures of business activity.

## **Accounting Policies & Pronouncements**

### **Application of Critical Accounting Estimates**

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

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

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Deferred policy acquisition costs ( DAC ) and other costs, including deferred sales inducements and value of business acquired;

Goodwill;

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

Policyholder liabilities;

## **Table of Contents**

Pension and other postretirement benefits;

Taxes on income; and

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

### ***DAC and Other Costs***

We amortize DAC and other costs over the expected lives of the respective contracts, based on our estimates of the level and timing of gross margins, gross profits, or gross premiums, depending on the type of contract. Variability in the level of amortization expense has historically been driven by our variable annuities and variable life insurance contracts, for which costs are amortized in proportion to total gross profits. In calculating gross profits for these contracts, we consider mortality, persistency, and other elements as well as rates of return on investments and the costs related to our guaranteed minimum death and guaranteed minimum income benefits. We estimate the amounts of gross profits that will be included in our U.S. GAAP results and in adjusted operating income, and utilize these estimates to calculate distinct amortization rates and expense amounts.

We regularly evaluate and adjust the balances for DAC and other costs for the impact of actual gross profits and changes in our assumptions regarding estimated future gross profits on amortization rates. Additionally, in the third quarter of each year, we perform an annual comprehensive review and update of the assumptions used in evaluating these balances. For the review performed during the third quarter of 2013, our variable annuities and variable life insurance businesses assume an 8.0% long-term equity expected rate of return and a 5.9% near-term mean reversion equity rate of return as of September 30, 2013. The use of a mean reversion approach is a common industry practice. Under this approach, we consider historical equity returns over a period of time and initially adjust future projected equity returns over the next four years (the near-term) so that the assets are projected to grow at the long-term expected rate of return for the entire period. If the near-term projected future rate of return is greater than our near-term maximum future rate of return of 13%, we use our maximum future rate of return.

The weighted average rate of return assumptions for these businesses consider many factors specific to each business, including asset durations, asset allocations and other factors. We update the near term equity rates of return and our estimate of total gross profits each quarter to reflect the result of the reversion to the mean approach, which assumes a convergence to the long-term equity expected rates of return. These market performance related adjustments to our estimate of total gross profits result in cumulative adjustments to prior amortization, reflecting the application of the new required rate of amortization to all prior periods' gross profits. The new required rate of amortization is also applied prospectively to future gross profits in calculating amortization in future periods. For additional information on our policies for DAC and other costs and for the remaining critical accounting estimates listed above, see our Annual Report on Form 10-K for the year ended December 31, 2012, under Management's Discussion and Analysis of Financial Condition and Results of Operations Accounting Policies & Pronouncements Application of Critical Accounting Estimates.

### **Adoption of New Accounting Pronouncements**

See Note 2 to our Unaudited Interim Consolidated Financial Statements for a discussion of newly adopted accounting pronouncements.

## **Results of Operations for Financial Services Businesses by Segment**

**U.S. Retirement Solutions and Investment Management Division**

*Individual Annuities*

The Individual Annuities segment offers variable and fixed annuities that provide our customers with tax deferred asset accumulation together with a base death benefit and a suite of optional guaranteed death and living benefits. As the investment return on the contractholder funds is generally attributed directly to the contractholder, we derive our revenue mainly from fee income generated on variable annuity account values, investment income earned on fixed annuity account values, and certain other management fees. Our expenses

**Table of Contents**

primarily consist of interest credited and other benefits to contractholders, amortization of DAC and other costs, expenses related to the selling and servicing of the various products we offer, costs of hedging certain risks associated with these products and the eventual payment of benefit guarantees and other general business expenses. These drivers of our business results are generally included in adjusted operating income, with exceptions related to certain guarantees, as discussed below.

The U.S. GAAP accounting and our adjusted operating income treatment for our guarantees differs depending upon the specific feature. The reserves for our guaranteed minimum death benefit ( GMDB ) and guaranteed minimum income benefit ( GMIB ) features are calculated based on our best estimate of actuarial and capital markets return assumptions. The risks associated with these benefit features are retained and results are included in adjusted operating income. In contrast, certain of our optional guaranteed living benefit features are accounted for as embedded derivatives and reported at fair value. Under U.S. GAAP, the fair values of these benefit features are based on assumptions a market participant would use in pricing these embedded derivatives. We hedge or limit our exposure to certain risks associated with these features through our living benefits hedging program and product design elements. Adjusted operating income, as discussed below in Adjusted Operating Income and Revenues, Benefits and Expenses excludes amounts related to changes in the market value of the embedded derivatives and related hedge positions, and the related impact to amortization of DAC and other costs. The items excluded from adjusted operating income are discussed below in Variable Annuity Living Benefits Hedging Program Results.

*Account Values*

Account values are a significant driver of our operating results. Since most fees are determined by the level of separate account assets, fee income varies according to the level of account values. Additionally, our fee income drives other items such as our pattern of amortization of DAC and other costs. Account values are driven by net flows from new business sales, the impact of market changes which can be either positive or negative, and outflows related to surrenders, withdrawals, benefit payments and policy charges. The annuity industry competitive landscape, which has been dynamic over the last few years, may impact our net flows and new business sales. The following tables set forth account value information for the periods indicated.

|  | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2013                                | 2012       | 2013                               | 2012       |
|  | (in millions)                       |            |                                    |            |
| <b>Total Individual Annuities(1):</b>                        |                                     |            |                                    |            |
| Beginning total account value                                | \$ 141,474                          | \$ 124,094 | \$ 135,342                         | \$ 113,535 |
| Sales  | 2,404                               | 5,926      | 9,081                              | 16,243     |
| Surrenders and withdrawals                                   | (1,864)                             | (1,614)    | (5,617)                            | (4,993)    |
| Net sales  | 540                                 | 4,312      | 3,464                              | 11,250     |
| Benefit payments   | (393)                               | (351)      | (1,196)                            | (1,069)    |
| Net flows  | 147                                 | 3,961      | 2,268                              | 10,181     |
| Change in market value, interest credited and other activity | 6,570                               | 5,342      | 12,125                             | 10,940     |
| Policy charges   | (813)                               | (692)      | (2,357)                            | (1,951)    |
| Ending total account value(2)                                | \$ 147,378                          | \$ 132,705 | \$ 147,378                         | \$ 132,705 |

(1) Includes variable and fixed annuities sold as retail investment products. Investments sold through defined contribution plan products are included with such products within the Retirement segment. Variable annuity account values were \$143.7 billion and \$128.9 billion as of September 30, 2013 and 2012, respectively. Fixed annuity account values were \$3.7 billion and \$3.8 billion as of September 30, 2013 and 2012, respectively.

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

- (2) As of September 30, 2013, includes variable annuity account values of \$86 billion, or 60%, invested in equity portfolios, \$44 billion, or 30%, invested in bond portfolios, \$7 billion, or 5%, invested in market value adjusted or fixed-rate accounts and \$7 billion, or 5%, invested in money market funds.



**Table of Contents**

As shown above, our account values are significantly impacted by net sales and the impact of market performance on customer accounts. The increases in account values as of September 30, 2013 compared to the prior periods were largely driven by favorable changes in the market value of contractholder funds, primarily reflecting equity market appreciation in 2013. Positive net sales also contributed to account value growth, but to a lesser extent in the current year periods, as results for the three and nine months ended September 30, 2013 compared to the prior year periods reflected declines in sales coupled with increases in surrenders and withdrawals. The declines in sales for both periods primarily reflect the impacts of actions we have taken to implement variable annuity product modifications for new sales to scale back benefits, increase pricing, and reduce commissions, and the closing of a share class. We also suspended or limited additional contractholder deposits for variable annuities with certain optional living benefit riders that are no longer being offered. The increases in surrenders and withdrawals were primarily driven by the higher overall level of account values. In addition to these impacts, policy charges increased for the three and nine months ended September 30, 2013 compared to the prior year periods, primarily reflecting higher average account values.

*Operating Results*

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

|   | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|---|-------------------------------------|----------|------------------------------------|----------|
|   | 2013                                | 2012     | 2013                               | 2012     |
|   | (in millions)                       |          |                                    |          |
| <b>Operating results:</b>   |                                     |          |                                    |          |
| Revenues  | \$ 1,120                            | \$ 1,018 | \$ 3,307                           | \$ 2,944 |
| Benefits and expenses   | 299                                 | 811      | 1,714                              | 2,209    |
| Adjusted operating income   | 821                                 | 207      | 1,593                              | 735      |
| Realized investment gains (losses), net, and related adjustments  | (2,742)                             | (1,491)  | (4,991)                            | (1,101)  |
| Related charges   | 740                                 | 682      | 1,494                              | 550      |
| Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ (1,181)                          | \$ (602) | \$ (1,904)                         | \$ 184   |

*Adjusted Operating Income*

*Three Month Comparison.* Adjusted operating income increased \$614 million. Excluding the impacts of changes in the estimated profitability of the business, discussed below, adjusted operating income increased \$115 million. The increase was driven by higher asset-based fee income due to growth in average variable annuity account values, as discussed in *Account Values* above, net of a related increase in asset-based commissions.

The impacts of changes in the estimated profitability of the business include adjustments to the amortization of DAC and other costs and to the reserves for the GMDB and GMIB features of our variable annuity products. These adjustments resulted in a \$451 million net benefit in the third quarter of 2013, and a \$48 million net charge in the third quarter of 2012. The \$451 million net benefit in third quarter of 2013 included a \$301 million net benefit resulting from an annual review and update of assumptions, driven by reductions to our lapse and GMIB utilization rate assumptions to reflect our review of emerging experience, future expectations and other data, and other refinements. The remaining net benefit also reflected the impact of positive market performance on customer accounts relative to our assumptions. The \$48 million net charge in the third quarter of 2012 included a \$106 million net charge resulting from the annual review and update of assumptions performed in that period,

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

driven by reductions to our long-term interest and equity rate of return assumptions, as well as updates to actuarial assumptions and other refinements. This net charge was partially offset by the impact of positive market performance on customer accounts relative to our assumptions.

---

**Table of Contents**

*Nine Month Comparison.* Adjusted operating income increased \$858 million. Excluding the impacts of changes in the estimated profitability of the business, discussed below, adjusted operating income increased \$294 million. The increase was driven by higher asset-based fee income due to growth in average variable annuity account values, net of a related increase in asset-based commissions.

The impacts of changes in the estimated profitability of the business include adjustments to the amortization of DAC and other costs and to the reserves for the GMDB and GMIB features of our variable annuity products. These adjustments resulted in net benefits of \$588 million and \$24 million in the first nine months of 2013 and 2012, respectively. The \$588 million net benefit in the first nine months of 2013 included a \$301 million net benefit resulting from an annual review and update of assumptions and other refinements, as discussed above. The remaining net benefit also reflected the impact of positive market performance on customer accounts relative to our assumptions. The \$24 million net benefit in the first nine months of 2012 primarily reflected the impact of positive market performance on customer accounts relative to our assumptions, which more than offset a \$106 million net charge from the annual review and update of assumptions and other refinements, as discussed above.

*Revenues, Benefits and Expenses*

*Three Month Comparison.* Revenues, as shown in the table above under Operating Results, increased \$102 million, primarily driven by a \$128 million increase in policy charges and fee income, and asset management fees and other income, due to growth in average variable annuity account values, as discussed in Account Values above. Partially offsetting this increase was a \$28 million decline in net investment income, driven by lower average account values in the general account due to surrenders of legacy general account products and net transfers from the general account to the separate accounts, driven by an automatic rebalancing element in some of our optional living benefit features. For additional information on the automatic rebalancing element, also referred to as an asset transfer feature, see Variable Annuity Risks and Risk Mitigants below.

Benefits and expenses, as shown in the table above under Operating Results, decreased \$512 million. Absent the \$499 million net decrease related to the impacts of certain changes in our estimated profitability of the business, discussed above, benefits and expenses decreased \$13 million. Interest credited to policyholders account balances declined \$14 million driven by lower average account values in the general account, as discussed above. The amortization of DAC decreased \$10 million, primarily due to lower amortization rates driven by the impacts of the annual review and update of assumptions and other refinements on the amortization rate applied to current period gross profits. Partially offsetting these decreases was a \$12 million increase in general and administrative expenses, net of capitalization, driven by higher asset-based commissions and asset management costs due to account value growth.

*Nine Month Comparison.* Revenues increased \$363 million, primarily driven by a \$421 million increase in policy charges and fee income, and asset management fees and other income, due to growth in average variable annuity account values. Partially offsetting this increase was a \$59 million decline in net investment income, driven by lower average account values in the general account due to surrenders of legacy general account products and net transfers from the general account to the separate accounts, driven by an automatic rebalancing element in some of our optional living benefit features.

Benefits and expenses decreased \$495 million. Absent the \$564 million net decrease related to the impacts of certain changes in our estimated profitability of the business, discussed above, benefits and expenses increased \$69 million. General and administrative expenses, net of capitalization, increased \$69 million, driven by higher asset-based commissions and asset management costs due to account value growth. The amortization of DAC increased \$20 million, primarily driven by higher gross profits related to increased fee income, which more than offset the impacts of lower amortization rates, as discussed above. These increases were partially offset by a \$33 million decline in interest credited to policyholders account balances driven by lower average account values in the general account, as discussed above.



---

**Table of Contents***Variable Annuity Risks and Risk Mitigants*

The primary risk exposures of our variable annuity contracts relate to actual deviations from, or changes to, the assumptions used in the original pricing of these products, including capital markets assumptions, such as equity market returns, interest rates and market volatility, and actuarial assumptions, such as contractholder longevity/mortality, the timing and amount of annuitization and withdrawals, and contract lapses. For our actuarial assumptions, we have retained the risk that actual experience will differ from the assumptions used in the original pricing of these products. For our capital markets assumptions, we hedge or limit our exposure to the risk created by capital markets fluctuations through a combination of product design elements, such as an automatic rebalancing element, and inclusion of certain optional living benefits in our living benefits hedging program.

Our automatic rebalancing element occurs at the contractholder level, and transfers assets between certain variable investment sub-accounts selected by the annuity contractholder and, depending on the benefit feature, a fixed-rate account in the general account or a bond fund sub-account within the separate accounts. The automatic rebalancing element associated with currently-sold products uses a designated bond fund sub-account within the separate accounts. The transfers are based on the static mathematical formula used with the particular benefit which considers a number of factors, including, but not limited to, the impact of investment performance on the contractholder's total account value. The objective of the automatic rebalancing element is to help mitigate our exposure to equity market risk and market volatility. Other product design elements we utilize include, among others, asset allocation restrictions, minimum issuance age requirements and certain limitations on the amount of subsequent contractholder deposits. In addition, certain fees are based on the greater of a benefit guarantee amount or the account value, which helps preserve certain revenue streams when market fluctuations cause account values to decline.

We use our living benefits hedging program to manage the risk associated with certain of our optional living benefit guarantees. This program represents a balance among three objectives that seek to: 1) provide severe scenario protection, 2) minimize net income volatility associated with an internally-defined hedge target, and 3) maintain capital efficiency. Through our hedge program, we enter into derivative positions that seek to replicate the net change in our hedge target, discussed further below. In addition to mitigating capital markets risk and income statement volatility, the hedging program is also focused on a long-term goal of accumulating assets that could be used to pay claims under these benefits irrespective of market path. For additional information regarding this program see [Variable Annuities Living Benefits Hedging Program Results](#) below.

For our optional living benefits features, claims will primarily represent the funding of contractholder lifetime withdrawals after the cumulative withdrawals have first exhausted the contractholder account value. Due to the age of the block, limited claim payments have occurred to date, and they are not expected to increase significantly within the next five years, based upon current assumptions. The timing and amount of actual future claims depend on actual returns on contractholder account value and actual contractholder behavior relative to our assumptions. The majority of our current optional living benefits features provide for guaranteed lifetime contractholder withdrawal payments based on a highest daily contract value. Late in the first quarter of 2013, we launched the Prudential Defined Income Variable Annuity, or PDI, to complement the variable annuity products we offer with the highest daily benefit. PDI also provides for guaranteed lifetime contractholder withdrawal payments, but restricts contractholder asset allocation to a single bond fund sub-account within the separate accounts.

The majority of our variable annuity contracts with optional living benefits features, and all new contracts sold with our highest daily living benefits feature, include two risk mitigants in the form of an automatic rebalancing element and inclusion in our living benefits hedging program. The guaranteed benefits features of certain legacy products that were sold prior to our implementation of the automatic rebalancing element product feature are included in our living benefits hedge program. Certain legacy guaranteed minimum accumulation benefit (GMAB) products include the automatic rebalancing element, but are not included in the hedging program. Our contracts with the GMIB feature and our new PDI product have neither risk mitigant.



**Table of Contents**

For our GMDBs, we provide a benefit payable in the event of death. Our base GMDB is generally equal to a return of cumulative deposits less any partial withdrawals. For certain products, we offer an optional enhanced GMDB based on the greater of a minimum return on the contract value or an enhanced value. We have retained the risk that the total amount of death benefit payable may be greater than the contractholder account value. However, a substantial portion of the account values associated with GMDBs are subject to an automatic rebalancing element because the contractholder also selected a living benefit feature which includes an automatic rebalancing element. All of the variable annuity account values with living benefit features also contain GMDBs. The living and death benefit features for these contracts cover the same insured life and, consequently, we have insured both the longevity and mortality risk on these lives.

The following table sets forth the risk profile of our optional living benefits and GMDB features as of the periods indicated.

|  | September 30, 2013 |            | December 31, 2012 |            | September 30, 2012 |            |
|--|--------------------|------------|-------------------|------------|--------------------|------------|
|  | Account Value      | % of Total | Account Value     | % of Total | Account Value      | % of Total |
| <b>Optional living benefit/GMDB features(1):</b> |                    |            |                   |            |                    |            |
| Both risk mitigants(2)                           | \$ 100,418         | 70%        | \$ 89,167         | 68%        | \$ 85,710          | 67%        |
| Hedging program only                             | 11,914             | 8%         | 11,744            | 9%         | 11,898             | 9%         |
| Automatic rebalancing only                       | 2,365              | 2%         | 2,787             | 2%         | 2,962              | 2%         |
| Neither risk mitigant                            | 3,921              | 3%         | 3,556             | 3%         | 3,631              | 3%         |
| Total optional living benefit/GMDB features      | \$ 118,618         |            | \$ 107,254        |            | \$ 104,201         |            |
| <b>GMDB features only(3):</b>                    |                    |            |                   |            |                    |            |
| Neither risk mitigant                            | 25,079             | 17%        | 24,354            | 18%        | 24,748             | 19%        |
| Total variable annuity account value             | \$ 143,697         |            | \$ 131,608        |            | \$ 128,949         |            |

- (1) All contracts with optional living benefit guarantees also contain GMDB features, covering the same insured life.
- (2) Contracts with both risk mitigants have optional living benefits that are included in our living benefits hedging program, and have an automatic rebalancing element.
- (3) Reflects contracts that only include a GMDB feature and do not have an automatic rebalancing element.

The increase in account values that include both risk mitigants as of September 30, 2013 compared to the prior periods primarily reflects sales of our latest product offerings with our highest daily optional living benefits feature, which include an automatic rebalancing element and are also included in our living benefits hedging program.

*Variable Annuity Living Benefits Hedging Program Results*

Under U.S. GAAP, the liability for certain optional living benefit features is accounted for as an embedded derivative and recorded at fair value, based on assumptions a market participant would use in pricing these features. The fair value is calculated as the present value of future expected benefit payments to contractholders less the present value of assessed rider fees attributable to the applicable living benefit features using option pricing techniques. See Note 13 to the Unaudited Interim Consolidated Financial Statements for additional information regarding the methodology and assumptions used in calculating the fair value under U.S. GAAP.





**Table of Contents**

As noted within Variable Annuity Risks and Risk Mitigants above, we maintain a hedge program to manage the risk associated with certain of these guarantees. Our hedge program utilizes an internally-defined hedge target. We review our hedge target and hedge program on an ongoing basis, and may periodically adjust them based on our evaluation of the risks associated with the guarantees and other factors. Based on our review in the third quarter of 2013, we adjusted our hedge target so that, as currently defined, it includes the following modifications to the assumptions used in the U.S. GAAP valuation:

The impact of non-performance risk ( NPR ) is excluded to maximize protection against the entire projected claim irrespective of the possibility of our own default.

The assumptions used in the projection of customer account values and living benefit costs are adjusted to reflect assumed return and volatility expectations for the underlying investments.

Actuarial assumptions are adjusted to remove risk margins and reflect our best estimates.

Due to these modifications, we expect differences each period between the change in the value of the embedded derivative as defined by U.S. GAAP and the change in the value of the hedge positions used to replicate the hedge target, thus potentially increasing volatility in U.S. GAAP earnings. The following table provides a reconciliation between the fair value of the embedded derivative as defined by U.S. GAAP and the value of our hedge target as of the periods indicated.

|   | As of<br>September 30,<br>2013 | As of<br>December 31,<br>2012 |
|---|--------------------------------|-------------------------------|
|   | (in billions)                  |                               |
| Embedded derivative liability as defined by U.S. GAAP   | \$ 2.0                         | \$ 3.3                        |
| Less: NPR Adjustment  | (3.5)                          | (4.8)                         |
| Embedded derivative liability as defined by U.S. GAAP, excluding NPR                                | 5.5                            | 8.1                           |
| Less: Portion of embedded derivative liability, excluding NPR, excluded from hedge target liability | 4.3                            | 2.3                           |
| Hedge target liability  | \$ 1.2                         | \$ 5.8                        |

We seek to replicate the changes in our hedge target by entering into a range of exchange-traded, cleared and over the counter equity and interest rate derivatives to hedge certain capital market risks present in our hedge target. The instruments include, but are not limited to, interest rate swaps, swaptions, floors and caps as well as equity options, total return swaps and equity futures. The following table sets forth the market and notional values of these instruments as of the periods indicated.

| Instrument | As of September 30, 2013 |              |               |              | As of December 31, 2012 |              |               |              |
|------------|--------------------------|--------------|---------------|--------------|-------------------------|--------------|---------------|--------------|
|            | Equity                   |              | Interest Rate |              | Equity                  |              | Interest Rate |              |
|            | Notional                 | Market Value | Notional      | Market Value | Notional                | Market Value | Notional      | Market Value |
|            | (in billions)            |              |               |              |                         |              |               |              |
| Futures    | \$ 0.6                   | \$ 0.0       | \$ 0.0        | \$ 0.0       | \$ 6.5                  | \$ (0.2)     | \$ 0.0        | \$ 0.0       |
| Swaps      | 10.5                     | (0.1)        | 61.0          | (1.4)        | 5.5                     | (0.1)        | 54.1          | 3.0          |
| Options    | 8.0                      | 0.4          | 24.9          | 0.2          | 10.7                    | 0.5          | 25.3          | 0.8          |

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|       |         |        |         |          |         |        |         |        |
|-------|---------|--------|---------|----------|---------|--------|---------|--------|
| Total | \$ 19.1 | \$ 0.3 | \$ 85.9 | \$ (1.2) | \$ 22.7 | \$ 0.2 | \$ 79.4 | \$ 3.8 |
|-------|---------|--------|---------|----------|---------|--------|---------|--------|

Due to cash flow timing differences between our hedging instruments and the corresponding hedge target, as well as other factors such as updates to actuarial assumptions which are not hedged, the market value of the hedge portfolio compared to our hedge target measured as of any specific point in time may be different and is not expected to be fully offsetting. In addition to the derivatives held as part of the hedging program, we have cash and other invested assets available to cover the future claims payable under these guarantees and other

**Table of Contents**

liabilities. For additional information on the liquidity needs associated with our hedging program, see [Liquidity and Capital Resources](#) Liquidity associated with other activities Hedging activities associated with living benefit guarantees.

The primary sources of differences between the changes in the fair value of the hedge positions and the hedge target, other than changes related to actuarial valuation assumption updates, fall into one of three categories:

**Fund Performance** In order to project future account value changes, we make certain assumptions about how each underlying fund will perform. We map contractholder funds to indices that we believe are comparable, are readily tradable and have active derivative markets. The difference between the modeled fund performance and actual fund performance results in basis differences that can be either positive or negative.

**Rebalancing Costs and Volatility** We incur costs associated with rebalancing hedge positions for basis differences between the hedge positions and the hedge target. Our hedge program is also subject to the impact of realized market volatility in excess of, or lower than, our hedge target volatility assumptions.

**Liability Basis** We make assumptions about expected changes in the hedge target related to contractholder behavior, which are not hedged, and capital markets impacts, which we attempt to replicate with our hedge program. The difference between the actual change in the hedge target and the expected changes we have modeled results in basis differences, which can be either positive or negative.

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

|   | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|---|-------------------------------------|------------|------------------------------------|------------|
|   | 2013                                | 2012(1)    | 2013                               | 2012(1)    |
|   | (2)<br>(in millions)                |            |                                    |            |
| <b>Hedge Program Results:</b>   |                                     |            |                                    |            |
| Change in fair value of hedge positions   | \$ (1,370)                          | \$ (1,386) | \$ (6,906)                         | \$ (1,475) |
| Change in value of hedge target(3)  | 1,590                               | 1,724      | 6,663                              | 1,910      |
| Net hedging impact(3)(4)  | 220                                 | 338        | (243)                              | 435        |
| <b>Reconciliation of Hedge Program Results to U.S. GAAP Results:</b>                    |                                     |            |                                    |            |
| Net hedging impact (from above)   | \$ 220                              | \$ 338     | \$ (243)                           | \$ 435     |
| Change in portions of U.S. GAAP liability, before NPR, excluded from hedge target(3)(5) | 108                                 | (169)      | 465                                | (642)      |
| Change in the NPR adjustment(3)   | (928)                               | (1,616)    | (3,012)                            | (887)      |
| Subtotal  | (600)                               | (1,447)    | (2,790)                            | (1,094)    |
| Related benefit to amortization of DAC and other costs(3)                               | 194                                 | 677        | 946                                | 574        |
| Net impact of assumption updates and other refinements(6)                               | (1,533)                             | (46)       | (1,533)                            | (46)       |

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|   |            |          |            |          |
|---|------------|----------|------------|----------|
| Net impact from changes in the U.S. GAAP embedded derivative and hedge positions, after the impact of NPR, DAC and other costs(4) | \$ (1,939) | \$ (816) | \$ (3,377) | \$ (566) |
|---|------------|----------|------------|----------|

- (1) Prior periods have been reclassified to conform to current period presentation.
- (2) Positive amount represents income; negative amount represents a loss.

**Table of Contents**

- (3) Excludes the impacts of assumption updates and other refinements.
- (4) Excludes \$226 million and \$139 million for the three months ended September 30, 2013 and 2012, respectively, and \$1,135 million and \$(155) million for the nine months ended September 30, 2013 and 2012, respectively representing the impact of managing interest rate risk through capital management strategies other than hedging of particular exposures. Because this decision is based on the capital considerations of the Company as a whole, the impact is reported in Corporate and Other operations. See Corporate and Other.
- (5) Represents the impact attributable to the difference between the value of the hedge target and the value of the embedded derivative as defined by U.S. GAAP, before adjusting for NPR, as discussed above.
- (6) Represents the total U.S. GAAP impact of assumption updates and other refinements on our hedge target, net of related changes in the NPR adjustment, related changes in amounts attributable to the difference between the value of the hedge target and the value of the embedded derivative as defined by U.S. GAAP, and related amortization of DAC and other costs.

The net hedging benefit of \$220 million for the three months ended September 30, 2013 was primarily driven by fund outperformance relative to indices and favorable liability basis. The net hedging charge of \$243 million for the nine months ended September 30, 2013 was primarily driven by fund underperformance relative to indices and realized volatility, partially offset by favorable liability basis. The net hedging benefits of \$338 million and \$435 million for the three and nine months ended September 30, 2012, respectively, were primarily driven by fund outperformance relative to indices and favorable liability basis. Each of these items resulted in partial offsets included in the related benefit to the amortization of DAC and other costs in all periods.

The net charges from the change in the NPR adjustment of \$928 million and \$3,012 million for the three and nine months ended September 30, 2013, respectively, were driven by net decreases in the base embedded derivative liability before NPR, primarily reflecting the impact of favorable capital markets conditions. The net charges from the change in the NPR adjustment of \$1,616 million and \$887 million for the three and nine months ended September 30, 2012, respectively, were driven by the tightening of our NPR credit spreads. Each of these items resulted in partial offsets included in the related benefit to the amortization of DAC and other costs in all periods.

The net charges from the impact of assumption updates and other refinements of \$1,533 million for both the three and nine months ended September 30, 2013 were primarily driven by modifications to our lapse rate assumptions to reflect our review of emerging experience, future expectations and other data, and other refinements. These updates increased expected claims significantly more than expected fees, which increased our net liability. The net charges from the impact of assumption updates and other refinements of \$46 million for both the three and nine months ended September 30, 2012 were primarily driven by modifications to our lapse, mortality and utilization rate assumptions to reflect our review of emerging experience, future expectations and other data.

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

**Table of Contents****Retirement***Operating Results*

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

|  | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|--|-------------------------------------|----------|------------------------------------|----------|
|  | 2013                                | 2012     | 2013                               | 2012     |
|  | (in millions)                       |          |                                    |          |
| <b>Operating results:</b>  |                                     |          |                                    |          |
| Revenues   | \$ 1,525                            | \$ 1,162 | \$ 4,382                           | \$ 3,511 |
| Benefits and expenses  | 1,288                               | 1,052    | 3,638                              | 3,098    |
| Adjusted operating income  | 237                                 | 110      | 744                                | 413      |
| Realized investment gains (losses), net, and related adjustments   | (208)                               | (65)     | (567)                              | (66)     |
| Related charges  | (2)                                 | 1        | (1)                                | 1        |
| Investment gains on trading account assets supporting insurance liabilities, net                         | 51                                  | 268      | (615)                              | 436      |
| Change in experience-rated contractholder liabilities due to asset value changes                         | (21)                                | (258)    | 597                                | (380)    |
| Income from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ 57                               | \$ 56    | \$ 158                             | \$ 404   |

*Adjusted Operating Income*

*Three Month Comparison.* Adjusted operating income increased \$127 million. Excluding the impact of changes in the estimated profitability of the business and certain other items discussed below, adjusted operating income increased \$89 million primarily driven by higher net investment spread results, higher asset-based fee income and a more favorable reserve impact from case experience. The increase in net investment spread results primarily reflects higher income on institutional investment products account values, driven by significant pension risk transfer transactions that closed in the fourth quarter of 2012, as well as higher income from non-coupon investments. Higher asset-based fee income was driven by increases in full service account values primarily from market appreciation, as well as net additions of investment-only stable value account values. The more favorable reserve impact from case experience reflects favorable mortality experience on several large structured settlement cases and the significant pension risk transfer contracts. These increases were partially offset by higher general and administrative expenses, net of capitalization, driven primarily by higher compensation costs.

The impact of changes in our estimated profitability of the business includes adjustments to the amortization of DAC, value of business acquired (VOBA) and reserves for our products. These changes resulted in net charges of \$4 million and \$13 million for the third quarter of 2013 and 2012, respectively, primarily related to our annual review and update of assumptions. The net charge in the third quarter of 2013 was driven by less favorable expected mortality assumptions, partially offset by improved net cash flow and net spread assumptions, while the net charge in the third quarter of 2012 was primarily driven by a reduction to the long-term interest and equity rate of return assumptions. Additionally, results for the third quarter of 2012 reflect a \$29 million charge for the write off of an intangible asset on a business we acquired in 2008.

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

*Nine Month Comparison.* Adjusted operating income increased \$331 million. Excluding the impact of changes in the estimated profitability of the business and certain other items discussed below, adjusted operating income increased \$286 million reflecting higher net investment spread results and a more favorable reserve impact from case experience, as well as higher asset-based fee income. The increase in net investment spread results primarily reflects higher income on institutional investment products account values, driven by significant

**Table of Contents**

pension risk transfer transactions, discussed above, and higher income from non-coupon investments. The more favorable reserve impact from case experience reflects the impact of favorable mortality related to these pension risk transfer contracts, partially resulting from a change in benefit administration. Higher asset-based fee income was driven by net additions of investment-only stable value account values and increases in full service account values primarily from market appreciation. These increases were partially offset by higher general and administrative expenses, net of capitalization, driven by higher compensation costs and strategic initiatives. In addition, full service net investment spread results were lower, driven by lower portfolio yields, partially offset by lower crediting rates driven by rate resets in the third quarter of 2012 and the first and third quarters of 2013.

The impact of changes in our estimated profitability of the business includes adjustments to the amortization of DAC, VOBA and reserves for our products. These changes resulted in net charges of \$3 million and a net charge of \$19 million for the first nine months of 2013 and 2012, respectively, primarily related to our annual review and update of assumptions. The net charge in the first nine months of 2013 was driven by less favorable expected mortality assumptions, partially offset by improved net cash flow and net spread assumptions, while the net charge in the first nine months of 2012 was primarily driven by a reduction to the long-term interest and equity rate of return assumptions. Additionally, results for the first nine months of 2012 reflect a \$29 million charge for the write off of an intangible asset on a business we acquired in 2008.

*Revenues, Benefits and Expenses*

*Three Month Comparison.* Revenues, as shown in the table above under Operating Results, increased \$363 million. Net investment income increased \$238 million reflecting higher income on institutional investment products account values, driven by the significant pension risk transfer transactions discussed above and higher income on non-coupon investments, partially offset by lower portfolio yields on full service general account stable value account values. Premiums increased \$113 million reflecting a net increase in sales of single premium annuities and the impact of amortization of deferred profits on the significant pension risk transfer transactions. Policy charges and fee income, and asset management fees and other income increased \$12 million, primarily from higher asset-based fees driven by increases in full service and investment-only stable value account values, as discussed above.

Benefits and expenses, as shown in the table above under Operating Results, increased \$236 million. Excluding the net decrease from the changes in our estimated profitability of the business and other items, as discussed above, which total \$38 million, benefits and expenses increased \$274 million. Policyholders' benefits, including the change in policy reserves, increased \$301 million, primarily driven by the pension risk transfer transactions discussed above, partially offset by a more favorable reserve impact from case experience. General and administrative expenses increased \$22 million, driven by higher compensation costs and strategic initiatives. Partially offsetting the increases above was a \$53 million decrease in interest credited to policyholders' account balances primarily reflecting the runoff of traditional guaranteed investment products in our institutional investment products business and the impact of crediting rate reductions on full service general account stable value account values.

*Nine Month Comparison.* Revenues increased \$871 million. Net investment income increased \$683 million driven primarily by higher income on institutional investment products account values, driven by the significant pension risk transfer transactions discussed above and higher income on non-coupon investments, partially offset by lower portfolio yields on full service general account stable value account values. Premiums increased \$151 million reflecting a net increase related to the amortization of deferred profits on the significant pension risk transfer transactions and a net increase in sales of single premium annuities. Policy charges and fee income, and asset management fees and other income, increased \$37 million, primarily from higher asset-based fees that were driven by increases in investment-only stable value account and full service account values, as discussed above.

Benefits and expenses increased \$540 million. Excluding the net decrease from the changes in our estimated profitability of the business and other items, as discussed above, which total \$45 million, benefits and expenses increased \$585 million. Policyholders' benefits, including the



change in policy reserves, increased \$664 million,

**Table of Contents**

primarily driven by the pension risk transfer transactions discussed above, partially offset by a more favorable reserve impact from case experience, partially resulting from a change in benefit administration. General and administrative expenses, net of capitalization, increased \$49 million, driven by higher compensation and strategic initiatives. Partially offsetting the increase above was a \$136 million decrease in interest credited to policyholders' account balances reflecting the runoff of traditional guaranteed investment products in our institutional investment products business and the impact of crediting rate reductions on full service general account stable value account values.

*Account Values*

Our account values are a significant driver of our operating results, and are primarily driven by net additions (withdrawals) and the impact of market changes. For our fee-based products, the income we earn varies with the level of fee-based account values. For our spread-based products, both the investment income and interest we credit to policyholders vary with the level of general account values. To a lesser extent, changes in account values impact our pattern of amortization of DAC and value of business acquired, and general and administrative expenses. The following table shows the changes in the account values and net additions (withdrawals) of Retirement segment products for the periods indicated. Net additions (withdrawals) are deposits and sales or additions, as applicable, minus withdrawals and benefits. Account values include both internally- and externally-managed client balances as the total balances drive revenue for the Retirement segment.

|   | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|---|-------------------------------------|------------|------------------------------------|------------|
|   | 2013                                | 2012       | 2013                               | 2012       |
| (in millions)   |                                     |            |                                    |            |
| <b>Full Service(1):</b>   |                                     |            |                                    |            |
| Beginning total account value   | \$ 157,738                          | \$ 142,405 | \$ 148,405                         | \$ 139,430 |
| Deposits and sales  | 5,455                               | 3,478      | 14,831                             | 12,487     |
| Withdrawals and benefits  | (4,627)                             | (4,063)    | (12,925)                           | (14,837)   |
| Change in market value, interest credited and interest income and other activity(2) | 6,798                               | 5,114      | 15,053                             | 9,854      |
| Ending total account value  | \$ 165,364                          | \$ 146,934 | \$ 165,364                         | \$ 146,934 |
| Net additions (withdrawals)   | \$ 828                              | \$ (585)   | \$ 1,906                           | \$ (2,350) |
| <b>Institutional Investment Products(3):</b>  |                                     |            |                                    |            |
| Beginning total account value   | \$ 144,101                          | \$ 102,443 | \$ 141,435                         | \$ 90,089  |
| Additions   | 5,034                               | 2,957      | 13,239                             | 15,813     |
| Withdrawals and benefits(4)   | (2,487)                             | (1,539)    | (7,268)                            | (5,909)    |
| Change in market value, interest credited and interest income                       | 547                                 | 1,509      | 87                                 | 3,999      |
| Other(4)  | (95)                                | (724)      | (393)                              | 654        |
| Ending total account value(5)(6)  | \$ 147,100                          | \$ 104,646 | \$ 147,100                         | \$ 104,646 |
| Net additions(7)  | \$ 2,547                            | \$ 1,418   | \$ 5,971                           | \$ 9,904   |

(1) Ending total account value for the full service business includes assets of Prudential's retirement plans of \$7.4 billion and \$6.5 billion as of September 30, 2013 and 2012, respectively.

(2) Change in market value, interest credited and interest income and other activity includes \$(1.4) billion for the nine months ended September 30, 2012 representing the divestiture of bank deposits held by Prudential Bank & Trust, FSB, as a result of our decision to limit its operations to trust services.

(3) Ending total account value for the institutional investment products business includes assets of Prudential's defined benefit plan of \$5.5 billion and \$6.1 billion as of September 30, 2013 and 2012, respectively. Ending total account value for the institutional investment products business also includes \$1.9 billion and \$1.5 billion as of September 30, 2013 and 2012, respectively related to collateralized funding agreements issued to the Federal Home Loan Bank of New York (FHLB NY). For additional information, see Note 9 to the Unaudited Interim Consolidated Financial Statements.



**Table of Contents**

- (4) Withdrawals and benefits includes (\$7) million and (\$17) million for the three and nine months ended September 30, 2013, respectively, and (\$9) million and (\$902) million for the three and nine months ended September 30, 2012, respectively, representing transfers from accounts we manage to externally-managed accounts. These transfers are offset in Other, as there is no net impact on ending account values for these transfers.
- (5) Ending total account value for the institutional investment products business includes investment-only stable value account values of \$70.0 billion and \$55.9 billion as of September 30, 2013 and 2012, respectively.
- (6) Ending total account value for the institutional investment products business includes \$32.2 billion as of September 30, 2013 related to significant pension risk transfer transactions that closed in the fourth quarter of 2012. These account values will decline over time resulting from benefit payments to contract holders.
- (7) Net additions for the institutional investment products business include investment-only stable value account value net additions of \$3.8 billion and \$10.1 billion for the three and nine months ended September 30, 2013, respectively, and \$2.0 billion and \$12.9 billion for the three and nine months ended September 30, 2012, respectively.

The increase in full service account values as of September 30, 2013 compared to September 30, 2012 primarily reflects the impact of equity market appreciation on the market value of customer funds. The increase in net additions (withdrawals) for the three months ended September 30, 2013 compared to the prior year period was primarily due to higher large plan sales. The increase in net additions (withdrawals) for the nine months ended September 30, 2013 compared to the prior year period is primarily driven by a lower volume of large plan lapses and a higher volume of large plan sales.

The increase in institutional investment products account values as of September 30, 2013 compared to September 30, 2012 is primarily driven by significant pension risk transfer transactions in the fourth quarter of 2012 and net additions of our fee-based investment-only stable value product. The increase in net additions for the three months ended September 30, 2013 compared to the prior year period was primarily due to increases in investment-only stable value sales. The decrease in net additions for the nine months ended September 30, 2013 compared to the prior year period was primarily due to decreases in investment-only stable value sales and an increase in benefit payments driven by the significant pension risk transfer transactions, discussed above.

**Asset Management****Operating Results**

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

|  | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |          |
|--|-------------------------------------|--------|------------------------------------|----------|
|  | 2013                                | 2012   | 2013                               | 2012     |
|  | (in millions)                       |        |                                    |          |
| <b>Operating results:</b>  |                                     |        |                                    |          |
| Revenues   | \$ 682                              | \$ 641 | \$ 2,007                           | \$ 1,687 |
| Expenses   | 482                                 | 452    | 1,460                              | 1,314    |
| Adjusted operating income  | 200                                 | 189    | 547                                | 373      |
| Realized investment gains (losses), net, and related adjustments   | 10                                  | (13)   | (2)                                | (18)     |
| Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests     | 17                                  | 21     | 81                                 | 41       |
| Income from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ 227                              | \$ 197 | \$ 626                             | \$ 396   |

*Adjusted Operating Income*

*Three Month Comparison.* Adjusted operating income increased \$11 million. The increase reflects higher asset management fees, driven by higher average asset values due to positive net flows and market appreciation since the third quarter of 2012. Also contributing to the increase were higher performance-based incentive fees,

**Table of Contents**

driven by outperformance within public equity accounts in 2013. These increases were partially offset by higher compensation costs and lower strategic investing results, primarily reflecting less favorable market appreciation on certain real estate-related investments.

*Nine Month Comparison.* Adjusted operating income increased \$174 million. The increase reflects higher asset management fees, driven by higher average asset values due to positive net flows and market appreciation since the third quarter of 2012. Also contributing to the increase were improved strategic investing results, as the prior year period included a \$75 million impairment of a real estate-related investment, as well as higher performance-based incentive fees, net of direct expenses, driven by outperformance within public equity accounts in 2013. These increases were partially offset by higher compensation costs.

*Revenues and Expenses*

The following tables set forth the Asset Management segment's revenues, presented on a basis consistent with the table above under Operating Results, by type.

|   | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |          |
|---|-------------------------------------|--------|------------------------------------|----------|
|   | 2013                                | 2012   | 2013                               | 2012     |
|   | (in millions)                       |        |                                    |          |
| <b>Revenues by type:</b>                    |                                     |        |                                    |          |
| Asset management fees by source:            |                                     |        |                                    |          |
| Institutional customers                     | \$ 210                              | \$ 194 | \$ 620                             | \$ 574   |
| Retail customers(1)                         | 161                                 | 132    | 460                                | 377      |
| General account                             | 101                                 | 98     | 310                                | 283      |
| Total asset management fees                 | 472                                 | 424    | 1,390                              | 1,234    |
| Incentive fees(2)                           | 40                                  | 25     | 73                                 | 25       |
| Transaction fees                            | 5                                   | 8      | 19                                 | 29       |
| Strategic investing                         | 15                                  | 32     | 28                                 | (46)     |
| Commercial mortgage(3)                      | 24                                  | 48     | 89                                 | 110      |
| Other related revenues(4)                   | 84                                  | 113    | 209                                | 118      |
| Service, distribution and other revenues(5) | 126                                 | 104    | 408                                | 335      |
| Total revenues                              | \$ 682                              | \$ 641 | \$ 2,007                           | \$ 1,687 |

(1) Consists of fees from: (a) individual mutual funds and variable annuities and variable life insurance separate account assets; (b) funds invested in proprietary mutual funds through our defined contribution plan products; and (c) third party sub-advisory relationships. Revenues from fixed annuities and the fixed-rate accounts of variable annuities and variable life insurance are included in the general account.

