

PRUDENTIAL FINANCIAL INC  
Form 10-Q  
August 08, 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 June 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 July 31, 2013, 463 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 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 June 30, 2013 and December 31, 2012</u>	1
<u>Unaudited Interim Consolidated Statements of Operations for the three and six months ended June 30, 2013 and 2012</u>	2
<u>Unaudited Interim Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2013 and 2012</u>	3
<u>Unaudited Interim Consolidated Statements of Equity for the six months ended June 30, 2013 and 2012</u>	4
<u>Unaudited Interim Consolidated Statements of Cash Flows for the six months ended June 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 June 30, 2013 and December 31, 2012</u>	112
<u>Unaudited Interim Supplemental Combining Statements of Operations for the three months ended June 30, 2013 and 2012</u>	113
<u>Unaudited Interim Supplemental Combining Statements of Operations for the six months ended June 30, 2013 and 2012</u>	114
<u>Notes to Unaudited Interim Supplemental Combining Financial Information</u>	115
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	117
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	227
Item 4. <u>Controls and Procedures</u>	228
<b><u>PART II OTHER INFORMATION</u></b>	
Item 1. <u>Legal Proceedings</u>	229
Item 1A. <u>Risk Factors</u>	229
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	229
Item 6. <u>Exhibits</u>	230
<b><u>SIGNATURES</u></b>	231

---

**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**

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

	June 30, 2013	December 31, 2012
<b>ASSETS</b>		
Fixed maturities, available-for-sale, at fair value (amortized cost: 2013-\$267,306; 2012-\$277,654)(1)	\$ 286,107	\$ 301,336
Fixed maturities, held-to-maturity, at amortized cost (fair value: 2013-\$3,769; 2012-\$4,511)(1)	3,562	4,268
Trading account assets supporting insurance liabilities, at fair value(1)	20,658	20,590
Other trading account assets, at fair value(1)	6,083	6,328
Equity securities, available-for-sale, at fair value (cost: 2013-\$6,532; 2012-\$6,759)	8,754	8,277
Commercial mortgage and other loans (includes \$303 and \$162 measured at fair value under the fair value option at June 30, 2013 and December 31, 2012, respectively)(1)	38,069	36,733
Policy loans	11,740	11,575
Other long-term investments (includes \$497 and \$465 measured at fair value under the fair value option at June 30, 2013 and December 31, 2012, respectively)(1)	9,949	10,028
Short-term investments	8,075	6,447
Total investments	392,997	405,582
Cash and cash equivalents(1)	13,045	18,100
Accrued investment income(1)	3,113	3,127
Deferred policy acquisition costs	14,968	14,100
Value of business acquired	3,846	3,248
Other assets(1)	13,592	11,887
Separate account assets	264,054	253,254
<b>TOTAL ASSETS</b>	<b>\$ 705,615</b>	<b>\$ 709,298</b>
<b>LIABILITIES AND EQUITY</b>		
<b>LIABILITIES</b>		
Future policy benefits	\$ 204,190	\$ 216,050
Policyholders' account balances(1)	136,607	134,413
Policyholders' dividends	5,630	7,507
Securities sold under agreements to repurchase	6,947	5,818
Cash collateral for loaned securities	5,707	3,941
Income taxes	5,106	8,551
Short-term debt	2,620	2,484
Long-term debt	23,642	24,729