(2) A portion of incentive fee revenue is offset in compensation expense in accordance with the terms of contractual agreements. Certain fees continue to be subject to positive or negative future adjustment based on cumulative fund performance in relation to specified benchmarks. As of September 30, 2013, \$110 million of cumulative incentive fee revenue, net of compensation, is subject to future adjustment.

(3) Includes mortgage origination and spread lending revenues of our commercial mortgage origination and servicing business.

(4) Future revenues will be impacted by the level and diversification of our strategic investments, the commercial real estate market, and other domestic and international markets.

(5)

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Includes payments from Wells Fargo under an agreement dated as of July 30, 2004, implementing arrangements with respect to money market mutual funds in connection with the combination of our retail securities brokerage and clearing operations with those of Wells Fargo. The agreement extends for ten years after termination of the Wachovia Securities joint venture, which occurred on December 31, 2009. The revenue from Wells Fargo under this agreement was \$19 million and \$17 million for the three months ended September 30, 2013 and 2012, respectively, and \$55 million and \$49 million for the nine months ended September 30, 2013 and 2012, respectively.

*Three Month Comparison.* Revenues, as shown in the table above, increased \$41 million. Asset management fees increased \$48 million, driven by higher average asset values due to positive net flows and market appreciation since the third quarter of 2012. Service, distribution and other revenues increased \$22 million, primarily due to higher servicing fee income from our commercial mortgage business.

**Table of Contents**

Performance-based incentive fee revenues increased \$15 million, primarily driven by outperformance within public equity accounts in 2013. Commercial mortgage revenues decreased \$24 million, driven by lower production and profitability levels and lower investment gains due to the disposition of real estate owned assets in 2012. Strategic investing results decreased \$17 million, primarily due to lower appreciation in certain real estate-related investments in 2013.

Expenses, as shown in the table above under Operating Results, increased \$30 million, primarily driven by higher compensation costs.

*Nine Month Comparison.* Revenues, as shown in the table above, increased \$320 million. Asset management fees increased \$156 million, driven by higher average asset values due to positive net flows and market appreciation since the third quarter of 2012. Strategic investing revenues increased \$74 million, as the prior year period included a \$75 million impairment of a real estate-related investment, partially offset by higher co-investment results in certain real estate investments in the prior year period. Service, distribution and other revenues increased \$73 million, which includes higher revenues from certain consolidated funds, which were fully offset by higher expenses related to noncontrolling interests in these funds, as well as higher servicing fee income from our commercial mortgage business. Performance-based incentive fee revenues increased \$48 million, driven by outperformance within public equity accounts in 2013. Commercial mortgage revenues decreased \$21 million, driven by lower production and profitability levels and lower investment gains due to the disposition of real estate owned assets in 2012. Transaction fees decreased \$10 million, due to declining acquisition and disposition volumes in certain real estate portfolios.

Expenses increased \$146 million, primarily driven by higher compensation costs, and higher expenses related to revenues associated with certain consolidated funds, as discussed above.

*Assets Under Management*

The following tables set forth assets under management by asset class and source as of the dates indicated.

|  | September 30,<br>2013 | December 31,<br>2012<br>(in billions) | September 30,<br>2012 |
|--|-----------------------|---------------------------------------|-----------------------|
| <b>Assets Under Management (at fair market value):</b> |                       |                                       |                       |
| Institutional customers:                               |                       |                                       |                       |
| Equity   | \$ 60.3               | \$ 51.7                               | \$ 51.5               |
| Fixed income   | 236.0                 | 230.8                                 | 221.0                 |
| Real estate  | 34.0                  | 31.2                                  | 30.6                  |
| Institutional customers(1)(2)                          | 330.3                 | 313.7                                 | 303.1                 |
| Retail customers:                                      |                       |                                       |                       |
| Equity   | 107.6                 | 86.6                                  | 86.3                  |
| Fixed income   | 49.3                  | 50.3                                  | 46.2                  |
| Real estate  | 2.2                   | 1.8                                   | 1.4                   |
| Retail customers(3)                                    | 159.1                 | 138.7                                 | 133.9                 |
| General account:                                       |                       |                                       |                       |
| Equity   | 8.3                   | 9.4                                   | 9.0                   |



Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|                               |          |          |          |
|-------------------------------|----------|----------|----------|
| Fixed income                  | 349.2    | 363.7    | 330.3    |
| Real estate                   | 1.2      | 1.5      | 1.4      |
| General account               | 358.7    | 374.6    | 340.7    |
| Total assets under management | \$ 848.1 | \$ 827.0 | \$ 777.7 |

(1) Consists of third-party institutional assets and group insurance contracts.

(2) As of September 30, 2013, December 31, 2012 and September 30, 2012, includes \$37.8 billion, \$37.2 billion and \$34.8 billion, respectively, of assets under management related to investment-only stable value products.

**Table of Contents**

- (3) Consists of: (a) individual mutual funds and variable annuities and variable life insurance separate account assets; (b) funds invested in proprietary mutual funds through our defined contribution plan products; and (c) third-party sub-advisory relationships. Fixed annuities and the fixed-rate accounts of variable annuities and variable life insurance are included in the general account.

|   | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          | Twelve Months Ended   |
|---|-------------------------------------|----------|------------------------------------|----------|-----------------------|
|   | 2013                                | 2012     | 2013                               | 2012     | September 30,<br>2013 |
| <b>Institutional Customers:</b>                               |                                     |          |                                    |          |                       |
| Beginning Assets Under Management                             | \$ 319.1                            | \$ 289.2 | \$ 313.7                           | \$ 271.8 | \$ 303.1              |
| Net additions (withdrawals), excluding money market activity: |                                     |          |                                    |          |                       |
| Third party(1)  | 4.1                                 | 3.4      | 14.1                               | 8.8      | 22.5                  |
| Affiliated(2)   | (0.1)                               | 0.3      | (0.1)                              | (1.2)    | (0.4)                 |
| Total   | 4.0                                 | 3.7      | 14.0                               | 7.6      | 22.1                  |
| Market appreciation   | 7.0                                 | 10.2     | 3.2                                | 23.3     | 6.2                   |
| Other increases (decreases)(4)                                | 0.2                                 | 0.0      | (0.6)                              | 0.4      | (1.1)                 |
| Ending Assets Under Management                                | \$ 330.3                            | \$ 303.1 | \$ 330.3                           | \$ 303.1 | \$ 330.3              |
| <b>Retail Customers:</b>                                      |                                     |          |                                    |          |                       |
| Beginning Assets Under Management                             | \$ 152.4                            | \$ 131.7 | \$ 138.7                           | \$ 119.3 | \$ 133.9              |
| Net additions (withdrawals), excluding money market activity: |                                     |          |                                    |          |                       |
| Third party   | (1.4)                               | 2.5      | 2.9                                | 9.4      | 6.3                   |
| Affiliated  | (2.2)                               | (6.2)    | 1.2                                | (8.2)    | 3.2                   |
| Total   | (3.6)                               | (3.7)    | 4.1                                | 1.2      | 9.5                   |
| Market appreciation   | 10.0                                | 6.1      | 16.7                               | 13.1     | 17.0                  |
| Other increases (decreases)(4)                                | 0.3                                 | (0.2)    | (0.4)                              | 0.3      | (1.3)                 |
| Ending Assets Under Management                                | \$ 159.1                            | \$ 133.9 | \$ 159.1                           | \$ 133.9 | \$ 159.1              |
| <b>General Account:</b>                                       |                                     |          |                                    |          |                       |
| Beginning Assets Under Management                             | \$ 354.5                            | \$ 331.4 | \$ 374.6                           | \$ 326.7 | \$ 340.7              |
| Net additions (withdrawals), excluding money market activity: |                                     |          |                                    |          |                       |
| Third party   | 0.0                                 | 0.0      | 0.0                                | 0.0      | 0.0                   |
| Affiliated(3)   | 0.7                                 | 2.1      | 6.3                                | 3.0      | 40.9                  |
| Total   | 0.7                                 | 2.1      | 6.3                                | 3.0      | 40.9                  |
| Market appreciation   | 1.9                                 | 6.3      | (3.8)                              | 14.0     | (2.6)                 |
| Other increases (decreases)(4)                                | 1.6                                 | 0.9      | (18.4)                             | (3.0)    | (20.3)                |
| Ending Assets Under Management                                | \$ 358.7                            | \$ 340.7 | \$ 358.7                           | \$ 340.7 | \$ 358.7              |

(1) Includes net additions into fixed income accounts related to investment-only stable value products of \$0.2 billion and \$0.6 billion for the three months ended September 30, 2013 and 2012, respectively, \$1.1 billion and \$4.1 billion for the nine months ended September 30, 2013 and 2012, respectively, and \$3.4 billion for the twelve months ended September 30, 2013.

(2) Includes \$1.0 billion from the acquisition of the Hartford Life Business for the nine and twelve months ended September 30, 2013.

(3) Includes \$7.9 billion for the nine and twelve months ended September 30, 2013 from the acquisition of the Hartford Life Business on January 2, 2013, and \$31.0 billion for the twelve months ended September 30, 2013 from two significant pension risk transfer transactions in the Retirement segment that occurred in 2012.

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

- (4) Includes the effect of foreign exchange rate changes, net money market activity, and transfers (to)/from the Retirement segment as a result of changes in the client contract form.

**Table of Contents***Strategic Investments*

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

|   | September 30,<br>2013      2012<br>(in millions) |               |
|---|--|---------------|
| <b>Co-Investments:</b>  |  |               |
| Real estate   | \$ 377   | \$ 462        |
| Fixed income  | 88   | 25            |
| <b>Seed Investments:</b>  |  |               |
| Real estate   | 31   | 31            |
| Public equity   | 160  | 225           |
| Fixed income  | 172  | 213           |
| <b>Loans Secured by Investor Equity Commitments or Fund Assets:</b> |  |               |
| Real estate secured by investor equity                              | 0  | 0             |
| Real estate secured by fund assets                                  | 0  | 0             |
| <b>Total</b>  | <b>\$ 828</b>                                    | <b>\$ 956</b> |

The \$128 million decrease in strategic investments was primarily driven by returns of capital on real estate co-investments and public equity seed investments. In addition to the strategic investments above, the Asset Management segment's commercial mortgage operations maintain an interim loan portfolio. See *General Account Investments*, *Invested Assets of Other Entities and Operations*, *Commercial Mortgage and Other Loans* below for additional details.

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

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

|                           | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |          |
|---------------------------|-------------------------------------|--------|------------------------------------|----------|
|                           | 2013                                | 2012   | 2013                               | 2012     |
|                           | (in millions)                       |        |                                    |          |
| <b>Operating results:</b> |                                     |        |                                    |          |
| Revenues                  | \$ 1,041                            | \$ 948 | \$ 3,408                           | \$ 2,527 |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|  |       |        |       |        |
|--|-------|--------|-------|--------|
| Benefits and expenses  | 893   | 836    | 2,982 | 2,242  |
| Adjusted operating income  | 148   | 112    | 426   | 285    |
| Realized investment gains (losses), net, and related adjustments   | (122) | 13     | (566) | 36     |
| Related charges  | 68    | 0      | 217   | 0      |
| Income from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ 94 | \$ 125 | \$ 77 | \$ 321 |

On January 2, 2013, we acquired the Hartford Life Business through a reinsurance transaction. We expect total pre-tax integration costs of approximately \$125 million to be incurred through 2015, including approximately \$50 million during 2013, of which \$43 million was incurred during the first nine months of 2013. After integration is complete, we expect annual cost savings of approximately \$90 million to be achieved by

## **Table of Contents**

2015 and, as of September 30, 2013, we have achieved approximately 65% of this annual savings on a run rate basis. Actual integration costs may exceed, and actual cost savings may fall short of, such expectations.

### *Adjusted Operating Income*

*Three Month Comparison.* Adjusted operating income increased \$36 million, including \$24 million of integration costs in the current quarter associated with the Hartford Life acquisition. The increase in adjusted operating income primarily reflects changes in our estimated profitability of the business resulting from our annual reviews and updates of assumptions, which resulted in a \$27 million net benefit in the current quarter compared to a \$27 million net charge in the year ago quarter. The \$27 million net benefit in the current quarter primarily reflects a favorable mortality assumption update while the \$27 million net charge in the year ago quarter primarily reflected reductions to the long-term interest rate and equity return assumptions.

Excluding the effect of the items discussed above, adjusted operating income increased \$6 million reflecting an earnings benefit of approximately \$32 million from the Hartford Life acquired in force business, largely offset by higher distribution costs reflecting expanded third party distribution and increased sales as well as lower net investment spread results reflecting lower reinvestment rates.

*Nine Month Comparison.* Adjusted operating income increased \$141 million. Excluding integration costs and the impact from the annual reviews and updates of assumptions discussed above, adjusted operating income increased \$130 million. This increase was driven by approximately \$106 million of earnings from the acquired in force business and a favorable \$85 million mortality variance. Mortality experience, net of reinsurance, was favorable relative to expected levels in the current year period, compared to unfavorable in the year ago period. These favorable items were partially offset by higher distribution costs reflecting expanded third party distribution and increased sales, higher compensation expenses, and lower net investment spread results driven by lower reinvestment rates partly mitigated by higher income from non-coupon investments.

### *Revenues, Benefits and Expenses*

*Three Month Comparison.* Revenues, as shown in the table above under Operating Results, increased \$93 million. Excluding the impact of our annual reviews and updates of assumptions, as discussed above, revenues increased \$359 million. Policy charges and fees and asset management fees and other income increased \$253 million reflecting growth in our universal life block of business, including the impact from the acquisition of the Hartford Life Business, partially offset by the continued expected run-off of variable life insurance in force. Net investment income increased \$92 million driven by business growth, including the impact of higher asset balances from the acquisition of the Hartford Life Business, partially offset by the impact of lower reinvestment rates.

Benefits and expenses, as shown in the table above under Operating Results, increased \$57 million. Excluding the impact of our annual reviews and updates of assumptions, as discussed above, benefits and expenses increased \$377 million. Insurance and annuity benefits, including interest credited to policyholders' account balances, increased \$276 million primarily reflecting business growth in our universal life block of business, including the impact of insurance liabilities acquired from the Hartford Life Business. General and administrative expenses, net of capitalization, increased \$82 million primarily driven by Hartford Life Business operating expenses and higher distribution costs supporting business growth, as well as integration costs in the current quarter.

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

*Nine Month Comparison.* Revenues increased \$881 million. Excluding the impact from our annual reviews and updates of assumptions, as discussed above, revenues increased \$1,147 million. Policy charges and fees and asset management fees and other income increased \$828 million primarily driven by business growth, particularly from our universal life block of business, including the impact from the acquisition of the Hartford Life Business, partially offset by the continued expected run-off of variable life insurance in force. Net

**Table of Contents**

investment income increased \$266 million reflecting business growth, including the impact of higher asset balances from the acquired Hartford Life Business, and greater contributions from non-coupon investments, partially offset by the impact of lower reinvestment rates.

Benefits and expenses increased \$740 million. Excluding the impact of our annual reviews and updates of assumptions, benefits and expenses increased \$1,060 million. Insurance and annuity benefits, including interest credited to policyholders' account balances, increased \$689 million primarily due to growth of our universal life block of business, including the impact of insurance liabilities acquired from the Hartford Life Business, partly offset by more favorable mortality experience, as discussed above. General and administrative expenses, net of capitalization, increased \$280 million primarily driven by Hartford Life Business operating expenses, higher distribution costs and higher compensation expenses, as well as integration costs in the current period.

*Sales Results*

Recent growth in annualized new business premiums has been driven by sales of universal life insurance products, most of which include secondary, or no lapse, guarantees. However, as a result of recent pricing and other actions taken, sales of these products have begun to decline from levels experienced earlier this year, and we expect further declines in the near future.

The following table sets forth individual life insurance annualized new business premiums, as defined under Segment Measures above, by distribution channel and product, for the periods indicated.

|                   | Three Months Ended September 30, 2013 |             |        | Three Months Ended September 30, 2012 |             |       |
|-------------------|---------------------------------------|-------------|--------|---------------------------------------|-------------|-------|
|                   | Prudential Agents                     | Third Party | Total  | Prudential Agents                     | Third Party | Total |
|                   | (in millions)                         |             |        |                                       |             |       |
| Variable Life     | \$ 4                                  | \$ 5        | \$ 9   | \$ 3                                  | \$ 1        | \$ 4  |
| Universal Life(1) | 9                                     | 98          | 107    | 10                                    | 42          | 52    |
| Term Life         | 9                                     | 40          | 49     | 9                                     | 33          | 42    |
| Total             | \$ 22                                 | \$ 143      | \$ 165 | \$ 22                                 | \$ 76       | \$ 98 |

|                   | Nine Months Ended September 30, 2013 |             |        | Nine Months Ended September 30, 2012 |             |        |
|-------------------|--------------------------------------|-------------|--------|--------------------------------------|-------------|--------|
|                   | Prudential Agents                    | Third Party | Total  | Prudential Agents                    | Third Party | Total  |
|                   | (in millions)                        |             |        |                                      |             |        |
| Variable Life     | \$ 11                                | \$ 14       | \$ 25  | \$ 10                                | \$ 3        | \$ 13  |
| Universal Life(1) | 30                                   | 358         | 388    | 27                                   | 101         | 128    |
| Term Life         | 31                                   | 121         | 152    | 29                                   | 98          | 127    |
| Total             | \$ 72                                | \$ 493      | \$ 565 | \$ 66                                | \$ 202      | \$ 268 |

- (1) Single pay life annualized new business premiums, which include 10% of excess (unscheduled) premiums, represented approximately 34% and 32% of Universal Life annualized new business premiums for the three months ended September 30, 2013 and 2012, respectively, and approximately 37% and 27% of Universal Life annualized new business premiums for the nine months ended September 30, 2013 and 2012, respectively.



## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Annualized new business premiums for the third quarter and first nine months of 2013 increased in comparison to the prior year periods. The increases in both periods are primarily driven by higher sales of universal life insurance products due to expanded distribution as a result of the acquisition of the Hartford Life Business, particularly through institutional channels, as well as a change in the competitive position of our products.

**Table of Contents****Group Insurance***Operating Results*

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

|  | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|--|-------------------------------------|----------|------------------------------------|----------|
|  | 2013                                | 2012     | 2013                               | 2012     |
|  | (in millions)                       |          |                                    |          |
| <b>Operating results:</b>  |                                     |          |                                    |          |
| Revenues   | \$ 1,342                            | \$ 1,420 | \$ 4,143                           | \$ 4,203 |
| Benefits and expenses  | 1,274                               | 1,385    | 4,044                              | 4,175    |
| Adjusted operating income  | 68                                  | 35       | 99                                 | 28       |
| Realized investment gains (losses), net, and related adjustments   | (4)                                 | (2)      | (8)                                | (8)      |
| Related charges  | (3)                                 | 0        | (4)                                | 0        |
| Income from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ 61                               | \$ 33    | \$ 87                              | \$ 20    |

*Adjusted Operating Income*

*Three Month Comparison.* Adjusted operating income increased \$33 million, primarily driven by a greater benefit from the impacts of annual reviews and updates of assumptions and other refinements. Results for the third quarter of 2013 included a \$45 million net benefit from these updates, primarily driven by the impact of favorable updates to actuarial assumptions used in calculating certain group life and group disability reserves, while the third quarter of 2012 included a \$7 million net benefit from these updates. Excluding these impacts, adjusted operating income decreased \$5 million, reflecting declines in net investment spread income, driven by lower portfolio yields, and higher general and administrative expenses driven by an increase in compensation costs and other costs to support business initiatives. Partially offsetting these decreases was more favorable underwriting results in our group life business driven by lower claim severity for non-retrospectively experience-rated contracts.

*Nine Month Comparison.* Adjusted operating income increased \$71 million, primarily driven by a greater benefit from the impacts of annual reviews and updates of assumptions performed in the third quarter, as discussed above. Excluding these impacts, adjusted operating income increased \$33 million, primarily driven by more favorable underwriting results in both our group life and group disability businesses. For our group life business, more favorable underwriting results were driven by lower claim severity for non-retrospectively experience-rated contracts, largely due to adverse claim severity that occurred in the first quarter of 2012. For our group disability business, more favorable underwriting results were driven by reduced claim incidence and higher claim resolutions for long-term contracts. Partially offsetting these increases were higher general and administrative expenses driven by higher compensation costs and other costs to support business initiatives, partly offset by reduced costs associated with updates to premium tax estimates and reduced litigation expenses.

*Revenues, Benefits and Expenses*

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

*Three Month Comparison.* Revenues, as shown in the table above under Operating Results, decreased \$78 million. Excluding a decrease of \$44 million resulting from the impacts of annual reviews and updates of assumptions discussed above, revenues decreased \$34 million. The decrease primarily reflects \$26 million lower premiums and policy charges and fee income, largely due to declines in our group life business driven by lapses.

Benefits and expenses, as shown in the table above under Operating Results, decreased \$111 million. Excluding an \$82 million decrease from the impacts of annual reviews and updates of assumptions discussed above, benefits and expenses decreased \$29 million. Policyholders' benefits, including the change in reserves,

**Table of Contents**

decreased \$43 million, driven by declines in our group life business. These declines reflect a decrease from non-retrospectively experience-rated contracts driven by lower claim severity. Partially offsetting this decrease was a \$13 million increase in general and administrative expenses, driven by higher compensation costs and other costs to support business initiatives.

*Nine Month Comparison.* Revenues decreased \$60 million. Excluding a decrease of \$44 million resulting from the impacts of annual reviews and updates of assumptions discussed above, revenues decreased \$16 million. The decrease primarily reflects \$18 million lower premiums and policy charges and fee income, largely due to declines in our group disability business. These declines were driven by our retrospectively-experience rated contracts, reflecting reduced claim incidence and higher claim resolutions for long-term contracts. Revenues for our group life business were relatively flat.

Benefits and expenses decreased \$131 million. Excluding an \$82 million decrease resulting from the impacts of annual reviews and updates of assumptions discussed above, benefits and expenses decreased \$49 million. Policyholders' benefits, including the change in reserves, decreased \$75 million, driven by declines in both our group life and group disability businesses. The decline in our group life business reflects a decrease from non-retrospectively experience-rated contracts due to lower claim severity, which more than offset an increase from retrospectively experience-rated contracts, driven by unfavorable claim experience. The decline in our group disability business reflects reduced claim incidence and higher claim resolutions for long-term contracts. Partially offsetting the decrease in benefits and expenses was a \$20 million increase in general and administrative expenses, reflecting higher compensation costs and other costs to support business initiatives, partly offset by a reduction in costs associated with updates to premium tax estimates and reduced litigation expenses.

*Benefits and Expense Ratios*

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

|   | Three Months Ended<br>September 30, |       | Nine Months Ended<br>September 30, |       |
|---|-------------------------------------|-------|------------------------------------|-------|
|   | 2013                                | 2012  | 2013                               | 2012  |
| <b>Benefits ratio(1):</b>                         |                                     |       |                                    |       |
| Group life  | 84.8%                               | 90.7% | 89.3%                              | 91.5% |
| Group disability                                  | 91.9%                               | 93.9% | 93.2%                              | 97.8% |
| <b>Administrative operating expense ratio(2):</b> |                                     |       |                                    |       |
| Group life  | 11.1%                               | 9.2%  | 9.9%                               | 9.4%  |
| Group disability                                  | 25.9%                               | 23.8% | 26.1%                              | 24.3% |

(1) Ratio of policyholder benefits to earned premiums, policy charges and fee income.

(2) Ratio of administrative operating expenses (excluding commissions) to gross premiums, policy charges and fee income.

*Three Month Comparison.* The group life benefits ratio improved 5.9 percentage points primarily driven by the favorable impacts of annual reviews and updates of assumptions discussed above, as well as lower claim severity. The group disability benefits ratio improved 2.0 percentage points primarily driven by the favorable impacts of annual reviews and updates of assumptions discussed above, as well as reduced claim incidence and higher claim resolutions for long-term contracts. The group life administrative operating expense ratio deteriorated 1.9 percentage points reflecting higher compensation costs and other costs to support business initiatives. The group disability administrative operating expense ratio deteriorated 2.1 percentage points reflecting higher costs invested in our claims management process.

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

*Nine Month Comparison.* The group life benefits ratio improved 2.2 percentage points primarily driven by the favorable impacts of annual reviews and updates of assumptions discussed above, as well as lower claim severity for non-retrospectively experience-rated contracts. The group disability benefits ratio improved

**Table of Contents**

4.6 percentage points primarily driven by the favorable impacts of annual reviews and updates of assumptions discussed above, as well as reduced claim incidence and higher claim resolutions for long-term contracts. The group life administrative operating expense ratio deteriorated 0.5 percentage points reflecting higher compensation costs and other costs to support business initiatives. The group disability administrative operating expense ratio deteriorated 1.8 percentage points reflecting higher costs invested in our claims management process.

*Sales Results*

The following table sets forth the Group Insurance segment's annualized new business premiums, as defined under Segment Measures above, for the periods indicated.

|   | Three Months Ended<br>September 30, |       | Nine Months Ended<br>September 30, |        |
|---|-------------------------------------|-------|------------------------------------|--------|
|   | 2013                                | 2012  | 2013                               | 2012   |
|   | (in millions)                       |       |                                    |        |
| <b>Annualized new business premiums(1):</b> |                                     |       |                                    |        |
| Group life                                  | \$ 33                               | \$ 18 | \$ 196                             | \$ 253 |
| Group disability                            | 13                                  | 28    | 65                                 | 128    |
| Total                                       | \$ 46                               | \$ 46 | \$ 261                             | \$ 381 |

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

Annualized new business premiums for the third quarter of 2013 were flat compared to the prior year period, as increases for group life, primarily driven by one large sale, were offset by decreases for group disability, primarily driven by large market case sales in the third quarter of 2012. Annualized new business premiums for the first nine months of 2013 declined compared to the prior year period, primarily driven by a change in our pricing discipline for both group life and group disability products, which had an immediate impact on new sales.

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

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

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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

**Table of Contents**

We utilize a yen hedging strategy that calibrates the hedge level to preserve the relative contribution of our yen-based business to the Company's overall return on equity. We implement this hedging strategy using a variety of instruments, including forward currency derivative contracts, as discussed above, as well as U.S. dollar-denominated assets and, to a lesser extent, dual currency and synthetic dual currency assets held locally in our Japanese insurance subsidiaries. We may also hedge using instruments held in our U.S. domiciled entities, such as U.S. dollar-denominated debt that has been swapped to yen.

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

|   | September 30,<br>2013 | December 31,<br>2012 |
|---|-----------------------|----------------------|
|   | (in billions)         |                      |
| Instruments hedging foreign currency exchange rate exposure on U.S. dollar-equivalent earnings: |                       |                      |
| Forward currency hedging program(1)   | \$ 3.0                | \$ 2.9               |
| Instruments hedging foreign currency exchange rate exposure on U.S. dollar-equivalent equity:   |                       |                      |
| Available-for-sale U.S. dollar-denominated investments, at amortized cost                       | 7.8                   | 7.0                  |
| Held-to-maturity U.S. dollar-denominated investments, at amortized cost                         | 0.2                   | 0.3                  |
| Other   | 0.1                   | 0.1                  |
| U.S. dollar-denominated assets held in yen-based entities(2)                                    | 8.1                   | 7.4                  |
| Yen-denominated liabilities held in U.S. dollar-based entities(3)                               | 0.8                   | 0.8                  |
| Dual currency and synthetic dual currency investments(4)  | 0.9                   | 0.9                  |
|   | 9.8                   | 9.1                  |
| <b>Total hedges</b>   | <b>\$ 12.8</b>        | <b>\$ 12.0</b>       |

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

(2) Excludes \$28.1 billion and \$26.8 billion as of September 30, 2013 and December 31, 2012, respectively, of U.S. dollar assets supporting U.S. dollar liabilities related to U.S. dollar-denominated products issued by our Japanese insurance operations.

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

(4) Dual currency and synthetic dual currency investments are held by our yen-based entities in the form of fixed maturities and loans with a yen-denominated principal component and U.S. dollar-denominated interest income. The amounts shown represent the present value of future U.S. dollar cash flows.

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

The financial results of our International Insurance segment reflect the impact of an intercompany arrangement with Corporate and Other operations pursuant to which the segment's non-U.S. dollar-denominated earnings are translated at fixed currency exchange rates. The fixed rates are determined in connection with a foreign currency income hedging program designed to mitigate the impact of exchange rate changes on the segment's U.S. dollar-equivalent earnings. Pursuant to this program, Corporate and Other operations execute forward currency contracts with third parties to sell the net exposure of projected earnings for certain currencies in exchange for U.S. dollars at specified exchange rates. The maturities of these contracts correspond with the future periods (typically on a three-year rolling basis) in which the identified non-U.S. dollar-denominated earnings are expected to be generated. In establishing the level of non-U.S. dollar-denominated earnings that will be hedged through this program, we exclude the anticipated level of U.S. dollar-denominated earnings that will be generated by dual currency and synthetic



dual currency investments, as well as the anticipated level of non-

**Table of Contents**

yen denominated earnings that will be generated by non-yen denominated products and investments. As of September 30, 2013, we have hedged 100% of expected yen-based earnings for 2013 and 100%, 61%, and 16% of expected yen-based earnings for 2014, 2015, and 2016, respectively. To the extent currently unhedged, our International Insurance segment's future expected U.S. dollar-equivalent earnings, particularly 2015 and each year thereafter, will be impacted by yen exchange rate movements.

As a result of this intercompany arrangement, our International Insurance segment's results for 2013 and 2012 reflect the impact of translating yen-denominated earnings at fixed currency exchange rates of 80 and 85 yen per U.S. dollar, respectively, and 1160 and 1180 Korean won per U.S. dollar, respectively.

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

|  | Three Months Ended<br>September 30, |                | Nine Months Ended<br>September 30, |                |
|--|-------------------------------------|----------------|------------------------------------|----------------|
|  | 2013                                | 2012           | 2013                               | 2012           |
|  | (in millions)                       |                |                                    |                |
| <b>International Insurance Segment:</b>                                  |                                     |                |                                    |                |
| Impact of intercompany arrangement(1)                                    | \$ 70                               | \$ (29)        | \$ 178                             | \$ (72)        |
| <b>Corporate and Other operations:</b>                                   |                                     |                |                                    |                |
| Impact of intercompany arrangement(1)                                    | (70)                                | 29             | (178)                              | 72             |
| Settlement gains (losses) on forward currency contracts                  | 72                                  | (20)           | 175                                | (68)           |
| Net benefit (detriment) to Corporate and Other operations                | 2                                   | 9              | (3)                                | 4              |
| <b>Net impact on consolidated revenues and adjusted operating income</b> | <b>\$ 72</b>                        | <b>\$ (20)</b> | <b>\$ 175</b>                      | <b>\$ (68)</b> |

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

As of September 30, 2013 and December 31, 2012, the notional amounts of these forward currency contracts were \$3.5 billion and \$3.4 billion, respectively, of which \$3.0 billion and \$2.9 billion, respectively, were related to our Japanese insurance operations.

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

Our international insurance operations primarily offer products denominated in local currency. However, several of our international insurance operations, most notably our Japanese operations, also offer products denominated in non-local currencies, primarily comprised of U.S. and Australian dollar-denominated products. The non-yen denominated insurance liabilities related to these products are supported by investments denominated in corresponding currencies, including a significant portion designated as available-for-sale. While the impact from foreign currency exchange rate movements on these non-yen denominated assets and liabilities is economically matched, the accounting for changes in the value of these assets and liabilities due to changes in foreign currency exchange rate movements differs, resulting in volatility in U.S. GAAP

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

earnings. For example, unrealized gains and losses on available-for-sale investments, including those arising from foreign currency exchange rate movements, are recorded in AOCI, whereas the non-yen denominated liabilities are remeasured for foreign currency exchange rate movements, and the related changes in value are recorded in earnings within Asset management fees and other income. Investments designated as held-to-maturity under U.S. GAAP are recorded at amortized cost on the balance sheet, but are remeasured for foreign currency exchange rate

**Table of Contents**

movements, with the related change in value recorded in earnings within Asset management fees and other income. Due to this non-economic volatility that is reflected in U.S. GAAP earnings, the gains and losses resulting from the remeasurement of these non-yen denominated liabilities, and certain related non-yen denominated assets, are excluded from adjusted operating income and included in Realized investment gains (losses), net, and related adjustments. For the three and nine months ended September 30, 2013, Realized investment gains (losses), net, and related adjustments includes net gains of \$1,180 million and net losses of \$2,758 million, respectively, reflecting the remeasurement of these non-yen denominated insurance liabilities and the remeasurement of certain related non-yen denominated assets.

The following table presents these non-yen denominated insurance liabilities and related non-yen denominated assets subject to remeasurement through earnings within our international insurance operations as of September 30, 2013 as well as the impact to pre-tax U.S. GAAP earnings assuming a hypothetical 5% depreciation/appreciation in value of the yen relative to the applicable currency based on balances as of September 30, 2013.

As discussed in Note 1 to our Unaudited Interim Consolidated Financial Statements, Gibraltar Life's current period results of operations represent earnings through August 31, 2013 and Gibraltar Life's current period assets and liabilities represent balances as of August 31, 2013.

|  | Balances subject to remeasurement,<br>as of September 30, 2013 |             |                                     | Hypothetical increase (decrease)<br>in pre-tax GAAP earnings(2) |                 |
|--|--|-------------|-------------------------------------|---|-----------------|
|  | Assets(1)  | Liabilities | Net Liabilities(1)<br>(in billions) | 5% depreciation   | 5% appreciation |
| U.S. dollar-denominated products(3)    | \$ 3.1   | \$ 20.2     | \$ 17.1                             | \$ (0.9)  | \$ 0.9          |
| Australian dollar-denominated products | 0.4  | 7.6         | 7.2                                 | (0.4)   | 0.4             |
| Euro-denominated products              | 0.1  | 0.3         | 0.2                                 | (0.0)   | 0.0             |
| Total                                  | \$ 3.6   | \$ 28.1     | \$ 24.5                             | \$ (1.3)  | \$ 1.3          |

- (1) Includes investments designated as held-to-maturity that are remeasured for foreign currency exchange rate movements with the change in value recorded in U.S. GAAP earnings; excludes \$28.1 billion of available-for-sale investments supporting these non-yen denominated insurance liabilities for which the impact from foreign currency exchange rate movements is recorded in AOCI. The tax impact may vary as discussed in Income Taxes below.
- (2) These pre-tax GAAP earnings impacts would largely be offset by a corresponding increase (decrease) in unrealized gains in AOCI.
- (3) Excludes \$6.3 billion of insurance liabilities for U.S. dollar-denominated products as of September 30, 2013 associated with Prudential of Japan. These liabilities are coinsured to our U.S. domiciled insurance entity and supported by U.S. dollar-denominated assets and, as a result, not subject to the remeasurement mismatch described above.

**International Insurance****Operating Results**

The results of our International Insurance operations are translated on the basis of weighted average monthly exchange rates, inclusive of the effects of the intercompany arrangement discussed above. To provide a better understanding of operating performance within the International Insurance segment, where indicated below, we have analyzed our results of operations excluding the effect of the year over year change in foreign currency exchange rates. Our results of operations excluding the effect of foreign currency fluctuations were derived by translating foreign currencies to U.S. dollars at uniform exchange rates for all periods presented, including for constant dollar information discussed below. The exchange rates used were Japanese yen at a rate of 80 yen per U.S. dollar and Korean won at a rate of 1160 won per U.S. dollar, both of

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

which were determined in connection with the foreign currency income hedging program discussed above. In addition, for constant dollar information discussed below, activity denominated in U.S. dollars is generally reported based on the amounts as transacted in U.S. dollars. Annualized new business premiums presented on a constant exchange rate basis in the Sales Results section below reflect translation based on these same uniform exchange rates.

**Table of Contents**

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

|   | Three Months Ended<br>September 30,<br>2013 |          | Nine Months Ended<br>September 30,<br>2012 |          |
|---|---|----------|--|----------|
|   | 2013  | 2012     | 2013                                       | 2012     |
|   | (in millions)                               |          |  |          |
| <b>Operating results:</b>   |   |          |  |          |
| Revenues:   |   |          |  |          |
| Life Planner operations   | \$ 2,173                                    | \$ 2,237 | \$ 6,774                                   | \$ 6,746 |
| Gibraltar Life and Other operations   | 3,086                                       | 5,917    | 10,775                                     | 13,631   |
|   | 5,259                                       | 8,154    | 17,549                                     | 20,377   |
| Benefits and expenses:  |   |          |  |          |
| Life Planner operations   | 1,749                                       | 1,844    | 5,560                                      | 5,597    |
| Gibraltar Life and Other operations   | 2,732                                       | 5,528    | 9,484                                      | 12,723   |
|   | 4,481                                       | 7,372    | 15,044                                     | 18,320   |
| Adjusted operating income:  |   |          |  |          |
| Life Planner operations   | 424   | 393      | 1,214                                      | 1,149    |
| Gibraltar Life and Other operations   | 354   | 389      | 1,291                                      | 908      |
|   | 778   | 782      | 2,505                                      | 2,057    |
| Realized investment gains (losses), net, and related adjustments(1)   | 1,505                                       | (483)    | (2,799)                                    | (443)    |
| Related charges   | (18)  | (17)     | (127)                                      | (38)     |
| Investment gains (losses) on trading account assets supporting insurance liabilities, net                       | 52  | (4)      | 342  | 66       |
| Change in experience-rated contractholder liabilities due to asset value changes                                | (52)  | 4        | (342)                                      | (66)     |
| Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests            | 1   | (61)     | (64)                                       | (61)     |
| Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ 2,266                                    | \$ 221   | \$ (485)                                   | \$ 1,515 |

(1) Includes gains and losses from changes in value of certain assets and liabilities relating to foreign currency exchange movements that are economically matched, as discussed above.

We have made significant progress integrating the acquired former Star and Edison businesses with Gibraltar Life and, as a result, have reduced our expected pre-tax integration costs from our original expectations by \$100 million. We now anticipate incurring approximately \$400 million of total pre-tax integration costs, of which \$329 million has been incurred to date. After integration is complete, we continue to expect annual cost savings of approximately \$250 million and, as of September 30, 2013, have achieved substantially all of the annual savings on a run rate basis.

In addition, on July 25, 2013, we signed an agreement with Dewan Housing Finance Corporation Limited under which they will become the new partner in our life insurance joint venture in India, subject to regulatory approval.

*Adjusted Operating Income*

*Three Month Comparison.* Adjusted operating income from our Life Planner operations increased \$31 million including a net favorable impact of \$13 million from currency fluctuations, inclusive of the currency hedging program discussed above. Both quarters benefited from a reduction in the amortization of deferred

## Table of Contents

policy acquisition costs and lower reserves from our annual reviews and updates of assumptions used in estimating the profitability of our business, and other refinements. This resulted in a \$19 million benefit in the current quarter primarily driven by lower lapse assumptions for variable and interest sensitive life insurance products, compared to a \$20 million benefit in the year ago quarter.

Excluding the effect of the items discussed above, adjusted operating income of our Life Planner operations increased \$19 million driven by the continued growth of business in force and strong persistency in our Japanese Life Planner operation, partly offset by lower contributions from net investment spreads as a result of lower reinvestment rates.

Adjusted operating income from our Gibraltar Life and Other operations decreased \$35 million including a favorable impact of \$11 million from currency fluctuations. The current quarter includes a \$108 million charge from our annual review and update of assumptions used in estimating the profitability of our business, and other refinements. This charge is primarily reflective of an increase in reserves for guaranteed minimum income benefit features on certain annuity products previously sold by the former Star and Edison businesses, due to higher annuity election rates and lower assumed lapse rates. In addition, the decline in adjusted operating income reflects the absence of a \$60 million gain that occurred in the year ago quarter from the partial sale of our investment in China Pacific Group, for which our remaining shares were sold in the first quarter of 2013. The current quarter benefited from lower integration costs relating to the acquisition of the Star and Edison Businesses, for which we incurred \$34 million in the year ago quarter compared to \$8 million in the current quarter.

Excluding the effect of the items discussed above, adjusted operating income from our Gibraltar Life and Other operations increased \$96 million, primarily reflecting business growth, favorable results from non-coupon investments and more favorable mortality experience. In addition, cost savings resulting from Star and Edison integration synergies were \$61 million in the current quarter, an increase of \$20 million from the year ago quarter.

*Nine Month Comparison.* Adjusted operating income from Life Planner operations increased \$65 million including a net favorable impact of \$40 million from currency fluctuations. Excluding currency fluctuations and the impact from our annual reviews and updates of assumptions and other refinements, as discussed above, adjusted operating income increased \$26 million. This increase primarily reflects growth of business in force driven by sales results and continued strong persistency, partly offset by the impact from lower reinvestment rates.

Adjusted operating income from our Gibraltar Life and Other operations increased \$383 million including a favorable impact of \$28 million from currency fluctuations. The current period benefited from lower integration costs relating to the acquisition of the Star and Edison Businesses, for which we incurred \$129 million in the year ago period compared to \$17 million in the current period. Adjusted operating income for both periods reflects the impact from partial sales of our investment in China Pacific Group, which contributed a \$66 million gain in the current period compared to a \$60 million gain in the year ago period. The current period also includes a \$108 million charge from our annual review and update of assumptions and other refinements, as discussed above.

Excluding the effect of the items discussed above, adjusted operating income from our Gibraltar Life and Other operations increased \$345 million, primarily reflecting favorable results from non-coupon investments, business growth, and \$171 million of cost savings resulting from Star and Edison integration synergies, compared to \$112 million in the year ago period. In addition, the current period benefited from accelerated earnings due to surrenders of fixed annuities denominated in Australian and U.S. dollars caused by the appreciation of these currencies relative to the Japanese yen.



---

**Table of Contents***Revenues, Benefits and Expenses*

*Three Month Comparison.* Revenues from our Life Planner operations, as shown in the table above under Operating Results, decreased \$64 million including a net unfavorable impact of \$232 million from currency fluctuations. Excluding the impact of currency fluctuations, revenues increased \$168 million. This increase in revenues came primarily from increases in premiums and policy charges and fee income of \$122 million driven by growth of business in force in our Japanese Life Planner operation. Net investment income increased \$25 million driven by investment portfolio growth partly offset by the impact from reinvestment at lower yields.

Benefits and expenses of our Life Planner operations, as shown in the table above under Operating Results, decreased \$95 million including a net favorable impact of \$245 million from currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased \$150 million, primarily reflecting an increase in policyholder benefits, including changes in reserves, driven by the growth of business in force, particularly within our Japanese Life Planner operation.

Revenues from our Gibraltar Life and Other operations decreased \$2,831 million including a net unfavorable impact of \$470 million from currency fluctuations. Excluding the impact of currency fluctuations, revenues decreased \$2,361 million driven by a \$2,327 million decline in premiums and policy charges and fee income, with a related decline in policyholder benefits, primarily reflecting reduced premiums from sales of yen-denominated single premium reduced death benefit whole life policies in the bank channel, as discussed further below. In addition, asset management fees and other income declined from the year ago quarter driven by the absence of a \$60 million gain that occurred in the year ago quarter from the partial sale of our investment in China Pacific Group, as discussed above. Net investment income increased \$61 million reflecting business growth and favorable results from non-coupon investments.

Benefits and expenses of our Gibraltar Life and Other operations decreased \$2,796 million including a net favorable impact of \$481 million from currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses decreased \$2,315 million. Policyholder benefits, including changes in reserves, decreased \$2,237 million primarily driven by lower sales of yen-denominated single premium reduced death benefit whole life policies, as discussed further below, partly offset by a reserve increase from our annual review and update of assumptions and other refinements, as discussed above. In addition, general and administrative expenses, net of capitalization, decreased driven by the benefit of lower integration costs and higher integration synergies relating to the acquisition of the Star and Edison Businesses, as discussed above.

*Nine Month Comparison.* Revenues from our Life Planner operations increased \$28 million including a net unfavorable impact of \$550 million from currency fluctuations. Excluding the impact of currency fluctuations, revenues increased \$578 million. This increase in revenues came primarily from increases in premiums and policy charges and fee income of \$478 million driven by growth of business in force in our Japanese Life Planner operation. In addition, net investment income increased \$104 million primarily reflecting investment portfolio growth, partly offset by the impact from lower reinvestment rates.

Benefits and expenses of our Life Planner operations decreased \$37 million including a net favorable impact of \$590 million from currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased \$553 million primarily driven by a \$426 million increase in policyholder benefits, including changes in reserves, reflecting growth of business in force. In addition, general and administrative expenses, net of capitalization, increased \$59 million driven by distribution growth and technology expenditures as well as due to lower expenses in our Korean operations in the year ago period.

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Revenues from our Gibraltar Life and Other operations decreased \$2,856 million including an unfavorable impact of \$1,289 million from currency fluctuations. Excluding the impact of currency fluctuations, revenues for Gibraltar Life decreased \$1,567 million. This decrease is driven by a \$1,706 million decrease in premiums and policy charges and fee income, with a related decline in policyholder benefits, primarily reflecting lower sales of yen-denominated single premium whole life products in the bank channel, as discussed further below, partly

**Table of Contents**

offset by increased premiums from growth in the Independent Agency and Life Consultant distribution channels. Net investment income increased \$248 million primarily reflecting favorable results from non-coupon investments and investment portfolio growth.

Benefits and expenses of our Gibraltar Life and Other operations decreased \$3,239 million including a net favorable impact of \$1,317 million from currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses decreased \$1,922 million. Policyholder benefits, including changes in reserves, decreased \$1,731 million primarily reflecting lower sales of yen-denominated single premium reduced death benefit whole life policies, as discussed further below, partly offset by a reserve increase from our annual review and update of assumptions and other refinements, as discussed above. In addition, general and administrative expenses, net of capitalization, decreased \$285 million primarily driven by lower integration costs and higher integration synergies relating to the acquisition of the Star and Edison Businesses.

*Sales Results*

The following table sets forth annualized new business premiums, as defined under Segment Measures above, on an actual and constant exchange rate basis for the periods indicated.

|  | Three Months Ended<br>September 30, |               | Nine Months Ended<br>September 30, |                 |
|--|-------------------------------------|---------------|------------------------------------|-----------------|
|  | 2013                                | 2012          | 2013                               | 2012            |
|  | (in millions)                       |               |                                    |                 |
| <b>Annualized new business premiums:</b> |                                     |               |                                    |                 |
| On an actual exchange rate basis:        |                                     |               |                                    |                 |
| Life Planner operations                  | \$ 237                              | \$ 274        | \$ 837                             | \$ 1,070        |
| Gibraltar Life                           | 407                                 | 680           | 1,364                              | 1,911           |
| <b>Total</b>                             | <b>\$ 644</b>                       | <b>\$ 954</b> | <b>\$ 2,201</b>                    | <b>\$ 2,981</b> |
| On a constant exchange rate basis:       |                                     |               |                                    |                 |
| Life Planner operations                  | \$ 265                              | \$ 271        | \$ 922                             | \$ 1,064        |
| Gibraltar Life                           | 461                                 | 670           | 1,514                              | 1,898           |
| <b>Total</b>                             | <b>\$ 726</b>                       | <b>\$ 941</b> | <b>\$ 2,436</b>                    | <b>\$ 2,962</b> |

The amount of annualized new business premiums for any given period can be significantly impacted by several factors, including but not limited to, changes in credited interest rates for certain products and other product modifications, changes in tax laws, changes in life insurance regulations or changes in the competitive environment. Sales volume may increase or decrease prior to such changes becoming effective, and then fluctuate in the other direction following such changes.

Recent trends in annualized new business premiums have been impacted by sales of the yen-denominated single premium reduced death benefit whole life product sold through the bank distribution channel. We view the bank distribution channel as a supplement to our core Life Planner and Gibraltar Life Consultant distribution channels and will pursue it on an opportunistic basis with a focus on profitable growth. To maintain overall profitability targets in the current low yen interest rate environment, at the end of September 2013, we suspended sales of the yen-denominated single premium reduced death benefit whole life product sold through the bank distribution channel.



**Table of Contents**

The tables below present annualized new business premiums on a constant exchange rate basis, by product and distribution channel, for the periods indicated.

|                    | Three Months Ended September 30, 2013 |        |               |         |                        | Three Months Ended September 30, 2012 |        |               |         |        |
|--------------------|---------------------------------------|--------|---------------|---------|------------------------|---------------------------------------|--------|---------------|---------|--------|
|                    | Accident &                            |        |               |         |                        | Accident &                            |        |               |         |        |
|                    | Life                                  | Health | Retirement(1) | Annuity | Total<br>(in millions) | Life                                  | Health | Retirement(1) | Annuity | Total  |
| Life Planners      | \$ 139                                | \$ 25  | \$ 90         | \$ 11   | \$ 265                 | \$ 119                                | \$ 21  | \$ 105        | \$ 26   | \$ 271 |
| Gibraltar Life:    |                                       |        |               |         |                        |                                       |        |               |         |        |
| Life Consultants   | 106                                   | 25     | 29            | 42      | 202                    | 110                                   | 30     | 30            | 33      | 203    |
| Banks(2)           | 174                                   | 1      | 2             | 27      | 204                    | 399                                   | 0      | 2             | 28      | 429    |
| Independent Agency | 20                                    | 8      | 18            | 9       | 55                     | 17                                    | 7      | 10            | 4       | 38     |
| Subtotal           | 300                                   | 34     | 49            | 78      | 461                    | 526                                   | 37     | 42            | 65      | 670    |
| Total              | \$ 439                                | \$ 59  | \$ 139        | \$ 89   | \$ 726                 | \$ 645                                | \$ 58  | \$ 147        | \$ 91   | \$ 941 |

(1) Includes retirement income, endowment and savings variable universal life.

(2) Single pay life annualized new business premiums, which include 10% of first year premiums, and 3-year limited pay annualized new business premiums, which include 100% of new business premiums, represented 33% and 50%, respectively, of total bank distribution channel annualized new business premiums, excluding annuity products, for the three months ended September 30, 2013, and 84% and 13%, respectively, of total bank distribution channel annualized new business premiums, excluding annuity products, for the three months ended September 30, 2012. Single pay and limited pay products generally have less death benefit protection per premium paid than more traditional recurring premium products.

*Three Month Comparison.* Annualized new business premiums, on a constant exchange rate basis, from our Life Planner operations decreased \$6 million driven by lower sales in Korea as a result of the discontinuance of a single premium immediate annuity product, partly offset by increased sales in Brazil. Sales in our Japanese Life Planner operation were relatively unchanged from the year ago quarter as increased sales of protection products were offset by lower sales of retirement income products.

Annualized new business premiums, on a constant exchange rate basis, from our Gibraltar Life operations decreased \$209 million, reflecting lower sales in the bank channel. Bank channel sales declined \$225 million as increased sales of recurring premium whole life products were more than offset by lower sales from our yen-denominated single premium reduced death benefit whole life product as a result of recent pricing changes and product modifications. As noted above, sales of this product were suspended at the end of September 2013.

|                    | Nine Months Ended September 30, 2013 |        |               |         |                        | Nine Months Ended September 30, 2012 |        |               |         |          |
|--------------------|--------------------------------------|--------|---------------|---------|------------------------|--------------------------------------|--------|---------------|---------|----------|
|                    | Accident &                           |        |               |         |                        | Accident &                           |        |               |         |          |
|                    | Life                                 | Health | Retirement(1) | Annuity | Total<br>(in millions) | Life                                 | Health | Retirement(1) | Annuity | Total    |
| Life Planners      | \$ 451                               | \$ 85  | \$ 353        | \$ 33   | \$ 922                 | \$ 357                               | \$ 170 | \$ 477        | \$ 60   | \$ 1,064 |
| Gibraltar Life:    |                                      |        |               |         |                        |                                      |        |               |         |          |
| Life Consultants   | 383                                  | 81     | 106           | 114     | 684                    | 325                                  | 125    | 145           | 115     | 710      |
| Banks(2)           | 568                                  | 2      | 6             | 73      | 649                    | 743                                  | 36     | 10            | 91      | 880      |
| Independent Agency | 75                                   | 31     | 51            | 24      | 181                    | 57                                   | 193    | 35            | 23      | 308      |
| Subtotal           | 1,026                                | 114    | 163           | 211     | 1,514                  | 1,125                                | 354    | 190           | 229     | 1,898    |

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|       |          |        |        |        |          |          |        |        |        |          |
|-------|----------|--------|--------|--------|----------|----------|--------|--------|--------|----------|
| Total | \$ 1,477 | \$ 199 | \$ 516 | \$ 244 | \$ 2,436 | \$ 1,482 | \$ 524 | \$ 667 | \$ 289 | \$ 2,962 |
|-------|----------|--------|--------|--------|----------|----------|--------|--------|--------|----------|

- (1) Includes retirement income, endowment and savings variable universal life.
- (2) Single pay life annualized new business premiums, which include 10% of first year premiums, and 3-year limited pay annualized new business premiums, which include 100% of new business premiums, represented 44% and 42%, respectively, of total bank distribution

**Table of Contents**

channel annualized new business premiums, excluding annuity products, for the nine months ended September 30, 2013, and 67% and 23%, respectively, of total bank distribution channel annualized new business premiums, excluding annuity products, for the nine months ended September 30, 2012. Single pay and limited pay products generally have less death benefit protection per premium paid than more traditional recurring premium products.

*Nine Month Comparison.* Annualized new business premiums, on a constant exchange rate basis, from our Life Planner operations decreased \$142 million, including a \$131 million decrease in Japan. The decline in Japan was driven by accelerated sales of U.S. dollar-denominated retirement income and cancer whole life products in the year ago period due to crediting rate and tax law changes, respectively. These items were partially offset by higher sales of yen-denominated retirement income and protection products.

Annualized new business premiums, on a constant exchange rate basis, from our Gibraltar Life operations decreased \$384 million. Bank channel sales declined \$231 million reflecting lower sales of our yen-denominated single premium reduced death benefit whole life product, as discussed above, partly offset by higher sales of recurring premium whole life products. Independent Agency and Life Consultant sales declined \$127 million and \$26 million, respectively, driven by accelerated sales of cancer whole life and U.S. dollar-denominated retirement income and whole life products in the year ago period due to tax law and crediting rate changes, respectively.

**Corporate and Other**

As described in our Annual Report on Form 10-K for the year ended December 31, 2012 under Business Financial Services Businesses Corporate and Other, Corporate and Other includes corporate operations, after allocations to our business segments, and divested businesses except for those that qualify for discontinued operations accounting treatment under U.S. GAAP.

|   | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|---|-------------------------------------|------------|------------------------------------|------------|
|   | 2013                                | 2012       | 2013                               | 2012       |
|   | (in millions)                       |            |                                    |            |
| <b>Operating results:</b>   |                                     |            |                                    |            |
| Capital debt interest expense   | \$ (156)                            | \$ (176)   | \$ (495)                           | \$ (519)   |
| Operating debt interest expense, net of investment income   | (37)                                | (12)       | (116)                              | (38)       |
| Pension and employee benefits   | 70                                  | 59         | 203                                | 164        |
| Other corporate activities(1)   | (189)                               | (285)      | (565)                              | (573)      |
| Adjusted operating income   | (312)                               | (414)      | (973)                              | (966)      |
| Realized investment gains (losses), net, and related adjustments  | 243                                 | 90         | 1,612                              | (9)        |
| Related charges   | (22)                                | (18)       | (46)                               | (15)       |
| Divested businesses   | 43                                  | (687)      | (12)                               | (664)      |
| Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests            | (1)                                 | 0          | 1                                  | (7)        |
| Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ (49)                             | \$ (1,029) | \$ 582                             | \$ (1,661) |

(1) Includes consolidating adjustments.

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

*Three Month Comparison.* The loss from Corporate and Other operations, on an adjusted operating income basis, decreased \$102 million. Net charges from corporate activities include the impact of our annual review and update of assumptions on the reserves for certain retained obligations relating to pre-demutualization policyholders to whom we had previously agreed to provide insurance for reduced or no premium in accordance with contractual settlements related to prior individual life insurance sales practices remediation. This update resulted in net charges of \$78 million for the third quarter of 2012. In addition, corporate retained expenses decreased primarily due to a \$16 million charge related to the prepayment of outstanding debt recorded in the



## Table of Contents

third quarter of 2012. Capital debt interest expense decreased \$20 million due to lower levels of capital debt and retirements of higher rate debt. Operating debt interest expense, net of investment income, increased \$25 million, primarily driven by higher levels of operating debt proceeds held in cash to provide additional flexibility for the cash needs in our businesses.

Results from pension and employee benefits increased \$11 million. Income from our qualified pension plan decreased \$5 million driven by changes in the discount rate and expected rate of return on plan assets as discussed in our Annual Report on Form 10-K for the year ended December 31, 2012, under Management's Discussion and Analysis of Financial Condition and Results of Operations Results of Operations for Financial Services Businesses by Segment Corporate and Other. The decline was more than offset by a favorable comparative impact of retained benefit expenses, including the impact of plan amendments.

*Nine Month Comparison.* The loss from Corporate and Other operations, on an adjusted operating income basis, increased \$7 million. Operating debt interest expense, net of investment income, increased \$78 million, primarily driven by higher levels of operating debt proceeds held in cash for debt prefunding activities and to provide additional flexibility for the cash needs in our businesses. Net charges from corporate activities include the impact of our annual review and update of assumptions on the reserves for certain retained obligations relating to pre-demutualization policyholders to whom we had previously agreed to provide insurance for reduced or no premium in accordance with contractual settlements related to prior individual life insurance sales practices remediation. This update resulted in net charges of \$78 million for the first nine months of 2012. Excluding the impact of this update, corporate retained expenses increased due to a \$27 million charge related to the prepayment of debt recorded in the first nine month of 2013 and higher compensation costs, partially offset by a favorable comparative impact for our estimate of payments arising from the use of new Social Security Master Death File matching criteria to identify deceased policy and contract holders and lower corporate advertising costs. Capital debt interest expense decreased \$24 million due to lower levels of capital debt and retirement of higher rate debt.

Results from pension and employee benefits increased \$39 million. Income from our qualified pension plan decreased \$15 million driven by changes in the discount rate and expected rate of return on plan assets as discussed above. The decline was more than offset by a favorable comparative impact of retained benefit expenses, including the impact of plan amendments.

### *Capital Protection Framework*

Corporate and Other operations includes the results of our Capital Protection Framework, which includes the capital hedge program. The capital hedge program broadly addresses the equity market exposure of the statutory capital of the Company as a whole, under stress scenarios, as described in our Annual Report on Form 10-K for the year ended December 31, 2012, under Liquidity and Capital Resources Capital. This hedge program resulted in charges for amortization of derivative costs of \$10 million and \$11 million for the three months ended September 30, 2013 and 2012, respectively, and \$35 million and \$28 million for the nine months ended September 30, 2013 and 2012, respectively.

We also manage certain of the risks associated with our variable annuity products through our living benefit hedging program, which is described under U.S. Retirement Solutions and Investment Management Division Individual Annuities.

In addition, we may choose to manage certain capital market related risks associated with various operations of the Financial Services Businesses through capital management strategies other than hedging of particular exposures. Realized investment gains (losses), net and related adjustments includes net gains of \$338 million and \$139 million for the three months ended September 30, 2013 and 2012, respectively, and net gains of \$1,504 million and net losses of \$155 million for the nine months ended September 30, 2013 and 2012, respectively, resulting from our decision to utilize these capital management strategies to manage a portion of our interest rate risk. The capital consequences associated with this

decision have been factored into our Capital Protection Framework.

**Table of Contents**

We assess the composition of these hedging programs on an ongoing basis, and we may change them from time to time based on our evaluation of our risk position or other factors. For more information on our Capital Protection Framework, see Liquidity and Capital Resources.

**Results of Operations of Closed Block Business**

We established the Closed Block Business effective as of the date of demutualization. The Closed Block Business includes our in force traditional domestic participating life insurance and annuity products and assets that are used for the payment of benefits and policyholder dividends on these policies, as well as other assets and equity and related liabilities that support these policies. We no longer offer these traditional domestic participating policies. See Note 6 to the Unaudited Interim Consolidated Financial Statements and Closed Block Business for additional details.

Each year, the Board of Directors of Prudential Insurance determines the dividends payable on participating policies for the following year based on the experience of the Closed Block, including investment income, net realized and unrealized investment gains, mortality experience and other factors. Although Closed Block experience for dividend action decisions is based upon statutory results, at the time the Closed Block was established, we developed, as required by U.S. GAAP, an actuarial calculation of the timing of the maximum future earnings from the policies included in the Closed Block. If actual cumulative earnings in any given period are greater than the cumulative earnings we expected, we record this excess as a policyholder dividend obligation. We will subsequently pay this excess to Closed Block policyholders as an additional dividend unless it is otherwise offset by future Closed Block performance that is less favorable than we originally expected. The policyholder dividends we charge to expense within the Closed Block Business will include any change in our policyholder dividend obligation that we recognize for the excess of actual cumulative earnings in any given period over the cumulative earnings we expected in addition to the actual policyholder dividends declared by the Board of Directors of Prudential Insurance.

As of September 30, 2013, the excess of actual cumulative earnings over the expected cumulative earnings was \$955 million, which was recorded as a policyholder dividend obligation. Actual cumulative earnings, as required by U.S. GAAP, reflect the recognition of realized investment gains and losses in the current period, as well as changes in assets and related liabilities that support the Closed Block policies. Additionally, the accumulation of net unrealized investment gains that have arisen subsequent to the establishment of the Closed Block have been reflected as a policyholder dividend obligation of \$3,641 million at September 30, 2013, to be paid to Closed Block policyholders unless offset by future experience, with an offsetting amount reported in AOCI.

*Operating Results*

Management does not consider adjusted operating income to assess the operating performance of the Closed Block Business. Consequently, results of the Closed Block Business for all periods are presented only in accordance with U.S. GAAP. The following table sets forth the Closed Block Business U.S. GAAP results for the periods indicated.

|                           | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|---------------------------|-------------------------------------|----------|------------------------------------|----------|
|                           | 2013                                | 2012     | 2013                               | 2012     |
|                           | (in millions)                       |          |                                    |          |
| <b>U.S. GAAP results:</b> |                                     |          |                                    |          |
| Revenues                  | \$ 1,595                            | \$ 1,504 | \$ 4,578                           | \$ 4,657 |
| Benefits and expenses     | 1,510                               | 1,435    | 4,470                              | 4,560    |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|   |       |       |        |       |
|---|-------|-------|--------|-------|
| Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ 85 | \$ 69 | \$ 108 | \$ 97 |
|---|-------|-------|--------|-------|

## **Table of Contents**

### *Income (loss) from Continuing Operations Before Income Taxes and Equity in Earnings of Operating Joint Ventures*

*Three Month Comparison.* Income from continuing operations before income taxes and equity in earnings of operating joint ventures increased \$16 million, primarily reflecting an increase in net realized investment gains. Net realized investment gains increased \$135 million driven by higher trading gains on equity securities and fixed maturities, partly offset by unfavorable changes in the value of currency derivatives used to hedge foreign denominated fixed maturities. For a discussion of Closed Block Business realized investment gains (losses), net, see Realized Investment Gains and Losses. Net investment income declined \$35 million primarily reflecting the impact from lower reinvestment rates. As a result of these items and other variances, the policyholder dividend obligation expense increased \$92 million. As noted above, as of September 30, 2013, the excess of actual cumulative earnings over the expected cumulative earnings was \$955 million. If actual cumulative earnings fall below expected cumulative earnings in future periods, earnings volatility in the Closed Block Business, which is primarily due to changes in investment results, may not be offset by changes in the cumulative policyholder dividend obligation.

*Nine Month Comparison.* Income from continuing operations before income taxes and equity in earnings of operating joint ventures increased \$11 million. This increase reflects the absence of a \$76 million reserve increase in the year ago period for estimated payments arising from the use of new Social Security Master Death File matching criteria to identify deceased policy and contract holders, as well as higher net realized investment gains. Net realized investment gains increased \$66 million driven by higher trading gains on equity securities and fixed maturities as well as lower credit impairments, partly offset by net unfavorable changes in the value of derivatives. For a discussion of Closed Block Business realized investment gains (losses), net, see Realized Investment Gains and Losses. Partially offsetting these favorable variances, net investment income declined \$88 million primarily reflecting the impact from lower reinvestment rates. As a result of these items and other variances, the policyholder dividend obligation expense increased \$51 million.

### *Revenues, Benefits and Expenses*

*Three Month Comparison.* Revenues, as shown in the table above under Operating Results, increased \$91 million, driven by a \$135 million increase in net realized investment gains partly offset by a \$35 million decline in net investment income, both of which are discussed above. In addition, premiums declined \$16 million, primarily due to the expected in force decline as policies terminate.

Benefits and expenses, as shown in the table above under Operating Results, increased \$75 million driven by a \$79 million increase in dividends to policyholders. This increase reflects a \$92 million increase in the policyholder dividend obligation expense, as discussed above, partly offset by a \$13 million decrease in dividends paid and accrued to policyholders driven by a decline in policies in force.

*Nine Month Comparison.* Revenues decreased \$79 million, driven by an \$88 million decline in net investment income, as discussed above, and a \$72 million decline in premiums due to the expected in force decline as policies terminate. These items were partly offset by a \$66 million increase in net realized investment gains, as discussed above.

Benefits and expenses decreased \$90 million, principally driven by a \$106 million decrease in policyholder benefits, including changes in reserves. This decrease primarily reflects the absence a \$76 million reserve increase in the year ago period for estimated payments arising from the use of new Social Security Master Death File matching criteria to identify deceased policy and contract holders, as well as the impact from the in force decline as policies terminate. Dividends to policyholders increased \$14 million due to a \$51 million increase in the policyholder dividend obligation expense reflecting higher cumulative earnings, partly offset by a \$37 million decrease in dividends paid and accrued to policyholders primarily due to a decline in policies in force.



---

**Table of Contents**

**Income Taxes**

Our income tax provision, on a consolidated basis, amounted to an income tax expense of \$509 million in the third quarter of 2013 compared to a benefit of \$328 million in the third quarter of 2012. The increase in income tax expense primarily reflects the impact of pre-tax income from continuing operations before income taxes and equity in earnings of operating joint ventures in the current quarter compared to pre-tax losses in the year ago quarter.

Our income tax provision, on a consolidated basis, amounted to an income tax benefit of \$595 million in the first nine months of 2013 compared to an expense of \$594 million in the first nine months of 2012. The first nine months of 2013 and 2012 include \$108 million and \$343 million, respectively, of an additional U.S. tax expense related to the realization of a portion of the local deferred tax assets existing on the opening day balance sheet for the Star and Edison Businesses and Prudential Gibraltar Financial Life Insurance Company, Ltd ( Prudential Gibraltar ). The U.S. tax expense for the first nine months of 2013 also reflects a change in repatriation assumption for Gibraltar Life and Prudential Gibraltar. During the first quarter of 2013, we determined that in addition to U.S. GAAP earnings, we would repatriate an additional amount from Gibraltar Life and Prudential Gibraltar, but that such additional amount would not exceed the deferred tax assets recorded in the Statement of Financial Position as of the acquisition date for Prudential Gibraltar and the Star and Edison Businesses. The U.S. tax expense for the first nine months of 2012 is reflective of the merger of Star and Edison Businesses into Gibraltar Life and it represented the recomputed U.S. tax liability on Gibraltar Life's prior earnings as a result of the repatriation assumption and the merger of the entities. The local utilization of the deferred tax asset coupled with the repatriation assumption related to the applicable earnings of our Japanese entities creates the effect of a double tax for U.S. GAAP purposes, whereas the tax expense will only be paid once.

Excluding the impact of the double tax, the benefit associated with income taxes increased \$954 million, driven in part by the impact of pre-tax losses in the first nine months of 2013 compared to pre-tax income in the first nine months of 2012. In addition, the tax rate for the first nine months of 2013 is limited to the tax benefit based on the loss in the first nine months of 2013, certain adjustments for discrete items and expected full year permanent differences, while the tax rate for the first nine months of 2012 was based on the anticipated full year effective tax rate with certain adjustments for discrete items. Future volatility in pre-tax income, such as that caused by the impact of foreign currency exchange rate movements on certain non-yen denominated assets and liabilities within our Japanese insurance operations, may impact the tax rate utilized and the resulting income tax expense, including the impact of the double tax.

For additional information regarding income taxes, see Note 12 to the Unaudited Interim Consolidated Financial Statements.

**Discontinued Operations**

Included within net income are the results of businesses which are reflected as discontinued operations under U.S. GAAP. Income (loss) from discontinued operations, net of taxes, was \$8 million and \$(2) million for the three months ended September 30, 2013 and 2012, respectively, and \$11 million and \$12 million for the nine months ended September 30, 2013 and 2012, respectively.

For additional information regarding discontinued operations see Note 3 to the Unaudited Interim Consolidated Financial Statements.

**Table of Contents****Divested Businesses**

Our income from continuing operations includes results from several businesses that have been or will be sold or exited that do not qualify for discontinued operations accounting treatment under U.S. GAAP. The results of these divested businesses are reflected in our Corporate and Other operations, but excluded from adjusted operating income. A summary of the results of these divested businesses that have been excluded from adjusted operating income is as follows for the periods indicated:

|  | Three Months Ended    |                       | Nine Months Ended     |                       |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
|  | September 30,<br>2013 | September 30,<br>2012 | September 30,<br>2013 | September 30,<br>2012 |
|  | (in millions)         |                       |                       |                       |
| Real Estate and Relocation Services                                      | \$ 25                 | \$ 7                  | \$ 53                 | \$ 21                 |
| Long Term Care   | 10                    | (680)                 | (49)                  | (662)                 |
| Wealth Management Solutions  | 9                     | (2)                   | (1)                   | (7)                   |
| Individual Health Insurance  | (2)                   | (1)                   | (12)                  | (7)                   |
| Financial Advisory   | (1)                   | (2)                   | (3)                   | (5)                   |
| Other(1)   | 2                     | (9)                   | 0                     | (4)                   |
| <b>Total divested businesses excluded from adjusted operating income</b> | <b>\$ 43</b>          | <b>\$ (687)</b>       | <b>\$ (12)</b>        | <b>\$ (664)</b>       |

(1) Primarily includes Property and Casualty Insurance and Prudential Securities Capital Markets.

*Long-Term Care.* Results for the third quarter and first nine months of 2013 improved in comparison to the prior year periods, primarily reflecting the favorable comparative impact of adjustments to deferred policy acquisition and other costs and the reserves for our long-term care products from updates to the estimated profitability of the business. These updates resulted in a net benefit of \$25 million and a net charge of \$698 million for the third quarter of 2013 and 2012, respectively.

*Wealth Management Solutions.* On July 1, 2013, we sold our wealth management solutions business to Envestnet Inc. Due to the existence of an ongoing contractual relationship between the Company and these operations, this disposition did not qualify for discontinued operations treatment under U.S. GAAP. As a result, we have classified the results of these operations, previously reported in the Asset Management segment, as a divested business and excluded its results from adjusted operating income.

**Experience-Rated Contractholder Liabilities,****Trading Account Assets Supporting Insurance Liabilities and Other Related Investments**

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



## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

fair value, and the realized and unrealized gains and losses are reported in Realized investment gains (losses), net. The commercial mortgage and other loans that support these experience-rated products are carried at unpaid principal, net of unamortized discounts and an allowance for losses, and are reflected on the statements of financial position as Commercial mortgage and other loans. Gains and losses on sales and changes in the valuation allowance for commercial mortgage and other loans are reported in Realized investment gains (losses), net.

**Table of Contents**

Our Retirement segment has two types of experience-rated products that are supported by TAASIL and other related investments. Fully participating products are those for which the entire return on underlying investments is passed back to the policyholders through a corresponding adjustment to the related liability. The adjustment to the liability is based on changes in the fair value of all of the related assets, including commercial mortgage and other loans, which are carried at amortized cost, less any valuation allowance. Partially participating products are those for which only a portion of the return on underlying investments is passed back to the policyholders over time through changes to the contractual crediting rates. The crediting rates are typically reset semiannually, often subject to a minimum crediting rate, and returns are required to be passed back within ten years.

In our International Insurance segment, the experience-rated products are fully participating. As a result, the entire return on the underlying investments is passed back to policyholders through a corresponding adjustment to the related liability.

Adjusted operating income excludes net investment gains and losses on TAASIL, related derivatives and commercial mortgage and other loans. This is consistent with the exclusion of realized investment gains and losses with respect to other investments supporting insurance liabilities managed on a consistent basis. In addition, to be consistent with the historical treatment of charges related to realized investment gains and losses on investments, adjusted operating income also excludes the change in contractholder liabilities due to asset value changes in the pool of investments (including changes in the fair value of commercial mortgage and other loans) supporting these experience-rated contracts, which are reflected in Interest credited to policyholders account balances. The result of this approach is that adjusted operating income for these products includes net fee revenue and interest spread we earn on these experience-rated contracts, and excludes changes in fair value of the pool of investments, both realized and unrealized, that we expect will ultimately accrue to the contractholders.

**Table of Contents**

The following tables set forth the impact of these items on results that are excluded from adjusted operating income for the periods indicated:

|   | Three Months Ended<br>September 30, |         | Nine Months Ended<br>September 30, |         |
|---|-------------------------------------|---------|------------------------------------|---------|
|   | 2013                                | 2012    | 2013                               | 2012    |
|   | (in millions)                       |         |                                    |         |
| <b>Retirement Segment:</b>  |                                     |         |                                    |         |
| Investment gains (losses) on:   |                                     |         |                                    |         |
| Trading account assets supporting insurance liabilities, net                              | \$ 51                               | \$ 268  | \$ (615)                           | \$ 436  |
| Derivatives   | (24)                                | (25)    | 41                                 | (66)    |
| Commercial mortgages and other loans  | (1)                                 | (2)     | 1                                  | (3)     |
| Change in experience-rated contractholder liabilities due to asset value changes(1)(2)    | (21)                                | (258)   | 597                                | (380)   |
| Net gains (losses)  | \$ 5                                | \$ (17) | \$ 24                              | \$ (13) |
| <b>International Insurance Segment:</b>   |                                     |         |                                    |         |
| Investment gains (losses) on trading account assets supporting insurance liabilities, net |                                     |         |                                    |         |
|   | \$ 52                               | \$ (4)  | \$ 342                             | \$ 66   |
| Change in experience-rated contractholder liabilities due to asset value changes          | (52)                                | 4       | (342)                              | (66)    |
| Net gains (losses)  | \$ 0                                | \$ 0    | \$ 0                               | \$ 0    |
| <b>Total:</b>   |                                     |         |                                    |         |
| Investment gains (losses) on:   |                                     |         |                                    |         |
| Trading account assets supporting insurance liabilities, net                              | \$ 103                              | \$ 264  | \$ (273)                           | \$ 502  |
| Derivatives   | (24)                                | (25)    | 41                                 | (66)    |
| Commercial mortgages and other loans  | (1)                                 | (2)     | 1                                  | (3)     |
| Change in experience-rated contractholder liabilities due to asset value changes(1)(2)    | (73)                                | (254)   | 255                                | (446)   |
| Net gains (losses)  | \$ 5                                | \$ (17) | \$ 24                              | \$ (13) |

- (1) Decreases to contractholder liabilities due to asset value changes are limited by certain floors and therefore do not reflect cumulative declines in recorded asset values of \$20 million and \$4 million as of September 30, 2013 and 2012, respectively. We have recovered and expect to recover in future periods these declines in recorded asset values through subsequent increases in recorded asset values or reductions in crediting rates on contractholder liabilities.
- (2) Included in the amounts above related to the change in the liability to contractholders as a result of commercial mortgage and other loans is a decrease of \$5 million and an increase of \$19 million for the three months ended September 30, 2013 and 2012, respectively, and a decrease of \$47 million and an increase of \$19 million for the nine months ended September 30, 2013 and 2012, respectively. As prescribed by U.S. GAAP, changes in the fair value of commercial mortgage and other loans held for investment in our general account, other than when associated with impairments, are not recognized in income in the current period, while the impact of these changes in fair value are reflected as a change in the liability to fully participating contractholders in the current period.

The net impacts for the Retirement segment of changes in experience-rated contractholder liabilities and investment gains and losses on trading account assets supporting insurance liabilities and other related investments reflect timing differences between the recognition of the mark-to-market adjustments and the recognition of the recovery of these adjustments in future periods through subsequent increases in asset values or reductions in crediting rates on contractholder liabilities for partially participating products. These impacts also reflect the difference between the fair value of the underlying commercial mortgage and other loans and the amortized cost, less any valuation allowance, of these loans, as described above.

**Table of Contents****Valuation of Assets and Liabilities****Fair Value of Assets and Liabilities**

The authoritative guidance related to fair value measurement establishes a framework that includes a three-level hierarchy used to classify the inputs used in measuring fair value. The level in the hierarchy within which the fair value falls is determined based on the lowest level input that is significant to the measurement. The fair values of assets and liabilities classified as Level 3 include at least one or more significant unobservable input in the measurement. See Note 13 to the Unaudited Interim Consolidated Financial Statements for an additional description of the valuation hierarchy levels.

The tables below present the balances of assets and liabilities measured at fair value on a recurring basis, as of the periods indicated, split between the Financial Services Businesses and Closed Block Business, and the portion of such assets and liabilities that are classified in Level 3 of the valuation hierarchy. See Note 13 to the Unaudited Interim Consolidated Financial Statements for the balances of assets and liabilities measured at fair value on a recurring basis by hierarchy level presented on a consolidated basis.

|  | As of September 30, 2013         |                     |                        |                     | As of December 31, 2012          |                     |                        |                     |
|--|----------------------------------|---------------------|------------------------|---------------------|----------------------------------|---------------------|------------------------|---------------------|
|  | Financial Services<br>Businesses |                     | Closed Block Business  |                     | Financial Services<br>Businesses |                     | Closed Block Business  |                     |
|  | Total at<br>Fair<br>Value        | Total<br>Level 3(1) | Total at<br>Fair Value | Total<br>Level 3(1) | Total at<br>Fair<br>Value        | Total<br>Level 3(1) | Total at<br>Fair Value | Total<br>Level 3(1) |
|  | (in millions)                    |                     |                        |                     |                                  |                     |                        |                     |
| Fixed maturities,<br>available-for-sale    | \$ 245,032                       | \$ 4,471            | \$ 43,734              | \$ 990              | \$ 254,917                       | \$ 4,261            | \$ 46,419              | \$ 1,207            |
| Trading account assets:                    |                                  |                     |                        |                     |                                  |                     |                        |                     |
| Fixed maturities                           | 22,533                           | 596                 | 162                    | 9                   | 20,605                           | 565                 | 139                    | 10                  |
| Equity securities                          | 2,165                            | 763                 | 120                    | 115                 | 2,341                            | 987                 | 136                    | 111                 |
| All other(2)                               | 2,554                            | 8                   | 0                      | 0                   | 3,697                            | 25                  | 0                      | 0                   |
| Subtotal                                   | 27,252                           | 1,367               | 282                    | 124                 | 26,643                           | 1,577               | 275                    | 121                 |
| Equity securities, available-for-sale      | 5,488                            | 280                 | 3,496                  | 2                   | 5,052                            | 321                 | 3,225                  | 9                   |
| Commercial mortgage and other loans        | 112                              | 19                  | 0                      | 0                   | 162                              | 48                  | 0                      | 0                   |
| Other long-term investments                | 1,275                            | 1,010               | 0                      | 0                   | 1,478                            | 1,053               | (95)                   | 0                   |
| Short-term investments                     | 6,052                            | 0                   | 1,892                  | 0                   | 5,130                            | 0                   | 1,260                  | 0                   |
| Cash equivalents                           | 5,465                            | 0                   | 677                    | 0                   | 13,063                           | 0                   | 537                    | 0                   |
| Other assets                               | 164                              | 6                   | 92                     | 0                   | 98                               | 8                   | 97                     | 0                   |
| Subtotal excluding separate account assets | 290,840                          | 7,153               | 50,173                 | 1,116               | 306,543                          | 7,268               | 51,718                 | 1,337               |
| Separate account assets                    | 275,091                          | 22,347              | 0                      | 0                   | 253,254                          | 21,132              | 0                      | 0                   |
| <b>Total assets</b>                        | <b>\$ 565,931</b>                | <b>\$ 29,500</b>    | <b>\$ 50,173</b>       | <b>\$ 1,116</b>     | <b>\$ 559,797</b>                | <b>\$ 28,400</b>    | <b>\$ 51,718</b>       | <b>\$ 1,337</b>     |
| Future policy benefits                     | \$ 1,928                         | \$ 1,928            | \$ 0                   | \$ 0                | \$ 3,348                         | \$ 3,348            | \$ 0                   | \$ 0                |
| Other liabilities                          | 1,130                            | 6                   | 0                      | 0                   | 90                               | 0                   | 0                      | 0                   |
| Notes of consolidated VIEs                 | 2,330                            | 2,330               | 0                      | 0                   | 1,406                            | 1,406               | 0                      | 0                   |
| <b>Total liabilities</b>                   | <b>\$ 5,388</b>                  | <b>\$ 4,264</b>     | <b>\$ 0</b>            | <b>\$ 0</b>         | <b>\$ 4,844</b>                  | <b>\$ 4,754</b>     | <b>\$ 0</b>            | <b>\$ 0</b>         |

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

- (1) The amount of Level 3 assets taken as a percentage of total assets measured at fair value on a recurring basis totaled 5.2% and 5.1% as of September 30, 2013 and December 31, 2012, respectively, for the Financial Services Businesses, and 2.2% and 2.6% as of September 30, 2013 and December 31, 2012, respectively, for the Closed Block Business. The amount of Level 3 liabilities was immaterial to our balance sheet.
- (2) All other primarily reflects derivatives. The amounts classified as Level 3 for the Financial Services Businesses exclude the impact of netting.

---

**Table of Contents**

The determination of fair value, which for certain assets and liabilities is dependent on the application of estimates and assumptions, can have a significant impact on our results of operations and may require the application of a greater degree of judgment depending on market conditions, as the ability to value assets and liabilities can be significantly impacted by a decrease in market activity or a lack of transactions executed in an orderly manner. The following sections provide information regarding certain assets and liabilities of our Financial Services Businesses and our Closed Block Business which are valued using Level 3 inputs and could have a significant impact on our results of operations.

***Fixed Maturity and Equity Securities***

Fixed maturity securities included in Level 3 in our fair value hierarchy are generally priced based on internally-developed valuations or indicative broker quotes. For certain private fixed maturity and equity securities, the internally-developed valuation model uses significant unobservable inputs and, accordingly, such securities are included in Level 3 in our fair value hierarchy. Level 3 fixed maturity securities included approximately \$4.9 billion and \$4.5 billion as of September 30, 2013 and December 31, 2012, respectively, of public fixed maturities, with values primarily based on indicative broker quotes, and approximately \$1.2 billion and \$1.5 billion as of September 30, 2013 and December 31, 2012, respectively, of private fixed maturities, with values primarily based on internally-developed models. Significant unobservable inputs used included: issue specific credit adjustments, material non-public financial information, management judgment, estimation of future earnings and cash flows, default rate assumptions, liquidity assumptions and indicative quotes from market makers. These inputs are usually considered unobservable, as not all market participants will have access to this data.

The impact our determination of fair value for fixed maturity and equity securities has on our results of operations is dependent on our classification of the security as either trading, available-for-sale, or held-to-maturity. For our investments classified as trading, the impact of changes in fair value is recorded within Asset management fees and other income. For our investments classified as available-for-sale, the impact of changes in fair value is recorded as an unrealized gain or loss in AOCI, a separate component of equity. Our investments classified as held-to-maturity are carried at amortized cost.

***Other Long-Term Investments***

Other long-term investments classified in Level 3 primarily include real estate held in consolidated investment funds and fund investments where the fair value option has been elected. The fair value of real estate held in consolidated investment funds is determined through an independent appraisal process. The appraisals generally utilize a discounted cash flow model. The appraisals also include replacement cost estimates and recent sales data as alternate methods of fair value. These appraisals and the related assumptions are updated at least annually. Since many of the assumptions utilized are unobservable and are considered to be significant inputs to the valuation, the real estate investments within other long-term investments are reflected within Level 3. Consolidated real estate investment funds classified as Level 3 totaled approximately \$0.5 billion as of both September 30, 2013 and December 31, 2012. The fair value of fund investments, where the fair value option has been elected, is primarily determined by the fund managers. Since the valuations may be based on unobservable market inputs and cannot be validated by the Company, these investments are included within Level 3. Investments in these funds included in Level 3 totaled approximately \$0.5 billion as of both September 30, 2013 and December 31, 2012.

***Derivative Instruments***

Derivatives classified as Level 3, excluding embedded derivatives which are discussed in Variable Annuity Optional Living Benefit Features below, include look-back equity options and other structured products. These derivatives are recorded at fair value either as assets, within Other trading account assets, or Other long-term investments, or as liabilities, within Other liabilities, and are valued based upon models with some

significant unobservable market inputs or inputs from less actively traded markets. We validate these

## **Table of Contents**

values through periodic comparison of our fair values to external broker-dealer values. The fair values of OTC derivative assets classified as Level 3 totaled approximately \$1 million and \$19 million as of September 30, 2013 and December 31, 2012, respectively, without giving consideration to the impact of netting.

All realized and unrealized changes in fair value of these derivatives, with the exception of the effective portion of qualifying cash flow hedges and hedges of net investments in foreign operations, are recorded in current earnings. Generally, the changes in fair value of these derivatives, excluding those that qualify for hedge accounting, are recorded in Realized investment gains (losses), net. For additional information regarding the impact of changes in fair value of derivative instruments on our results of operations see Realized Investment Gains and Losses below.

### ***Separate Account Assets***

Separate account assets included in Level 3 primarily include real estate investments for which values are determined as described above under Other Long-Term Investments. Separate account liabilities are reported at contract value and not fair value.

### ***Variable Annuity Optional Living Benefit Features***

Future policy benefits classified in Level 3 primarily include liabilities related to guarantees associated with the optional living benefit features of certain variable annuity contracts offered by our Individual Annuities segment, including guaranteed minimum accumulation benefits (GMAB), guaranteed minimum withdrawal benefits (GMWB) and guaranteed minimum income and withdrawal benefits (GMIWB). These benefits are accounted for as embedded derivatives and carried at fair value with changes in fair value included in Realized investment gains (losses), net. The fair values of the GMAB, GMWB and GMIWB liabilities are calculated as the present value of future expected benefit payments to customers less the present value of assessed rider fees attributable to the embedded derivative feature. This methodology could result in either a liability or contra-liability balance, based on capital market conditions and various policyholder behavior assumptions. Since there is no observable active market for the transfer of these obligations, the valuations are calculated using internally-developed models with option pricing techniques. These models utilize significant assumptions that are primarily unobservable, including assumptions as to lapse rates, NPR, utilization rates, withdrawal rates, mortality rates and equity market volatility. Future policy benefits classified as Level 3 were net liabilities of \$1.9 billion and \$3.3 billion as of September 30, 2013 and December 31, 2012, respectively. For additional information see Results of Operations for Financial Services Businesses by Segment U.S. Retirement Solutions and Investment Management Division Individual Annuities.