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

Other liabilities(1)	13,057	11,683
Notes issued by consolidated variable interest entities (includes \$2,055 and \$1,406 measured at fair value under the fair value option at June 30, 2013 and December 31, 2012, respectively)(1)	2,147	1,577
Separate account liabilities	264,054	253,254
 Total liabilities	 669,707	 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 June 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 June 30, 2013 and December 31, 2012, respectively)	0	0
Additional paid-in capital	24,383	24,380
Common Stock held in treasury, at cost (197,155,559 and 197,077,940 shares at June 30, 2013 and December 31, 2012, respectively)	(12,176)	(12,163)
Accumulated other comprehensive income (loss)	8,449	10,214
Retained earnings	14,486	16,138
 Total Prudential Financial, Inc. equity	 35,148	 38,575
 Noncontrolling interests	 760	 716
 Total equity	 35,908	 39,291
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$ 705,615</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 Six Months Ended June 30, 2013 and 2012 (in millions, except per share amounts)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
<b>REVENUES</b>				
Premiums	\$ 6,922	\$ 7,556	\$ 14,006	\$ 14,329
Policy charges and fee income	1,375	1,062	2,731	2,111
Net investment income	3,711	3,358	7,349	6,678
Asset management fees and other income	(940)	2,397	(2,110)	2,262
Realized investment gains (losses), net:				
Other-than-temporary impairments on fixed maturity securities	(180)	(346)	(488)	(919)
Other-than-temporary impairments on fixed maturity securities transferred to Other Comprehensive Income	147	253	385	714
Other realized investment gains (losses), net	(991)	1,856	(1,644)	584
Total realized investment gains (losses), net	(1,024)	1,763	(1,747)	379
Total revenues	10,044	16,136	20,229	25,759
<b>BENEFITS AND EXPENSES</b>				
Policyholders' benefits	7,024	7,427	14,243	13,870
Interest credited to policyholders' account balances	394	1,247	1,444	2,213
Dividends to policyholders	445	604	1,005	1,046
Amortization of deferred policy acquisition costs	220	1,237	438	1,012
General and administrative expenses	2,727	2,652	5,410	5,412
Total benefits and expenses	10,810	13,167	22,540	23,553
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES</b>				
	(766)	2,969	(2,311)	2,206
Income tax expense (benefit)	(273)	743	(1,104)	922
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES</b>				
	(493)	2,226	(1,207)	1,284
Equity in earnings of operating joint ventures, net of taxes	5	6	54	13
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS</b>				
	(488)	2,232	(1,153)	1,297
Income from discontinued operations, net of taxes	2	7	3	14
<b>NET INCOME (LOSS)</b>				
	(486)	2,239	(1,150)	1,311
Less: Income attributable to noncontrolling interests	35	15	77	26
<b>NET INCOME (LOSS) ATTRIBUTABLE TO PRUDENTIAL FINANCIAL, INC</b>				
	\$ (521)	\$ 2,224	\$ (1,227)	\$ 1,285
<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.	\$ (1.14)	\$ 4.74	\$ (2.69)	\$ 2.69
Income from discontinued operations, net of taxes	0.01	0.01	0.01	0.03



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

Net income (loss) attributable to Prudential Financial, Inc.	\$ (1.13)	\$ 4.75	\$ (2.68)	\$ 2.72
<b>Diluted earnings per share-Common Stock:</b>				
Income (loss) from continuing operations attributable to Prudential Financial, Inc.	\$ (1.14)	\$ 4.67	\$ (2.69)	\$ 2.66
Income from discontinued operations, net of taxes	0.01	0.02	0.01	0.03
Net income (loss) attributable to Prudential Financial, Inc.	\$ (1.13)	\$ 4.69	\$ (2.68)	\$ 2.69
Dividends declared per share of Common Stock	\$ 0.40		\$ 0.80	
<b>Closed Block Business</b>				
<b>Basic and Diluted earnings per share-Class B Stock:</b>				
Income (loss) from continuing operations attributable to Prudential Financial, Inc.	\$ 1.00	\$ (6.00)	\$ 6.50	\$ 0.50
Income (loss) from discontinued operations, net of taxes	0.00	(0.50)	0.00	(0.50)
Net income (loss) attributable to Prudential Financial, Inc.	\$ 1.00	\$ (6.50)	\$ 6.50	\$ 0.00
Dividends declared per share of Class B Stock	\$ 2.41		\$ 4.82	

*See Notes to Unaudited Interim Consolidated Financial Statements*

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
<b>NET INCOME (LOSS)</b>	\$ (486)	\$ 2,239	\$ (1,150)	\$ 1,311
Other comprehensive income (loss), before tax:				
Foreign currency translation adjustments:				
Foreign currency translation adjustments for the period	(504)	276	(1,406)	97
Reclassification adjustment for amounts included in net income (loss)	(1)	0	0	0
Total	(505)	276	(1,406)	97
Net unrealized investment gains (losses):				
Unrealized investment gains (losses) for the period	(5,080)	1,278	(628)	4,169
Reclassification adjustment for (gains) losses included in net income (loss)	(350)	56	(524)	149
Total	(5,430)	1,334	(1,152)	4,318
Defined benefit pension and postretirement unrecognized net periodic benefit:				
Impact of foreign currency changes and other	11	0	30	14
Amortization included in net income (loss)	32	25	63	50
Total	43	25	93	64
Other comprehensive income (loss), before tax	(5,892)	1,635	(2,465)	4,479
Less: Income tax expense (benefit) related to:				
Foreign currency translation adjustments	(132)	93	(401)	59
Net unrealized investment gains (losses)	(1,816)	437	(342)	1,520
Defined benefit pension and postretirement unrecognized net periodic benefit	15	14	33	15
Total	(1,933)	544	(710)	1,594
Other comprehensive income (loss), net of taxes	(3,959)	1,091	(1,755)	2,885
Comprehensive income (loss)	(4,445)	3,330	(2,905)	4,196
Less: Comprehensive income (loss) attributable to noncontrolling interests	45	52	87	59
<b>Comprehensive income (loss) attributable to Prudential Financial, Inc.</b>	<b>\$ (4,490)</b>	<b>\$ 3,278</b>	<b>\$ (2,992)</b>	<b>\$ 4,137</b>