For additional information about the key estimates and assumptions used in our determination of fair value, see Note 13 of our Unaudited Interim Consolidated Financial Statements.

### **Realized Investment Gains and Losses**

Realized investment gains and losses are generated from numerous sources, including the following significant items:



sale of investments

adjustments to the cost basis of investments for other-than-temporary impairments

recognition of other-than-temporary impairments in earnings for foreign denominated securities that are approaching maturity and are in an unrealized loss position due to foreign currency exchange rate movements

prepayment premiums received on private fixed maturity securities

net changes in the allowance for losses, certain restructurings and foreclosures on commercial mortgage and other loans

**Table of Contents**

fair value changes on commercial mortgage loans carried at fair value

fair value changes on embedded derivatives and free-standing derivatives that do not qualify for hedge accounting treatment

The level of other-than-temporary impairments generally reflects economic conditions and is expected to increase when economic conditions worsen and to decrease when economic conditions improve. Historically, the causes of other-than-temporary impairments have been specific to each individual issuer and have not directly resulted in impairments to other securities within the same industry or geographic region. We may also realize additional credit and interest rate related losses through sales of investments pursuant to our credit risk and portfolio management objectives. For additional information regarding our policies regarding other-than-temporary-impairments for fixed maturity and equity securities, see Note 2 to the Unaudited Interim Consolidated Financial Statements.

We use interest rate and currency swaps and other derivatives to manage interest and currency exchange rate exposures arising from mismatches between assets and liabilities, including duration mismatches. We use derivative contracts to mitigate the risk that unfavorable changes in currency exchange rates will materially affect U.S. dollar equivalent earnings generated by certain of our non-U.S. businesses. We also use equity-based and interest rate derivatives to hedge a portion of the risks embedded in certain variable annuity products with optional living benefit guarantees. Derivative contracts also include forward purchases and sales of to-be-announced mortgage-backed securities primarily related to our dollar roll program. Many of these derivative contracts do not qualify for hedge accounting and, consequently, we recognize the changes in fair value of such contracts from period to period in current earnings, although we do not necessarily account for the related assets or liabilities the same way.

Accordingly, realized investment gains and losses from our derivative activities can contribute significantly to fluctuations in net income. For a further discussion of optional living benefit guarantees and related hedge positions in our Individual Annuities segment, see Results of Operations for Financial Services Businesses by Segment U.S. Retirement Solutions and Investment Management Division Individual Annuities above.

Adjusted operating income generally excludes Realized investment gains (losses), net, subject to certain exceptions. These exceptions primarily include realized investment gains or losses within certain of our businesses for which such gains or losses are a principal source of earnings, gains or losses associated with terminating hedges of foreign currency earnings and current period yield adjustments, and related charges and adjustments. Other-than-temporary impairments, interest rate related losses and credit related losses on sales (other than those related to certain of our businesses which primarily originate investments for sale or syndication to unrelated investors) are excluded from adjusted operating income.

**Table of Contents**

The following tables set forth Realized investment gains (losses), net, by investment type for the Financial Services Businesses and Closed Block Business, as well as related charges and adjustments associated with the Financial Services Businesses, for the periods indicated. For additional details regarding adjusted operating income, which is our measure of performance for the segments of our Financial Services Businesses, see Note 11 to the Unaudited Interim Consolidated Financial Statements.

|  | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2013                                | 2012       | 2013                               | 2012       |
| (in millions)  |                                     |            |                                    |            |
| <b>Realized investment gains (losses), net:</b>                              |                                     |            |                                    |            |
| Financial Services Businesses  | \$ (2,319)                          | \$ (1,519) | \$ (4,141)                         | \$ (1,284) |
| Closed Block Business  | 209                                 | 74         | 284                                | 218        |
| Consolidated realized investment gains (losses), net                         | \$ (2,110)                          | \$ (1,445) | \$ (3,857)                         | \$ (1,066) |
| <b>Financial Services Businesses:</b>  |                                     |            |                                    |            |
| Realized investment gains (losses), net:                                     |                                     |            |                                    |            |
| Fixed maturity securities  | \$ 300                              | \$ (85)    | \$ 595                             | \$ (194)   |
| Equity securities  | 18                                  | 10         | 82                                 | (59)       |
| Commercial mortgage and other loans  | 25                                  | 23         | 61                                 | 45         |
| Derivative instruments   | (2,685)                             | (1,467)    | (4,907)                            | (1,012)    |
| Other  | 23                                  | 0          | 28                                 | (64)       |
| Total  | \$ (2,319)                          | \$ (1,519) | \$ (4,141)                         | \$ (1,284) |
| Related adjustments  | 1,000                               | (432)      | (3,181)                            | (325)      |
| Realized investment gains (losses), net, and related adjustments             | (1,319)                             | (1,951)    | (7,322)                            | (1,609)    |
| Related charges  | 763                                 | 648        | 1,533                              | 498        |
| Realized investment gains (losses), net, and related charges and adjustments | \$ (556)                            | \$ (1,303) | \$ (5,789)                         | \$ (1,111) |
| <b>Closed Block Business:</b>  |                                     |            |                                    |            |
| Realized investment gains (losses), net:                                     |                                     |            |                                    |            |
| Fixed maturity securities  | \$ 69                               | \$ 32      | \$ 118                             | \$ 46      |
| Equity securities  | 181                                 | 30         | 287                                | 62         |
| Commercial mortgage and other loans  | 5                                   | 5          | 7                                  | 4          |
| Derivative instruments   | (45)                                | 9          | (123)                              | 109        |
| Other  | (1)                                 | (2)        | (5)                                | (3)        |
| Total  | \$ 209                              | \$ 74      | \$ 284                             | \$ 218     |

**2013 to 2012 Three Month Comparison***Financial Services Businesses*

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

The Financial Services Businesses net realized investment losses were \$2,319 million in the third quarter of 2013, compared to net realized investment losses of \$1,519 million in the third quarter of 2012.

**Table of Contents**

Net realized gains on fixed maturity securities were \$300 million in the third quarter of 2013, compared to net realized losses of \$85 million in the third quarter of 2012, as set forth in the following table:

|  | Three Months Ended<br>September 30, |                |
|--|-------------------------------------|----------------|
|  | 2013                                | 2012           |
|  | (in millions)                       |                |
| <b>Realized investment gains (losses), net Fixed Maturity Securities Financial Services Businesses</b> |                                     |                |
| Gross realized investment gains:   |                                     |                |
| Gross gains on sales and maturities(1)   | \$ 449                              | \$ 65          |
| Private bond prepayment premiums   | 28                                  | 6              |
| <b>Total gross realized investment gains</b>   | <b>477</b>                          | <b>71</b>      |
| Gross realized investment losses:  |                                     |                |
| Net other-than-temporary impairments recognized in earnings(2)   | (28)                                | (82)           |
| Gross losses on sales and maturities(1)  | (147)                               | (72)           |
| Credit related losses on sales   | (2)                                 | (2)            |
| <b>Total gross realized investment losses</b>  | <b>(177)</b>                        | <b>(156)</b>   |
| <b>Realized investment gains (losses), net Fixed Maturity Securities</b>                               | <b>\$ 300</b>                       | <b>\$ (85)</b> |
| <b>Net gains (losses) on sales and maturities Fixed Maturity Securities(1)</b>                         | <b>\$ 302</b>                       | <b>\$ (7)</b>  |

- (1) Amounts exclude prepayment premiums, other-than-temporary impairments, and credit related losses through sales of investments pursuant to our credit risk objectives.
- (2) Excludes the portion of other-than-temporary impairments recorded in Other comprehensive income (loss), representing any difference between the fair value of the impaired debt security and the net present value of its projected future cash flows at the time of impairment.

Net gains on sales and maturities of fixed maturity securities were \$302 million in the third quarter of 2013 and were primarily due to sales within our International Insurance segment which were initiated for purposes of duration management. Net losses on sales and maturities of fixed maturity securities were \$7 million in the third quarter of 2012 and were primarily due to sales within our International Insurance segment. See below for additional information regarding the other-than-temporary impairments of fixed maturity securities in the third quarter of 2013 and 2012.

Net realized gains on equity securities were \$18 million in the third quarter of 2013 and included net trading gains on sales of equity securities of \$19 million, primarily within our International Insurance segment, partially offset by other-than-temporary impairments of \$1 million. Net realized gains on equity securities were \$10 million in the third quarter of 2012 and included net trading gains on sales of equity securities of \$31 million, primarily within our Corporate and Other operations, partially offset by other-than-temporary impairments of \$21 million. See below for additional information regarding the other-than-temporary impairments of equity securities in the third quarter of 2013 and 2012.

Net realized gains on commercial mortgage and other loans in the third quarter of 2013 were \$25 million, primarily related to a net decrease in the loan loss reserve of \$32 million. Net realized gains on commercial mortgage and other loans in the third quarter of 2012 were \$23 million, primarily related to a net decrease in the loan loss reserve of \$25 million and higher servicing revenue within our commercial mortgage operations, partially offset by realized losses related to restructurings and sales of loans held within our Retirement segment. For additional information regarding our commercial mortgage and other loan loss reserves, see General Account Investments Commercial Mortgage and Other

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Loans Commercial Mortgage and Other Loan Quality below.

Net realized losses on derivatives were \$2,685 million in the third quarter of 2013, compared to net realized losses of \$1,467 million in the third quarter of 2012. The net derivative losses in 2013 primarily reflect net losses of \$2,507 million on product related embedded derivatives and related hedge positions mainly associated with

**Table of Contents**

certain variable annuity contracts as well as net mark-to-market losses of \$155 million on interest rate derivatives used to manage duration as long-term interest rates increased. The net derivative losses in the third quarter of 2012 primarily reflect net losses of \$1,360 million on product related embedded derivatives and related hedge positions primarily associated with certain variable annuity contracts. Also contributing to these losses were net losses of \$82 million on foreign currency forward contracts used to hedge the future income of non-U.S. businesses, primarily in Japan, due to the weakening of the U.S. dollar against the Japanese yen. For additional information, see Results of Operations for Financial Services Businesses by Segment U.S. Retirement Solutions and Investment Management Division Individual Annuities above.

Net realized gains on other investments were \$23 million in the third quarter of 2013 and included net gains of \$27 million, primarily within our Corporate and Other segment, offset by other-than-temporary-impairments of \$4 million. Net realized losses on other investments were less than \$1 million in the third quarter of 2012.

Related adjustments include the portions of Realized investment gains (losses), net that are included in adjusted operating income and the portions of Asset management fees and other income and Net investment income that are excluded from adjusted operating income. These adjustments are made to arrive at Realized investment gains (losses), net, and related adjustments which are excluded from adjusted operating income. Results include a net positive related adjustment of \$1,000 million for the third quarter of 2013 and a net negative related adjustment of \$432 million for the third quarter of 2012. The adjustments in both periods were primarily driven by the impact of foreign currency exchange rate movements on certain non-yen denominated assets and liabilities within our Japanese insurance operations for which the foreign currency exposure is economically matched and offset in AOCI. For additional information, see Results of Operations for Financial Services Businesses by Segment International Insurance Division Impact of foreign currency exchange rate movements on earnings U.S. GAAP earnings impact of products denominated in non-local currencies above.

Charges that relate to Realized investment gains (losses), net, and related adjustments are also excluded from adjusted operating income, and may be reflected as net charges or net benefits. Results include net related benefits of \$763 million and \$648 million for the third quarter of 2013 and of 2012, respectively. The impacts in both periods were primarily driven by the portion of amortization of deferred policy acquisition and other costs relating to changes in value of embedded derivatives and related hedge positions associated with certain variable annuity contracts. For additional information, see Note 11 to the Unaudited Interim Consolidated Financial Statements.

During the third quarter of 2013, we recorded other-than-temporary impairments of \$33 million in earnings, compared to \$103 million in the third quarter of 2012. The following tables set forth, for the periods indicated, the composition of other-than-temporary impairments recorded in earnings attributable to the Financial Services Businesses by asset type, and for fixed maturity securities, by reason.

|   | Three Months Ended<br>September 30, |               |
|---|-------------------------------------|---------------|
|   | 2013                                | 2012          |
|   | (in millions)                       |               |
| <b>Other than temporary impairments recorded in earnings Financial Services Businesses(1)</b> |                                     |               |
| Public fixed maturity securities  | \$ 20                               | \$ 73         |
| Private fixed maturity securities   | 8                                   | 9             |
| Total fixed maturity securities   | 28                                  | 82            |
| Equity securities   | 1                                   | 21            |
| Other invested assets(2)  | 4                                   | 0             |
| <b>Total</b>  | <b>\$ 33</b>                        | <b>\$ 103</b> |

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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



**Table of Contents**

|   | Three Months Ended<br>September 30, |              |
|---|-------------------------------------|--------------|
|   | 2013                                | 2012         |
|   | (in millions)                       |              |
| <b>Other than-temporary impairments on fixed maturity securities recorded in earnings</b> |                                     |              |
| <b>Businesses(1)</b>  |                                     |              |
| Due to credit events or adverse conditions of the respective issuer(2)                    | \$ 26                               | \$ 28        |
| Due to other accounting guidelines(3)   | 2                                   | 54           |
| <b>Total</b>  | <b>\$ 28</b>                        | <b>\$ 82</b> |

- (1) Excludes the portion of other-than-temporary impairment recorded in Other comprehensive income (loss), representing any difference between the fair value of the impaired debt security and the net present value of its projected future cash flows at the time of impairment.
- (2) Represents circumstances where we believe credit events or other adverse conditions of the respective issuers have caused, or will lead to, a deficiency in the contractual cash flows related to the investment. The amount of the impairment recorded in earnings is the difference between the amortized cost of the debt security and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security prior to impairment.
- (3) Primarily represents circumstances where securities with losses from foreign currency exchange rate movements approach maturity.

Fixed maturity security other-than-temporary impairments in the third quarter of 2013 were concentrated in asset-backed securities collateralized by sub-prime mortgages, and the consumer non-cyclical and consumer cyclical sectors within corporate securities. These other-than-temporary impairments were primarily related to intent to sell securities or related to securities with liquidity concerns, downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers. Fixed maturity security other-than-temporary impairments in the third quarter of 2012 were concentrated in the finance, capital goods, consumer non-cyclical and technology sectors within corporate securities, and asset-backed securities collateralized by sub-prime mortgages. These other-than-temporary impairments were primarily related to securities with unrealized losses from foreign currency exchange rate movements that are approaching maturity or related to securities with liquidity concerns, downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers.

Equity security other-than-temporary impairments in the third quarter of both 2013 and 2012 were primarily driven by circumstances where the decline in value was maintained for one year or greater or where we intended to sell the security.

*Closed Block Business*

For the Closed Block Business, net realized investment gains in the third quarter of 2013 were \$209 million, compared to net realized investment gains of \$74 million in the third quarter of 2012.

**Table of Contents**

Net realized gains on fixed maturity securities were \$69 million in the third quarter of 2013, compared to net realized gains of \$32 million in the third quarter of 2012, as set forth in the following table:

|  | Three Months Ended<br>September 30, |              |
|--|-------------------------------------|--------------|
|  | 2013                                | 2012         |
|  | (in millions)                       |              |
| <b>Realized investment gains (losses), net Fixed Maturity Securities Closed Block Business</b> |                                     |              |
| Gross realized investment gains:   |                                     |              |
| Gross gains on sales and maturities(1)   | \$ 118                              | \$ 50        |
| Private bond prepayment premiums   | 13                                  | 8            |
| <b>Total gross realized investment gains</b>   | <b>131</b>                          | <b>58</b>    |
| Gross realized investment losses:  |                                     |              |
| Net other-than-temporary impairments recognized in earnings(2)                                 | (15)                                | (13)         |
| Gross losses on sales and maturities(1)  | (43)                                | (13)         |
| Credit related losses on sales   | (4)                                 | 0            |
| <b>Total gross realized investment losses</b>  | <b>(62)</b>                         | <b>(26)</b>  |
| <b>Realized investment gains (losses), net Fixed Maturity Securities</b>                       | <b>\$ 69</b>                        | <b>\$ 32</b> |
| <b>Net gains (losses) on sales and maturities Fixed Maturity Securities(1)</b>                 | <b>\$ 75</b>                        | <b>\$ 37</b> |

- (1) Amounts exclude prepayment premiums, other-than-temporary impairments, and credit related losses through sales of investments pursuant to our credit risk objectives.
- (2) Excludes the portion of other-than-temporary impairments recorded in Other comprehensive income (loss), representing any difference between the fair value of the impaired debt security and the net present value of its projected future cash flows at the time of impairment.

Net realized gains on equity securities were \$181 million in the third quarter of 2013, primarily driven by net trading gains on sales of equity securities. Net realized gains on equity securities were \$30 million in the third quarter of 2012 and included net trading gains on sales of equity securities of \$33 million, partially offset by other-than-temporary-impairments of \$3 million.

In both the third quarter of 2013 and 2012, net realized gains on commercial mortgage and other loans were \$5 million, primarily related to a net decrease in the loan loss reserve of \$5 million. For additional information regarding our loan loss reserves, see General Account Investments Commercial Mortgage and Other Loans Commercial Mortgage and Other Loan Quality below.

Net realized losses on derivatives were \$45 million in the third quarter of 2013, compared to net realized gains of \$9 million in the third quarter of 2012. Derivative losses in the third quarter of 2013 primarily reflect net losses of \$79 million on currency derivatives used to hedge foreign denominated investments as the U.S. dollar weakened against the euro and other currencies. Partially offsetting these losses were net gains of \$21 million on interest rate derivatives primarily used to manage duration. Derivative gains in the third quarter of 2012 primarily reflect net mark-to-market gains of \$23 million on interest rate derivatives primarily used to manage duration as short-term interest rates decreased and net gains of \$15 million on to be announced ( TBA ) forward contracts. Partially offsetting these gains were net losses of \$25 million related to currency derivatives used to hedge foreign denominated investments as the U.S. dollar weakened against the euro.



**Table of Contents**

During the third quarter of 2013, we recorded other-than-temporary impairments of \$19 million in earnings, compared to \$18 million in the third quarter of 2012. The following tables set forth, for the periods indicated, the composition of other-than-temporary impairments recorded in earnings attributable to the Closed Block Business by asset type, and for fixed maturity securities, by reason.

|   | <b>Three Months Ended<br/>September 30,</b> |              |
|---|---|--------------|
|   | <b>2013</b>                                 | <b>2012</b>  |
| <b>(in millions)</b>  |   |              |
| <b>Other-than-temporary impairments recorded in earnings Closed Block Business(1)</b> |   |              |
| Public fixed maturity securities  | \$ 11                                       | \$ 8         |
| Private fixed maturity securities   | 4   | 5            |
| Total fixed maturity securities   | 15  | 13           |
| Equity securities   | 2   | 3            |
| Other invested assets(2)  | 2   | 2            |
| <b>Total</b>  | <b>\$ 19</b>                                | <b>\$ 18</b> |

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

|  | <b>Three Months Ended<br/>September 30,</b> |              |
|--|---|--------------|
|  | <b>2013</b>                                 | <b>2012</b>  |
| <b>(in millions)</b>   |   |              |
| <b>Other-than-temporary impairments on fixed maturity securities recorded in earnings Closed Block Business(1)</b> |   |              |
| Due to credit events or adverse conditions of the respective issuer(2)   | \$ 14                                       | \$ 13        |
| Due to other accounting guidelines   | 1   | 0            |
| <b>Total</b>   | <b>\$ 15</b>                                | <b>\$ 13</b> |

- (1) Excludes the portion of other-than-temporary impairment recorded in Other comprehensive income (loss), representing any difference between the fair value of the impaired debt security and the net present value of its projected future cash flows at the time of impairment.
- (2) Represents circumstances where we believe credit events or other adverse conditions of the respective issuers have caused, or will lead to, a deficiency in the contractual cash flows related to the investment. The amount of the impairment recorded in earnings is the difference between the amortized cost of the debt security and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security prior to impairment.

Fixed maturity security other-than-temporary impairments in the third quarter of 2013 were concentrated in asset-backed securities collateralized by sub-prime mortgages and in the consumer non-cyclical sector within corporate securities. Fixed maturity security other-than-temporary impairments in the third quarter of 2012 were concentrated in asset-backed securities collateralized by sub-prime mortgages and reflect adverse financial conditions of the respective issuers.

Equity security other-than-temporary impairments in the third quarter of 2013 and 2012 were primarily due to circumstances where the decline in value was maintained for one year or greater.

*2013 to 2012 Nine Month Comparison*

*Financial Services Businesses*

The Financial Services Businesses' net realized investment losses were \$4,141 million in the first nine months of 2013, compared to net realized investment losses of \$1,284 million in the first nine months of 2012.

**Table of Contents**

Net realized gains on fixed maturity securities were \$595 million in the first nine months of 2013, compared to net realized losses of \$194 million in the first nine months of 2012, as set forth in the following table:

|  | Nine Months Ended<br>September 30, |                 |
|--|------------------------------------|-----------------|
|  | 2013                               | 2012            |
|  | (in millions)                      |                 |
| <b>Realized investment gains (losses), net Fixed Maturity Securities Financial Services Businesses</b> |                                    |                 |
| Gross realized investment gains:   |                                    |                 |
| Gross gains on sales and maturities(1)   | \$ 953                             | \$ 229          |
| Private bond prepayment premiums   | 57                                 | 14              |
| <b>Total gross realized investment gains</b>   | <b>1,010</b>                       | <b>243</b>      |
| Gross realized investment losses:  |                                    |                 |
| Net other-than-temporary impairments recognized in earnings(2)   | (110)                              | (238)           |
| Gross losses on sales and maturities(1)  | (277)                              | (176)           |
| Credit related losses on sales   | (28)                               | (23)            |
| <b>Total gross realized investment losses</b>  | <b>(415)</b>                       | <b>(437)</b>    |
| <b>Realized investment gains (losses), net Fixed Maturity Securities</b>                               | <b>\$ 595</b>                      | <b>\$ (194)</b> |
| <b>Net gains (losses) on sales and maturities Fixed Maturity Securities(1)</b>                         | <b>\$ 676</b>                      | <b>\$ 53</b>    |

- (1) Amounts exclude prepayment premiums, other-than-temporary impairments, and credit related losses through sales of investments pursuant to our credit risk objectives.
- (2) Excludes the portion of other-than-temporary impairments recorded in Other comprehensive income (loss), representing any difference between the fair value of the impaired debt security and the net present value of its projected future cash flows at the time of impairment.

Net trading gains on sales and maturities of fixed maturity securities in the first nine months of 2013 were \$676 million, primarily due to sales within our International Insurance segment initiated for purposes of duration management as well as resulting from surrenders of fixed annuities denominated in Australian and U.S. dollars. Net trading gains on sales and maturities of fixed maturity securities in the first nine months of 2012 were \$53 million primarily due to sales within our International Insurance, Retirement and Individual Annuities segments. See below for additional information regarding the other-than-temporary impairments of fixed maturity securities in the first nine months of 2013 and 2012.

Net realized gains on equity securities were \$82 million in the first nine months of 2013 and included net trading gains on sales of \$91 million, partially offset by other-than-temporary impairments of \$9 million. Net realized losses on equity securities were \$59 million in the first nine months of 2012 and included other-than-temporary impairments of \$93 million and net trading gains on sales of \$34 million, primarily within our Corporate and Other operations. See below for additional information regarding the other-than-temporary impairments of equity securities in the first nine months of 2013 and 2012.

Net realized gains on commercial mortgage and other loans in the first nine months of 2013 were \$61 million, primarily related to a net decrease in the loan loss reserve of \$46 million. Net realized gains on commercial mortgage and other loans in the first nine months of 2012 were \$45 million, primarily related to a net decrease in the loan loss reserve of \$46 million. For additional information regarding our commercial mortgage and other loan loss reserves, see General Account Investments Commercial Mortgage and Other Loans Commercial Mortgage and Other Loan Quality below.

Net realized losses on derivatives were \$4,907 million in the first nine months of 2013, compared to net realized losses of \$1,012 million in the first nine months of 2012. The net derivative losses in the first nine months of 2013 primarily reflect net losses of \$3,789 million on product related embedded derivatives and related hedge positions mainly associated with certain variable annuity contracts as well as net mark-to-market

**Table of Contents**

losses of \$761 million on interest rate derivatives used to manage duration as interest rates increased. Also contributing to the net derivative losses were net losses of \$629 million on foreign currency derivatives used to hedge portfolio assets in our Japan business primarily due to the weakening of the Japanese yen against the U.S. dollar and other currencies. Partially offsetting these losses were net gains of \$315 million on foreign currency forward contracts used to hedge the future income of non-U.S. businesses, predominantly in Japan, due to the strengthening of the U.S. dollar against the Japanese yen. The net derivative losses in the first nine months of 2012 primarily reflect net losses of \$1,294 million on product related embedded derivatives and related hedge positions mainly associated with certain variable annuity contracts. Partially offsetting these losses were net mark-to-market gains of \$138 million on interest rate derivatives used to manage duration as interest rates decreased and gains of \$91 million on fee-based synthetic guaranteed investment contracts which are accounted for as derivatives. For additional information, see Results of Operations for Financial Services Businesses by Segment U.S. Retirement Solutions and Investment Management Division Individual Annuities above.

Net realized gains on other investments were \$28 million in the first nine months of 2013 and included net trading gains of \$38 million, primarily within our Corporate and Other segment, partially offset by other-than-temporary impairments of \$10 million on real estate, joint venture and limited partnership investments. Net realized losses on other investments were \$64 million in the first nine months of 2012 and included a \$74 million impairment on real estate, joint venture and limited partnership investments, of which \$58 million relates to prior periods, partially offset by net trading gains of \$10 million, primarily within our Corporate and Other segment.

Related adjustments include net negative adjustments of \$3,181 million and \$325 million for the first nine months of 2013 and the first nine months of 2012, respectively. The adjustments in both periods were primarily driven by the impact of foreign currency exchange rate movements on certain non-yen denominated assets and liabilities within our Japanese insurance operations for which the foreign currency exposure is economically matched and offset in AOCI.

Related charges include net related benefits of \$1,533 million and \$498 million for the first nine months of 2013 and 2012, respectively. The impacts in both periods were primarily driven by the portion of amortization of deferred policy acquisition and other costs relating to changes in value of embedded derivatives and related hedge positions associated with certain variable annuity contracts.

During the first nine months of 2013, we recorded other-than-temporary impairments of \$129 million in earnings, compared to \$405 million in the first nine months of 2012. The following tables set forth, for the periods indicated, the composition of other-than-temporary impairments recorded in earnings attributable to the Financial Services Businesses by asset type, and for fixed maturity securities, by reason.

|   | Nine Months Ended<br>September 30, |               |
|---|------------------------------------|---------------|
|   | 2013                               | 2012          |
|   | (in millions)                      |               |
| <b>Other-than-temporary impairments recorded in earnings Financial Services Businesses(1)</b> |                                    |               |
| Public fixed maturity securities  | \$ 89                              | \$ 203        |
| Private fixed maturity securities   | 21                                 | 35            |
| Total fixed maturity securities   | 110                                | 238           |
| Equity securities   | 9                                  | 93            |
| Other invested assets(2)  | 10                                 | 74            |
| <b>Total</b>  | <b>\$ 129</b>                      | <b>\$ 405</b> |



## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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

**Table of Contents**

|   | Nine Months Ended<br>September 30, |               |
|---|------------------------------------|---------------|
|   | 2013                               | 2012          |
|   | (in millions)                      |               |
| <b>Other-than-temporary impairments on fixed maturity securities recorded in earnings</b> |                                    |               |
| <b>Businesses(1)</b>  |                                    |               |
| Due to credit events or adverse conditions of the respective issuer(2)                    | \$ 56                              | \$ 90         |
| Due to other accounting guidelines(3)   | 54                                 | 148           |
| <b>Total</b>  | <b>\$ 110</b>                      | <b>\$ 238</b> |

- (1) Excludes the portion of other-than-temporary impairment recorded in Other comprehensive income (loss), representing any difference between the fair value of the impaired debt security and the net present value of its projected future cash flows at the time of impairment.
- (2) Represents circumstances where we believe credit events or other adverse conditions of the respective issuers have caused, or will lead to, a deficiency in the contractual cash flows related to the investment. The amount of the impairment recorded in earnings is the difference between the amortized cost of the debt security and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security prior to impairment.
- (3) Primarily represents circumstances where securities with losses from foreign currency exchange rate movements approach maturity or where we intend to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis.

Fixed maturity security other-than-temporary impairments in the first nine months of 2013 were concentrated in asset-backed securities collateralized by sub-prime mortgages, and in the communications, utility and consumer non-cyclical sectors within corporate securities. These other-than-temporary impairments were primarily related to intent to sell securities or related to securities with liquidity concerns, downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers. During the first nine months of 2013, we recorded other-than-temporary impairments of \$2 million related to securities with unrealized losses from foreign currency exchange rate movements that are approaching maturity. Fixed maturity security other-than-temporary impairments in the first nine months of 2012 were concentrated in the consumer non-cyclical and technology sectors within corporate securities, and asset-backed securities collateralized by sub-prime mortgages. These other-than-temporary impairments were primarily related to securities with unrealized losses from foreign currency exchange rate movements that are approaching maturity or related to securities with liquidity concerns, downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers.

Equity security other-than-temporary impairments in the first nine months of 2013 and 2012 were primarily driven by circumstances where the decline in value was maintained for one year or greater or where we intended to sell the security.

*Closed Block Business*

For the Closed Block Business, net realized investment gains in the first nine months of 2013 were \$284 million, compared to net realized investment gains of \$218 million in the first nine months of 2012.

**Table of Contents**

Net realized gains on fixed maturity securities were \$118 million in the first nine months of 2013, compared to net realized gains of \$46 million in the first nine months of 2012, as set forth in the following table:

|  | Nine Months Ended<br>September 30, |               |
|--|------------------------------------|---------------|
|  | 2013                               | 2012          |
|  | (in millions)                      |               |
| <b>Realized investment gains (losses), net Fixed Maturity Securities Closed Block Business</b> |                                    |               |
| Gross realized investment gains:   |                                    |               |
| Gross gains on sales and maturities(1)   | \$ 213                             | \$ 143        |
| Private bond prepayment premiums   | 26                                 | 11            |
| <b>Total gross realized investment gains</b>   | <b>239</b>                         | <b>154</b>    |
| Gross realized investment losses:  |                                    |               |
| Net other-than-temporary impairments recognized in earnings(2)                                 | (36)                               | (62)          |
| Gross losses on sales and maturities(1)  | (74)                               | (38)          |
| Credit related losses on sales   | (11)                               | (8)           |
| <b>Total gross realized investment losses</b>  | <b>(121)</b>                       | <b>(108)</b>  |
| <b>Realized investment gains (losses), net Fixed Maturity Securities</b>                       | <b>\$ 118</b>                      | <b>\$ 46</b>  |
| <b>Net gains (losses) on sales and maturities Fixed Maturity Securities(1)</b>                 | <b>\$ 139</b>                      | <b>\$ 105</b> |

- (1) Amounts exclude prepayment premiums, other-than-temporary impairments, and credit related losses through sales of investments pursuant to our credit risk objectives.
- (2) Excludes the portion of other-than-temporary impairments recorded in Other comprehensive income (loss), representing any difference between the fair value of the impaired debt security and the net present value of its projected future cash flows at the time of impairment.

Net realized gains on equity securities were \$287 million in the first nine months of 2013, resulting from net trading gains on sales of equity securities. Net realized gains on equity securities were \$62 million in the first nine months of 2012 and included net trading gains on sales of equity securities of \$83 million, partially offset by other-than-temporary impairments of \$21 million. See below for additional information regarding the other-than-temporary impairments of equity securities in the first nine months of 2013 and 2012.

Net realized gains on commercial mortgage and other loans in the first nine months of 2013 were \$7 million, primarily related to a net decrease in loan loss reserves of \$10 million. Net realized gains on commercial mortgage and other loans of \$4 million in the first nine months of 2012 were primarily related to a net increase in loan loss reserves. For additional information regarding our loan loss reserves, see General Account Investments Commercial Mortgage and Other Loans Commercial Mortgage and Other Loan Quality below.

Net realized losses on derivatives were \$123 million in the first nine months of 2013, compared to net realized gains of \$109 million in the first nine months of 2012. Derivative losses in the first nine months of 2013 primarily reflect net losses of \$76 million on interest rate derivatives primarily used to manage duration as long-term interest rates increased as well as losses of \$48 million on currency derivatives used to hedge foreign denominated investments as the U.S. dollar weakened against the euro. Derivative gains of \$109 million in the first nine months of 2012 primarily reflect net gains of \$95 million on interest rate derivatives primarily used to manage duration and net gains of \$26 million on TBA forward contracts as interest rates declined, partially offset by and net losses of \$14 million on credit default swaps as credit spreads tightened.

Net realized losses on other investments were \$5 million and \$3 million in the first nine months of 2013 and 2012, respectively, driven by other-than-temporary impairments on joint venture and limited partnership investments in both periods.

**Table of Contents**

During the first nine months of 2013, we recorded other-than-temporary impairments of \$44 million in earnings, compared to \$86 million in the first nine months of 2012. The following tables set forth, for the periods indicated, the composition of other-than-temporary impairments recorded in earnings attributable to the Closed Block Business by asset type, and for fixed maturity securities, by reason.

|   | Nine Months Ended<br>September 30, |              |
|---|------------------------------------|--------------|
|   | 2013                               | 2012         |
| (in millions)   |                                    |              |
| <b>Other-than-temporary impairments recorded in earnings Closed Block Business(1)</b> |                                    |              |
| Public fixed maturity securities  | \$ 26                              | \$ 48        |
| Private fixed maturity securities   | 10                                 | 14           |
| Total fixed maturity securities   | 36                                 | 62           |
| Equity securities   | 2                                  | 21           |
| Other invested assets(2)  | 6                                  | 3            |
| <b>Total</b>  | <b>\$ 44</b>                       | <b>\$ 86</b> |

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

|  | Nine Months Ended<br>September 30, |              |
|--|------------------------------------|--------------|
|  | 2013                               | 2012         |
| (in millions)  |                                    |              |
| <b>Other-than-temporary impairments on fixed maturity securities recorded in earnings Closed Block Business(1)</b> |                                    |              |
| Due to credit events or adverse conditions of the respective issuer(2)   | \$ 31                              | \$ 61        |
| Due to other accounting guidelines   | 5                                  | 1            |
| <b>Total</b>   | <b>\$ 36</b>                       | <b>\$ 62</b> |

- (1) Excludes the portion of other-than-temporary impairment recorded in Other comprehensive income (loss), representing any difference between the fair value of the impaired debt security and the net present value of its projected future cash flows at the time of impairment.
- (2) Represents circumstances where we believe credit events or other adverse conditions of the respective issuers have caused, or will lead to, a deficiency in the contractual cash flows related to the investment. The amount of the impairment recorded in earnings is the difference between the amortized cost of the debt security and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security prior to impairment.

Fixed maturity security other-than-temporary impairments in the first nine months of 2013 were concentrated in asset-backed securities collateralized by sub-prime mortgages and in the consumer non-cyclical, communications, and utility sectors within corporate securities. Other-than-temporary impairments in the first nine months of 2012 were concentrated in asset-backed securities collateralized by sub-prime mortgages and in the utility and communications sectors within corporate securities and reflect adverse financial conditions of the respective issuers.

Equity security other-than-temporary impairments in the first nine months 2013 and 2012 were primarily due to circumstances where the decline in value was maintained for one year or greater.



**Table of Contents****General Account Investments****Portfolio Composition**

Our investment portfolio consists of public and private fixed maturity securities, commercial mortgage and other loans, policy loans, and non-coupon assets, which include equity securities and other long-term investments such as joint ventures and limited partnerships, real estate held through direct ownership, and seed money investments in separate accounts. The composition of our general account reflects, within the discipline provided by our risk management approach, our need for competitive results and the selection of diverse investment alternatives available primarily through our Asset Management segment. The size of our portfolio enables us to invest in asset classes that may be unavailable to the typical investor.

On January 2, 2013, we completed the acquisition of the Hartford Life Business. Our Financial Services Businesses' general account portfolio, as of September 30, 2013, includes \$7.5 billion of invested assets at carrying value from this acquisition, which consists of \$6.8 billion of fixed maturity securities, \$0.6 billion of commercial mortgage and other loans, and \$0.1 billion of other invested assets. For additional details regarding this transaction, see Executive Summary, above.

The following tables set forth the composition of the investments of our general account apportioned between the Financial Services Businesses and the Closed Block Business as of the dates indicated.

|  | September 30, 2013            |   |                   | % of Total    |
|--|-------------------------------|---|-------------------|---------------|
|  | Financial Services Businesses | Closed Block Business<br>(\$ in millions) | Total             |               |
| Fixed maturities:  |                               |   |                   |               |
| Public, available-for-sale, at fair value                              | \$ 214,658                    | \$ 26,993                                 | \$ 241,651        | 61.7%         |
| Public, held-to-maturity, at amortized cost                            | 2,677                         | 0   | 2,677             | 0.7           |
| Private, available-for-sale, at fair value                             | 30,026                        | 16,741                                    | 46,767            | 11.9          |
| Private, held-to-maturity, at amortized cost                           | 952                           | 0   | 952               | 0.3           |
| Trading account assets supporting insurance liabilities, at fair value | 21,131                        | 0   | 21,131            | 5.4           |
| Other trading account assets, at fair value                            | 1,359                         | 282                                       | 1,641             | 0.4           |
| Equity securities, available-for-sale, at fair value                   | 5,486                         | 3,496                                     | 8,982             | 2.3           |
| Commercial mortgage and other loans, at book value                     | 29,511                        | 9,788                                     | 39,299            | 10.0          |
| Policy loans, at outstanding balance                                   | 6,827                         | 5,036                                     | 11,863            | 3.0           |
| Other long-term investments(1)   | 6,678                         | 1,965                                     | 8,643             | 2.2           |
| Short-term investments   | 6,142                         | 2,093                                     | 8,235             | 2.1           |
| <b>Total general account investments</b>                               | <b>325,447</b>                | <b>66,394</b>                             | <b>391,841</b>    | <b>100.0%</b> |
| Invested assets of other entities and operations(2)                    | 6,798                         | 0   | 6,798             |               |
| <b>Total investments</b>   | <b>\$ 332,245</b>             | <b>\$ 66,394</b>                          | <b>\$ 398,639</b> |               |

**Table of Contents**

|  | Financial<br>Services<br>Businesses | December 31, 2012                               |                   |               |
|--|-------------------------------------|---|-------------------|---------------|
|  |                                     | Closed<br>Block<br>Business<br>(\$ in millions) | Total             | % of Total    |
| <b>Fixed maturities:</b>   |                                     |   |                   |               |
| Public, available-for-sale, at fair value                              | \$ 225,306                          | \$ 28,790                                       | \$ 254,096        | 63.7%         |
| Public, held-to-maturity, at amortized cost                            | 3,116                               | 0   | 3,116             | 0.8           |
| Private, available-for-sale, at fair value                             | 29,246                              | 17,629  | 46,875            | 11.7          |
| Private, held-to-maturity, at amortized cost                           | 1,152                               | 0   | 1,152             | 0.3           |
| Trading account assets supporting insurance liabilities, at fair value | 20,590                              | 0   | 20,590            | 5.2           |
| Other trading account assets, at fair value                            | 1,426                               | 275   | 1,701             | 0.4           |
| Equity securities, available-for-sale, at fair value                   | 5,031                               | 3,225   | 8,256             | 2.1           |
| Commercial mortgage and other loans, at book value                     | 26,623                              | 9,608   | 36,231            | 9.1           |
| Policy loans, at outstanding balance                                   | 6,455                               | 5,120   | 11,575            | 2.9           |
| Other long-term investments(1)   | 6,665                               | 2,012   | 8,677             | 2.2           |
| Short-term investments   | 5,124                               | 1,261   | 6,385             | 1.6           |
| <b>Total general account investments</b>                               | <b>330,734</b>                      | <b>67,920</b>                                   | <b>398,654</b>    | <b>100.0%</b> |
| Invested assets of other entities and operations(2)                    | 6,928                               | 0   | 6,928             |               |
| <b>Total investments</b>   | <b>\$ 337,662</b>                   | <b>\$ 67,920</b>                                | <b>\$ 405,582</b> |               |

- (1) Other long-term investments consist of real estate and non-real estate-related investments in joint ventures and partnerships, investment real estate held through direct ownership and other miscellaneous investments. For additional information regarding these investments, see Other Long-Term Investments below.
- (2) Includes invested assets of our asset management and derivative operations. Excludes assets of our asset management operations managed for third parties and those assets classified as Separate account assets on our balance sheet. For additional information regarding these investments, see Invested Assets of Other Entities and Operations below.

The decrease in general account investments attributable to the Financial Services Businesses in the first nine months of 2013 was primarily due to the translation impact of the yen weakening against the U.S. dollar, as well as a net decrease in fair value driven by an increase in U.S. interest rates, partially offset by assets acquired as part of the Hartford transaction as discussed above as well as portfolio growth driven by the reinvestment of net investment income. The general account investments attributable to the Closed Block Business also decreased in the first nine months of 2013, primarily due to net operating outflows and a net decrease in fair value driven by an increase in interest rates, partially offset by the reinvestment of net investment income. For information regarding the methodology used in determining the fair value of our fixed maturities, see Note 13 to the Unaudited Interim Consolidated Financial Statements.

We have substantial insurance operations in Japan, with 43% and 46% of our Financial Services Businesses general account investments relating to our Japanese insurance operations as of September 30, 2013 and December 31, 2012, respectively.



**Table of Contents**

The following table sets forth the composition of the investments of our Japanese insurance operations general account as of the dates indicated.

|  | September 30,<br>2013 | December 31,<br>2012 |
|--|-----------------------|----------------------|
|  | (in millions)         |                      |
| <b>Fixed maturities:</b>   |                       |                      |
| Public, available-for-sale, at fair value                              | \$ 113,609            | \$ 124,710           |
| Public, held-to-maturity, at amortized cost                            | 2,677                 | 3,116                |
| Private, available-for-sale, at fair value                             | 6,504                 | 6,252                |
| Private, held-to-maturity, at amortized cost                           | 952                   | 1,152                |
| Trading account assets supporting insurance liabilities, at fair value | 1,897                 | 1,838                |
| Other trading account assets, at fair value                            | 907                   | 1,195                |
| Equity securities, available-for-sale, at fair value                   | 2,474                 | 2,126                |
| Commercial mortgage and other loans, at book value                     | 6,380                 | 6,156                |
| Policy loans, at outstanding balance                                   | 2,376                 | 2,665                |
| Other long-term investments(1)   | 1,741                 | 2,215                |
| Short-term investments   | 281                   | 318                  |
| <b>Total Japanese general account investments</b>                      | <b>\$ 139,798</b>     | <b>\$ 151,743</b>    |

(1) Other long-term investments consist of real estate and non-real estate-related investments in joint ventures and partnerships, investment real estate held through direct ownership, derivatives, and other miscellaneous investments.

The decrease in general account investments related to our Japanese insurance operations in the first nine months of 2013 was primarily attributable to the translation impact of the yen weakening against the U.S. dollar, partially offset by portfolio growth as a result of business inflows and the reinvestment of net investment income, as well as a net increase in fair value driven by declining interest rates on yen-denominated investments.

The functional currency of our Japanese insurance subsidiaries is the yen and, although the majority of the Japanese general account is invested in yen-denominated investments, our Japanese insurance operations also hold significant investments denominated in U.S. and Australian dollars.

As of September 30, 2013, our Japanese insurance operations had \$43.1 billion, at fair value, of investments denominated in U.S. dollars, including \$3.6 billion that were hedged to yen through third party derivative contracts and \$30.2 billion that support liabilities denominated in U.S. dollars. As of December 31, 2012, our Japanese insurance operations had \$44.9 billion, at fair value, of investments denominated in U.S. dollars, including \$4.4 billion that were hedged to yen through third party derivative contracts and \$31.6 billion that support liabilities denominated in U.S. dollars. The \$1.8 billion decrease in the fair value of U.S. dollar-denominated investments from December 31, 2012, is primarily attributable to an increase in interest rates, partially offset by portfolio growth as a result of business inflows.

Our Japanese insurance operations had \$8.3 billion and \$8.6 billion, at fair value, of investments denominated in Australian dollars that support liabilities denominated in Australian dollars as of September 30, 2013, and December 31, 2012, respectively. The \$0.3 billion decrease in the fair value of Australian dollar-denominated investments from December 31, 2012, is primarily attributable to an increase in interest rates, partially offset by portfolio growth as a result of net business inflows.

*Eurozone Exposure*

Our investment portfolio includes direct investment exposure to the Eurozone region. We define this region as consisting of those countries within the European Union that have adopted the euro as their sole legal currency. The Eurozone region currently consists of seventeen countries, including Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal,

**Table of Contents**

Slovakia, Slovenia and Spain. Included in this region are peripheral countries, which we currently define as consisting of Greece, Ireland, Italy, Portugal and Spain. Specific country exposure is determined based on the issuer's country of incorporation.

The following table sets forth the composition of our gross direct exposure to the Eurozone region, by country of incorporation, attributable to the Financial Services Businesses, as of September 30, 2013.

**Eurozone Gross Direct Exposure Financial Services Businesses**

| Country                              | Amortized Cost  |                 |                    | September 30, 2013   |                 | Fair Value      |                  |                    |                  |
|--------------------------------------|-----------------|-----------------|--------------------|----------------------|-----------------|-----------------|------------------|--------------------|------------------|
|                                      | Sovereigns(6)   | Institutions(7) | All Other Exposure | Total Amortized Cost |                 | Sovereigns(6)   | Institutions(7)  | All Other Exposure | Total Fair Value |
|                                      |                 |                 |                    | Cost                 | (in millions)   |                 |                  |                    |                  |
| Non-peripheral countries:            |                 |                 |                    |                      |                 |                 |                  |                    |                  |
| France                               | \$ 257          | \$ 551          | \$ 2,152           | \$ 2,960             | \$ 311          | \$ 566          | \$ 2,395         | \$ 3,272           |                  |
| Netherlands                          | 11              | 518             | 2,670              | 3,199                | 14              | 574             | 2,814            | 3,402              |                  |
| Germany                              | 416             | 177             | 920                | 1,513                | 502             | 200             | 993              | 1,695              |                  |
| Luxembourg                           | 0               | 256             | 1,113              | 1,369                | 0               | 278             | 1,129            | 1,407              |                  |
| Other non-peripheral(1)              | 103             | 27              | 546                | 676                  | 118             | 28              | 582              | 728                |                  |
| <b>Total non-peripheral exposure</b> | <b>787</b>      | <b>1,529</b>    | <b>7,401</b>       | <b>9,717</b>         | <b>945</b>      | <b>1,646</b>    | <b>7,913</b>     | <b>10,504</b>      |                  |
| Peripheral countries:                |                 |                 |                    |                      |                 |                 |                  |                    |                  |
| Italy(2)                             | 904             | 22              | 290                | 1,216                | 943             | 25              | 284              | 1,252              |                  |
| Ireland                              | 0               | 87              | 519                | 606                  | 0               | 99              | 555              | 654                |                  |
| Spain                                | 26              | 15              | 117                | 158                  | 31              | 15              | 117              | 163                |                  |
| Other peripheral(3)                  | 0               | 0               | 0                  | 0                    | 0               | 0               | 0                | 0                  |                  |
| <b>Total peripheral exposure</b>     | <b>930</b>      | <b>124</b>      | <b>926</b>         | <b>1,980</b>         | <b>974</b>      | <b>139</b>      | <b>956</b>       | <b>2,069</b>       |                  |
| International agencies(4)            | 0               | 100             | 1,108              | 1,208                | 0               | 105             | 1,257            | 1,362              |                  |
| <b>Total exposure(5)</b>             | <b>\$ 1,717</b> | <b>\$ 1,753</b> | <b>\$ 9,435</b>    | <b>\$ 12,905</b>     | <b>\$ 1,919</b> | <b>\$ 1,890</b> | <b>\$ 10,126</b> | <b>\$ 13,935</b>   |                  |

(1) Other non-peripheral countries include Austria, Belgium, Cyprus, Estonia, Finland, Malta, Slovakia, and Slovenia.

(2) Principally represents Italian government securities owned by our Italian insurance operations.

(3) Other peripheral countries include Greece and Portugal.

(4) International agencies include agencies such as Eurofima, European Investment Bank, Council of Europe Development, and Nordic Investment Bank, where a single country of incorporation could not be determined.

(5) Of the \$12,905 million of amortized cost represented above, 96% is related to fixed maturities, and the remaining 4% is related to all other asset types.

(6) Sovereigns include local governments.

(7) Financial institutions include banking, brokerage, non-captive consumer and diversified finance, health insurance, life insurance, property and casualty insurance, other finance and real estate investment trusts.

Our gross direct exposure to the Eurozone region attributable to the Closed Block Business was \$4,158 million of amortized cost (fair value, \$4,536 million), as of September 30, 2013, of which \$3,609 million (fair value, \$3,951 million) represented non-peripheral exposure and \$549 million (fair value, \$585 million) represented peripheral exposure. Approximately 15% and 17% of the non-peripheral and peripheral exposure, respectively, was related to financial institutions, and less than 1% and 2% of the non-peripheral and peripheral exposures was related to sovereigns, respectively. Of the \$4,158 million of amortized cost represented above, 96% was related to fixed maturities, and the remaining 4% was related to all other asset types.



**Table of Contents****Investment Results**

The following tables set forth the income yield and investment income for each major investment category of our general account for the periods indicated. The yields are based on net investment income as reported under U.S. GAAP and do not include adjustments, such as settlements of duration management swaps that are included in adjusted operating income.

|   | Three Months Ended September 30, 2013 |          |                          |        |          |          |
|---|---------------------------------------|----------|--------------------------|--------|----------|----------|
|   | Financial Services<br>Businesses      |          | Closed Block<br>Business |        | Combined |          |
|   | Yield(1)                              | Amount   | Yield(1)                 | Amount | Yield(1) | Amount   |
|   | (\$ in millions)                      |          |                          |        |          |          |
| Fixed maturities  | 3.76%                                 | \$ 2,133 | 5.16%                    | \$ 495 | 3.96%    | \$ 2,628 |
| Trading account assets supporting insurance liabilities | 3.69                                  | 192      | 0.00                     | 0      | 3.69     | 192      |
| Equity securities                                       | 6.92                                  | 72       | 3.45                     | 21     | 5.65     | 93       |
| Commercial mortgage and other loans                     | 4.96                                  | 353      | 5.70                     | 139    | 5.15     | 492      |
| Policy loans  | 4.82                                  | 81       | 6.17                     | 77     | 5.40     | 158      |
| Short-term investments and cash equivalents             | 0.24                                  | 7        | 0.78                     | 2      | 0.27     | 9        |
| Other investments                                       | 6.34                                  | 126      | 6.49                     | 36     | 6.37     | 162      |
| Gross investment income before investment expenses      | 3.86                                  | 2,964    | 5.26                     | 770    | 4.09     | 3,734    |
| Investment expenses                                     | (0.12)                                | (65)     | (0.25)                   | (37)   | (0.14)   | (102)    |
| Investment income after investment expenses             | 3.74%                                 | 2,899    | 5.01%                    | 733    | 3.95%    | 3,632    |
| Investment results of other entities and operations(2)  |                                       | 18       |                          | 0      |          | 18       |
| Total investment income                                 |                                       | \$ 2,917 |                          | \$ 733 |          | \$ 3,650 |

|   | Three Months Ended September 30, 2012 |          |                          |        |          |          |
|---|---------------------------------------|----------|--------------------------|--------|----------|----------|
|   | Financial Services<br>Businesses      |          | Closed Block<br>Business |        | Combined |          |
|   | Yield(1)                              | Amount   | Yield(1)                 | Amount | Yield(1) | Amount   |
|   | (\$ in millions)                      |          |                          |        |          |          |
| Fixed maturities  | 3.69%                                 | \$ 1,897 | 5.37%                    | \$ 532 | 3.96%    | \$ 2,429 |
| Trading account assets supporting insurance liabilities | 4.00                                  | 198      | 0.00                     | 0      | 4.00     | 198      |
| Equity securities                                       | 6.47                                  | 68       | 2.89                     | 18     | 5.15     | 86       |
| Commercial mortgage and other loans                     | 5.50                                  | 356      | 6.13                     | 149    | 5.67     | 505      |
| Policy loans  | 4.60                                  | 73       | 5.77                     | 74     | 5.12     | 147      |
| Short-term investments and cash equivalents             | 0.21                                  | 7        | 2.12                     | 2      | 0.24     | 9        |
| Other investments                                       | 5.26                                  | 83       | 5.79                     | 33     | 5.40     | 116      |
| Gross investment income before investment expenses      | 3.83                                  | 2,682    | 5.43                     | 808    | 4.11     | 3,490    |
| Investment expenses                                     | (0.11)                                | (61)     | (0.25)                   | (40)   | (0.13)   | (101)    |
| Investment income after investment expenses             | 3.72%                                 | 2,621    | 5.18%                    | 768    | 3.98%    | 3,389    |
| Investment results of other entities and operations(2)  |                                       | 44       |                          | 0      |          | 44       |
| Total investment income                                 |                                       | \$ 2,665 |                          | \$ 768 |          | \$ 3,433 |

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

- (1) Yields are annualized, for interim periods, and are based on quarterly average carrying values except for fixed maturities, equity securities and securities lending activity. Yields for fixed maturities are based on amortized cost. Yields for equity securities are based on

**Table of Contents**

cost. Yields for fixed maturities and short-term investments and cash equivalents are calculated net of liabilities and rebate expenses corresponding to securities lending activity. Yields exclude investment income on assets other than those included in invested assets. Prior periods yields are presented on a basis consistent with the current period presentation.

(2) Includes invested assets of our asset management and derivative operations, as described below under Invested Assets of Other Entities and Operations.

See below for a discussion of the change in the Financial Services Businesses yields. The decrease in net investment income yield attributable to the Closed Block Business for the three months ended September 30, 2013, compared to the three months ended September 30, 2012, was primarily due to the impact of lower interest rates on floating rate investments due to rate resets and lower fixed income reinvestment rates.

The following tables set forth the income yield and investment income for each major investment category of our general account for the periods indicated. The yields are based on net investment income as reported under U.S. GAAP and do not include adjustments, such as settlements of duration management swaps that are included in adjusted operating income.

|   | Nine Months Ended September 30, 2013 |          |                       |          |          |           |
|---|--------------------------------------|----------|-----------------------|----------|----------|-----------|
|   | Financial Services Businesses        |          | Closed Block Business |          | Combined |           |
|   | Yield(1)                             | Amount   | Yield(1)              | Amount   | Yield(1) | Amount    |
|   | (\$ in millions)                     |          |                       |          |          |           |
| Fixed maturities  | 3.75%                                | \$ 6,416 | 5.29%                 | \$ 1,515 | 3.97%    | \$ 7,931  |
| Trading account assets supporting insurance liabilities | 3.80                                 | 584      | 0.00                  | 0        | 3.80     | 584       |
| Equity securities                                       | 6.53                                 | 200      | 3.55                  | 65       | 5.42     | 265       |
| Commercial mortgage and other loans                     | 5.07                                 | 1,042    | 5.79                  | 413      | 5.25     | 1,455     |
| Policy loans  | 4.76                                 | 235      | 5.95                  | 221      | 5.27     | 456       |
| Short-term investments and cash equivalents             | 0.21                                 | 23       | 0.96                  | 5        | 0.24     | 28        |
| Other investments                                       | 6.45                                 | 379      | 9.46                  | 160      | 7.12     | 539       |
| Gross investment income before investment expenses      | 3.84                                 | 8,879    | 5.47                  | 2,379    | 4.10     | 11,258    |
| Investment expenses                                     | (0.12)                               | (222)    | (0.26)                | (113)    | (0.14)   | (335)     |
| Investment income after investment expenses             | 3.72%                                | 8,657    | 5.21%                 | 2,266    | 3.96%    | 10,923    |
| Investment results of other entities and operations(2)  |                                      | 76       |                       | 0        |          | 76        |
| Total investment income                                 |                                      | \$ 8,733 |                       | \$ 2,266 |          | \$ 10,999 |

|   | Nine Months Ended September 30, 2012 |          |                       |          |          |          |
|---|--------------------------------------|----------|-----------------------|----------|----------|----------|
|   | Financial Services Businesses        |          | Closed Block Business |          | Combined |          |
|   | Yield(1)                             | Amount   | Yield(1)              | Amount   | Yield(1) | Amount   |
|   | (\$ in millions)                     |          |                       |          |          |          |
| Fixed maturities  | 3.75%                                | \$ 5,610 | 5.50%                 | \$ 1,619 | 4.04%    | \$ 7,229 |
| Trading account assets supporting insurance liabilities | 4.05                                 | 591      | 0.00                  | 0        | 4.05     | 591      |
| Equity securities                                       | 6.10                                 | 186      | 3.19                  | 61       | 4.98     | 247      |
| Commercial mortgage and other loans                     | 5.42                                 | 1,020    | 6.17                  | 430      | 5.62     | 1,450    |
| Policy loans  | 4.62                                 | 215      | 5.95                  | 227      | 5.22     | 442      |
| Short-term investments and cash equivalents             | 0.25                                 | 24       | 1.28                  | 6        | 0.28     | 30       |
| Other investments                                       | 4.10                                 | 194      | 7.55                  | 127      | 5.01     | 321      |
| Gross investment income before investment expenses      | 3.83                                 | 7,840    | 5.60                  | 2,470    | 4.15     | 10,310   |
| Investment expenses                                     | (0.11)                               | (186)    | (0.26)                | (116)    | (0.14)   | (302)    |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|  |       |          |       |          |       |           |
|--|-------|----------|-------|----------|-------|-----------|
| Investment income after investment expenses            | 3.72% | 7,654    | 5.34% | 2,354    | 4.01% | 10,008    |
| Investment results of other entities and operations(2) |       | 103      |       | 0        |       | 103       |
| Total investment income                                |       | \$ 7,757 |       | \$ 2,354 |       | \$ 10,111 |



**Table of Contents**

- (1) Yields are annualized, for interim periods, and are based on quarterly average carrying values except for fixed maturities, equity securities and securities lending activity. Yields for fixed maturities are based on amortized cost. Yields for equity securities are based on cost. Yields for fixed maturities and short-term investments and cash equivalents are calculated net of liabilities and rebate expenses corresponding to securities lending activity. Yields exclude investment income on assets other than those included in invested assets. Prior period's yields are presented on a basis consistent with the current period presentation.
- (2) Includes invested assets of our asset management and derivative operations.

See below for a discussion of the change in the Financial Services Businesses' yields. The decrease in net investment income yield attributable to the Closed Block Business for the nine months ended September 30, 2013, compared to the nine months ended September 30, 2012, was primarily due to the impact of lower interest rates on floating rate investments due to rate resets and lower fixed income reinvestment rates.

The following table sets forth the income yield and investment income for each major investment category of the Financial Services Businesses' general account, excluding the Japanese insurance operations' portion of the general account which is presented separately below, for the periods indicated. The yields are based on net investment income as reported under U.S. GAAP and do not include adjustments, such as settlements of duration management swaps that are included in adjusted operating income.

|   | Three Months Ended<br>September 30, 2013 |          | Three Months Ended<br>September 30, 2012 |          |
|---|--|----------|--|----------|
|   | Yield(1)                                 | Amount   | Yield(1)                                 | Amount   |
|   | (\$ in millions)                         |          |  |          |
| Fixed maturities  | 4.52%                                    | \$ 1,327 | 5.21%                                    | \$ 1,053 |
| Trading account assets supporting insurance liabilities | 3.83                                     | 182      | 4.13                                     | 186      |
| Equity securities                                       | 7.88                                     | 47       | 8.15                                     | 46       |
| Commercial mortgage and other loans                     | 5.19                                     | 290      | 5.89                                     | 294      |
| Policy loans  | 5.37                                     | 58       | 5.41                                     | 48       |
| Short-term investments and cash equivalents             | 0.24                                     | 6        | 0.24                                     | 6        |
| Other investments                                       | 5.01                                     | 67       | 4.08                                     | 24       |
| Gross investment income before investment expenses      | 4.38                                     | 1,977    | 4.89                                     | 1,657    |
| Investment expenses                                     | (0.11)                                   | (25)     | (0.10)                                   | (17)     |
| Investment income after investment expenses             | 4.27%                                    | 1,952    | 4.79%                                    | 1,640    |
| Investment results of other entities and operations(2)  |  | 18       |  | 44       |
| Total investment income                                 |  | \$ 1,970 |  | \$ 1,684 |

- (1) Yields are annualized, for interim periods, and are based on quarterly average carrying values except for fixed maturities, equity securities and securities lending activity. Yields for fixed maturities are based on amortized cost. Yields for equity securities are based on cost. Yields for fixed maturities and short-term investments and cash equivalents are calculated net of liabilities and rebate expenses corresponding to securities lending activity. Yields exclude investment income on assets other than those included in invested assets. Prior period's yields are presented on a basis consistent with the current period presentation.
- (2) Includes invested assets of our asset management and derivative operations.

The decrease in net investment income yield attributable to the Financial Services Businesses' general account, excluding the Japanese operations portfolio, for the three months ended September 30, 2013, compared to the three months ended September 30, 2012, was primarily the result of lower interest rates on floating rate investments due to rate resets and lower fixed maturity reinvestment rates. The decrease also reflects the

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

addition of assets from the significant pension risk transfer transactions that closed in the fourth quarter of 2012, as well as the Hartford transaction discussed above, which reflect market yields at the time of acquisition. These decreases were partially offset by higher income from non-coupon investments.

**Table of Contents**

The following table sets forth the income yield and investment income for each major investment category of the Financial Services Businesses general account, excluding the Japanese insurance operations portion of the general account which is presented separately below, for the periods indicated. The yields are based on net investment income as reported under U.S. GAAP and do not include adjustments, such as settlements of duration management swaps that are included in adjusted operating income.

|   | Nine Months Ended<br>September 30, 2013 |                            | Nine Months Ended<br>September 30, 2012 |          |
|---|---|----------------------------|---|----------|
|   | Yield(1)                                | Amount<br>(\$ in millions) | Yield(1)                                | Amount   |
| Fixed maturities  | 4.61%                                   | \$ 3,957                   | 5.30%                                   | \$ 3,154 |
| Trading account assets supporting insurance liabilities | 3.97                                    | 556                        | 4.23                                    | 561      |
| Equity securities                                       | 7.70                                    | 133                        | 8.63                                    | 136      |
| Commercial mortgage and other loans                     | 5.31                                    | 850                        | 5.81                                    | 846      |
| Policy loans  | 5.43                                    | 169                        | 5.53                                    | 142      |
| Short-term investments and cash equivalents             | 0.22                                    | 20                         | 0.28                                    | 20       |
| Other investments                                       | 6.41                                    | 238                        | 3.50                                    | 61       |
| Gross investment income before investment expenses      | 4.46                                    | 5,923                      | 4.92                                    | 4,920    |
| Investment expenses                                     | (0.12)                                  | (104)                      | (0.10)                                  | (49)     |
| Investment income after investment expenses             | 4.34%                                   | 5,819                      | 4.82%                                   | 4,871    |
| Investment results of other entities and operations(2)  |   | 76                         |   | 103      |
| Total investment income                                 |   | \$ 5,895                   |   | \$ 4,974 |

- (1) Yields are annualized, for interim periods, and are based on quarterly average carrying values except for fixed maturities, equity securities and securities lending activity. Yields for fixed maturities are based on amortized cost. Yields for equity securities are based on cost. Yields for fixed maturities and short-term investments and cash equivalents are calculated net of liabilities and rebate expenses corresponding to securities lending activity. Yields exclude investment income on assets other than those included in invested assets. Prior periods yields are presented on a basis consistent with the current period presentation.
- (2) Includes invested assets of our asset management and derivative operations.

The decrease in net investment income yield attributable to the Financial Services Businesses general account, excluding the Japanese operations portfolio, for the nine months ended September 30, 2013, compared to the nine months ended September 30, 2012, was primarily the result of lower interest rates on floating rate investments due to rate resets and lower fixed maturity reinvestment rates. The decrease also reflects the addition of assets from the significant pension risk transfer transactions that closed in the fourth quarter of 2012, as well as the Hartford transaction discussed above, which reflect market yields at the time of acquisition. These decreases were partially offset by higher income from non-coupon investments.

**Table of Contents**

The following table sets forth the income yield and investment income for each major investment category of our Japanese operations general account for the periods indicated. The yields are based on net investment income as reported under U.S. GAAP and do not include adjustments, such as settlements of duration management swaps that are included in adjusted operating income.

|   | Three Months Ended<br>September 30, 2013 |                            | Three Months Ended<br>September 30, 2012 |        |
|---|--|----------------------------|--|--------|
|   | Yield(1)                                 | Amount<br>(\$ in millions) | Yield(1)                                 | Amount |
| Fixed maturities  | 2.95%                                    | \$ 806                     | 2.71%                                    | \$ 844 |
| Trading account assets supporting insurance liabilities | 2.24                                     | 10                         | 2.63                                     | 12     |
| Equity securities                                       | 5.62                                     | 25                         | 4.58                                     | 22     |
| Commercial mortgage and other loans                     | 4.12                                     | 63                         | 4.18                                     | 62     |
| Policy loans  | 3.80                                     | 23                         | 3.57                                     | 25     |
| Short-term investments and cash equivalents             | 0.21                                     | 1                          | 0.14                                     | 1      |
| Other investments                                       | 9.15                                     | 59                         | 6.00                                     | 59     |
| Gross investment income before investment expenses      | 3.12                                     | 987                        | 2.83                                     | 1,025  |
| Investment expenses                                     | (0.12)                                   | (40)                       | (0.12)                                   | (44)   |
| Total investment income                                 | 3.00%                                    | \$ 947                     | 2.71%                                    | \$ 981 |

- (1) Yields are annualized, for interim periods, and are based on quarterly average carrying values except for fixed maturities, equity securities and securities lending activity. Yields for fixed maturities are based on amortized cost. Yields for equity securities are based on cost. Yields for fixed maturities and short-term investments and cash equivalents are calculated net of liabilities and rebate expenses corresponding to securities lending activity. Yields exclude investment income on assets other than those included in invested assets. Prior periods yields are presented on a basis consistent with the current period presentation.

The increase in net investment income yield on the Japanese insurance portfolio for the three months ended September 30, 2013, compared to the three months ended September 30, 2012, was primarily attributable to more favorable results from non-coupon investments and growth in higher-yielding assets supporting both U.S. and Australian dollar-denominated products, partially offset by lower fixed maturity reinvestment rates in both the U.S. and Japan.

Both the U.S. dollar-denominated and Australian dollar-denominated fixed maturities that are not hedged to yen through third party derivative contracts provide a yield that is substantially higher than the yield on comparable yen-denominated fixed maturities. The average amortized cost of U.S. dollar-denominated fixed maturities that are not hedged to yen through third party derivative contracts was approximately \$32.0 billion and \$30.6 billion for the three months ended September 30, 2013 and 2012, respectively. The majority of U.S. dollar-denominated fixed maturities support liabilities that are denominated in U.S. dollars. The average amortized cost of Australian dollar-denominated fixed maturities that are not hedged to yen through third party derivative contracts was \$7.8 billion and \$7.5 billion for the three months ended September 30, 2013 and 2012, respectively. The Australian dollar-denominated fixed maturities support liabilities that are denominated in Australian dollars.

**Table of Contents**

The following table sets forth the income yield and investment income for each major investment category of our Japanese operations general account for the periods indicated. The yields are based on net investment income as reported under U.S. GAAP and do not include adjustments, such as settlements of duration management swaps that are included in adjusted operating income.

|   | Nine Months Ended<br>September 30, 2013 |                            | Nine Months Ended<br>September 30, 2012 |          |
|---|---|----------------------------|---|----------|
|   | Yield(1)                                | Amount<br>(\$ in millions) | Yield(1)                                | Amount   |
| Fixed maturities  | 2.88%                                   | \$ 2,459                   | 2.73%                                   | \$ 2,456 |
| Trading account assets supporting insurance liabilities | 2.05                                    | 28                         | 2.28                                    | 30       |
| Equity securities                                       | 5.01                                    | 67                         | 3.40                                    | 50       |
| Commercial mortgage and other loans                     | 4.21                                    | 192                        | 4.09                                    | 174      |
| Policy loans  | 3.61                                    | 66                         | 3.50                                    | 73       |
| Short-term investments and cash equivalents             | 0.18                                    | 3                          | 0.16                                    | 4        |
| Other investments                                       | 6.51                                    | 141                        | 4.45                                    | 133      |
| Gross investment income before investment expenses      | 3.00                                    | 2,956                      | 2.79                                    | 2,920    |
| Investment expenses                                     | (0.12)                                  | (118)                      | (0.13)                                  | (137)    |
| Total investment income                                 | 2.88%                                   | \$ 2,838                   | 2.66%                                   | \$ 2,783 |

- (1) Yields are annualized, for interim periods, and are based on quarterly average carrying values except for fixed maturities, equity securities and securities lending activity. Yields for fixed maturities are based on amortized cost. Yields for equity securities are based on cost. Yields for fixed maturities and short-term investments and cash equivalents are calculated net of liabilities and rebate expenses corresponding to securities lending activity. Yields exclude investment income on assets other than those included in invested assets. Prior periods yields are presented on a basis consistent with the current period presentation.

The increase in net investment income yield on the Japanese insurance portfolio for the nine months ended September 30, 2013, compared to the nine months ended September 30, 2012, was primarily attributable to more favorable results from non-coupon investments and growth in higher-yielding assets supporting both U.S. and Australian dollar-denominated products, partially offset by lower fixed maturity reinvestment rates in both the U.S. and Japan.

Both the U.S. dollar-denominated and Australian dollar-denominated fixed maturities that are not hedged to yen through third party derivative contracts provide a yield that is substantially higher than the yield on comparable yen-denominated fixed maturities. The average amortized cost of U.S. dollar-denominated fixed maturities that are not hedged to yen through third party derivative contracts was approximately \$31.8 billion and \$29.3 billion for the nine months ended September 30, 2013, and 2012, respectively. The majority of U.S. dollar-denominated fixed maturities support liabilities that are denominated in U.S. dollars. The average amortized cost of Australian dollar-denominated fixed maturities that are not hedged to yen through third party derivative contracts was approximately \$7.9 billion and \$6.9 billion for the nine months ended September 30, 2013, and 2012, respectively. The Australian dollar-denominated fixed maturities support liabilities that are denominated in Australian dollars.

For additional information regarding U.S. and Australian dollar investments held in our Japanese insurance operations see, Results of Operations for Financial Services Businesses by Segment International Insurance Division.

**Table of Contents****Fixed Maturity Securities***Fixed Maturity Securities and Unrealized Gains and Losses by Industry Category*

The following table sets forth the composition of the portion of our fixed maturity securities portfolio by industry category attributable to the Financial Services Businesses as of the dates indicated and the associated gross unrealized gains and losses.

**Fixed Maturity Securities Financial Services Businesses**

| Industry(1)                 | September 30, 2013 |                           |                            | December 31, 2012 |                           |                            | Fair Value |            |
|-----------------------------|--------------------|---------------------------|----------------------------|-------------------|---------------------------|----------------------------|------------|------------|
|                             | Amortized Cost     | Gross Unrealized Gains(2) | Gross Unrealized Losses(2) | Amortized Cost    | Gross Unrealized Gains(2) | Gross Unrealized Losses(2) |            |            |
| (in millions)               |                    |                           |                            |                   |                           |                            |            |            |
| Corporate securities:       |                    |                           |                            |                   |                           |                            |            |            |
| Finance                     | \$ 20,795          | \$ 1,257                  | \$ 391                     | \$ 21,661         | \$ 21,772                 | \$ 1,279                   | \$ 285     | \$ 22,766  |
| Consumer non-cyclical       | 23,047             | 1,779                     | 834                        | 23,992            | 21,727                    | 1,898                      | 269        | 23,356     |
| Utility                     | 18,813             | 1,279                     | 756                        | 19,336            | 17,993                    | 1,601                      | 344        | 19,250     |
| Capital goods               | 10,428             | 864                       | 319                        | 10,973            | 10,251                    | 896                        | 144        | 11,003     |
| Consumer cyclical           | 10,462             | 715                       | 359                        | 10,818            | 9,927                     | 756                        | 147        | 10,536     |
| Foreign agencies            | 4,949              | 607                       | 80                         | 5,476             | 5,706                     | 732                        | 8          | 6,430      |
| Energy                      | 9,028              | 605                       | 350                        | 9,283             | 7,923                     | 745                        | 83         | 8,585      |
| Communications              | 7,071              | 526                       | 316                        | 7,281             | 7,552                     | 610                        | 119        | 8,043      |
| Basic industry              | 6,572              | 350                       | 278                        | 6,644             | 6,215                     | 416                        | 69         | 6,562      |
| Transportation              | 5,719              | 441                       | 120                        | 6,040             | 5,288                     | 478                        | 43         | 5,723      |
| Technology                  | 4,133              | 270                       | 154                        | 4,249             | 4,656                     | 279                        | 77         | 4,858      |
| Industrial other            | 2,455              | 194                       | 40                         | 2,609             | 2,261                     | 196                        | 3          | 2,454      |
| Total corporate securities  | 123,472            | 8,887                     | 3,997                      | 128,362           | 121,271                   | 9,886                      | 1,591      | 129,566    |
| Foreign government(3)       | 76,663             | 6,920                     | 290                        | 83,293            | 82,376                    | 6,782                      | 65         | 89,093     |
| Residential mortgage-backed | 6,331              | 349                       | 56                         | 6,624             | 8,360                     | 435                        | 30         | 8,765      |
| Asset-backed securities(4)  | 7,861              | 210                       | 203                        | 7,868             | 8,209                     | 202                        | 407        | 8,004      |
| Commercial mortgage-backed  | 9,387              | 397                       | 92                         | 9,692             | 7,413                     | 595                        | 14         | 7,994      |
| U.S. Government             | 8,354              | 1,573                     | 135                        | 9,792             | 10,525                    | 2,474                      | 34         | 12,965     |
| State & Municipal(5)        | 2,851              | 205                       | 131                        | 2,925             | 2,303                     | 378                        | 5          | 2,676      |
| Total(6)                    | \$ 234,919         | \$ 18,541                 | \$ 4,904                   | \$ 248,556        | \$ 240,457                | \$ 20,752                  | \$ 2,146   | \$ 259,063 |

- (1) Investment data has been classified based on standard industry categorizations for domestic public holdings and similar classifications by industry for all other holdings.
- (2) Includes \$275 million of gross unrealized gains and \$32 million of gross unrealized losses as of September 30, 2013, compared to \$310 million of gross unrealized gains and \$67 million of gross unrealized losses as of December 31, 2012, on securities classified as held-to-maturity.
- (3) As of September 30, 2013 and December 31, 2012, based on amortized cost, 80% and 81%, respectively, represent Japanese government bonds held by our Japanese insurance operations, with no other individual country representing more than 8% of the balance.
- (4) Includes securities collateralized by sub-prime mortgages. See Asset-Backed Securities below.
- (5) Includes securities related to the Build America Bonds program.
- (6) Excluded from the above are securities held outside the general account in other entities and operations. For additional information regarding investments held outside the general account, see Invested Assets of Other Entities and Operations below. Also excluded from the table above are fixed maturity securities

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

classified as trading. See Trading Account Assets Supporting Insurance Liabilities and Other Trading Account Assets for additional information.

The decrease in net unrealized gains from December 31, 2012 to September 30, 2013, was primarily due to a net increase in U.S. interest rates.

**Table of Contents**

The following table sets forth the composition of the portion of our fixed maturity securities portfolio by industry category attributable to the Closed Block Business as of the dates indicated and the associated gross unrealized gains and losses.

**Fixed Maturity Securities Closed Block Business**

| Industry(1)                 | September 30, 2013 |                        |                         | December 31, 2012 |                        |                         | Fair Value | Fair Value |
|-----------------------------|--------------------|------------------------|-------------------------|-------------------|------------------------|-------------------------|------------|------------|
|                             | Amortized Cost     | Gross Unrealized Gains | Gross Unrealized Losses | Amortized Cost    | Gross Unrealized Gains | Gross Unrealized Losses |            |            |
| (in millions)               |                    |                        |                         |                   |                        |                         |            |            |
| Corporate securities:       |                    |                        |                         |                   |                        |                         |            |            |
| Utility                     | \$ 4,657           | \$ 556                 | \$ 40                   | \$ 5,173          | \$ 4,773               | \$ 862                  | \$ 12      | \$ 5,623   |
| Consumer non-cyclical       | 4,726              | 535                    | 40                      | 5,221             | 4,419                  | 750                     | 5          | 5,164      |
| Finance                     | 4,202              | 303                    | 18                      | 4,487             | 3,728                  | 442                     | 17         | 4,153      |
| Consumer cyclical           | 3,276              | 335                    | 17                      | 3,594             | 3,003                  | 477                     | 10         | 3,470      |
| Capital goods               | 2,477              | 275                    | 8                       | 2,744             | 2,523                  | 376                     | 1          | 2,898      |
| Energy                      | 1,819              | 186                    | 10                      | 1,995             | 1,879                  | 305                     | 0          | 2,184      |
| Communications              | 1,461              | 138                    | 19                      | 1,580             | 1,513                  | 268                     | 4          | 1,777      |
| Basic industry              | 1,338              | 103                    | 22                      | 1,419             | 1,324                  | 186                     | 3          | 1,507      |
| Transportation              | 1,271              | 129                    | 7                       | 1,393             | 1,386                  | 186                     | 4          | 1,568      |
| Industrial other            | 1,010              | 67                     | 10                      | 1,067             | 1,074                  | 110                     | 2          | 1,182      |
| Technology                  | 688                | 58                     | 10                      | 736               | 626                    | 103                     | 7          | 722        |
| Foreign agencies            | 435                | 39                     | 5                       | 469               | 355                    | 68                      | 0          | 423        |
| Total corporate securities  | 27,360             | 2,724                  | 206                     | 29,878            | 26,603                 | 4,133                   | 65         | 30,671     |
| Asset-backed securities(2)  | 4,174              | 57                     | 168                     | 4,063             | 4,592                  | 71                      | 320        | 4,343      |
| Commercial mortgage-backed  | 4,010              | 72                     | 73                      | 4,009             | 4,029                  | 179                     | 2          | 4,206      |
| U.S. Government             | 3,097              | 407                    | 19                      | 3,485             | 3,401                  | 966                     | 0          | 4,367      |
| Residential mortgage-backed | 1,136              | 62                     | 5                       | 1,193             | 1,520                  | 97                      | 3          | 1,614      |
| Foreign government(3)       | 347                | 58                     | 7                       | 398               | 345                    | 103                     | 2          | 446        |
| State & Municipal           | 659                | 56                     | 7                       | 708               | 647                    | 126                     | 1          | 772        |
| Total(4)                    | \$ 40,783          | \$ 3,436               | \$ 485                  | \$ 43,734         | \$ 41,137              | \$ 5,675                | \$ 393     | \$ 46,419  |

- (1) Investment data has been classified based on standard industry categorizations for domestic public holdings and similar classifications by industry for all other holdings.
- (2) Includes securities collateralized by sub-prime mortgages. See [Asset-Backed Securities](#) below.
- (3) As of September 30, 2013 and December 31, 2012, based on amortized cost, no individual foreign country represented more than 11% and 13%, respectively.
- (4) The table above excludes fixed maturity securities classified as trading. See [Other Trading Account Assets](#) for additional information.

The decrease in net unrealized gains from December 31, 2012 to September 30, 2013, was primarily due to a net increase in U.S. interest rates.

*Asset-Backed Securities*

Included within asset-backed securities attributable to both the Financial Services Businesses and the Closed Block Business are securities collateralized by sub-prime mortgages. While there is no market standard definition, we define sub-prime mortgages as residential mortgages



## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

that are originated to weaker quality obligors as indicated by weaker credit scores, as well as mortgages with higher loan-to-value ratios or limited documentation. The deterioration of the U.S. housing market since prices peaked in 2006 and higher unemployment levels over the past several years, coupled with relaxed underwriting standards for some originators of sub-prime mortgages through 2007, have led to higher delinquency rates, particularly for those mortgages issued in 2006 and 2007. This has resulted in increased attention given to potential deficiencies in

**Table of Contents**

lenders foreclosure documentation, causing delays in the foreclosure process. From the perspective of an investor in securities backed by sub-prime collateral, significant delays in foreclosure proceedings have resulted in increased servicing costs which negatively affect the value of the impacted securities. Separately, as an investor in sub-prime securities, we are pursuing legal and other actions with respect to potential remedies arising from any potential deficiencies related to the original lending and securitization practices. For additional information, see Note 15 to our Unaudited Interim Consolidated Financial Statements.

The following tables set forth the amortized cost and fair value of our asset-backed securities attributable to the Financial Services Businesses as of the dates indicated, by credit quality, and for asset-backed securities collateralized by sub-prime mortgages, by year of issuance (vintage).

**Asset-Backed Securities at Amortized Cost Financial Services Businesses**

| Vintage  | September 30, 2013<br>Lowest Rating Agency Rating |                 |               |                      |                 | Total<br>Amortized<br>Cost | Total<br>December<br>31,<br>2012 |
|--|---|-----------------|---------------|----------------------|-----------------|----------------------------|----------------------------------|
|  | AAA   | AA              | A             | BBB<br>(in millions) | BB and<br>below |                            |                                  |
| Collateralized by sub-prime mortgages:             |   |                 |               |                      |                 |                            |                                  |
| 2013 2008  | \$ 0  | \$ 0            | \$ 0          | \$ 0                 | \$ 0            | \$ 0                       | \$ 0                             |
| 2007   | 0   | 0               | 0             | 1                    | 367             | 368                        | 430                              |
| 2006   | 2   | 0               | 33            | 52                   | 596             | 683                        | 828                              |
| 2005   | 0   | 2               | 7             | 26                   | 239             | 274                        | 293                              |
| 2004 & Prior                                       | 0   | 3               | 28            | 34                   | 561             | 626                        | 691                              |
| <b>Total collateralized by sub-prime mortgages</b> | <b>2</b>  | <b>5</b>        | <b>68</b>     | <b>113</b>           | <b>1,763</b>    | <b>1,951</b>               | <b>2,242</b>                     |
| Other asset-backed securities:                     |   |                 |               |                      |                 |                            |                                  |
| Collateralized loan obligations                    | 2,047   | 436             | 0             | 0                    | 0               | 2,483                      | 1,858                            |
| Collateralized by non-sub-prime mortgages          | 1,024   | 49              | 6             | 16                   | 5               | 1,100                      | 1,444                            |
| Collateralized by credit cards                     | 487   | 0               | 46            | 10                   | 0               | 543                        | 695                              |
| Collateralized by auto loans                       | 654   | 0               | 0             | 0                    | 1               | 655                        | 694                              |
| Other asset-backed securities(1)                   | 144   | 624             | 108           | 146                  | 107             | 1,129                      | 1,276                            |
| <b>Total asset-backed securities(2)</b>            | <b>\$ 4,358</b>                                   | <b>\$ 1,114</b> | <b>\$ 228</b> | <b>\$ 285</b>        | <b>\$ 1,876</b> | <b>\$ 7,861</b>            | <b>\$ 8,209</b>                  |

- (1) Includes asset-backed securities collateralized by education loans, aircraft, equipment leases, franchises, externally-managed investments in the European market, and timeshares. Approximately 95% of the \$408 million of education loans included above carry a Department of Education guaranty as of September 30, 2013.
- (2) Excluded from the table above are asset-backed securities held outside the general account in other entities and operations. Also excluded from the table above are asset-backed securities classified as trading.

**Table of Contents****Asset-Backed Securities at Fair Value Financial Services Businesses**

| Vintage  | September 30, 2013<br>Lowest Rating Agency Rating |                 |               |                      |                 | Total<br>Fair<br>Value | Total<br>December<br>31,<br>2012 |
|--|---|-----------------|---------------|----------------------|-----------------|------------------------|----------------------------------|
|  | AAA   | AA              | A             | BBB<br>(in millions) | BB and<br>below |                        |                                  |
| Collateralized by sub-prime mortgages:             |   |                 |               |                      |                 |                        |                                  |
| 2013 2008  | \$ 0  | \$ 0            | \$ 0          | \$ 0                 | \$ 0            | \$ 0                   | \$ 0                             |
| 2007   | 0   | 0               | 0             | 1                    | 330             | 331                    | 339                              |
| 2006   | 2   | 0               | 31            | 44                   | 581             | 658                    | 698                              |
| 2005   | 0   | 2               | 7             | 26                   | 224             | 259                    | 251                              |
| 2004 & Prior                                       | 0   | 3               | 28            | 33                   | 521             | 585                    | 594                              |
| <b>Total collateralized by sub-prime mortgages</b> | <b>2</b>  | <b>5</b>        | <b>66</b>     | <b>104</b>           | <b>1,656</b>    | <b>1,833</b>           | <b>1,882</b>                     |
| Other asset-backed securities:                     |   |                 |               |                      |                 |                        |                                  |
| Collateralized loan obligations                    | 2,045   | 439             | 0             | 0                    | 7               | 2,491                  | 1,871                            |
| Collateralized by non-sub-prime mortgages          | 1,079   | 50              | 5             | 15                   | 5               | 1,154                  | 1,524                            |
| Collateralized by credit cards                     | 502   | 0               | 46            | 10                   | 0               | 558                    | 714                              |
| Collateralized by auto loans                       | 657   | 0               | 0             | 0                    | 1               | 658                    | 702                              |
| Other asset-backed securities(1)                   | 146   | 640             | 113           | 161                  | 114             | 1,174                  | 1,311                            |
| <b>Total asset-backed securities(2)</b>            | <b>\$ 4,431</b>                                   | <b>\$ 1,134</b> | <b>\$ 230</b> | <b>\$ 290</b>        | <b>\$ 1,783</b> | <b>\$ 7,868</b>        | <b>\$ 8,004</b>                  |

(1) Includes asset-backed securities collateralized by education loans, aircraft, equipment leases, franchises, externally-managed investments in the European market, and timeshares. Approximately 95% of the \$410 million of education loans included above carry a Department of Education guaranty as of September 30, 2013.

(2) Excluded from the table above are asset-backed securities held outside the general account in other entities and operations. Also excluded from the table above are asset-backed securities classified as trading.

The tables above provide ratings as assigned by nationally recognized rating agencies as of September 30, 2013, including Standard & Poor's, Moody's, and Fitch. In making our investment decisions, rather than relying solely on the rating agencies' evaluations, we assign internal ratings to our asset-backed securities based upon our dedicated asset-backed securities unit's independent evaluation of the underlying collateral and securitization structure, including any guarantees from monoline bond insurers.