*See Notes to Unaudited Interim Consolidated Financial Statements*

Table of Contents

## PRUDENTIAL FINANCIAL, INC.

## Unaudited Interim Consolidated Statements of Equity(1)

Six Months Ended June 30, 2013 and 2012 (in millions)

	Prudential Financial, Inc. Equity							
	Common Stock	Additional Paid-in Capital	Retained Earnings	Common Stock Held In Treasury	Accumulated Other Comprehensive Income (Loss)	Total Prudential Financial, Inc. Equity	Noncontrolling Interests	Total Equity
<b>Balance December 31, 2012</b>	\$ 6	\$ 24,380	\$ 16,138	\$ (12,163)	\$ 10,214	\$ 38,575	\$ 716	\$ 39,291
Common Stock acquired				(250)		(250)	0	(250)
Contributions from noncontrolling interests						0	1	1
Distributions to noncontrolling interests						0	(72)	(72)
Consolidations/deconsolidations of noncontrolling interests						0	28	28
Stock-based compensation programs		3	(39)	237		201		201
Dividends declared on Common Stock			(376)			(376)	0	(376)
Dividends declared on Class B Stock			(10)			(10)	0	(10)
Comprehensive income:								
Net income			(1,227)			(1,227)	77	(1,150)
Other comprehensive income, net of tax					(1,765)	(1,765)	10	(1,755)
Total comprehensive income (loss)						(2,992)	87	(2,905)
<b>Balance, June 30, 2013</b>	\$ 6	\$ 24,383	\$ 14,486	\$ (12,176)	\$ 8,449	\$ 35,148	\$ 760	\$ 35,908

	Prudential Financial, Inc. Equity							
	Common Stock	Additional Paid-in Capital	Retained Earnings	Common Stock Held In Treasury	Accumulated Other Comprehensive Income (Loss)	Total Prudential Financial, Inc. Equity	Noncontrolling Interests	Total Equity
<b>Balance, December 31, 2011</b>	\$ 6	\$ 24,293	\$ 16,629	\$ (11,920)	\$ 5,245	\$ 34,253	\$ 588	\$ 34,841
Common Stock acquired				(500)		(500)		(500)
Contributions from noncontrolling interests						0	2	2
Distributions to noncontrolling interests						0	(40)	(40)
Consolidations/deconsolidations of noncontrolling interests						0	0	0
Stock-based compensation programs		25	(163)	303		165		165
Dividends declared on Common Stock						0		0
Dividends declared on Class B Stock						0		0
Comprehensive income:								
Net income			1,285			1,285	26	1,311
Other comprehensive income, net of tax					2,852	2,852	33	2,885
Total comprehensive income						4,137	59	4,196
<b>Balance, June 30, 2012</b>	\$ 6	\$ 24,318	\$ 17,751	\$ (12,117)	\$ 8,097	\$ 38,055	\$ 609	\$ 38,664

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****Six Months Ended June 30, 2013 and 2012 (in millions)**

	<b>2013</b>	<b>2012</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income (loss)	\$ (1,150)	\$ 1,311
Adjustments to reconcile net income to net cash provided by operating activities:		
Realized investment (gains) losses, net	1,747	(379)
Policy charges and fee income	(856)	(657)
Interest credited to policyholders' account balances	1,444	2,213
Depreciation and amortization	161	203
Gains on trading account assets supporting insurance liabilities, net	378	(238)
Change in:		
Deferred policy acquisition costs	(1,131)	(734)
Future policy benefits and other insurance liabilities	4,774	5,631
Other trading account assets	(39)	(10)
Income taxes	(2,681)	335
Other, net	(261)	(1,639)
<b>Cash flows from operating activities</b>	<b>2,386</b>	<b>6,036</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from the sale/maturity/prepayment of:		
Fixed maturities, available-for-sale	26,806	20,116
Fixed maturities, held-to-maturity	275	247
Trading account assets supporting insurance liabilities and other trading account assets	12,639	7,336
Equity securities, available-for-sale	2,082	2,100
Commercial mortgage and other loans	2,737	2,037
Policy loans	1,176	1,169
Other long-term investments	805	882
Short-term investments	21,896	14,858
Payments for the purchase/origination of:		
Fixed maturities, available-for-sale	(30,252)	(26,266)
Fixed maturities, held-to-maturity	(37)	0
Trading account assets supporting insurance liabilities and other trading account assets	(14,019)	(7,140)
Equity securities, available-for-sale	(1,982)	(1,816)
Commercial mortgage and other loans	(3,753)	(3,419)
Policy loans	(905)	(912)
Other long-term investments	(1,522)	(939)
Short-term investments	(23,090)	(13,944)
Acquisition of business, net of cash acquired.	(488)	0
Other, net	(221)	182
<b>Cash flows used in investing activities</b>	<b>(7,853)</b>	<b>(5,509)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Policyholders' account deposits	12,245	11,479
Policyholders' account withdrawals	(12,957)	(12,389)
Net change in securities sold under agreements to repurchase and cash collateral for loaned securities	2,914	2,058
Cash dividends paid on Common Stock	(397)	(50)
Cash dividends paid on Class B Stock	(10)	0
Net change in financing arrangements (maturities 90 days or less)	496	(211)
Common Stock acquired	(237)	(500)
Common Stock reissued for exercise of stock options	116	94
Proceeds from the issuance of debt (maturities longer than 90 days)	1,443	1,311

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Repayments of debt (maturities longer than 90 days)	(2,848)	(602)
Excess tax benefits from share-based payment arrangements	13	51
Change in bank deposits	0	(1,730)
Other, net	487	(5)
<b>Cash flows from (used in) financing activities</b>	<b>1,265</b>	<b>(494)</b>
Effect of foreign exchange rate changes on cash balances	(853)	(42)
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>(5,055)</b>	<b>(9)</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>\$ 13,045</b>	<b>\$ 14,242</b>
<b>NON-CASH TRANSACTIONS DURING THE PERIOD</b>		
Treasury Stock shares issued for stock-based compensation programs	\$ 102	\$ 206

*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 June 30, 2013, include the assets and liabilities of Gibraltar Life as of May 31, 2013 and the results of operations for Gibraltar Life for the three and six months ended May 31, 2013.

***Use of Estimates***

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

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 three and six months ended June 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

---

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

policyholders' dividends that would result from the realization of unrealized gains and losses, are included in Accumulated other comprehensive income (loss) (AOCI).

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

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

Equity securities available-for-sale are comprised of common stock, mutual fund shares, non-redeemable preferred stock, and certain perpetual preferred stock, and are carried at fair value. The associated unrealized gains and losses, net of tax, and the effect on deferred policy acquisition costs, value of business acquired, deferred sales inducements, future policy benefits and policyholders' dividends that would result from the realization of unrealized gains and losses, are included in 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.

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

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.

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

Impaired loans include those loans for which it is probable that amounts due 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.

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



**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

consideration various factors including financial ratios and qualitative assessments based on non-financial information. In cases where there are personal or third party guarantors, the credit quality of the guarantor is also reviewed. These factors are used in developing the allowance for losses. Based on the diversity of the loans in these categories and their immateriality, the Company has not disclosed the credit quality indicators related to these loans in Note 4.

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

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

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

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

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

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

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.



**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

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

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

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

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

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

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.



**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

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

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

Derivatives are used in a non-broker-dealer capacity to manage the interest rate and currency characteristics of assets or liabilities and to mitigate volatility of expected non-U.S. earnings and net investments in foreign operations resulting from changes in currency exchange rates. Additionally, derivatives may be used to seek to reduce exposure to interest rate, credit, foreign currency and equity risks associated with assets held or expected

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

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.

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

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

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

The Company formally documents at inception all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives designated as fair value, cash 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.

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

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.

---

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

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 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.

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

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



**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

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.

***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.

**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 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

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

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.