On an amortized cost basis, asset-backed securities collateralized by sub-prime mortgages attributable to the Financial Services Businesses decreased from \$2.242 billion as of December 31, 2012, to \$1.951 billion as of September 30, 2013, primarily reflecting sales, principal paydowns and other-than-temporary impairments recognized. Gross unrealized losses related to our asset-backed securities collateralized by sub-prime mortgages attributable to the Financial Services Businesses were \$189 million as of September 30, 2013, and \$390 million as of December 31, 2012. For additional information regarding other-than-temporary impairments of asset-backed securities collateralized by sub-prime mortgages see Realized Investment Gains and Losses above. For information regarding the methodology used in determining the fair value of our asset-backed securities collateralized by sub-prime mortgages, see Note 13 to the Unaudited Interim Consolidated Financial Statements.

The weighted average estimated subordination percentage of our asset-backed securities collateralized by sub-prime mortgages attributable to the Financial Services Businesses, excluding those supported by guarantees from monoline bond insurers, was 28% as of September 30, 2013.

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

The subordination percentage represents the current weighted average estimated percentage of the capital structure subordinated to our investment holding that is available to absorb losses before the security incurs the first dollar loss of principal. As of September 30, 2013, based on amortized cost, approximately 58% of the asset-backed securities collateralized by sub-prime mortgages attributable to the Financial Services Businesses have estimated credit subordination percentages of 20% or more, and 41% have estimated credit subordination percentages of 30% or more.

**Table of Contents**

In addition to subordination, certain securities, referred to as front pay or second pay securities, benefit from the prioritization of principal cash flows within the senior tranches of the structure. In most instances, these shorter duration senior securities have priority to principal cash flows over other securities in the structure, including longer duration senior securities. Included within the \$1.951 billion of asset-backed securities collateralized by sub-prime mortgages attributable to the Financial Services Businesses as of September 30, 2013, were \$321 million of securities, on an amortized cost basis, that represent front pay or second pay securities, depending on the overall structure of the securities.

The following tables set forth the amortized cost and fair value of our asset-backed securities attributable to the Closed Block Business as of the dates indicated, by credit quality, and for asset-backed securities collateralized by sub-prime mortgages, by year of issuance (vintage).

**Asset-Backed Securities at Amortized Cost Closed Block Business**

| Vintage  | September 30, 2013<br>Lowest Rating Agency Rating |               |               |               |                                  | Total<br>Amortized<br>Cost | Total<br>December<br>31,<br>2012 |
|--|---|---------------|---------------|---------------|----------------------------------|----------------------------|----------------------------------|
|  | AAA   | AA            | A             | BBB           | BB and<br>below<br>(in millions) |                            |                                  |
| Collateralized by sub-prime mortgages:             |   |               |               |               |                                  |                            |                                  |
| 2013 2008  | \$ 0  | \$ 0          | \$ 0          | \$ 0          | \$ 0                             | \$ 0                       | \$ 0                             |
| 2007   | 0   | 4             | 0             | 20            | 225                              | 249                        | 324                              |
| 2006   | 4   | 83            | 0             | 6             | 501                              | 594                        | 711                              |
| 2005   | 7   | 17            | 59            | 15            | 99                               | 197                        | 233                              |
| 2004 & Prior                                       | 0   | 2             | 13            | 19            | 413                              | 447                        | 503                              |
| <b>Total collateralized by sub-prime mortgages</b> | <b>11</b>   | <b>106</b>    | <b>72</b>     | <b>60</b>     | <b>1,238</b>                     | <b>1,487</b>               | <b>1,771</b>                     |
| Other asset-backed securities:                     |   |               |               |               |                                  |                            |                                  |
| Collateralized by auto loans                       | 838   | 0             | 0             | 0             | 0                                | 838                        | 892                              |
| Collateralized loan obligations                    | 510   | 117           | 0             | 0             | 0                                | 627                        | 599                              |
| Collateralized by credit cards                     | 334   | 0             | 0             | 23            | 2                                | 359                        | 450                              |
| Collateralized by education loans(1)               | 17  | 419           | 0             | 0             | 0                                | 436                        | 450                              |
| Other asset-backed securities(2)                   | 90  | 55            | 53            | 218           | 11                               | 427                        | 430                              |
| <b>Total asset-backed securities(3)</b>            | <b>\$ 1,800</b>                                   | <b>\$ 697</b> | <b>\$ 125</b> | <b>\$ 301</b> | <b>\$ 1,251</b>                  | <b>\$ 4,174</b>            | <b>\$ 4,592</b>                  |

- (1) Approximately 95% of the \$436 million of education loans included above carry a Department of Education guaranty as of September 30, 2013.
- (2) Includes asset-backed securities collateralized by externally-managed investments in the European market, franchises, equipment leases, aircraft, manufacturing and timeshares.
- (3) Excluded from the table above are asset-backed securities classified as trading.

**Table of Contents****Asset-Backed Securities at Fair Value Closed Block Business**

| Vintage  | September 30, 2013<br>Lowest Rating Agency Rating |               |               |                      |                 | Total<br>Fair<br>Value | Total<br>December<br>31,<br>2012 |
|--|---|---------------|---------------|----------------------|-----------------|------------------------|----------------------------------|
|  | AAA   | AA            | A             | BBB<br>(in millions) | BB and<br>below |                        |                                  |
| Collateralized by sub-prime mortgages:             |   |               |               |                      |                 |                        |                                  |
| 2013 2008  | \$ 0  | \$ 0          | \$ 0          | \$ 0                 | \$ 0            | \$ 0                   | \$ 0                             |
| 2007   | 0   | 4             | 0             | 19                   | 203             | 226                    | 269                              |
| 2006   | 4   | 81            | 0             | 6                    | 417             | 508                    | 543                              |
| 2005   | 7   | 17            | 56            | 14                   | 89              | 183                    | 205                              |
| 2004 & Prior                                       | 0   | 2             | 12            | 18                   | 380             | 412                    | 442                              |
| <b>Total collateralized by sub-prime mortgages</b> | <b>11</b>   | <b>104</b>    | <b>68</b>     | <b>57</b>            | <b>1,089</b>    | <b>1,329</b>           | <b>1,459</b>                     |
| Other asset-backed securities:                     |   |               |               |                      |                 |                        |                                  |
| Collateralized by auto loans                       | 839   | 0             | 0             | 0                    | 0               | 839                    | 896                              |
| Collateralized by credit cards                     | 335   | 0             | 0             | 24                   | 2               | 361                    | 454                              |
| Collateralized loan obligations                    | 513   | 117           | 0             | 0                    | 5               | 635                    | 605                              |
| Collateralized by education loans(1)               | 17  | 423           | 0             | 0                    | 0               | 440                    | 453                              |
| Other asset-backed securities(2)                   | 91  | 56            | 58            | 241                  | 13              | 459                    | 476                              |
| <b>Total asset-backed securities(3)</b>            | <b>\$ 1,806</b>                                   | <b>\$ 700</b> | <b>\$ 126</b> | <b>\$ 322</b>        | <b>\$ 1,109</b> | <b>\$ 4,063</b>        | <b>\$ 4,343</b>                  |

(1) Approximately 96% of the \$440 million of education loans included above carry a Department of Education guaranty as of September 30, 2013.

(2) Includes asset-backed securities collateralized by externally-managed investments in the European market, franchises, equipment leases, aircraft, manufacturing and timeshares.

(3) Excluded from the table above are asset-backed securities classified as trading.

On an amortized cost basis, asset-backed securities collateralized by sub-prime mortgages attributable to the Closed Block Business decreased from \$1.771 billion as of December 31, 2012, to \$1.487 billion as of September 30, 2013, primarily reflecting sales, principal paydowns and other-than-temporary impairments recognized. Gross unrealized losses related to our asset-backed securities collateralized by sub-prime mortgages attributable to the Closed Block Business were \$164 million as of September 30, 2013, and \$315 million as of December 31, 2012. For additional information regarding other-than-temporary impairments of asset-backed securities collateralized by sub-prime mortgages see

Realized Investment Gains and Losses above. For information regarding the methodology used in determining the fair value of our asset-backed securities collateralized by sub-prime mortgages, see Note 13 to the Unaudited Interim Consolidated Financial Statements.

The weighted average estimated subordination percentage of asset-backed securities collateralized by sub-prime mortgages attributable to the Closed Block Business, excluding those supported by guarantees from monoline bond insurers, was 33% as of September 30, 2013. The subordination percentage represents the current weighted average estimated percentage of the capital structure subordinated to our investment holding that is available to absorb losses before the security incurs the first dollar loss of principal. As of September 30, 2013, based on amortized cost, approximately 69% of the asset-backed securities collateralized by sub-prime mortgages attributable to the Closed Block Business have estimated credit subordination percentages of 20% or more, and 48% have estimated credit subordination percentages of 30% or more.

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

In addition to subordination, certain securities, referred to as front pay or second pay securities, benefit from the prioritization of principal cash flows within the senior tranches of the structure. In most instances, these shorter duration senior securities have priority to principal cash flows over other securities in the structure, including longer duration senior securities. Included within the \$1.487 billion of asset-backed securities collateralized by sub-prime mortgages attributable to the Closed Block Business as of September 30, 2013, were \$226 million of securities, on an amortized cost basis, that represent front pay or second pay securities, depending on the overall structure of the securities.

**Table of Contents***Residential Mortgage-Backed Securities*

The following tables set forth the amortized cost of our residential mortgage-backed securities attributable to the Financial Services Businesses and Closed Block Business as of the dates indicated.

**Residential Mortgage-Backed Securities at Amortized Cost**

|  | <b>September 30, 2013</b>                |                       |                              |                       |
|--|--|-----------------------|------------------------------|-----------------------|
|  | <b>Financial Services Businesses</b>     |                       | <b>Closed Block Business</b> |                       |
|  | <b>Amortized<br/>Cost</b>                | <b>% of Total</b>     | <b>Amortized<br/>Cost</b>    | <b>% of Total</b>     |
|  | (\$ in millions)                         |                       |                              |                       |
| <b>By security type:</b>                     |  |                       |                              |                       |
| Agency pass-through securities(1)            | \$ 6,217                                 | 98.2%                 | \$ 1,006                     | 88.6%                 |
| Collateralized mortgage obligations(2)(3)    | 114                                      | 1.8                   | 130                          | 11.4                  |
| Total residential mortgage-backed securities | \$ 6,331                                 | 100.0%                | \$ 1,136                     | 100.0%                |
| Portion rated AA or higher(4)                | \$ 6,227                                 | 98.4%                 | \$ 1,006                     | 88.6%                 |
|  | <b>December 31, 2012</b>                 |                       |                              |                       |
|  | <b>Financial Services<br/>Businesses</b> |                       | <b>Closed Block Business</b> |                       |
|  | <b>Amortized<br/>Cost</b>                | <b>% of<br/>Total</b> | <b>Amortized<br/>Cost</b>    | <b>% of<br/>Total</b> |
|  | (\$ in millions)                         |                       |                              |                       |
| <b>By security type:</b>                     |  |                       |                              |                       |
| Agency pass-through securities(1)            | \$ 8,183                                 | 97.9%                 | \$ 1,364                     | 89.7%                 |
| Collateralized mortgage obligations(2)(3)    | 177                                      | 2.1                   | 156                          | 10.3                  |
| Total residential mortgage-backed securities | \$ 8,360                                 | 100.0%                | \$ 1,520                     | 100.0%                |
| Portion rated AA or higher(4)                | \$ 8,247                                 | 98.7%                 | \$ 1,364                     | 89.7%                 |

(1) As of September 30, 2013, of these securities, for the Financial Services Businesses, \$4.750 billion are supported by U.S. government and \$1.467 billion are supported by foreign governments. As of December 31, 2012, of these securities, for the Financial Services Businesses, \$6.359 billion were supported by the U.S. government and \$1.824 billion were supported by foreign governments. For the Closed Block Business, all of the securities are supported by the U.S. government as of both September 30, 2013 and December 31, 2012.

(2) Includes alternative residential mortgage loans of \$30 million and \$36 million in the Financial Services Businesses, and \$65 million and \$76 million in the Closed Block Business, as of September 30, 2013 and December 31, 2012, respectively.

(3) As of September 30, 2013, of these collateralized mortgage obligations, for the Financial Services Businesses, 8% have credit ratings of A or above, 36% have BBB credit ratings and the remaining 56% have below investment grade ratings and, as of December 31, 2012, 57% have credit ratings of A or above, 5% have BBB credit ratings and the remaining 38% have below investment grade ratings. As of both September 30, 2013 and December 31, 2012, for the Closed Block Business, 13% have BBB credit ratings and 87% have below investment grade ratings.

(4) Based on lowest external rating agency rating.

*Commercial Mortgage-Backed Securities*



## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

The commercial real estate market was severely impacted by the financial crisis and the subsequent recession; however, market fundamentals appear to have bottomed and have shown signs of improvement since late 2010. Commercial real estate vacancy rates have declined from their peak, rent growth has turned positive, and prices of commercial real estate have stabilized. Additionally, the elevated delinquency rate on mortgages in the commercial mortgage-backed securities market has slowed and refinancing activity has increased, reflecting the improvement in these fundamentals. The loans included in new issues seem to reflect better underwriting and lower levels of leverage compared to 2007.

**Table of Contents**

The following tables set forth the amortized cost and fair value of our commercial mortgage-backed securities attributable to the Financial Services Businesses as of the dates indicated, by credit quality and by year of issuance (vintage).

**Commercial Mortgage-Backed Securities at Amortized Cost Financial Services Businesses**

| <u>Vintage</u>                                       | September 30, 2013<br>Lowest Rating Agency Rating(1) |        |       |                      |                 | Total<br>Amortized<br>Cost | Total<br>December<br>31,<br>2012 |
|--|--|--------|-------|----------------------|-----------------|----------------------------|----------------------------------|
|  | AAA  | AA     | A     | BBB<br>(in millions) | BB and<br>below |                            |                                  |
| 2013 2008  | \$ 1,954   | \$ 503 | \$ 8  | \$ 9                 | \$ 1            | \$ 2,475                   | \$ 566                           |
| 2007   | 891  | 44     | 25    | 5                    | 0               | 965                        | 1,196                            |
| 2006   | 3,046  | 142    | 6     | 4                    | 0               | 3,198                      | 2,781                            |
| 2005   | 2,150  | 66     | 9     | 4                    | 0               | 2,229                      | 2,113                            |
| 2004 & Prior   | 419  | 76     | 24    | 0                    | 1               | 520                        | 757                              |
| Total commercial mortgage-backed securities(2)(3)(4) | \$ 8,460   | \$ 831 | \$ 72 | \$ 22                | \$ 2            | \$ 9,387                   | \$ 7,413                         |

- (1) The table above provides ratings as assigned by nationally recognized rating agencies as of September 30, 2013, including Standard & Poor's, Moody's, Fitch and Realpoint.
- (2) Excluded from the table above are commercial mortgage-backed securities held outside the general account in other entities and operations. Also excluded from the table above are commercial mortgage-backed securities classified as trading.
- (3) Included in the table above, as of September 30, 2013, are downgraded super senior securities with amortized cost of \$167 million in AA and \$63 million in A.
- (4) Included in the table above, as of September 30, 2013, are agency commercial mortgage-backed securities with amortized cost of \$537 million, all rated AA.

**Commercial Mortgage-Backed Securities at Fair Value Financial Services Businesses**

| <u>Vintage</u>                                    | September 30, 2013<br>Lowest Rating Agency Rating(1) |        |       |                      |                 | Total<br>Fair<br>Value | Total<br>December<br>31,<br>2012 |
|---|--|--------|-------|----------------------|-----------------|------------------------|----------------------------------|
|   | AAA  | AA     | A     | BBB<br>(in millions) | BB and<br>below |                        |                                  |
| 2013 2008   | \$ 1,901   | \$ 510 | \$ 9  | \$ 8                 | \$ 0            | \$ 2,428               | \$ 609                           |
| 2007  | 914  | 46     | 25    | 5                    | 1               | 991                    | 1,275                            |
| 2006  | 3,206  | 149    | 6     | 4                    | 0               | 3,365                  | 3,062                            |
| 2005  | 2,233  | 74     | 10    | 5                    | 0               | 2,322                  | 2,261                            |
| 2004 & Prior                                      | 464  | 93     | 28    | 0                    | 1               | 586                    | 787                              |
| Total commercial mortgage-backed securities(2)(3) | \$ 8,718   | \$ 872 | \$ 78 | \$ 22                | \$ 2            | \$ 9,692               | \$ 7,994                         |

- (1) The table above provides ratings as assigned by nationally recognized rating agencies as of September 30, 2013, including Standard & Poor's, Moody's, Fitch and Realpoint.
- (2)

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Excluded from the table above are commercial mortgage-backed securities held outside the general account in other entities and operations. Also excluded from the table above are commercial mortgage-backed securities classified as trading.

- (3) Included in the table above, as of September 30, 2013, are agency commercial mortgage-backed securities with fair value of \$547 million, all rated AA.

Included in the tables above are commercial mortgage-backed securities collateralized by non-U.S. properties, all related to Japanese commercial mortgage-backed securities held by our Japanese insurance operations, with an amortized cost of \$10 million in AAA, and \$1 million in BB and below as of September 30, 2013, and \$12 million in AAA, \$4 million in BBB and \$18 million in BB and below as of December 31, 2012.

**Table of Contents**

Included in the tables above are commercial mortgage-backed securities collateralized by U.S. properties, all related to commercial mortgage-backed securities held by our Japanese insurance operations, with an amortized cost of \$465 million in AAA, \$97 million in AA, \$32 million in A and \$8 million in BBB as of September 30, 2013, and \$674 million in AAA, \$116 million in AA, \$40 million in A and \$9 million in BBB as of December 31, 2012.

The following table sets forth the amortized cost of our AAA commercial mortgage-backed securities attributable to the Financial Services Businesses as of the dates indicated, by type and by year of issuance (vintage).

**AAA Rated Commercial Mortgage-Backed Securities Amortized Cost by Type and Vintage Financial Services Businesses**

| <u>Vintage</u> | September 30, 2013                       |  |           |        | Other AAA    |                   |       | Total AAA Securities at Amortized Cost |
|----------------|--|--|-----------|--------|--------------|-------------------|-------|--|
|                | Super Senior AAA Structures              |  | Mezzanine | Junior | Other Senior | Other Subordinate | Other |  |
|                | Super Senior (shorter duration tranches) | Super Senior (longest duration tranches) |           |        |              |                   |       |  |
| 2013 2008      | \$ 1,935                                 | \$ 10                                    | \$ 0      | \$ 0   | \$ 0         | \$ 7              | \$ 2  | \$ 1,954                               |
| 2007           | 888                                      | 3  | 0         | 0      | 0            | 0                 | 0     | 891                                    |
| 2006           | 1,350                                    | 1,686                                    | 0         | 0      | 0            | 0                 | 10    | 3,046                                  |
| 2005           | 276                                      | 1,847                                    | 0         | 4      | 0            | 23                | 0     | 2,150                                  |
| 2004 & Prior   | 5  | 185                                      | 0         | 34     | 160          | 35                | 0     | 419                                    |
| Total          | \$ 4,454                                 | \$ 3,731                                 | \$ 0      | \$ 38  | \$ 160       | \$ 65             | \$ 12 | \$ 8,460                               |

The following tables set forth the amortized cost and fair value of our commercial mortgage-backed securities attributable to the Closed Block Business as of the dates indicated, by credit quality and by year of issuance (vintage).

**Commercial Mortgage-Backed Securities at Amortized Cost Closed Block Business**

| <u>Vintage</u>                                    | September 30, 2013             |        |      |       |              | Total Amortized Cost | Total December 31, 2012 |
|---|--------------------------------|--------|------|-------|--------------|----------------------|-------------------------|
|   | Lowest Rating Agency Rating(1) |        |      |       |              |                      |                         |
|   | AAA                            | AA     | A    | BBB   | BB and below |                      |                         |
| 2013 2008   | \$ 936                         | \$ 737 | \$ 0 | \$ 9  | \$ 0         | \$ 1,682             | \$ 847                  |
| 2007  | 384                            | 42     | 0    | 0     | 5            | 431                  | 552                     |
| 2006  | 978                            | 109    | 0    | 0     | 0            | 1,087                | 1,301                   |
| 2005  | 708                            | 25     | 0    | 0     | 0            | 733                  | 1,091                   |
| 2004 & Prior                                      | 66                             | 7      | 0    | 4     | 0            | 77                   | 238                     |
| Total commercial mortgage-backed securities(2)(3) | \$ 3,072                       | \$ 920 | \$ 0 | \$ 13 | \$ 5         | \$ 4,010             | \$ 4,029                |

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

- (1) The table above provides ratings as assigned by nationally recognized rating agencies as of September 30, 2013, including Standard & Poor's, Moody's, Fitch and Realpoint.
- (2) Included in the table above, as of September 30, 2013, are downgraded super senior securities with amortized cost of \$135 million in AA.
- (3) Included in the table above, as of September 30, 2013, are agency commercial mortgage-backed securities with amortized cost of \$37 million in AAA and \$779 million in AA.

**Table of Contents****Commercial Mortgage-Backed Securities at Fair Value Closed Block Business**

| <u>Vintage</u>                                 | September 30, 2013<br>Lowest Rating Agency Rating(1) |        |      |                      |                 | Total<br>Fair<br>Value | Total<br>December<br>31,<br>2012 |
|--|--|--------|------|----------------------|-----------------|------------------------|----------------------------------|
|  | AAA  | AA     | A    | BBB<br>(in millions) | BB and<br>below |                        |                                  |
| 2013 2008                                      | \$ 904   | \$ 709 | \$ 0 | \$ 8                 | \$ 0            | \$ 1,621               | \$ 869                           |
| 2007   | 389  | 42     | 0    | 0                    | 13              | 444                    | 579                              |
| 2006   | 1,002  | 112    | 0    | 0                    | 0               | 1,114                  | 1,375                            |
| 2005   | 724  | 28     | 0    | 0                    | 0               | 752                    | 1,141                            |
| 2004 & Prior                                   | 67   | 6      | 0    | 5                    | 0               | 78                     | 242                              |
| Total commercial mortgage-backed securities(2) | \$ 3,086   | \$ 897 | \$ 0 | \$ 13                | \$ 13           | \$ 4,009               | \$ 4,206                         |

- (1) The table above provides ratings as assigned by nationally recognized rating agencies as of September 30, 2013, including Standard & Poor's, Moody's, Fitch and Realpoint.
- (2) Included in the table above, as of September 30, 2013, are agency commercial mortgage-backed securities with fair value of \$34 million in AAA and \$751 million in AA.

The following table sets forth the amortized cost our AAA commercial mortgage-backed securities attributable to the Closed Block Business as of the dates indicated, by type and by year of issuance (vintage).

**AAA Rated Commercial Mortgage-Backed Securities Amortized Cost by Type and Vintage Closed Block Business**

| <u>Vintage</u> | September 30, 2013                                   |  |           |                         |                 | Other<br>Subordinate | Other | Total AAA<br>Securities at<br>Amortized<br>Cost |
|----------------|--|--|-----------|-------------------------|-----------------|----------------------|-------|---|
|                | Super Senior AAA Structures                          |  |           | Other AAA               |                 |                      |       |   |
|                | Super<br>Senior<br>(shorter<br>duration<br>tranches) | Super<br>Senior<br>(longest<br>duration<br>tranches) | Mezzanine | Junior<br>(in millions) | Other<br>Senior |                      |       |   |
| 2013 2008      | \$ 899   | \$ 0   | \$ 0      | \$ 0                    | \$ 0            | \$ 0                 | \$ 0  | \$ 899  |
| 2007           | 384  | 0  | 0         | 0                       | 0               | 0                    | 0     | 384   |
| 2006           | 317  | 661  | 0         | 0                       | 0               | 0                    | 0     | 978   |
| 2005           | 374  | 334  | 0         | 0                       | 0               | 0                    | 0     | 708   |
| 2004 & Prior   | 34   | 10   | 0         | 0                       | 19              | 3                    | 0     | 66  |
| Total(1)       | \$ 2,008   | \$ 1,005   | \$ 0      | \$ 0                    | \$ 19           | \$ 3                 | \$ 0  | \$ 3,035  |

- (1) Excluded from the table above, as of September 30, 2013, are agency commercial mortgage-backed securities with amortized cost of \$37 million.

*Fixed Maturity Securities Credit Quality*

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

The Securities Valuation Office, or SVO, of the NAIC, evaluates the investments of insurers for statutory reporting purposes and assigns fixed maturity securities to one of six categories called NAIC Designations. In general, NAIC Designations of 1 highest quality, or 2 high quality, include fixed maturities considered investment grade, which include securities rated Baa3 or higher by Moody's or BBB- or higher by Standard & Poor's. NAIC Designations of 3 through 6 generally include fixed maturities referred to as below investment grade, which include securities rated Ba1 or lower by Moody's and BB+ or lower by Standard & Poor's. The NAIC Designations for commercial mortgage-backed securities and non-agency residential mortgage-backed securities, including our asset-backed securities collateralized by sub-prime mortgages, are based on security level expected losses as modeled by an independent third-party (engaged by the NAIC) and the statutory carrying value of the security, including any purchase discounts or impairment charges previously recognized.

**Table of Contents**

As a result of time lags between the funding of investments, the finalization of legal documents, and the completion of the SVO filing process, the fixed maturity portfolio generally includes securities that have not yet been rated by the SVO as of each balance sheet date. Pending receipt of SVO ratings, the categorization of these securities by NAIC Designation is based on the expected ratings indicated by internal analysis.

Investments of our international insurance companies are not subject to NAIC guidelines. Investments of our Japanese insurance operations are regulated locally by the Financial Services Agency, an agency of the Japanese government. The Financial Services Agency has its own investment quality criteria and risk control standards. Our Japanese insurance companies comply with the Financial Services Agency's credit quality review and risk monitoring guidelines. The credit quality ratings of the investments of our Japanese insurance companies are based on ratings assigned by internationally recognized credit rating agencies, including Moody's and Standard & Poor's, or rating equivalents based on ratings assigned by Japanese credit rating agencies.

The following table sets forth our fixed maturity portfolio by NAIC Designation attributable to the Financial Services Businesses as of the dates indicated.

**Fixed Maturity Securities Financial Services Businesses**

| (1)(2)<br>NAIC Designation                        | Amortized<br>Cost | September 30, 2013              |                                     | Fair<br>Value     | Amortized<br>Cost | December 31, 2012               |                                     | Fair<br>Value     |  |
|---|-------------------|---------------------------------|-------------------------------------|-------------------|-------------------|---------------------------------|-------------------------------------|-------------------|--|
|   |                   | Gross<br>Unrealized<br>Gains(3) | Gross<br>Unrealized<br>Losses(3)(4) |                   |                   | Gross<br>Unrealized<br>Gains(3) | Gross<br>Unrealized<br>Losses(3)(4) |                   |  |
|   |                   |                                 |                                     | (in millions)     |                   |                                 |                                     |                   |  |
| 1   | \$ 180,524        | \$ 14,532                       | \$ 3,377                            | \$ 191,679        | \$ 189,129        | \$ 16,564                       | \$ 1,037                            | \$ 204,656        |  |
| 2   | 44,859            | 3,431                           | 1,210                               | 47,080            | 42,424            | 3,688                           | 656                                 | 45,456            |  |
| Subtotal High or Highest Quality<br>Securities(5) | 225,383           | 17,963                          | 4,587                               | 238,759           | 231,553           | 20,252                          | 1,693                               | 250,112           |  |
| 3   | 6,575             | 345                             | 194                                 | 6,726             | 6,086             | 301                             | 233                                 | 6,154             |  |
| 4   | 2,331             | 165                             | 83                                  | 2,413             | 1,982             | 133                             | 129                                 | 1,986             |  |
| 5   | 506               | 37                              | 35                                  | 508               | 650               | 27                              | 74                                  | 603               |  |
| 6   | 124               | 31                              | 5                                   | 150               | 186               | 39                              | 17                                  | 208               |  |
| Subtotal Other Securities(6)(7)                   | 9,536             | 578                             | 317                                 | 9,797             | 8,904             | 500                             | 453                                 | 8,951             |  |
| <b>Total Fixed Maturities</b>                     | <b>\$ 234,919</b> | <b>\$ 18,541</b>                | <b>\$ 4,904</b>                     | <b>\$ 248,556</b> | <b>\$ 240,457</b> | <b>\$ 20,752</b>                | <b>\$ 2,146</b>                     | <b>\$ 259,063</b> |  |

(1) Reflects equivalent ratings for investments of the international insurance operations.

(2) Includes, as of September 30, 2013 and December 31, 2012, 308 securities with amortized cost of \$765 million (fair value, \$794 million) and 104 securities with amortized cost of \$793 million (fair value, \$847 million), respectively, that have been categorized based on expected NAIC Designations pending receipt of SVO ratings.

(3) Includes \$275 million of gross unrealized gains and \$32 million gross unrealized losses as of September 30, 2013, compared to \$310 million of gross unrealized gains and \$67 million of gross unrealized losses as of December 31, 2012, on securities classified as held-to-maturity.

(4) As of September 30, 2013, includes gross unrealized losses of \$272 million on public fixed maturities and \$45 million on private fixed maturities considered to be other than high or highest quality and, as of December 31, 2012, includes gross unrealized losses of \$401 million on public fixed maturities and \$52 million on private fixed maturities considered to be other than high or highest quality.

(5) On amortized cost basis, as of September 30, 2013, includes \$199,841 million of public fixed maturities and \$25,542 million of private fixed maturities and, as of December 31, 2012, includes \$206,966 million of public fixed maturities and \$24,587 million of private fixed maturities.

(6) On an amortized cost basis, as of September 30, 2013, includes \$6,281 million of public fixed maturities and \$3,255 million of private fixed maturities and, as of December 31, 2012, includes \$5,416 million of public fixed maturities and \$3,488 million of private fixed maturities.



## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

- (7) On an amortized cost basis, as of September 30, 2013, securities considered below investment grade based on lowest of external rating agency ratings, total \$11.0 billion, or 5% of the total fixed maturities, and include securities considered high or highest quality by the NAIC based on the rules described above.

**Table of Contents**

The following table sets forth our fixed maturity portfolio by NAIC Designation attributable to the Closed Block Business as of the dates indicated.

**Fixed Maturity Securities Closed Block Business**

| (1)<br>NAIC Designation                        | September 30, 2013 |                              |                                  |                  | December 31, 2012 |                              |                                  |                  |
|--|--------------------|------------------------------|----------------------------------|------------------|-------------------|------------------------------|----------------------------------|------------------|
|  | Amortized<br>Cost  | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses(2) | Fair<br>Value    | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses(2) | Fair<br>Value    |
|  | (in millions)      |                              |                                  |                  |                   |                              |                                  |                  |
| 1  | \$ 22,908          | \$ 1,805                     | \$ 258                           | \$ 24,455        | \$ 23,197         | \$ 3,353                     | \$ 114                           | \$ 26,436        |
| 2  | 14,610             | 1,472                        | 113                              | 15,969           | 14,581            | 2,091                        | 58                               | 16,614           |
| Subtotal High or Highest Quality Securities(3) | 37,518             | 3,277                        | 371                              | 40,424           | 37,778            | 5,444                        | 172                              | 43,050           |
| 3  | 2,050              | 106                          | 54                               | 2,102            | 1,989             | 156                          | 94                               | 2,051            |
| 4  | 979                | 22                           | 46                               | 955              | 1,015             | 35                           | 92                               | 958              |
| 5  | 180                | 9                            | 13                               | 176              | 271               | 13                           | 34                               | 250              |
| 6  | 56                 | 22                           | 1                                | 77               | 84                | 27                           | 1                                | 110              |
| Subtotal Other Securities(4)(5)                | 3,265              | 159                          | 114                              | 3,310            | 3,359             | 231                          | 221                              | 3,369            |
| <b>Total Fixed Maturities</b>                  | <b>\$ 40,783</b>   | <b>\$ 3,436</b>              | <b>\$ 485</b>                    | <b>\$ 43,734</b> | <b>\$ 41,137</b>  | <b>\$ 5,675</b>              | <b>\$ 393</b>                    | <b>\$ 46,419</b> |

- (1) Includes, as of September 30, 2013 and December 31, 2012, 72 securities with amortized cost of \$907 million (fair value, \$923 million) and 51 securities with amortized cost of \$885 million (fair value, \$941 million), respectively, that have been categorized based on expected NAIC Designations pending receipt of SVO ratings.
- (2) As of September 30, 2013, includes gross unrealized losses of \$99 million on public fixed maturities and \$15 million on private fixed maturities considered to be other than high or highest quality and, as of December 31, 2012, includes gross unrealized losses of \$207 million on public fixed maturities and \$14 million on private fixed maturities considered to be other than high or highest quality.
- (3) On an amortized cost basis, as of September 30, 2013, includes \$23,843 million of public fixed maturities and \$13,675 million of private fixed maturities and, as of December 31, 2012, includes \$23,884 million of public fixed maturities and \$13,894 million of private fixed maturities.
- (4) On an amortized cost basis, as of September 30, 2013, includes \$1,655 million public fixed maturities and \$1,610 million of private fixed maturities and, as of December 31, 2012, includes \$1,603 million of public fixed maturities and \$1,756 million of private fixed maturities.
- (5) On an amortized cost basis, as of September 30, 2013, securities considered below investment grade based on lowest of external rating agency ratings, totaled \$4.2 billion, or 10% of the total fixed maturities, and include securities considered high or highest quality by the NAIC based on the rules described above.

*Credit Derivative Exposure to Public Fixed Maturities*

In addition to the credit exposure from public fixed maturities noted above, we sell credit derivatives to enhance the return on our investment portfolio by creating credit exposure similar to an investment in public fixed maturity cash instruments.

In a credit derivative, we may sell credit protection on an identified name or a broad based index, and in return receive a quarterly premium. This premium or credit spread generally corresponds to the difference between the yield on the reference names (or index underlying reference names) public fixed maturity cash instruments and swap rates at the time the agreement is executed.

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

The majority of the underlying reference names in single name and index credit derivatives where we have sold credit protection, as well as all the counterparties to these agreements, are investment grade credit quality and our credit derivatives have a remaining term to maturity of three years or less. Credit derivative contracts are recorded at fair value with changes in fair value, including the premium received, recorded in Realized investment gains (losses), net. The premium received for the credit derivatives we sell attributable to the Financial Services Businesses was less than \$1 million and \$3 million for the three and nine months ended September 30, 2013, respectively, and \$0 million and \$2 million for the three and nine months ended September 30, 2012, respectively, and is included in adjusted operating income as an adjustment to Realized investment gains (losses), net.

---

## **Table of Contents**

As of September 30, 2013, the Financial Services Businesses had no outstanding sell protection credit derivatives. As of December 31, 2012, the Financial Services Businesses had \$1,065 million of outstanding notional amounts, reported at fair value as an asset of \$2 million, where we have sold credit protection through credit derivatives. These amounts exclude a credit derivative related to surplus notes issued by a subsidiary of Prudential Insurance and embedded derivatives contained in certain externally-managed investments in the European market. See Note 14 to the Unaudited Interim Consolidated Financial Statements for additional information regarding these derivatives.

As of both September 30, 2013 and December 31, 2012, the Closed Block Business had \$5 million of outstanding notional amounts, each reported at fair value as an asset of less than \$1 million of exposure, where we have sold credit protection through credit derivatives.

In addition to selling credit protection, we have purchased credit protection using credit derivatives in order to hedge specific credit exposures in our investment portfolio. As of September 30, 2013 and December 31, 2012, the Financial Services Businesses had \$1.182 billion and \$1.370 billion of outstanding notional amounts, reported at fair value as a liability of \$29 million and of \$27 million, respectively. As of September 30, 2013 and December 31, 2012, the Closed Block Business had \$304 million and \$309 million of outstanding notional amounts, reported at fair value as a liability of \$9 million and \$8 million, respectively. The premium paid for the credit derivatives we purchase attributable to the Financial Services Businesses was \$8 million and \$23 million for the three and nine months ended September 30, 2013, respectively, and \$9 million and \$29 million for the three and nine months ended September 30, 2012, respectively, and is included in adjusted operating income as an adjustment to Realized investment gains (losses), net. See Note 14 to the Unaudited Interim Consolidated Financial Statements for additional information regarding credit derivatives and an overall description of our derivative activities.

### *Other-Than-Temporary Impairments of Fixed Maturity Securities*

We maintain separate monitoring processes for public and private fixed maturities and create watch lists to highlight securities that require special scrutiny and management. Our public fixed maturity asset managers formally review all public fixed maturity holdings on a quarterly basis and more frequently when necessary to identify potential credit deterioration whether due to ratings downgrades, unexpected price variances, and/or company or industry specific concerns.

For private placements, our credit and portfolio management processes help ensure prudent controls over valuation and management. We have separate pricing and authorization processes to establish checks and balances for new investments. We apply consistent standards of credit analysis and due diligence for all transactions, whether they originate through our own in-house origination staff or through agents. Our regional offices closely monitor the portfolios in their regions. We set all valuation standards centrally, and we assess the fair value of all investments quarterly. Our private fixed maturity asset managers formally review all private fixed maturity holdings on a quarterly basis and more frequently when necessary to identify potential credit deterioration whether due to ratings downgrades, unexpected price variances, and/or company or industry specific concerns. For additional information regarding our policies regarding other-than-temporary impairments for fixed maturity securities, see Note 2 to the Unaudited Interim Consolidated Financial Statements.

Other-than-temporary impairments of general account fixed maturity securities attributable to the Financial Services Businesses that were recognized in earnings were \$28 million and \$82 million for the three months ended September 30, 2013 and 2012, respectively, and \$110 million and \$228 million for the nine months ended September 30, 2013 and 2012, respectively. Included in the other-than-temporary impairments of general account fixed maturities attributable to the Financial Services Businesses for the three months ended September 30, 2013 and 2012, were \$18 million and \$13 million, respectively, of other-than-temporary impairments on asset-backed securities collateralized by sub-prime mortgages. Other-than-temporary impairments of general account fixed maturities attributable to the Financial Services Businesses for the nine months ended September 30, 2013 and 2012 include \$30 million and \$47 million, respectively, of other-than-temporary impairments on asset-backed securities collateralized by sub-prime mortgages.



**Table of Contents**

Other-than-temporary impairments of fixed maturity securities attributable to the Closed Block Business that were recognized in earnings were \$15 million and \$13 million for the three months ended September 30, 2013, and 2012, respectively, and \$36 million and \$62 million for the nine months ended September 30, 2013 and 2012, respectively. Included in the other-than-temporary impairments of fixed maturities attributable to the Closed Block Business for the three months ended September 30, 2013, and 2012, were \$10 million and \$7 million, respectively, of other-than-temporary impairments on asset-backed securities collateralized by sub-prime mortgages. Other-than-temporary impairments of general account fixed maturities attributable to the Closed Block Business for the nine months ended September 30, 2013 and 2012 include \$17 million and \$33 million, respectively, of other-than-temporary impairments on asset-backed securities collateralized by sub-prime mortgages. For a further discussion of other-than-temporary impairments, see [Realized Investment Gains and Losses](#) above.

**Trading Account Assets Supporting Insurance Liabilities**

Certain products included in the Retirement and International Insurance segments are experience-rated, meaning that we expect the investment results associated with these products will ultimately accrue to contractholders. The investments supporting these experience-rated products, excluding commercial mortgage and other loans, are primarily classified as trading and are reflected on the balance sheet as [Trading account assets supporting insurance liabilities](#), at fair value. [Realized and unrealized gains and losses](#) for these investments are reported in [Asset management fees and other income](#), and excluded from adjusted operating income. Investment income for these investments is reported in [Net investment income](#), and is included in adjusted operating income.

The following table sets forth the composition of this portfolio as of the dates indicated.

|   | September 30, 2013 |            | December 31, 2012 |            |
|---|--------------------|------------|-------------------|------------|
|   | Amortized Cost     | Fair Value | Amortized Cost    | Fair Value |
| (in millions)   |                    |            |                   |            |
| Short-term investments and cash equivalents                             | \$ 1,119           | \$ 1,119   | \$ 938            | \$ 938     |
| Fixed maturities:   |                    |            |                   |            |
| Corporate securities  | 11,991             | 12,566     | 11,076            | 12,107     |
| Commercial mortgage-backed securities                                   | 2,382              | 2,420      | 2,096             | 2,229      |
| Residential mortgage-backed securities                                  | 1,731              | 1,729      | 1,965             | 2,026      |
| Asset-backed securities   | 1,177              | 1,187      | 1,179             | 1,116      |
| Foreign government bonds  | 613                | 627        | 683               | 708        |
| U.S. government authorities and agencies and obligations of U.S. states | 308                | 344        | 369               | 426        |
| Total fixed maturities  | 18,202             | 18,873     | 17,368            | 18,612     |
| Equity securities   | 899                | 1,139      | 943               | 1,040      |
| Total trading account assets supporting insurance liabilities           | \$ 20,220          | \$ 21,131  | \$ 19,249         | \$ 20,590  |

As a percentage of amortized cost, 78% and 75% of the portfolio was publicly traded as of September 30, 2013 and December 31, 2012, respectively. As of both September 30, 2013 and December 31, 2012, 93% of the fixed maturity portfolio was considered high or highest quality based on NAIC or equivalent rating. As of September 30, 2013, \$1.652 billion of the residential mortgage-backed securities were publicly traded agency pass-through securities, which are supported by implicit or explicit government guarantees, of which 99% have credit ratings of A or higher. Collateralized mortgage obligations, including approximately \$62 million secured by ALT-A mortgages, represented the remaining \$79 million of residential mortgage-backed securities, of which 31% have credit ratings of A or better and 69% are BBB and below. For a discussion of changes in the fair value of our trading account assets supporting insurance liabilities see [Experience-Rated Contractholder Liabilities, Trading Account Assets Supporting Insurance Liabilities and Other Related Investments](#), above.



**Table of Contents****Other Trading Account Assets**

Other trading account assets consist primarily of certain financial instruments that contain an embedded derivative where we elected to classify the entire instrument as a trading account asset rather than bifurcate. These instruments are carried at fair value, with realized and unrealized gains and losses reported in Asset management fees and other income, and excluded from adjusted operating income. Interest and dividend income from these investments is reported in Net investment income, and is included in adjusted operating income.

The following table sets forth the composition of our other trading account assets as of the dates indicated.

|   | September 30, 2013               |               |                          |               | December 31, 2012                |               |                          |               |
|---|----------------------------------|---------------|--------------------------|---------------|----------------------------------|---------------|--------------------------|---------------|
|   | Financial Services<br>Businesses |               | Closed Block<br>Business |               | Financial Services<br>Businesses |               | Closed Block<br>Business |               |
|   | Amortized<br>Cost                | Fair<br>Value | Amortized<br>Cost        | Fair<br>Value | Amortized<br>Cost                | Fair<br>Value | Amortized<br>Cost        | Fair<br>Value |
|   | (in millions)                    |               |                          |               |                                  |               |                          |               |
| Short-term investments and cash equivalents | \$ 0                             | \$ 0          | \$ 0                     | \$ 0          | \$ 1                             | \$ 1          | \$ 0                     | \$ 0          |
| Fixed maturities                            | 601                              | 602           | 146                      | 161           | 533                              | 452           | 127                      | 139           |
| Equity securities(1)                        | 686                              | 757           | 105                      | 121           | 933                              | 973           | 123                      | 136           |
| Total other trading account assets          | \$ 1,287                         | \$ 1,359      | \$ 251                   | \$ 282        | \$ 1,467                         | \$ 1,426      | \$ 250                   | \$ 275        |

(1) Included in equity securities are perpetual preferred stock securities that have characteristics of both debt and equity securities.

Included in the \$601 million of fixed maturities attributable to the Financial Services Businesses as of September 30, 2013, on an amortized cost basis, are \$184 million of asset-backed securities, 62% of which have credit ratings of A or above, 21% have BBB credit ratings, and the remaining 17% have BB and below credit ratings. Included in the \$146 million of fixed maturities attributable to the Closed Block Business as of September 30, 2013, on an amortized cost basis, are \$9 million of asset-backed securities, all of which have credit ratings of A or above.