***Discontinued Operations***

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in millions)			
Real estate investments sold or held for sale(1)	\$ 2	\$ 12	\$ 2	\$ 22
Global commodities business	0	0	2	0
Income from discontinued operations before income taxes	2	12	4	22
Income tax expense	0	5	1	8
Income from discontinued operations, net of taxes	\$ 2	\$ 7	\$ 3	\$ 14

(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.

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

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

	June 30, 2013	December 31, 2012
	(in millions)	
Total assets	\$ 33	\$ 13
Total liabilities	\$ 0	\$ 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:

	June 30, 2013				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	\$ 12,190	\$ 2,851	\$ 106	\$ 14,935	\$ 0
Obligations of U.S. states and their political subdivisions	3,367	359	113	3,613	0
Foreign government bonds	72,511	6,484	183	78,812	1
Corporate securities	148,214	12,915	3,922	157,207	(4)
Asset-backed securities(1)	11,075	235	409	10,901	(840)
Commercial mortgage-backed securities	12,513	524	179	12,858	4
Residential mortgage-backed securities(2)	7,436	416	71	7,781	(11)
<b>Total fixed maturities, available-for-sale</b>	<b>\$ 267,306</b>	<b>\$ 23,784</b>	<b>\$ 4,983</b>	<b>\$ 286,107</b>	<b>\$ (850)</b>
<b>Equity securities, available-for-sale</b>	<b>\$ 6,532</b>	<b>\$ 2,263</b>	<b>\$ 41</b>	<b>\$ 8,754</b>	

	June 30, 2013				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	\$ 994	\$ 106	\$ 0	\$ 1,100	\$ 0
Corporate securities(4)	908	31	36	903	0
Asset-backed securities(1)	760	42	1	801	0
Commercial mortgage-backed securities	253	30	0	283	0
Residential mortgage-backed securities(2)	647	35	0	682	0
<b>Total fixed maturities, held-to-maturity(4)</b>	<b>\$ 3,562</b>	<b>\$ 244</b>	<b>\$ 37</b>	<b>\$ 3,769</b>	<b>\$ 0</b>

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

- (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 \$902 million of net unrealized gains on impaired available-for-sale securities and less than \$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 \$1,750 million (fair value, \$1,796 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 June 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	\$ 12,783	\$ 13,420	\$ 0	\$ 0
Due after one year through five years	47,274	51,613	58	59
Due after five years through ten years	56,713	61,766	310	316
Due after ten years(1)	119,512	127,768	1,534	1,628
Asset-backed securities	11,075	10,901	760	801
Commercial mortgage-backed securities	12,513	12,858	253	283
Residential mortgage-backed securities	7,436	7,781	647	682
Total	\$ 267,306	\$ 286,107	\$ 3,562	\$ 3,769

(1) Excludes notes with amortized cost of \$1,750 million (fair value, \$1,796 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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in millions)			
<b>Fixed maturities, available-for-sale</b>				
Proceeds from sales	\$ 8,139	\$ 3,795	\$ 14,634	\$ 9,458
Proceeds from maturities/repayments	6,705	5,296	12,444	10,285
Gross investment gains from sales, prepayments, and maturities	413	141	642	268
Gross investment losses from sales and maturities	(88)	(80)	(194)	(158)
<b>Fixed maturities, held-to-maturity</b>				
Gross investment gains from prepayments	\$ 0	\$ 0	\$ 0	\$ 0
Proceeds from maturities/repayments	148	124	273	247
<b>Equity securities, available-for-sale</b>				



Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Proceeds from sales	\$ 1,137	\$ 1,068	\$ 2,185	\$ 2,150
Gross investment gains from sales	124	92	231	214
Gross investment losses from sales	(29)	(75)	(52)	(161)
<b>Fixed maturity and equity security impairments</b>				
Net writedowns for other-than-temporary impairment losses on fixed maturities recognized in earnings(1)	\$ (33)	\$ (93)	\$ (103)	\$ (205)
Writedowns for impairments on equity securities	(1)	(41)	(8)	(90)

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

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

	<b>Three Months Ended June 30, 2013</b>	<b>Six Months Ended June 30, 2013</b>
	(in millions)	
Balance, beginning of period	\$ 1,089	\$ 1,166
Credit loss impairments previously recognized on securities which matured, paid down, prepaid or were sold during the period	(53)	(150)
Credit loss impairments previously recognized on securities impaired to fair value during the period(1)	0	0
Credit loss impairment recognized in the current period on securities not previously impaired	7	8
Additional credit loss impairments recognized in the current period on securities previously impaired	27	39
Increases due to the passage of time on previously recorded credit losses	14	26
Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected	(4)	(9)
Balance, end of period	\$ 1,080	\$ 1,080