**Commercial Mortgage and Other Loans****Investment Mix**

As of September 30, 2013 and December 31, 2012, respectively, we held approximately 10% and 9% of our general account investments in commercial mortgage and other loans. This percentage is net of a \$203 million and \$244 million allowance for losses as of September 30, 2013 and December 31, 2012, respectively.

The following table sets forth the composition of our commercial mortgage and other loans portfolio, before the allowance for losses, as of the dates indicated.



Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|   | September 30, 2013            |                       | December 31, 2012             |                       |
|---|-------------------------------|-----------------------|-------------------------------|-----------------------|
|   | Financial Services Businesses | Closed Block Business | Financial Services Businesses | Closed Block Business |
|   | (in millions)                 |                       |                               |                       |
| Commercial and agricultural mortgage loans          | \$ 27,644                     | \$ 9,790              | \$ 24,139                     | \$ 9,666              |
| Uncollateralized loans                              | 1,392                         | 45                    | 1,833                         | 0                     |
| Residential property loans                          | 600                           | 0                     | 790                           | 0                     |
| Other collateralized loans                          | 31                            | 0                     | 47                            | 0                     |
| <b>Total commercial mortgage and other loans(1)</b> | <b>\$ 29,667</b>              | <b>\$ 9,835</b>       | <b>\$ 26,809</b>              | <b>\$ 9,666</b>       |

(1) Excluded from the table above are commercial mortgage loans held outside the general account in other entities and operations. For additional information regarding commercial mortgage loans held outside the general account, see [Invested Assets of Other Entities and Operations](#) below.

## **Table of Contents**

We originate commercial and agricultural mortgage loans using a dedicated investment staff and a network of independent companies through our various regional offices. All loans are underwritten consistently to our standards using a proprietary quality rating system that has been developed from our experience in real estate and mortgage lending.

Uncollateralized loans primarily represent reverse dual currency loans and corporate loans which do not meet the definition of a security under authoritative accounting guidance.

Residential property loans primarily include Japanese recourse loans. Upon default of these recourse loans we can make a claim against the personal assets of the property owner, in addition to the mortgaged property. These loans are also backed by third party guarantors.

Other collateralized loans attributable to the Financial Services Businesses include \$31 million and \$45 million of collateralized consumer loans as of September 30, 2013 and December 31, 2012, respectively.

### *Composition of Commercial and Agricultural Mortgage Loans*

The commercial real estate market was severely impacted by the financial crisis and the subsequent recession, though the flow of capital to commercial real estate has been strong since 2010. Portfolio lenders have been actively originating loans, focusing primarily on higher quality properties in major markets, resulting in an increase in the liquidity and availability of capital in the commercial mortgage loan market. For most property types, the market fundamentals are stable or improving. In addition, the commercial banks are active and there has been increased loan origination activity by securitization lenders as commercial mortgage market spreads have generally tightened. These conditions have led to greater competition for portfolio lenders such as our general account, though underwriting remains conservative. Commercial real estate fundamentals continue to improve while employment growth has been modest, and delinquency rates on our commercial mortgage loans remain low, from an historic standpoint, and are stable. For additional information see [Realized Investment Gains and Losses](#) above.

**Table of Contents**

Our commercial and agricultural mortgage loan portfolio strategy emphasizes diversification by property type and geographic location. The following tables set forth the breakdown of the gross carrying values of our general account investments in commercial and agricultural mortgage loans by geographic region and property type as of the dates indicated.

|   | September 30, 2013               |               |                            |               | December 31, 2012                |               |                            |               |
|---|----------------------------------|---------------|----------------------------|---------------|----------------------------------|---------------|----------------------------|---------------|
|   | Financial Services<br>Businesses |               | Closed Block<br>Business   |               | Financial Services<br>Businesses |               | Closed Block<br>Business   |               |
|   | Gross<br>Carrying<br>Value       | % of<br>Total | Gross<br>Carrying<br>Value | % of<br>Total | Gross<br>Carrying<br>Value       | % of<br>Total | Gross<br>Carrying<br>Value | % of<br>Total |
| (\$ in millions)                                  |                                  |               |                            |               |                                  |               |                            |               |
| <b>Commercial and agricultural mortgage loans</b> |                                  |               |                            |               |                                  |               |                            |               |
| <b>by region:</b>                                 |                                  |               |                            |               |                                  |               |                            |               |
| U.S. Regions:                                     |                                  |               |                            |               |                                  |               |                            |               |
| Pacific   | \$ 8,240                         | 29.9%         | \$ 3,367                   | 34.4%         | \$ 7,600                         | 31.5%         | \$ 3,423                   | 35.4%         |
| South Atlantic                                    | 5,755                            | 20.8          | 1,824                      | 18.6          | 4,846                            | 20.1          | 1,814                      | 18.8          |
| Middle Atlantic                                   | 3,807                            | 13.8          | 1,920                      | 19.6          | 3,706                            | 15.3          | 2,050                      | 21.2          |
| East North Central                                | 2,584                            | 9.3           | 705                        | 7.2           | 2,000                            | 8.3           | 570                        | 5.9           |
| West South Central                                | 2,769                            | 10.0          | 818                        | 8.4           | 2,220                            | 9.2           | 730                        | 7.6           |
| Mountain  | 1,338                            | 4.8           | 266                        | 2.7           | 1,254                            | 5.2           | 350                        | 3.6           |
| New England                                       | 904                              | 3.3           | 389                        | 4.0           | 638                              | 2.6           | 323                        | 3.3           |
| West North Central                                | 574                              | 2.1           | 106                        | 1.1           | 466                              | 1.9           | 137                        | 1.4           |
| East South Central                                | 307                              | 1.1           | 137                        | 1.4           | 305                              | 1.3           | 142                        | 1.5           |
| Subtotal-U.S.                                     | 26,278                           | 95.1          | 9,532                      | 97.4          | 23,035                           | 95.4          | 9,539                      | 98.7          |
| Asia  | 753                              | 2.7           | 0                          | 0.0           | 648                              | 2.7           | 0                          | 0.0           |
| Other   | 613                              | 2.2           | 258                        | 2.6           | 456                              | 1.9           | 127                        | 1.3           |
| Total commercial and agricultural mortgage loans  | \$ 27,644                        | 100.0%        | \$ 9,790                   | 100.0%        | \$ 24,139                        | 100.0%        | \$ 9,666                   | 100.0%        |

|   | September 30, 2013               |               |                            |               | December 31, 2012                |               |                            |               |
|---|----------------------------------|---------------|----------------------------|---------------|----------------------------------|---------------|----------------------------|---------------|
|   | Financial Services<br>Businesses |               | Closed Block<br>Business   |               | Financial Services<br>Businesses |               | Closed Block<br>Business   |               |
|   | Gross<br>Carrying<br>Value       | % of<br>Total | Gross<br>Carrying<br>Value | % of<br>Total | Gross<br>Carrying<br>Value       | % of<br>Total | Gross<br>Carrying<br>Value | % of<br>Total |
| (\$ in millions)  |                                  |               |                            |               |                                  |               |                            |               |
| <b>Commercial and agricultural mortgage loans by property type:</b> |                                  |               |                            |               |                                  |               |                            |               |
| Industrial  | \$ 5,807                         | 21.0%         | \$ 1,659                   | 17.0%         | \$ 5,832                         | 24.1%         | \$ 1,804                   | 18.7%         |
| Retail  | 6,043                            | 21.9          | 2,646                      | 27.0          | 5,449                            | 22.6          | 2,658                      | 27.5          |
| Office  | 5,262                            | 19.0          | 2,539                      | 25.9          | 4,459                            | 18.5          | 2,363                      | 24.4          |
| Apartments/Multi-Family   | 5,236                            | 18.9          | 1,179                      | 12.0          | 3,879                            | 16.1          | 1,159                      | 12.0          |
| Other   | 2,424                            | 8.8           | 563                        | 5.8           | 2,203                            | 9.1           | 598                        | 6.2           |
| Agricultural properties   | 1,528                            | 5.5           | 612                        | 6.2           | 1,468                            | 6.1           | 645                        | 6.7           |
| Hospitality   | 1,344                            | 4.9           | 592                        | 6.1           | 849                              | 3.5           | 439                        | 4.5           |
| Total commercial and agricultural mortgage loans                    | \$ 27,644                        | 100.0%        | \$ 9,790                   | 100.0%        | \$ 24,139                        | 100.0%        | \$ 9,666                   | 100.0%        |

Loan-to-value and debt service coverage ratios are measures commonly used to assess the quality of commercial and agricultural mortgage loans. The loan-to-value ratio compares the amount of the loan to the fair value of the underlying property collateralizing the loan, and is

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

commonly expressed as a percentage. Loan-to-value ratios greater than 100% indicate that the loan amount is greater than the collateral value. A smaller loan-to-value ratio indicates a greater excess of collateral value over the loan amount. The debt service coverage ratio

**Table of Contents**

compares a property's net operating income to its debt service payments. Debt service coverage ratios less than 1.0 times indicate that property operations do not generate enough income to cover the loan's current debt payments. A larger debt service coverage ratio indicates a greater excess of net operating income over the debt service payments.

As of September 30, 2013, our general account investments in commercial and agricultural mortgage loans attributable to the Financial Services Businesses had a weighted average debt service coverage ratio of 2.09 times, and a weighted average loan-to-value ratio of 57%. As of September 30, 2013, approximately 96% of commercial and agricultural mortgage loans attributable to the Financial Services Businesses were fixed rate loans. As of September 30, 2013, our general account investments in commercial and agricultural mortgage loans attributable to the Closed Block Business had a weighted average debt service coverage ratio of 2.08 times, and a weighted average loan-to-value ratio of 53%. As of September 30, 2013, all of the commercial and agricultural mortgage loans attributable to the Closed Block Business were fixed rate loans. For those general account commercial and agricultural mortgage loans attributable to the Financial Services Businesses that were originated in 2013, the weighted average debt service coverage ratio was 2.56 times and the weighted average loan-to-value ratio was 63%.

The values utilized in calculating these loan-to-value ratios are developed as part of our periodic review of the commercial and agricultural mortgage loan portfolio, which includes an internal evaluation of the underlying collateral value. Our periodic review also includes a quality re-rating process, whereby we update the internal quality rating originally assigned at underwriting based on the proprietary quality rating system mentioned above. As discussed below, the internal quality rating is a key input in determining our allowance for loan losses.

For loans with collateral under construction, renovation or lease-up, a stabilized value and projected net operating income are used in the calculation of the loan-to-value and debt service coverage ratios. Our commercial and agricultural mortgage loan portfolio attributable to the Financial Services Businesses included approximately \$0.6 billion and \$0.5 billion of such loans as of September 30, 2013 and December 31, 2012, respectively, and our commercial and agricultural mortgage loan portfolio attributable to the Closed Block Business included approximately \$0.1 billion of such loans as of both September 30, 2013 and December 31, 2012. All else being equal, these loans are inherently more risky than those collateralized by properties that have already stabilized; however, improvement in the general risk profile of our overall commercial mortgage loan portfolio has enabled us to pursue incremental volume in this area. As of September 30, 2013, there are no loan-specific reserves related to these loans attributable to the Financial Services Businesses or the Closed Block Business. In addition, these pre-stabilized loans are included in the calculation of our portfolio reserve as discussed below. For information regarding similar loans we hold as part of our commercial and agricultural mortgage operations, see [Invested Assets of Other Entities and Operations](#) below.

**Table of Contents**

The following tables set forth the gross carrying value of our general account investments in commercial and agricultural mortgage loans attributable to the Financial Services Businesses and the Closed Block Business as of the dates indicated by loan-to-value and debt service coverage ratios.

**Commercial and Agricultural Mortgage Loans by Loan-to-Value and Debt Service Coverage Ratios Financial Services Businesses**

| Loan-to-Value Ratio                                     | September 30, 2013          |                   |                      | Total<br>Commercial<br>and Agricultural<br>Mortgage<br>Loans |
|---|-----------------------------|-------------------|----------------------|--|
|   | Debt Service Coverage Ratio |                   |                      |  |
|   | Greater<br>than<br>1.2x     | 1.0x to<br>< 1.2x | Less<br>than<br>1.0x |  |
|   | (in millions)               |                   |                      |  |
| 0%-59.99%   | \$ 13,686                   | \$ 540            | \$ 186               | \$ 14,412  |
| 60%-69.99%  | 8,296                       | 398               | 73                   | 8,767  |
| 70%-79.99%  | 3,085                       | 575               | 185                  | 3,845  |
| Greater than 80%  | 197                         | 130               | 293                  | 620  |
| <b>Total commercial and agricultural mortgage loans</b> | <b>\$ 25,264</b>            | <b>\$ 1,643</b>   | <b>\$ 737</b>        | <b>\$ 27,644</b>   |

**Commercial and Agricultural Mortgage Loans by Loan-to-Value and Debt Service Coverage Ratios Closed Block Business**

| Loan-to-Value Ratio                                     | September 30, 2013          |                   |                      | Total<br>Commercial<br>and Agricultural<br>Mortgage<br>Loans |
|---|-----------------------------|-------------------|----------------------|--|
|   | Debt Service Coverage Ratio |                   |                      |  |
|   | Greater<br>than<br>1.2x     | 1.0x to<br>< 1.2x | Less<br>than<br>1.0x |  |
|   | (in millions)               |                   |                      |  |
| 0%-59.99%   | \$ 5,542                    | \$ 284            | \$ 70                | \$ 5,896   |
| 60%-69.99%  | 2,904                       | 50                | 34                   | 2,988  |
| 70%-79.99%  | 546                         | 197               | 43                   | 786  |
| Greater than 80%  | 32                          | 38                | 50                   | 120  |
| <b>Total commercial and agricultural mortgage loans</b> | <b>\$ 9,024</b>             | <b>\$ 569</b>     | <b>\$ 197</b>        | <b>\$ 9,790</b>  |

The following table sets forth the breakdown of our commercial and agricultural mortgage loans by year of origination as of September 30, 2013.

| Year of Origination | September 30, 2013  |               |   |               |
|---------------------|---|---------------|---|---------------|
|                     | Financial Services Businesses<br>Gross<br>Carrying<br>Value | % of<br>Total | Closed Block Business<br>Gross<br>Carrying<br>Value | % of<br>Total |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|  | (\$ in millions) |        |          |        |
|--|------------------|--------|----------|--------|
| 2013   | \$ 6,233         | 22.5%  | \$ 1,182 | 12.1%  |
| 2012   | 4,941            | 17.9   | 1,815    | 18.6   |
| 2011   | 4,831            | 17.5   | 1,413    | 14.4   |
| 2010   | 2,910            | 10.5   | 1,025    | 10.5   |
| 2009   | 1,076            | 3.9    | 393      | 4.0    |
| 2008   | 1,873            | 6.8    | 746      | 7.6    |
| 2007 & prior                                     | 5,780            | 20.9   | 3,216    | 32.8   |
| Total commercial and agricultural mortgage loans | \$ 27,644        | 100.0% | \$ 9,790 | 100.0% |

**Table of Contents***Commercial Mortgage and Other Loan Quality*

Ongoing review of the portfolio is performed and loans are placed on watch list status based on a predefined set of criteria, where they are assigned to one of the following categories. We place loans on early warning status in cases where, based on our analysis of the loan's collateral, the financial situation of the borrower or tenants or other market factors, we believe a loss of principal or interest could occur. We classify loans as closely monitored when we determine there is a collateral deficiency or other credit events that may lead to a potential loss of principal or interest. Loans not in good standing are those loans where we have concluded that there is a high probability of loss of principal, such as when the loan is in the process of foreclosure or the borrower is in bankruptcy. In our domestic operations, our workout and special servicing professionals manage the loans on the watch list. As described below, in determining our allowance for losses, we evaluate each loan on the watch list to determine if it is probable that amounts due according to the contractual terms of the loan agreement will not be collected. In our international portfolios, we monitor delinquency in consumer loans on a pool basis and evaluate any servicing relationship and guarantees the same way we do for commercial mortgage loans.

We establish an allowance for losses to provide for the risk of credit losses inherent in the lending process. The allowance includes loan specific reserves for loans that are determined to be impaired as a result of our loan review process and a portfolio reserve for probable incurred but not specifically identified losses for loans which are not on the watch list. We define an impaired loan as a loan for which we estimate it is probable that amounts due according to the contractual terms of the loan agreement will not be collected. The loan specific portion of the loss allowance is based on our assessment as to ultimate collectability of loan principal and interest. Valuation allowances for an impaired loan are recorded based on the present value of expected future cash flows discounted at the loan's effective interest rate or based on the fair value of the collateral if the loan is collateral dependent. The portfolio reserve for incurred but not specifically identified losses considers the current credit composition of the portfolio based on the internal quality ratings mentioned above. The portfolio reserves are determined using past loan experience, including historical credit migration, loss probability, and loss severity factors by property type. These factors are reviewed and updated as appropriate. The valuation allowance for commercial mortgage and other loans can increase or decrease from period to period based on these factors.

Our general account investments in commercial mortgage and other loans attributable to the Financial Services Businesses, based upon the recorded investment gross of allowance for credit losses, was \$29.667 billion and \$26.809 billion as of September 30, 2013 and December 31, 2012, respectively. As a percentage of recorded investment gross of allowance, more than 99% of the assets were current for both periods.

Our general account investments in commercial mortgage and other loans attributable to the Closed Block Business, based upon the recorded investment gross of allowance for credit losses, was \$9.835 billion and \$9.666 billion as of September 30, 2013 and December 31, 2012, respectively. As a percentage of recorded investment gross of allowance, more than 99% of the assets were current as of September 30, 2013 and December 31, 2012, respectively.

The following table sets forth the change in valuation allowances for our commercial mortgage and other loan portfolio as of the dates indicated:

|   | September 30, 2013            |                       | December 31, 2012             |                       |
|---|-------------------------------|-----------------------|-------------------------------|-----------------------|
|   | Financial Services Businesses | Closed Block Business | Financial Services Businesses | Closed Block Business |
|   | (in millions)                 |                       |                               |                       |
| Allowance, beginning of year                  | \$ 186                        | \$ 58                 | \$ 250                        | \$ 60                 |
| Addition to/(release of) allowance for losses | 1                             | (8)                   | (11)                          | (2)                   |
| Charge-offs, net of recoveries                | (27)                          | (3)                   | (51)                          | 0                     |
| Change in foreign exchange                    | (4)                           | 0                     | (2)                           | 0                     |



Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|                          |        |       |        |       |
|--------------------------|--------|-------|--------|-------|
| Allowance, end of period | \$ 156 | \$ 47 | \$ 186 | \$ 58 |
| Loan specific reserve    | \$ 10  | \$ 3  | \$ 41  | \$ 7  |
| Portfolio reserve        | \$ 146 | \$ 44 | \$ 145 | \$ 51 |

**Table of Contents****Equity Securities***Investment Mix*

The equity securities attributable to the Financial Services Businesses consist principally of investments in common and preferred stock of publicly-traded companies as well as mutual fund shares. The following table sets forth the composition of our equity securities portfolio attributable to the Financial Services Businesses and the associated gross unrealized gains and losses as of the dates indicated.

**Equity Securities Financial Services Businesses**

|                                 | September 30, 2013 |                              |                               | December 31, 2012              |          |                              |                               |               |
|---------------------------------|--------------------|------------------------------|-------------------------------|--------------------------------|----------|------------------------------|-------------------------------|---------------|
|                                 | Cost               | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value<br>(in millions) | Cost     | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
| Non-redeemable preferred stocks | \$ 18              | \$ 5                         | \$ 1                          | \$ 22                          | \$ 15    | \$ 2                         | \$ 0                          | \$ 17         |
| Mutual fund common stocks(1)    | 2,156              | 511                          | 2                             | 2,665                          | 1,874    | 516                          | 0                             | 2,390         |
| Other common stocks             | 2,103              | 718                          | 22                            | 2,799                          | 2,392    | 274                          | 42                            | 2,624         |
| Total equity securities(2)      | \$ 4,277           | \$ 1,234                     | \$ 25                         | \$ 5,486                       | \$ 4,281 | \$ 792                       | \$ 42                         | \$ 5,031      |

(1) Includes mutual fund shares representing our interest in the underlying assets of certain of our separate account investments supporting corporate-owned life insurance. These mutual funds invest primarily in high yield bonds.

(2) Amounts presented exclude hedge funds and other alternative investments which are reported in Other long-term investments.

The following table sets forth the composition of our equity securities portfolio attributable to the Closed Block Business and the associated gross unrealized gains and losses as of the dates indicated.

**Equity Securities Closed Block Business**

|                                 | September 30, 2013 |                              |                               | December 31, 2012              |          |                              |                               |               |
|---------------------------------|--------------------|------------------------------|-------------------------------|--------------------------------|----------|------------------------------|-------------------------------|---------------|
|                                 | Cost               | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value<br>(in millions) | Cost     | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
| Non-redeemable preferred stocks | \$ 0               | \$ 0                         | \$ 0                          | \$ 0                           | \$ 10    | \$ 2                         | \$ 0                          | \$ 12         |
| Mutual fund common stocks       | 8                  | 4                            | 0                             | 12                             | 0        | 0                            | 0                             | 0             |
| Other common stocks             | 2,397              | 1,103                        | 16                            | 3,484                          | 2,447    | 779                          | 13                            | 3,213         |
| Total equity securities         | \$ 2,405           | \$ 1,107                     | \$ 16                         | \$ 3,496                       | \$ 2,457 | \$ 781                       | \$ 13                         | \$ 3,225      |

*Other-Than-Temporary Impairments of Equity Securities*

For those equity securities classified as available-for-sale, we record unrealized gains and losses to the extent cost is different from estimated fair value. All securities with unrealized losses are subject to our review to identify other-than-temporary impairments in value. For additional information regarding our policies regarding other-than-temporary impairments for equity securities see Note 2 to the Unaudited Interim Consolidated Financial Statements.

Impairments of equity securities attributable to the Financial Services Businesses were \$1 million and \$21 million for the three months ended September 30, 2013, and 2012, respectively, and \$9 million and \$93 million for the nine months ended September 30, 2013, and 2012, respectively. Impairments of equity securities attributable to the Closed Block Business were \$2 million and \$3 million for the three months ended September 30, 2013, and 2012, respectively, and \$2 million and \$21 million for the nine months ended September 30, 2013, and 2012, respectively. For a further discussion of impairments, see [Realized Investment Gains and Losses](#) above.

**Table of Contents****Other Long-Term Investments**

The following table sets forth the composition of Other long-term investments as of the dates indicated.

|  | September 30, 2013            |                       | December 31, 2012             |                       |
|--|-------------------------------|-----------------------|-------------------------------|-----------------------|
|  | Financial Services Businesses | Closed Block Business | Financial Services Businesses | Closed Block Business |
|  | (in millions)                 |                       |                               |                       |
| Joint ventures and limited partnerships:     |                               |                       |                               |                       |
| Real estate-related                          | \$ 271                        | \$ 475                | \$ 320                        | \$ 504                |
| Non-real estate-related                      | 3,868                         | 1,698                 | 3,861                         | 1,538                 |
| Real estate held through direct ownership(1) | 1,453                         | 0                     | 1,602                         | 0                     |
| Other(2)                                     | 1,086                         | (208)                 | 882                           | (30)                  |
| Total other long-term investments            | \$ 6,678                      | \$ 1,965              | \$ 6,665                      | \$ 2,012              |

(1) Primarily includes investments in office buildings within our Japanese insurance operations.

(2) Primarily includes derivatives and member and activity stock held in the Federal Home Loan Banks of New York and Boston. For additional information regarding our holdings in the Federal Home Loan Banks of New York and Boston, see Note 9 to the Unaudited Interim Consolidated Financial Statements.

**Invested Assets of Other Entities and Operations**

Invested Assets of Other Entities and Operations includes investments held outside the general account and primarily represents investments associated with our asset management and derivative operations. Our derivative operation acts on behalf of affiliates primarily to manage interest rate, foreign currency, credit, and equity exposures. Assets within our asset management operations managed for third parties and those assets classified as Separate account assets on our balance sheet are not included.

The following table sets forth the composition of investments held outside the general account, based on the parameters described above, as of the dates indicated.

|   | September 30, | December 31, |
|---|---------------|--------------|
|   | 2013          | 2012         |
|   | (in millions) |              |
| Fixed Maturities:                                     |               |              |
| Public, available-for-sale, at fair value             | \$ 262        | \$ 272       |
| Private, available-for-sale, at fair value            | 86            | 93           |
| Other trading account assets, at fair value(1)        | 4,762         | 4,627        |
| Equity securities, available-for-sale, at fair value  | 2             | 21           |
| Commercial mortgage and other loans, at book value(2) | 198           | 502          |
| Other long-term investments                           | 1,226         | 1,351        |
| Short-term investments                                | 262           | 62           |
| Total investments                                     | \$ 6,798      | \$ 6,928     |

- (1) Primarily related to our derivative operation used to manage interest rate, foreign currency, credit and equity exposures as well as assets associated with consolidated variable interest entities for which the Company is the investment manager. For further information on these consolidated variable interest entities, see Note 5 to the Unaudited Interim Consolidated Financial Statements.
- (2) Book value is generally based on unpaid principal balance net of any allowance for losses, the lower of cost or fair value, or fair value, depending on the loan.

*Commercial Mortgage and Other Loans*

Our asset management operations include our commercial mortgage operations, which provide mortgage origination, asset management and servicing for our general account, institutional clients, and government sponsored entities such as Fannie Mae, the Federal Housing Administration, and Freddie Mac.

**Table of Contents**

We also carry shorter-term interim loans for spread lending that are collateralized by assets generally under renovation or lease up. All else being equal, these interim loans are inherently more risky than those collateralized by properties that have already stabilized. Our interim loans are generally paid off through refinancing or the sale of the underlying collateral by the borrower.

The following table sets forth information regarding the interim loan portfolio held outside the general account in other entities and operations as of the dates indicated.

|  | September 30,<br>2013 | December 31,<br>2012 |
|--|-----------------------|----------------------|
|  | (\$ in millions)      |                      |
| <b>Interim Loan Portfolio:</b>                   |                       |                      |
| Principal balance of loans outstanding           | \$ 45                 | \$ 239               |
| Allowance for credit or valuation-related losses | \$ 3                  | \$ 14                |
| Weighted average loan-to-value ratio(1)          | 89%                   | 91%                  |
| Weighted average debt service coverage ratio(1)  | 1.41                  | 1.25                 |

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

As of September 30, 2013, we hold no commercial real estate held-for-sale related to foreclosed interim loans. The mortgage loans of our commercial mortgage operations are included in Commercial mortgage and other loans, with related derivatives and other hedging instruments primarily included in Other trading account assets and Other long-term investments.

*Other Long-Term Investments*

Other long-term investments include strategic investments made as part of our asset management operations. We make these strategic investments in real estate, as well as fixed income, public equity and real estate securities, including controlling interests. Certain of these investments are made primarily for purposes of co-investment in our managed funds and structured products. Other strategic investments are made with the intention to sell or syndicate to investors, including our general account, or for placement in funds and structured products that we offer and manage (seed investments). As part of our asset management operations, we also make loans to our managed funds that are secured by equity commitments from investors or assets of the funds. Other long-term investments also include certain assets in consolidated investment funds where the Company is deemed to exercise control over these funds.

**Liquidity and Capital Resources**

This section supplements, and should be read in conjunction with, Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources included in our Annual Report on Form 10-K for the year ended December 31, 2012.

**Overview**

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Liquidity refers to the ability to generate sufficient cash resources to meet the payment obligations of the Company. Capital refers to the long term financial resources available to support the operations of our businesses, fund business growth, and provide a cushion to withstand adverse circumstances. Our ability to generate and maintain sufficient liquidity and capital depends on the profitability of our businesses, general economic conditions and our access to the capital markets and the alternate sources of liquidity and capital described herein.

Effective and prudent liquidity and capital management is a priority across the organization. Management monitors the liquidity of Prudential Financial and its subsidiaries on a daily basis and projects borrowing and capital needs over a multi-year time horizon through our quarterly planning process. We believe that cash flows

**Table of Contents**

from the sources of funds available to us are sufficient to satisfy the current liquidity requirements of Prudential Financial and its subsidiaries, including under reasonably foreseeable stress scenarios. We have a capital management framework in place that facilitates the allocation of capital and approval of capital uses, and we forecast capital sources and uses on a quarterly basis. We also employ a Capital Protection Framework to ensure the availability of capital resources in order to maintain adequate capitalization on a consolidated basis and competitive risk-based capital ratios and solvency margins for our insurance subsidiaries under various stress scenarios.

On September 19, 2013, the Financial Stability Oversight Council made a final determination that Prudential Financial should be subject to stricter prudential regulatory standards and supervision by the Board of Governors of the Federal Reserve System (as a Covered Company) under the Dodd-Frank Act. As a Covered Company under the Dodd-Frank Act, Prudential Financial is now subject to stricter prudential regulatory standards, which include or will include requirements (some of which are subject to future rulemaking) regarding risk-based capital, leverage, liquidity and stress-testing, and may also include additional standards regarding capital, short-term debt limits and other related subjects as appropriate. In addition, the Financial Stability Board, consisting of representatives of national financial authorities of the G20 nations, identified the Company as a global systemically important insurer. For information on these recent actions and their potential impact on us, see Executive Summary Regulatory Developments above, as well as Business Regulation and Risk Factors included in our 2012 Annual Report on Form 10-K.

During the nine months ended September 30, 2013, we took the following significant actions that impacted our liquidity and capital position:

We repositioned Prudential Financial's capital structure through a \$1.1 billion net reduction in senior notes outstanding and a \$0.3 billion net increase in junior subordinated notes outstanding;

We repurchased \$500 million of shares of our Common Stock and declared aggregate Common Stock dividends of \$563 million; and

We made an investment in our Individual Life business through our acquisition of the Hartford Life Business.

**Capital**

The primary components of capitalization for the Financial Services Businesses consist of the equity we attribute to the Financial Services Businesses and outstanding capital debt, including junior subordinated debt, of the Financial Services Businesses. As shown in the table below, as of September 30, 2013 the Financial Services Businesses had \$37.2 billion in capital, all of which was available to support the aggregate capital requirements of its three divisions and its Corporate and Other operations. Based on our assessment of these businesses and operations, we believe this level of capital is consistent with our ratings targets.

|   | September 30,<br>2013 | December 31,<br>2012 |
|---|-----------------------|----------------------|
|   | (in millions)         |                      |
| Attributed Equity(1)                              | \$ 26,128             | \$ 27,088            |
| Junior subordinated debt (i.e. hybrid securities) | 4,884                 | 4,594                |
| Other capital debt                                | 6,170                 | 6,049                |
| Total capital                                     | \$ 37,182             | \$ 37,731            |



## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

- (1) Excludes AOCI. This amount may be subject to volatility due to, among other things, the impact of foreign currency exchange rate movements on certain non-yen denominated assets and liabilities within our Japanese insurance operations, for which the foreign currency exposure is economically matched and offset in AOCI (see Results of Operations for Financial Services Businesses by Segment International Insurance Division Impact of foreign currency exchange rate movements on earnings U.S. GAAP earnings impact of products denominated in non-local currencies for additional information).

**Table of Contents**

We manage Prudential Insurance, Prudential of Japan, Gibraltar Life, and our other domestic and international insurance subsidiaries to regulatory capital levels consistent with our AA ratings targets. We utilize the Risk-Based Capital, or RBC, ratio as a primary measure of the capital adequacy of our domestic insurance subsidiaries and the Solvency Margin ratio as a primary measure of the capital adequacy of our Japanese insurance subsidiaries.

The table below presents the RBC ratios of certain of our domestic insurance subsidiaries as of December 31, 2012<sup>(1)</sup>, the most recent statutory fiscal year-end and RBC filing date for these subsidiaries:

|   |       |
|---|-------|
| Prudential Insurance                            | 456 % |
| Prudential Annuities Life Assurance Corporation | 421 % |

- (1) The RBC ratio calculations are intended to assist insurance regulators in measuring an insurer's solvency and ability to pay future claims. The reporting of RBC measures is not intended for the purpose of ranking any insurance company or for use in connection with any marketing, advertising or promotional activities, but is available to the public.

The table below presents the solvency margins of our most significant international insurance subsidiaries as of March 31, 2013, the most recent statutory fiscal year-end, and June 30, 2013, the most recent solvency margin filing date for these subsidiaries:

|                                | As of June 30,<br>2013 | As of March 31,<br>2013 |
|--------------------------------|------------------------|-------------------------|
| Prudential of Japan            | 728%                   | 749%                    |
| Gibraltar Life consolidated(1) | 899%                   | 896%                    |

- (1) Reflects the merger of the acquired Star and Edison entities with Gibraltar Life, which became effective January 1, 2012, and includes Prudential Gibraltar, a wholly-owned subsidiary of Gibraltar Life.

All of our domestic and international insurance subsidiaries have capital levels that substantially exceed the minimum level required by applicable insurance regulations.

The regulatory capital levels of our domestic and international insurance subsidiaries can be materially impacted by interest rates, equity market and real estate market fluctuations, changes in the values of derivatives, the level of impairments recorded, credit quality migration of the investment portfolio, foreign exchange rate movements and business growth, among other items. In addition, particularly for our domestic insurance subsidiaries, the recapture of business subject to third-party reinsurance arrangements due to defaults by, or credit quality migration affecting, the third-party reinsurers or for other reasons could result in higher required statutory capital levels. Our regulatory capital levels are also affected by statutory accounting rules, which are subject to change by each applicable insurance regulator.

We employ a Capital Protection Framework to ensure that sufficient capital resources are available to maintain adequate capitalization on a consolidated basis and competitive RBC ratios and solvency margins for our insurance subsidiaries under various stress scenarios. The Capital Protection Framework incorporates the potential impacts from market related stresses, including equity markets, real estate, interest rates, credit losses, and foreign currency exchange rates. Potential sources of capital include on-balance sheet capital, derivatives, reinsurance and contingent sources of capital. Although we continue to enhance our approach, we believe we currently have access to sufficient resources to maintain adequate capitalization and competitive RBC ratios and solvency margins under a range of potential stress scenarios.

*Captive Reinsurance Companies*

We use captive reinsurance companies in our domestic insurance operations to more effectively manage our reserves and capital on an economic basis and to enable the aggregation and transfer of risks. Our captive reinsurance companies assume business from affiliates only. To support the risks they assume, our captives are capitalized to a level we believe is consistent with the AA financial strength rating targets of our insurance subsidiaries. All of our captive reinsurance companies are wholly-owned subsidiaries and are located

## **Table of Contents**

domestically, typically in the state of domicile of the direct writing insurance subsidiary that cedes the majority of business to the captive. In addition to state insurance regulation, our captives are subject to internal policies governing their activities. Prudential Financial provides support to these captives through net worth maintenance agreements and in the normal course of business will contribute capital to the captives to support business growth and other needs. In addition, in connection with financing arrangements, Prudential Financial guarantees certain of the captives' obligations.

Recently, the NAIC, the New York State Department of Financial Services and other regulators have increased their focus on life insurers' use of captive reinsurance companies. We cannot predict what, if any, changes may result from these reviews. If insurance laws are changed in a way that impairs the use of captive reinsurance companies, our ability to write certain products and efficiently manage their associated risks could be adversely affected and we may need to increase prices on certain products, modify certain products or find alternate financing sources, any of which could adversely affect our competitiveness, capital and financial position and results of operations.

Our domestic life insurance subsidiaries are subject to a regulation entitled "Valuation of Life Insurance Policies," commonly known as "Regulation XXX," and a supporting guideline entitled "The Application of the Valuation of Life Insurance Policies," commonly known as "Guideline AXXX." The regulation and supporting guideline require insurers to establish statutory reserves for term and universal life insurance policies with long-term premium guarantees that are consistent with the statutory reserves required for other individual life insurance policies with similar guarantees. Many market participants believe that these levels of reserves are non-economic. We use captive reinsurance companies to implement reinsurance and capital management actions to satisfy these reserve requirements by financing the non-economic reserves through the issuance of surplus notes by the captives, which are treated as capital for statutory purposes.

We reinsure living benefit guarantees on certain variable annuity and retirement products from our domestic life insurance companies to a captive reinsurance company, Pruco Reinsurance, Ltd., or Pruco Re. This enables us to aggregate these risks within Pruco Re and manage them more efficiently through a hedging program. We believe Pruco Re currently maintains an adequate level of capital and has access to liquidity to support this hedging program. However, as discussed below under "Liquidity associated with other activities," Hedging activities associated with living benefit guarantees, Pruco Re's capital and liquidity needs can vary significantly due to, among other things, changes in equity markets, interest rates, mortality and policyholder behavior. Through our Capital Protection Framework, we hold on-balance sheet capital and maintain access to committed sources of capital that are available to meet these needs as they arise.

We reinsure 90% of the short-term risks of Prudential Insurance's Closed Block Business to a captive reinsurance company domiciled in New Jersey. These short-term risks represent the impact of variations in experience of the Closed Block that are expected to be recovered over time as a result of corresponding adjustments to policyholder dividends. The reinsurance arrangement is intended to alleviate the short-term statutory surplus volatility within Prudential Insurance resulting from the Closed Block Business, including volatility caused by the impact of any unrealized mark-to-market losses and realized credit losses within the investment portfolio. In October 2011, in connection with the Closed Block reinsurance arrangement, we entered into a \$2 billion letter of credit facility with certain financial institutions, pursuant to which the New Jersey captive can obtain a letter of credit during a 3-year availability period to support its funding obligations under the reinsurance arrangement. Prudential Financial guarantees all obligations of the New Jersey captive under the facility, including its obligation to reimburse any draws made under a letter of credit. Because experience of the Closed Block is ultimately passed along to policyholders over time through the annual policyholder dividend, we believe that any draw under a letter of credit is unlikely. Our ability to obtain a letter of credit under the facility is subject to the continued satisfaction of customary conditions similar to those contained in our credit facilities described in Note 9 to our Unaudited Interim Consolidated Financial Statements.

**Table of Contents****Shareholder Distributions**

In June 2013, our Board of Directors authorized the Company to repurchase at management's discretion up to \$1.0 billion of its outstanding Common Stock during the period from July 1, 2013 through June 30, 2014. This authorization supersedes the Board's previous \$1.0 billion repurchase authority that covered the prior twelve-month period. A total of 6.6 million shares of our Common Stock were repurchased under the prior authorization for a total cost of \$400 million. The timing and amount of any future share repurchases will be determined by management based on market conditions and other considerations, including increased capital needs of our businesses due to changes in regulatory capital requirements and opportunities for growth and acquisitions. The following table sets forth information about repurchases of shares of Prudential Financial's Common Stock, as well as declarations of Common Stock dividends during each of the three months ended March 31, June 30 and September 30, 2013:

| Three months ended: | Dividend Amount |   | Shares Repurchased |            |
|---------------------|-----------------|---|--------------------|------------|
|                     | Per Share       | Aggregate<br>(in millions, except per share data) | Shares             | Total Cost |
| March 31, 2013      | \$ 0.40         | \$ 188  |                    | \$         |
| June 30, 2013       | \$ 0.40         | \$ 188  | 3.9                | \$ 250     |
| September 30, 2013  | \$ 0.40         | \$ 187  | 3.2                | \$ 250     |

**Liquidity**

Liquidity management and stress testing are performed on a legal entity basis as the ability to transfer funds between subsidiaries is limited due in part to regulatory restrictions. Liquidity needs are determined through daily and quarterly cash flow forecasting at the holding company and within our operating subsidiaries. A minimum cash balance of \$1.3 billion is targeted to ensure adequate liquidity is available at Prudential Financial to cover fixed expenses in the event that we experience reduced cash flows from our operating subsidiaries. This targeted minimum balance is reviewed and approved annually by the Finance Committee of the Board of Directors.

To mitigate the risk of having limited or no access to financing due to stressed market conditions, we aim to prefund capital debt in advance of maturity. We mitigate the refinancing risk associated with our debt that is used to fund operating needs by matching the term of debt with the assets financed. Short term financing, such as commercial paper, is used to fund short term needs only. To ensure adequate liquidity in stress scenarios, stress testing is performed on a quarterly basis for our major operating subsidiaries. Liquidity risk is further mitigated by our access to the alternative sources of liquidity discussed below.

**Liquidity of Prudential Financial**

The principal sources of funds available to Prudential Financial, the parent holding company, are dividends and returns of capital from its subsidiaries, repayments of operating loans from subsidiaries and cash and short-term investments. These sources of funds may be supplemented by Prudential Financial's access to the capital markets as well as the Alternative Sources of Liquidity described below.

The primary uses of funds at Prudential Financial include servicing debt, paying operating expenses, making capital contributions and loans to subsidiaries, paying declared shareholder dividends and repurchasing outstanding shares of Common Stock executed under Board authority.

As of September 30, 2013, Prudential Financial had cash and short-term investments of \$5,671 million, a decrease of \$2,892 million from December 31, 2012. We maintain an intercompany liquidity account that is designed to optimize the use of cash by facilitating the lending and borrowing of funds between Prudential Financial and its subsidiaries on a daily basis. Excluding net borrowings from this intercompany liquidity account, Prudential Financial had cash and short-term investments of \$4,669 million as of September 30, 2013, a decrease of \$758 million from December 31, 2012.

**Table of Contents**

The following table sets forth Prudential Financial's principal sources and uses of cash and short-term investments, excluding net borrowings from our intercompany liquidity account, for the period indicated.

|  | <b>Nine Months Ended<br/>September 30,<br/>2013<br/>(in millions)</b> |
|--|---|
| <b>Sources:</b>  |   |
| Dividends and/or returns of capital from subsidiaries(1)                           | \$ 1,695  |
| Proceeds from the issuance of junior subordinated debt (hybrid securities)         | 1,210   |
| Proceeds from the issuance of long-term senior debt                                | 1,050   |
| Net receipts under intercompany loan agreements(2)                                 | 727   |
| Proceeds from stock-based compensation and exercise of stock options               | 371   |
| Interest income from subsidiaries on intercompany agreements, net of interest paid | 138   |
| Proceeds from short-term debt, net of repayments                                   | 72  |
| Net income tax refunds(3)  | 329   |
| <b>Total sources</b>   | <b>5,592</b>  |
| <b>Uses:</b>   |   |
| Maturities of long-term senior debt, excluding retail medium-term notes            | 1,581   |
| Capital contributions to subsidiaries(4)   | 1,417   |
| Repayments of junior subordinated debt (hybrid securities)                         | 920   |
| Interest paid on external debt   | 718   |
| Repayment of retail medium-term notes  | 613   |
| Common Stock dividends(5)  | 585   |
| Share repurchases(6)   | 487   |
| Class B Stock dividends  | 14  |
| Other, net   | 15  |
| <b>Total uses</b>  | <b>6,350</b>  |
| <b>Net decrease in cash and short-term investments</b>                             | <b>\$ 758</b>   |

- (1) Includes dividends and/or returns of capital of \$1,043 million from international subsidiaries, \$381 million from asset management subsidiaries, \$184 million from Prudential Annuities Life Assurance Corporation and \$87 million from other subsidiaries.
- (2) Includes net repayments of \$214 million by asset management subsidiaries, \$199 million by Pruco Re, \$77 million by the Prudential Real Estate Financial Services of America and \$50 million by Pruco Life Insurance Company and net proceeds of \$204 million from the issuance of debt to Gibraltar Life, offset by net repayments of \$17 million to other subsidiaries.
- (3) Primarily includes tax settlements pursuant to the tax allocation agreement between Prudential Financial and its subsidiaries, net of estimated tax payments to the Internal Revenue Service.
- (4) Includes capital contributions of \$712 million to Prudential Insurance, of which \$615 million was paid to The Hartford in connection with our acquisition of its life insurance business, \$442 million to international subsidiaries, \$236 million to Pruco Re, \$25 million to asset management subsidiaries and \$2 million to other subsidiaries.
- (5) Includes cash payments made on dividends declared in prior periods.
- (6) Excludes \$13 million related to trades that settled in October 2013.

*Restrictions on Dividends and Returns of Capital from Subsidiaries*

Our domestic and international insurance companies are subject to regulatory limitations on the payment of dividends and other transfers of funds to Prudential Financial and other affiliates. In general, the payment of dividends by any of our subsidiaries is subject to declaration by

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

their Board of Directors and can be affected by market conditions and other factors. See Note 15 to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2012 for details on specific dividend restrictions.

In May 2013, Prudential Insurance paid an ordinary dividend of \$232 million to its parent, Prudential Holdings, LLC ( Prudential Holdings ), which amount remained at Prudential Holdings. In June 2013, Prudential Insurance paid an ordinary dividend in the form of real property, with a value of \$42 million, which was ultimately contributed to a subsidiary of Prudential Financial related to the development of a new office building located in Newark, New Jersey.



**Table of Contents**

In September of 2013, The Prudential Life Insurance Company Ltd., or POJ, paid a dividend of ¥25.0 billion, or approximately \$255 million, to its parent, Prudential Holdings of Japan. In April 2013, Gibraltar Life repaid subordinated debt of ¥6.7 billion or approximately \$68 million, and paid a dividend of ¥16.9 billion, or approximately \$170 million, on its preferred stock in August 2013, in each case to its parent, Prudential Holdings of Japan. Additionally, in June 2013, Prudential of Korea paid a dividend of (Won)40.0 billion or approximately \$31 million to its parent, Prudential International Insurance Holdings Ltd. Approximately \$490 million of these distributions was ultimately sent to Prudential Financial.

**Liquidity of Insurance Subsidiaries**

There have been no material changes to the liquidity position of our domestic and international insurance subsidiaries since December 31, 2012. We continue to believe that cash generated by ongoing operations and the liquidity profile of our assets provide sufficient liquidity under reasonably foreseeable stress scenarios for each of our insurance subsidiaries.

The principal sources of cash for our insurance subsidiaries are premiums and certain annuity considerations, investment and fee income, and investment maturities and sales associated with our insurance and annuity operations, as well as internal and external borrowings. The principal uses of that liquidity include benefits, claims, dividends paid to policyholders, and payments to policyholders and contractholders in connection with surrenders, withdrawals and net policy loan activity. Other uses of liquidity include commissions, general and administrative expenses, purchases of investments, hedging activity and payments in connection with financing activities. We use a projection process for cash flows from operations to ensure sufficient liquidity is available to meet projected cash outflows, including claims.

We manage the liquidity of our insurance operations to ensure stable, reliable and cost-effective sources of cash flows to meet all of our obligations. Liquidity within each of our insurance subsidiaries is provided by a variety of sources, including portfolios of liquid assets. The investment portfolios of our subsidiaries are integral to the overall liquidity of our insurance operations. We segment our investment portfolios and employ an asset/liability management approach specific to the requirements of each of our product lines. This enhances the discipline applied in managing the liquidity, as well as the interest rate and credit risk profiles, of each portfolio in a manner consistent with the unique characteristics of the product liabilities.

The following table sets forth the fair value of our domestic insurance operations' portfolio of liquid assets, including cash and short-term investments, fixed maturity investments other than those designated as held-to-maturity, by NAIC or equivalent rating, and public equity securities, as of the dates indicated.

|                                    | Prudential<br>Insurance | September 30, 2013 |                           |          | December 31,<br>2012 |
|------------------------------------|-------------------------|--------------------|---------------------------|----------|----------------------|
|                                    |                         | PRIAC              | Other(1)<br>(in billions) | Total    |                      |
| Cash and short-term investments    | \$ 6.4                  | \$ 1.2             | \$ 0.6                    | \$ 8.2   | \$ 7.4               |
| Fixed maturity investments:        |                         |                    |                           |          |                      |
| High or highest quality            | 123.5                   | 18.9               | 9.1                       | 151.5    | 158.6                |
| Other than high or highest quality | 8.6                     | 1.5                | 0.6                       | 10.7     | 10.0                 |
| Subtotal                           | 132.1                   | 20.4               | 9.7                       | 162.2    | 168.6                |
| Public equity securities           | 3.8                     | 0.0                | 0.0                       | 3.8      | 3.6                  |
| Total                              | \$ 142.3                | \$ 21.6            | \$ 10.3                   | \$ 174.2 | \$ 179.6             |

(1) Includes PALAC and Pruco Life insurance companies.

221

**Table of Contents**

The following table sets forth the fair value of our international insurance operations portfolio of liquid assets, including cash and short-term investments, fixed maturity investments other than those designated as held-to-maturity, by NAIC or equivalent rating, and public equity securities, as of the dates indicated.

|                                    | September 30, 2013  |                   |                               | Total    | December 31, 2012 |
|------------------------------------|---------------------|-------------------|-------------------------------|----------|-------------------|
|                                    | Prudential of Japan | Gibraltar Life(1) | All Other(2)<br>(in billions) |          |                   |
| Cash and short-term investments    | \$ 1.0              | \$ 3.8            | \$ 0.3                        | \$ 5.1   | \$ 5.2            |
| Fixed maturity investments:        |                     |                   |                               |          |                   |
| High or highest quality(3)         | 27.6                | 84.2              | 11.9                          | 123.7    | 134.9             |
| Other than high or highest quality | 0.4                 | 2.3               | 0.1                           | 2.8      | 2.5               |
| Subtotal                           | 28.0                | 86.5              | 12.0                          | 126.5    | 137.4             |
| Public equity securities           | 1.6                 | 2.2               | 0.4                           | 4.2      | 3.8               |
| Total(4)                           | \$ 30.6             | \$ 92.5           | \$ 12.7                       | \$ 135.8 | \$ 146.4          |

(1) Includes Prudential Gibraltar.

(2) Represents our international insurance operations, excluding Japan.

(3) Of the \$123.7 billion of fixed maturity investments that are not designated as held to-maturity and considered high or highest quality as of September 30, 2013, \$86.4 billion, or 70%, were invested in government or government agency bonds.

(4) The decline in liquid assets from December 31, 2012 was driven by depreciation of the yen relative to the U.S. dollar, partly offset by business growth.

**Liquidity associated with other activities****Hedging activities associated with living benefit guarantees**

As discussed in Captive Reinsurance Companies above, we reinsure living benefit guarantees on certain variable annuity and retirement products from our domestic life insurance companies to Pruco Re. This enables us to execute our living benefit hedging program primarily within a single legal entity. As part of the living benefit hedging program, we enter into a range of exchange-traded, cleared and other over the counter equity and interest rate derivatives to hedge certain optional living benefit features accounted for as embedded derivatives against changes in certain capital market conditions such as interest rates and equity index levels. For a full discussion of our living benefits hedging program, see Results of Operations for Financial Services Businesses by Segment U.S. Retirement Solutions and Investment Management Division Individual Annuities. Pruco Re requires access to sufficient liquidity to support these hedging activities, including meeting payments for periodic settlements, purchases, maturities, terminations and breakage. The liquidity needs can vary materially due to, among other items, changes in interest rates, equity markets, mortality and policyholder behavior. Currently, we fund these liquidity needs with a combination of capital contributions and loans from Prudential Financial and affiliates.

The living benefits hedging activity in Pruco Re may also result in collateral postings on derivatives to or from counterparties. The net collateral position depends on changes in interest rates and equity markets related to the amount of the exposures hedged. Depending on market conditions, the collateral posting requirements can result in material liquidity needs. In addition, certain derivatives entered into on or after June 10, 2013 are required to be cleared under the Dodd-Frank Act. These cleared derivatives typically have additional collateral requirements. As of September 30, 2013 and December 31, 2012, the living benefit hedging derivatives were in a net receive position of \$1.1 billion and \$4.4 billion, respectively, for which collateral of \$0.7 billion and \$4.4 billion, respectively, was posted by external counterparties. The decline in the

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

collateral position was primarily driven by rising interest rates and equity market appreciation.

Additionally, for certain of our domestic insurance companies to claim statutory reinsurance reserve credit for business ceded to Pruco Re, Pruco Re must collateralize its obligations under the reinsurance arrangement. Effective August 31, 2013, Prudential Annuities Life Assurance Corporation ( PALAC ) re-domesticated from

---

**Table of Contents**

Connecticut to Arizona, and, as a result, PALAC is able to claim reinsurance reserve credit for business ceded to Pruco Re without the need for Pruco Re to post collateral. Pruco Life Insurance Company, our other Arizona-domiciled insurance subsidiary, is also able to claim reinsurance reserve credit for business ceded to Pruco Re without the need for Pruco Re to post collateral. However, for business ceded to Pruco Re by Pruco Life Insurance Company of New Jersey ( PLNJ ), Pruco Re must continue to collateralize its obligations. We satisfy collateral posting requirements by depositing assets into statutory reserve credit trusts. Funding needs for the statutory reserve credit trusts are separate and distinct from capital needs of Pruco Re. However, assets pledged to the statutory reserve credit trusts may include assets supporting the capital of Pruco Re provided that they meet eligibility requirements prescribed by the Arizona Department of Insurance. Reinsurance reserve credit requirements and the amount of assets required to be maintained in the statutory reserve credit trusts can move materially in either direction due to changes in equity markets, interest rates, actuarial assumptions and other factors. As of September 30, 2013, for the applicable domestic insurance entities, the statutory reserve credit trusts required collateral of \$19 million, a decrease of \$2.2 billion from December 31, 2012, primarily driven by the re-domestication of PALAC discussed above.

*Foreign exchange hedging activities*

We employ various hedging strategies to manage potential exposure to foreign currency exchange rate movements, particularly those associated with the Japanese yen. Our overall yen hedging strategy calibrates the hedge level to preserve the relative contribution of our yen-based business to the Company's overall return on equity. For further information on our hedging strategies, see Results of Operations for Financial Services Businesses by Segment International Insurance Division. Our hedging strategies, which include both internal and external hedging programs, may impact the liquidity of both Prudential Financial and our international insurance subsidiaries.

The internal-only hedges are between Prudential Financial (through a subsidiary) and certain of our yen-based entities and serve to hedge changes in market value of U.S. dollar-denominated investments held on the books of these yen-based entities attributable to changes in the yen-dollar exchange rate. These U.S. dollar-denominated investments are part of our hedging strategy to mitigate the impact of foreign currency exchange rate movements on our U.S. dollar-equivalent equity. Absent an internal hedge, changes in market value of these U.S. dollar-denominated investments attributable to changes in the yen-dollar exchange rate would create volatility in the solvency margins of these subsidiaries. To minimize this volatility, we enter into inter-company hedges. Cash settlements from these hedging activities result in cash flows between Prudential Financial and these yen-based subsidiaries. The cash flows are dependent on changes in foreign currency exchange rates and the notional amount of the exposures hedged. During the first nine months of 2013, Prudential Financial received \$735 million of net cash settlements related to the internal hedge program, which were paid by the yen-based subsidiaries. As of September 30, 2013, the market value of the internal hedges was an asset of \$322 million due from the yen-based subsidiaries. Significant yen depreciation over an extended period of time could result in additional net cash inflows to Prudential Financial. Conversely, a significant yen appreciation could result in net cash outflows from Prudential Financial.

Our external hedges primarily serve to hedge a portion of our prospective non-U.S. dollar denominated earnings streams and, to a lesser extent, our U.S. dollar-equivalent equity. The external hedges are between a subsidiary of Prudential Financial and external parties. Cash settlements on these activities result in cash flows between the Company and the external parties and are dependent on changes in foreign currency exchange rates and the notional amount of the exposures hedged. During the first nine months of 2013, the Company received \$10 million for these external hedge settlements. As of September 30, 2013, the net asset related to these external foreign currency hedges was \$575 million. A significant depreciation in the yen and other foreign currencies could result in net cash inflows to the Company while a significant appreciation in the yen and other foreign currencies could result in net cash outflows from the Company.

*Asset Management operations*

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

The principal sources of liquidity for our fee-based asset management businesses include asset management fees and commercial mortgage origination and servicing fees. The principal uses of liquidity include general and administrative expenses and distributions of dividends and returns of capital to Prudential Financial. The primary

## **Table of Contents**

liquidity risks for our fee-based asset management businesses relate to their profitability, which is impacted by market conditions and our investment management performance. We believe the cash flows from our fee-based asset management businesses are adequate to satisfy the current liquidity requirements of these operations, as well as requirements that could arise under reasonably foreseeable stress scenarios, which are monitored through the use of internal measures.

The principal sources of liquidity for our strategic investments and interim loans held in our asset management businesses are cash flows from investments, the ability to liquidate investments, and available borrowing lines from internal sources, including Prudential Funding and Prudential Financial. The primary liquidity risks include the inability to sell assets in a timely manner, declines in the value of assets and credit defaults. There have been no material changes to the liquidity position of our asset management operations since December 31, 2012.

### *Alternative Sources of Liquidity*

In addition to the sources of liquidity discussed throughout this section, Prudential Financial and certain subsidiaries have access to the following alternative sources of liquidity:

Asset-based financing, as discussed further below.

Membership in the Federal Home Loan Banks, which provides Prudential Insurance and PRIAC the ability to obtain loans and to issue funding agreements up to specified regulatory limits that are collateralized by qualifying mortgage-related assets or U.S. Treasury securities. As of September 30, 2013, Prudential Insurance had an estimated maximum borrowing capacity of \$6.7 billion, of which \$2.3 billion was outstanding. PRIAC had an estimated maximum borrowing capacity of \$2.2 billion with no advances outstanding. As of September 30, 2013, Prudential Insurance and PRIAC had qualifying assets available but not pledged with fair value of \$3.0 billion and \$1.6 billion, respectively.

Commercial paper programs maintained at Prudential Financial and Prudential Funding, a wholly-owned subsidiary of Prudential Insurance, with authorized issuance capacity of \$3.0 billion and \$7.0 billion, respectively, of which \$185 million and \$804 million, respectively, were outstanding as of September 30, 2013.

Credit facilities in an aggregate amount of \$3.75 billion, which includes a \$2 billion facility expiring in December 2016 that has Prudential Financial as borrower and a \$1.75 billion facility expiring in December 2014 that has both Prudential Financial and Prudential Funding as borrowers. There were no outstanding borrowings under these credit facilities as of September 30, 2013, or as of the date of this filing.

For further information on our Federal Home Loan Bank memberships, commercial paper programs and credit facilities, see Note 9 to our Unaudited Interim Consolidated Financial Statements.

### *Asset-based Financing*

We conduct asset-based or secured financing within our insurance and other subsidiaries, including transactions such as securities lending, repurchase agreements and mortgage dollar rolls to earn spread income, to borrow funds, or to facilitate trading activity. These programs are

## Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

primarily driven by portfolio holdings of securities that are lendable based on counterparty demand for these securities in the marketplace. The collateral received in connection with these programs is primarily used to purchase securities in the short-term spread portfolios of our insurance entities. Investments held in the short-term spread portfolios include cash and cash equivalents, short-term investments, mortgage loans and fixed maturities, including mortgage- and asset-backed securities, with a weighted average life at time of purchase by the short-term portfolios of four years or less. Floating rate assets comprise the majority of our short-term spread portfolio. These short-term portfolios are subject to specific investment policy statements, which among other things, do not allow for significant asset/liability interest rate duration mismatch.



**Table of Contents**

The following table sets forth our liabilities under asset-based or secured financing programs attributable to the Financial Services Businesses and Closed Block Business as of the dates indicated.

|   | September 30, 2013            |                       |              | December 31, 2012             |                       |              |
|---|-------------------------------|-----------------------|--------------|-------------------------------|-----------------------|--------------|
|   | Financial Services Businesses | Closed Block Business | Consolidated | Financial Services Businesses | Closed Block Business | Consolidated |
|   | (in millions)                 |                       |              |                               |                       |              |
| Securities sold under agreements to repurchase  | \$ 3,530                      | \$ 3,628              | \$ 7,158     | \$ 3,436                      | \$ 2,382              | \$ 5,818     |
| Cash collateral for loaned securities   | 4,988                         | 967                   | 5,955        | 2,864                         | 1,077                 | 3,941        |
| Securities sold but not yet purchased   | 25                            | 0                     | 25           | 0                             | 0                     | 0            |
| Total(1)  | \$ 8,543                      | \$ 4,595              | \$ 13,138    | \$ 6,300                      | \$ 3,459              | \$ 9,759     |
| Portion of above securities that may be returned to the Company overnight requiring immediate return of the cash collateral | \$ 7,060                      | \$ 1,938              | \$ 8,998     | \$ 4,536                      | \$ 1,566              | \$ 6,102     |
| Weighted average maturity, in days(2)   | 28                            | 49                    |              | 25                            | 67                    |              |

(1) The daily weighted average outstanding for the three and nine months ended September 30, 2013 was \$8,583 million and \$7,491 million for the Financial Services Businesses and \$4,472 million and \$4,118 for the Closed Block Business, respectively.

(2) Excludes securities that may be returned to the Company overnight.

Outstanding liabilities under these programs increased \$3.4 billion, as recent growth in our portfolio of invested assets was utilized to take advantage of attractive financing and investment opportunities.

As of September 30, 2013, our domestic insurance entities had assets eligible for the asset-based or secured financing programs of \$78.3 billion, of which \$10 billion were on loan. Taking into account market conditions and outstanding loan balances as of September 30, 2013, we believe approximately \$21.6 billion of the remaining eligible assets are readily lendable, of which approximately \$15.8 billion relates to the Financial Services Businesses; however, these amounts are subject to potential regulatory constraints and to changes in market conditions.

In addition, as of September 30, 2013, our Closed Block Business had outstanding mortgage dollar rolls, under which we are committed to repurchase \$652 million of mortgage-backed securities, or TBA forward contracts. These repurchase agreements do not qualify as secured borrowings and are accounted for as derivatives. These mortgage-backed securities are considered high or highest quality based on NAIC or equivalent rating.

**Table of Contents****Financing Activities**

As of September 30, 2013, total short- and long-term debt of the Company on a consolidated basis was \$26.8 billion, a decrease of \$0.5 billion from December 31, 2012. The following table sets forth total consolidated borrowings of the Company as of the dates indicated.

|   | September 30, 2013      |                       |              | December 31, 2012       |                       |              |
|---|-------------------------|-----------------------|--------------|-------------------------|-----------------------|--------------|
|   | Prudential<br>Financial | Other<br>Subsidiaries | Consolidated | Prudential<br>Financial | Other<br>Subsidiaries | Consolidated |
| (in millions)                                     |                         |                       |              |                         |                       |              |
| <b>General obligation short-term debt:</b>        |                         |                       |              |                         |                       |              |
| Commercial paper                                  | \$ 185                  | \$ 804                | \$ 989       | \$ 113                  | \$ 359                | \$ 472       |
| Current portion of long-term debt and other(1)(2) | 1,519                   | 535                   | 2,054        | 1,734                   | 203                   | 1,937        |
| Subtotal  | 1,704                   | 1,339                 | 3,043        | 1,847                   | 562                   | 2,409        |
| <b>General obligation long-term debt:</b>         |                         |                       |              |                         |                       |              |
| Senior debt(2)(3)                                 | 11,475                  | 1,467                 | 12,942       | 12,404                  | 1,916                 | 14,320       |
| Junior subordinated debt                          | 4,884                   | 0                     | 4,884        | 4,594                   | 0                     | 4,594        |
| Surplus notes(4)                                  | 0                       | 4,141                 | 4,141        | 0                       | 4,140                 | 4,140        |
| Subtotal  | 16,359                  | 5,608                 | 21,967       | 16,998                  | 6,056                 | 23,054       |
| Total general obligations                         | 18,063                  | 6,947                 | 25,010       | 18,845                  | 6,618                 | 25,463       |
| <b>Limited recourse borrowing(5):</b>             |                         |                       |              |                         |                       |              |
| Current portion of long-term debt                 | 0                       | 75                    | 75           | 0                       | 75                    | 75           |
| Long-term debt                                    | 0                       | 1,675                 | 1,675        | 0                       | 1,675                 | 1,675        |
| Total limited recourse borrowings                 | 0                       | 1,750                 | 1,750        | 0                       | 1,750                 | 1,750        |
| Total borrowings                                  | \$ 18,063               | \$ 8,697              | \$ 26,760    | \$ 18,845               | \$ 8,368              | \$ 27,213    |

- (1) Includes collateralized borrowings from the Federal Home Loan Bank of New York of \$100 million at both September 30, 2013 and December 31, 2012. For additional information on these borrowings, see Note 9 to our Unaudited Interim Consolidated Financial Statements.
- (2) Does not include \$2,057 million and \$1,780 million of medium-term notes of consolidated trust entities secured by funding agreements purchased with the proceeds of such notes as of September 30, 2013 and December 31, 2012, respectively, or \$1,947 million of collateralized funding agreements issued to the Federal Home Loan Bank of New York as of both September 30, 2013 and December 31, 2012. These notes and funding agreements are included in Policyholders' account balances. For additional information on these obligations, see Note 5 to our Unaudited Interim Consolidated Financial Statements and Note 10 to the Consolidated Financial Statements included in our 2012 Annual Report on Form 10-K.
- (3) Includes collateralized borrowings from the Federal Home Loan Bank of New York of \$280 million at both September 30, 2013 and December 31, 2012. For additional information on these borrowings, see Note 9 to our Unaudited Interim Consolidated Financial Statements.
- (4) Amounts are net of assets under set-off arrangements of \$1,250 million and \$1,000 million, as of September 30, 2013 and December 31, 2012, respectively.
- (5) Limited and non-recourse borrowing represents outstanding debt of Prudential Holdings, LLC that is attributable to the Closed Block Business. See Prudential Holdings, LLC Notes within Note 14 to the Consolidated Financial Statements included our 2012 Annual Report on Form 10-K for additional information.

As of September 30, 2013 and December 31, 2012, we were in compliance with all debt covenants related to the borrowings in the table above. For further information on our short- and long-term debt obligations, see Note 9 to our Unaudited Interim Consolidated Financial Statements included in this Quarterly Report on Form 10-Q and Management's Discussion and Analysis of Financial Condition and Results of

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Operations Liquidity and Capital Resources included in our Annual Report on Form 10-K for the year ended December 31, 2012.

## **Table of Contents**

Prudential Financial borrowings of \$18.1 billion decreased \$0.8 billion from December 31, 2012, driven by \$1.6 billion of maturities of medium-term notes, the redemption of all of our \$920 million 9.0% Junior Subordinated Notes due 2068 and the repayment of \$613 million aggregate principal amount of retail notes, partially offset by the issuance of \$1.2 billion of junior subordinated notes and the issuance of \$1.1 billion of medium-term notes. As of September 30, 2013, \$294 million of retail notes remained outstanding with no option to redeem at par.

Subsidiary borrowings of \$8.7 billion increased \$0.3 billion from December 31, 2012, due primarily to an increase in commercial paper issued by Prudential Funding, LLC.

As we continue to underwrite term and universal life insurance business, including through the recently-acquired Hartford Life Business, we expect to have additional borrowing needs to finance non-economic reserves required under Regulation XXX and Guideline AXXX. We believe we have sufficient financing resources in place to meet our financing needs under Regulation XXX into 2014. Based on an increased level of guaranteed universal life policies in force, we are pursuing a solution to address Guideline AXXX financing needs through 2014.

## **Ratings**

Financial strength ratings (which are sometimes referred to as claims-paying ratings) and credit ratings are important factors affecting public confidence in an insurer and its competitive position in marketing products. Nationally Recognized Statistical Ratings Organizations continually review the financial performance and financial condition of the entities they rate, including Prudential Financial and its rated subsidiaries. Our credit ratings are also important for our ability to raise capital through the issuance of debt and for the cost of such financing.

A downgrade in the credit or financial strength ratings of Prudential Financial or its rated subsidiaries could potentially, among other things, limit our ability to market products, reduce our competitiveness, increase the number or value of policy surrenders and withdrawals, increase our borrowing costs and potentially make it more difficult to borrow funds, adversely affect the availability of financial guarantees, such as letters of credit, cause additional collateral requirements or other required payments under certain agreements, allow counterparties to terminate derivative agreements and/or hurt our relationships with creditors, distributors, or trading counterparties thereby potentially negatively affecting our profitability, liquidity, and/or capital. In addition, we consider our own risk of non-performance in determining the fair value of our liabilities. Therefore, changes in our credit or financial strength ratings may affect the fair value of our liabilities.

**Table of Contents**

Financial strength ratings represent the opinions of rating agencies regarding the financial ability of an insurance company to meet its obligations under an insurance policy. Credit ratings represent the opinions of rating agencies regarding an entity's ability to repay its indebtedness. The following table summarizes the ratings for Prudential Financial and certain of its subsidiaries as of the date of this filing.

|  | A.M.<br>Best(1) | S&P(2)           | Moody's(3)       | Fitch(4)         |
|--|-----------------|------------------|------------------|------------------|
| <b>Last review date</b>  | <b>5/9/2013</b> | <b>5/22/2013</b> | <b>7/11/2013</b> | <b>7/25/2013</b> |
| <b>Current outlook</b>   | <b>Stable</b>   | <b>Stable(5)</b> | <b>Stable</b>    | <b>Stable</b>    |
| <b>Financial Strength Ratings:</b>                               |                 |                  |                  |                  |
| The Prudential Insurance Company of America                      | A+              | AA-              | A1               | A+               |
| Pruco Life Insurance Company                                     | A+              | AA-              | A1               | A+               |
| Pruco Life Insurance Company of New Jersey                       | A+              | AA-              | NR*              | A+               |
| Prudential Annuities Life Assurance Corporation                  | A+              | AA-              | NR               | A+               |
| Prudential Retirement Insurance and Annuity Company              | A+              | AA-              | A1               | A+               |
| The Prudential Life Insurance Company Ltd. (Prudential of Japan) | NR              | AA-              | NR               | NR               |
| Gibraltar Life Insurance Company, Ltd.                           | NR              | AA-              | NR               | NR               |
| The Prudential Gibraltar Financial Life Insurance Co. Ltd.       | NR              | AA-              | NR               | NR               |
| <b>Credit Ratings:</b>   |                 |                  |                  |                  |
| Prudential Financial, Inc.:                                      |                 |                  |                  |                  |
| Short-term borrowings  | AMB-1           | A-1              | P-2              | F2               |
| Long-term senior debt  | a-              | A                | Baa1             | BBB+             |
| Junior subordinated long-term debt                               | bbb             | BBB+             | Baa2             | BBB-             |
| The Prudential Insurance Company of America:                     |                 |                  |                  |                  |
| Capital and surplus notes  | a               | A                | A3               | A-               |
| Prudential Funding, LLC:   |                 |                  |                  |                  |
| Short-term debt  | AMB-1           | A-1+             | P-1              | F1               |
| Long-term senior debt  | a+              | AA-              | A2               | A                |
| PRICOA Global Funding I:   |                 |                  |                  |                  |
| Long-term senior debt  | aa-             | AA-              | A1               | A+               |

\* NR indicates not rated.

- (1) A.M. Best Company, which we refer to as A.M. Best, financial strength ratings for insurance companies currently range from A++ (superior) to S (Suspended). A.M. Best's ratings reflect its opinion of an insurance company's financial strength, operating performance and ability to meet its obligations to policyholders. An A.M. Best long-term credit rating is an opinion of the ability of an obligor to pay interest and principal in accordance with the terms of the obligation. A.M. Best long-term credit ratings range from aaa (exceptional) to d (in default), with ratings from aaa to bbb considered as investment grade. An A.M. Best short-term credit rating reflects an opinion of the issuer's fundamental credit quality. Ratings range from AMB-1+, which represents an exceptional ability to repay short-term debt obligations, to AMB-4, which correlates with a speculative (bb) long-term rating.
- (2) Standard & Poor's Rating Services, which we refer to as S&P, financial strength ratings currently range from AAA (extremely strong) to R (regulatory supervision). These ratings reflect S&P's opinion of an operating insurance company's financial capacity to meet the obligations of its insurance policies in accordance with their terms. A + or - indicates relative strength within a category. An S&P credit rating is a current opinion of the creditworthiness of an obligor with respect to a specific financial obligation, a specific class of financial obligations or a specific financial program. S&P's long-term issue credit ratings range from AAA (extremely strong) to D (default). S&P short-term ratings range from A-1 (highest category) to D (default).
- (3) Moody's Investors Service, Inc., which we refer to as Moody's, insurance financial strength ratings currently range from Aaa (exceptional) to C (lowest). Moody's insurance ratings reflect the ability of insurance companies to repay punctually senior policyholder claims and obligations. Numeric modifiers are used to refer to the ranking within the group with 1 being the highest and 3 being the lowest. These modifiers are used to indicate relative strength within a category. Moody's credit ratings currently range from Aaa (highest) to C (default). Moody's credit ratings grade debt according to its investment quality. Moody's considers A1, A2 and A3 rated debt to be upper medium grade obligations, subject to low credit risk. Moody's short-term ratings are opinions of the ability of issuers to honor senior financial obligations and contracts. Prime ratings range from Prime-1 (P-1), which represents a superior ability for repayment of senior short-term debt obligations, to Prime-3 (P-3), which represents an acceptable ability for repayment of such obligations. Issuers rated Not Prime do not fall within any of the Prime rating categories.

**Table of Contents**

- (4) Fitch Ratings Ltd., which we refer to as Fitch, financial strength ratings currently range from AAA (exceptionally strong) to C (distressed). Fitch's ratings reflect its assessment of the likelihood of timely payment of policyholder and contractholder obligations. Fitch long-term credit ratings currently range from AAA (highest credit quality), which denotes exceptionally strong capacity for timely payment of financial commitments, to D (default). Investment grade ratings range between AAA and BBB. Short-term ratings range from F1 (highest credit quality) to C (high default risk). Within long-term and short-term ratings, a + or a - may be appended to a rating to denote relative status within major rating categories.
- (5) S&P has the ratings of our U.S.-domiciled entities on stable outlook and the ratings of our Japanese insurance entities on negative outlook as part of S&P's decision to put the sovereign debt ratings of Japan on negative outlook.

The ratings set forth above reflect current opinions of each rating agency. Each rating should be evaluated independently of any other rating. These ratings are not directed toward shareholders and do not in any way reflect evaluations of the safety and security of the Common Stock. These ratings are reviewed periodically and may be changed at any time by the rating agencies. As a result, we cannot assure stakeholders that we will maintain our current ratings in the future.

Rating agencies use an outlook statement for both industry sectors and individual companies. For an industry sector, a stable outlook generally implies that over the next 12-18 months the rating agency expects ratings to remain unchanged among companies in the sector. Currently, A.M. Best, S&P and Fitch all have the U.S. life insurance industry on stable outlook, and Moody's has the U.S. life insurance industry on negative outlook. For a particular company, an outlook generally indicates a medium- or long-term trend (generally six months to two years) in credit fundamentals, which if continued, may lead to a rating change. These indicators are not necessarily a precursor of a rating change nor do they preclude a rating agency from changing a rating at any time without notice. Currently, Moody's, A.M. Best and Fitch have all of the Company's ratings on stable outlook; and S&P has the ratings of our U.S.-domiciled entities on stable outlook and the ratings of our Japanese insurance entities on negative outlook as part of S&P's decision to put the sovereign debt ratings of Japan on negative outlook.

Requirements to post collateral or make other payments as a result of ratings downgrades under certain agreements, including derivative agreements, can be satisfied in cash or by posting permissible securities held by the subsidiaries subject to the agreements. A ratings downgrade of three ratings levels from the ratings levels as of September 30, 2013 (relating to financial strength ratings in certain cases and credit ratings in other cases) would result in estimated additional collateral posting requirements or payments under such agreements of approximately \$23 million. The amount of collateral required to be posted for derivative agreements is also dependent on the fair value of the derivative positions as of the balance sheet date. For additional information regarding the potential impacts of a ratings downgrade on our derivative agreements see Note 14 to our Unaudited Interim Consolidated Financial Statements. In addition, a ratings downgrade by A.M. Best to A- for our domestic life insurance companies would require Prudential Insurance to post a letter of credit in the amount of approximately \$1.6 billion, based on the level of statutory reserves related to the variable annuity business acquired from Allstate, that we estimate would result in annual cash outflows of approximately \$9 million, or collateral posting in the form of cash or securities to be held in a trust. We believe that the posting of such collateral would not be a material liquidity event for Prudential Insurance.

In view of the difficulties experienced recently by many financial institutions, the rating agencies have heightened the level of scrutiny that they apply to such institutions, have increased the frequency and scope of their credit reviews, have requested additional information from the companies that they rate, and may adjust upward the capital and other requirements employed in the rating agency models for maintenance of certain ratings levels, such as the financial strength ratings currently held by our life insurance subsidiaries. In addition, actions we might take to access third party financing or to realign our capital structure may in turn cause rating agencies to reevaluate our ratings.

## **Table of Contents**

The following is a summary of the significant changes or actions in our ratings and rating outlooks that have occurred from January 1, 2013 through the date of this filing.

On May 9, 2013, A.M. Best affirmed Prudential Financial's long-term senior debt rating at *a-* and short-term debt rating at *AMB-1*. A.M. Best also affirmed the *A+* financial strength ratings of Prudential's core subsidiaries, including Prudential Insurance, Prudential Annuities Life Assurance Corporation, and Prudential Retirement Insurance and Annuity Company, with stable outlooks.

On May 22, 2013, S&P affirmed the long-term senior debt rating of Prudential Financial at *A* and the financial strength ratings of Prudential's core subsidiaries at *AA-*. All U.S. ratings have stable outlooks, while our Japanese subsidiaries have negative outlooks due to a negative outlook on the Japan sovereign rating.

On July 11, 2013, Moody's upgraded the long-term senior debt rating of Prudential Financial from *Baa2* to *Baa1*. Moody's also upgraded the financial strength ratings of our domestic subsidiaries including Prudential Insurance, Prudential Retirement Insurance and Annuity Company, and Pruco Life Insurance Company from *A2* to *A1*. In addition, Moody's upgraded Prudential Funding's short-term debt rating from *P-2* to *P-1* and long-term debt rating from *A3* to *A2*. All ratings were assigned stable outlooks.

On July 25, 2013, Fitch affirmed Prudential Financial's long-term senior debt rating at *A-*. Fitch also affirmed the financial strength ratings of our U.S. operating entities at *A+*.

## **Off-Balance Sheet Arrangements**

### **Guarantees and Other Contingencies**

In the course of our business, we provide certain guarantees and indemnities to third parties pursuant to whom we may be contingently required to make payments now or in the future. See *Commitments and Guarantees* within Note 15 to the Unaudited Interim Consolidated Financial Statements for additional information.

### **Other Contingent Commitments**

We also have other commitments, some of which are contingent upon events or circumstances not under our control, including those at the discretion of our counterparties. See *Commitments and Guarantees* within Note 15 to the Unaudited Interim Consolidated Financial Statements for additional information regarding these commitments.

### **Other Off-Balance Sheet Arrangements**

We do not have retained assets or contingent interests in assets transferred to unconsolidated entities, or variable interests in unconsolidated entities or other similar transactions, arrangements or relationships that serve as credit, liquidity or market risk support, that we believe are reasonably likely to have a material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or our access to or requirements for capital resources. In addition, we do not have relationships with any unconsolidated entities that are contractually limited to narrow activities that facilitate our transfer of or access to associated assets.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risk is the risk of fluctuations in the value of financial instruments as a result of absolute or relative changes in interest rates, foreign currency exchange rates, equity prices or commodity prices. To varying degrees, our products and services, and the investment activities supporting them, generate exposure to market risk. The market risk incurred and our strategies for managing this risk vary by product. There have been no



**Table of Contents**

material changes in our market risk exposures from December 31, 2012, a description of which may be found in our Annual Report on Form 10-K, for the year ended December 31, 2012, Item 7A, "Quantitative and Qualitative Disclosures about Market Risk", filed with the Securities and Exchange Commission. See Item 1A, "Risk Factors" included in the Annual Report on Form 10-K for the year ended December 31, 2012, for a discussion of how difficult conditions in the financial markets and the economy in general may materially adversely affect our business and results of our operations.

**ITEM 4. CONTROLS AND PROCEDURES**

In order to ensure that the information we must disclose in our filings with the SEC is recorded, processed, summarized, and reported on a timely basis, the Company's management, including our Chief Executive Officer and Chief Financial Officer, have reviewed and evaluated the effectiveness of our disclosure controls and procedures, as defined in Exchange Act Rule 13a-15(e), as of September 30, 2013. Based on such evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of September 30, 2013, our disclosure controls and procedures were effective. No change in our internal control over financial reporting, as defined in Exchange Act Rule 13a-15(f), occurred during the quarter ended September 30, 2013, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

---

**Table of Contents**

**PART II OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

See Note 15 to the Unaudited Interim Consolidated Financial Statements under **Litigation and Regulatory Matters** for a description of material pending litigation and regulatory matters affecting us, and certain risks to our businesses presented by such matters, which is incorporated herein by reference.

**ITEM 1A. RISK FACTORS**

You should carefully consider the risks described under **Risk Factors** in our Annual Report on Form 10-K for the year ended December 31, 2012 ( **2012 Form 10-K** ). These risks could materially affect our business, results of operations or financial condition, cause the trading price of our Common Stock to decline materially or cause our actual results to differ materially from those expected or those expressed in any forward looking statements made by or on behalf of the Company. These risks are not exclusive, and additional risks to which we are subject include, but are not limited to, the factors mentioned under **Forward-Looking Statements** above and the risks of our businesses described elsewhere in this Quarterly Report on Form 10-Q.

The risk factor contained in our 2012 Form 10-K titled **The Dodd-Frank Wall Street Reform and Consumer Protection Act has and will subject us to substantial additional federal regulation and we cannot predict the effect on our business, results of operations, cash flows or financial condition** is hereby updated to note that on September 19, 2013, the Financial Stability Oversight Council (the **Council** ) made a final determination that Prudential Financial should be subject to stricter prudential regulatory standards and supervision by the Board of Governors of the Federal Reserve System (as a **Covered Company** ) pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act. On October 18, 2013, the Company confirmed that it would not seek to rescind the final determination of the Council. As a **Covered Company** under the Dodd-Frank Act, Prudential Financial is now subject to supervision and examination by the Federal Reserve Bank of Boston and to stricter prudential regulatory standards, which include or will include requirements (some of which are subject to future rulemaking) regarding risk-based capital, leverage, liquidity, stress-testing, overall risk management, resolution plans, early remediation and credit concentration; and may also include additional standards regarding capital, public disclosure, short-term debt limits and other related subjects as appropriate. The Company must also seek pre-approval from the Federal Reserve for acquisition of certain companies engaged in financial activities.

The risk factor titled **Foreign governmental actions could subject us to additional regulation** is hereby updated to note that in October 2013, the International Association of Insurance Supervisors (the **IAIS** ) announced that it expects to develop a risk-based global insurance capital standard applicable to internationally active insurance groups ( **IAIGs** ) by 2016, with full implementation scheduled to begin in 2019. In addition, the IAIS seeks to promote the financial stability of IAIGs by endorsing: uniform standards for insurer corporate governance and enterprise risk management; group-wide supervision of IAIGs; a framework for group capital adequacy assessment that accounts for group-wide risks; additional regulatory and disclosure requirements for insurance groups; and the establishment of ongoing supervisory colleges. In October 2013, several of the Company's domestic and foreign insurance regulators convened a supervisory college. The purpose of the supervisory college is to promote ongoing supervisory coordination, facilitate the sharing of information among regulators and to enhance each regulator's understanding of the Company's risk profile.

The risk factor titled **Our businesses are heavily regulated and changes in regulation may reduce our profitability** is hereby updated to note that the IAIS is developing a model framework ( **ComFrame** ) for the supervision of IAIGs that contemplates group wide supervision across national boundaries. ComFrame requires each IAIG to conduct its own risk and solvency assessment ( **ORSA** ) to monitor and manage its overall solvency. Also, the National Association of Insurance Commissioners ( **NAIC** ) has recently adopted the NAIC Risk Management and ORSA model act which, following enactment at the state level, will require a large insurer beginning in 2015 to at least annually assess the adequacy of its and its group's risk management and current and future solvency position.



**Table of Contents**

In addition, the NAIC, the New York State Department of Financial Services and other regulators recently increased their focus on life insurers use of captive reinsurance companies. We cannot predict what, if any, changes may result from these reviews. If applicable insurance laws are changed in a way that impairs the use of captive reinsurance companies, our ability to write certain products and efficiently manage their associated risks could be adversely affected and we may need to increase prices on certain products, modify certain products or find alternate financing sources, any of which could adversely affect our competitiveness, capital and financial position and results of operations.

For additional information, see Management's Discussion and Analysis of Financial Condition and Results of Operations Executive Summary Regulatory Developments.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

(c) The following table provides information about purchases by the Company during the quarter ended September 30, 2013, of its Common Stock:

| Period                                       | Total Number of Shares Purchased(1) | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Program(2) | Approximate Dollar Value of Shares that May Yet be Purchased under the Program(2) |
|--|-------------------------------------|------------------------------|---|---|
| July 1, 2013 through July 31, 2013           | 1,081,032                           | \$ 77.36                     | 1,077,109   |   |
| August 1, 2013 through August 31, 2013       | 1,055,761                           | \$ 79.03                     | 1,054,480   |   |
| September 1, 2013 through September 30, 2013 | 1,056,853                           | \$ 79.01                     | 1,054,907   |   |
| Total  | 3,193,646                           | \$ 78.46                     | 3,186,496   | \$ 750,012,165  |

(1) Includes shares of Common Stock withheld from participants for income tax withholding purposes whose shares of restricted stock units vested during the period. Such restricted stock units were originally issued to participants pursuant to the Prudential Financial, Inc. Omnibus Incentive Plan that was adopted by the Company's Board of Directors in March 2003 (as subsequently amended and restated).

(2) In June 2013, the Board authorized the Company to repurchase up to \$1.0 billion of its outstanding Common Stock during the twelve month period starting July 1, 2013 through June 30, 2014.

**ITEM 6. EXHIBITS**

|      |   |
|------|---|
| 12.1 | Statement of Ratio of Earnings to Fixed Charges.          |
| 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. |

|                |   |
|----------------|---|
| 101.INS - XBRL | Instance Document.                                |
| 101.SCH - XBRL | Taxonomy Extension Schema Document.               |
| 101.CAL - XBRL | Taxonomy Extension Calculation Linkbase Document. |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

|                |  |
|----------------|--|
| 101.LAB - XBRL | Taxonomy Extension Label Linkbase Document.        |
| 101.PRE - XBRL | Taxonomy Extension Presentation Linkbase Document. |
| 101.DEF - XBRL | Taxonomy Extension Definition Linkbase Document.   |

**Table of Contents**

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, 21st Floor

Newark, New Jersey 07102

**Table of Contents**

**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/ ROBERT M. FALZON  
**Robert M. Falzon**

**Executive Vice President and Chief Financial Officer**

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

Date: November 7, 2013

**Table of Contents**

**EXHIBIT INDEX**

|                |   |
|----------------|---|
| 12.1           | Statement of Ratio of Earnings to Fixed Charges.          |
| 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. |
| 101.INS - XBRL | Instance Document.  |
| 101.SCH - XBRL | Taxonomy Extension Schema Document.                       |
| 101.CAL - XBRL | Taxonomy Extension Calculation Linkbase Document.         |
| 101.LAB - XBRL | Taxonomy Extension Label Linkbase Document.               |
| 101.PRE - XBRL | Taxonomy Extension Presentation Linkbase Document.        |
| 101.DEF - XBRL | Taxonomy Extension Definition Linkbase Document.          |