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

	<b>Three Months Ended June 30, 2012</b>	<b>Six Months Ended June 30, 2012</b>
	(in millions)	
Balance, beginning of period	\$ 1,465	\$ 1,475
Credit loss impairments previously recognized on securities which matured, paid down, prepaid or were sold during the period	(67)	(85)
	0	(59)

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

Credit loss impairments previously recognized on securities impaired to fair value during the period(1)		
Credit loss impairment recognized in the current period on securities not previously impaired	6	30
Additional credit loss impairments recognized in the current period on securities previously impaired	21	58
Increases due to the passage of time on previously recorded credit losses	16	29
Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected	(8)	(15)
Balance, end of period	\$ 1,433	\$ 1,433

- (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:

	June 30, 2013		December 31, 2012	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(in millions)			
Short-term investments and cash equivalents	\$ 1,281	\$ 1,281	\$ 938	\$ 938
Fixed maturities:				
Corporate securities	11,493	12,013	11,076	12,107
Commercial mortgage-backed securities	2,439	2,481	2,096	2,229
Residential mortgage-backed securities(1)	1,761	1,756	1,965	2,026
Asset-backed securities(2)	1,075	1,086	1,179	1,116
Foreign government bonds	594	611	683	708
U.S. government authorities and agencies and obligations of U.S. states	342	383	369	426
<b>Total fixed maturities</b>	<b>17,704</b>	<b>18,330</b>	<b>17,368</b>	<b>18,612</b>
Equity securities	825	1,047	943	1,040
<b>Total trading account assets supporting insurance liabilities</b>	<b>\$ 19,810</b>	<b>\$ 20,658</b>	<b>\$ 19,249</b>	<b>\$ 20,590</b>

(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 (\$596) million and \$17 million during the three months ended June 30, 2013 and 2012, respectively, and (\$493) million and \$280 million during the six months ended June 30, 2013 and 2012, respectively.

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

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

	June 30, 2013		December 31, 2012	
	Amortized Cost	Fair Value (in millions)	Amortized Cost	Fair Value
Short-term investments and cash equivalents	\$ 56	\$ 58	\$ 42	\$ 42
Fixed maturities	3,241	3,240	2,196	2,132
Equity securities	1,065	1,161	1,363	1,437
Other	3	6	3	6
<b>Subtotal</b>	<b>4,365</b>	<b>4,465</b>	<b>3,604</b>	<b>3,617</b>
Derivative instruments		1,618		2,711
<b>Total other trading account assets</b>	<b>\$ 4,365</b>	<b>\$ 6,083</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 \$13 million and (\$49) million during the three months ended June 30, 2013 and 2012, respectively, and \$87 million and \$88 million during the six months ended June 30, 2013 and 2012, respectively.

***Concentrations of Financial Instruments***

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

As of both June 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.

June 30, 2013

December 31, 2012

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

	Amortized Cost	Fair Value (in millions)	Amortized Cost	Fair Value
<b>Investments in Japanese government and government agency securities:</b>				
Fixed maturities, available-for-sale	\$ 58,135	\$ 62,410	\$ 66,590	\$ 70,997
Fixed maturities, held-to-maturity	971	1,077	1,118	1,223
Trading account assets supporting insurance liabilities	453	459	513	524
Other trading account assets	36	36	39	40
Short-term investments	0	0	0	0
Cash equivalents	367	367	1,637	1,637
 Total	 \$ 59,962	 \$ 64,349	 \$ 69,897	 \$ 74,421

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

	June 30, 2013		December 31, 2012	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(in millions)			
<b>Investments in South Korean government and government agency securities:</b>				
Fixed maturities, available-for-sale	\$ 5,794	\$ 6,527	\$ 5,837	\$ 6,883
Fixed maturities, held-to-maturity	0	0	0	0
Trading account assets supporting insurance liabilities	61	60	62	63
Other trading account assets	2	2	2	2
Short-term investments	0	0	0	0
Cash equivalents	0	0	0	0
Total	\$ 5,857	\$ 6,589	\$ 5,901	\$ 6,948

**Commercial Mortgage and Other Loans**

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

	June 30, 2013		December 31, 2012	
	Amount (in millions)	% of Total	Amount (in millions)	% of Total
<b>Commercial and agricultural mortgage loans by property type:</b>				
Office	\$ 7,533	20.9%	\$ 6,890	20.1%
Retail	8,045	22.3	8,190	23.9
Apartments/Multi-Family	6,453	17.9	5,235	15.3
Industrial	7,517	20.8	7,636	22.3
Hospitality	1,610	4.5	1,322	3.9
Other	2,758	7.6	2,841	8.3
Total commercial mortgage loans	33,916	94.0	32,114	93.8
Agricultural property loans	2,152	6.0	2,122	6.2
Total commercial and agricultural mortgage loans by property type	36,068	100.0%	34,236	100.0%
Valuation allowance	(219)		(229)	
Total net commercial and agricultural mortgage loans by property type	35,849		34,007	
<b>Other loans</b>				
Uncollateralized loans	1,512		1,836	
Residential property loans	619		790	
Other collateralized loans	115		140	

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Total other loans	2,246	2,766
Valuation allowance	(26)	(40)
Total net other loans	2,220	2,726
Total commercial mortgage and other loans(1)	\$ 38,069	\$ 36,733

(1) Includes loans held at fair value.



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

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 (8%) at June 30, 2013.

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

	Commercial Mortgage Loans	Agricultural Property Loans	June 30, 2013			Uncollateralized Loans	Total
			Residential Property Loans	Other Collateralized Loans	(in millions)		
Allowance for losses, beginning of year	\$ 209	\$ 20	\$ 11	\$ 12	\$ 17	\$ 269	
Addition to / (release of) allowance of losses	5	0	(2)	(8)	2	(3)	
Charge-offs, net of recoveries	(15)	0	0	0	0	(15)	
Change in foreign exchange	0	0	(2)	0	(4)	(6)	
<b>Total ending balance</b>	<b>\$ 199</b>	<b>\$ 20</b>	<b>\$ 7</b>	<b>\$ 4</b>	<b>\$ 15</b>	<b>\$ 245</b>	

	Commercial Mortgage Loans	Agricultural Property Loans	December 31, 2012			Uncollateralized Loans	Total
			Residential Property Loans	Other Collateralized Loans	(in millions)		
Allowance for losses, beginning of year	\$ 294	\$ 19	\$ 16	\$ 18	\$ 20	\$ 367	
Addition to / (release of) allowance of losses	(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:

	June 30, 2013						
	Commercial Mortgage Loans	Agricultural Property Loans	Residential Property Loans	Other Collateralized Loans	Uncollateralized Loans		Total
	(in millions)						
<b>Allowance for Credit Losses:</b>							
Ending balance: individually evaluated for impairment	\$ 35	\$ 12	\$ 0	\$ 4	\$ 0		\$ 51
Ending balance: collectively evaluated for impairment	164	8	7	0	15		194
Ending balance: loans acquired with deteriorated credit quality	0	0	0	0	0		0
<b>Total ending balance</b>	<b>\$ 199</b>	<b>\$ 20</b>	<b>\$ 7</b>	<b>\$ 4</b>	<b>\$ 15</b>		<b>\$ 245</b>
<b>Recorded Investment:(1)</b>							
Ending balance gross of reserves: individually evaluated for impairment	\$ 960	\$ 51	\$ 0	\$ 82	\$ 2		\$ 1,095
Ending balance gross of reserves: collectively evaluated for impairment	32,956	2,101	619	33	1,510		37,219
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>\$ 33,916</b>	<b>\$ 2,152</b>	<b>\$ 619</b>	<b>\$ 115</b>	<b>\$ 1,512</b>		<b>\$ 38,314</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 Mortgage Loans	Agricultural Property Loans	Residential Property Loans	Other Collateralized Loans	Uncollateralized Loans		Total
	(in millions)						
<b>Allowance for Credit Losses:</b>							
Ending balance: individually evaluated for impairment	\$ 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:

	June 30, 2013				
	Recorded Investment(1)	Unpaid Principal Balance	Related Allowance (in millions)	Average Recorded Investment Before Allowance(2)	Interest Income Recognized(3)
<b>With no related allowance recorded:</b>					
Commercial mortgage loans	\$ 67	\$ 67	\$ 0	\$ 31	\$ 2
Agricultural property loans	0	0	0	0	0
Residential property loans	0	0	0	0	0
Other collateralized loans	0	0	0	0	0
Uncollateralized loans	0	2	0	0	0
<b>Total with no related allowance</b>	<b>\$ 67</b>	<b>\$ 69</b>	<b>\$ 0</b>	<b>\$ 31</b>	<b>\$ 2</b>
<b>With an allowance recorded:</b>					
Commercial mortgage loans	\$ 121	\$ 121	\$ 35	\$ 152	\$ 1
Agricultural property loans	18	18	12	18	0
Residential property loans	0	0	0	0	0
Other collateralized loans	6	6	3	10	3
Uncollateralized loans	0	0	0	0	0
<b>Total with related allowance</b>	<b>\$ 145</b>	<b>\$ 145</b>	<b>\$ 50</b>	<b>\$ 180</b>	<b>\$ 4</b>
<b>Total:</b>					
Commercial mortgage loans	\$ 188	\$ 188	\$ 35	\$ 183	\$ 3
Agricultural property loans	18	18	12	18	0
Residential property loans	0	0	0	0	0
Other collateralized loans	6	6	3	10	3
Uncollateralized loans	0	2	0	0	0
<b>Total</b>	<b>\$ 212</b>	<b>\$ 214</b>	<b>\$ 50</b>	<b>\$ 211</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 Investment(1)	Unpaid Principal Balance	Related Allowance (in millions)	Average Recorded Investment Before Allowance(2)	Interest Income 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 June 30, 2013 and December 31, 2012 was \$282 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 June 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 June 30, 2013, based upon the recorded investment gross of allowance for credit losses.

**Commercial mortgage loans**

	Debt Service Coverage Ratio June 30, 2013			Total
	Greater than 1.2X	1.0X to <1.2X (in millions)	Less than 1.0X	
<b>Loan-to-Value Ratio</b>				
0%-59.99%	\$ 16,341	\$ 696	\$ 224	\$ 17,261
60%-69.99%	9,502	442	265	10,209
70%-79.99%	4,484	728	180	5,392
Greater than 80%	190	322	542	1,054
Total commercial mortgage loans	\$ 30,517	\$ 2,188	\$ 1,211	\$ 33,916

**Agricultural property loans**

	Debt Service Coverage Ratio June 30, 2013			Total
	Greater than 1.2X	1.0X to <1.2X (in millions)	Less than 1.0X	
<b>Loan-to-Value Ratio</b>				
0%-59.99%	\$ 1,676	\$ 174	\$ 44	\$ 1,894
60%-69.99%	212	0	0	212
70%-79.99%	0	0	0	0
Greater than 80%	0	0	46	46
Total agricultural property loans	\$ 1,888	\$ 174	\$ 90	\$ 2,152

**Total commercial and agricultural mortgage loans**

	Debt Service Coverage Ratio June 30, 2013			Total
	Greater than 1.2X	1.0X to <1.2X	Less than 1.0X	



Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

	(in millions)			
<b>Loan-to-Value Ratio</b>				
0%-59.99%	\$ 18,017	\$ 870	\$ 268	\$ 19,155
60%-69.99%	9,714	442	265	10,421
70%-79.99%	4,484	728	180	5,392
Greater than 80%	190	322	588	1,100
Total commercial and agricultural mortgage loans	\$ 32,405	\$ 2,362	\$ 1,301	\$ 36,068

**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 1.2X	1.0X to <1.2X (in millions)	Less than 1.0X	
<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 1.2X	1.0X to <1.2X (in millions)	Less than 1.0X	
<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 1.2X	1.0X to <1.2X	Less than 1.0X	

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
 Total commercial and agricultural mortgage loans	 \$ 30,108	 \$ 3,020	 \$ 1,108	 \$ 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.

	June 30, 2013							
	Current	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days - Accruing (in millions)	Greater Than 90 Days - Not Accruing	Total Past Due	Total Commercial Mortgage and Other Loans	Non Accrual Status
Commercial mortgage loans	\$ 33,753	\$ 47	\$ 0	\$ 0	\$ 116	\$ 163	\$ 33,916	\$ 188
Agricultural property loans	2,104	0	0	0	48	48	2,152	48
Residential property loans	595	10	3	0	11	24	619	10
Other collateralized loans	113	0	0	0	2	2	115	7
Uncollateralized loans	1,512	0	0	0	0	0	1,512	0
Total	\$ 38,077	\$ 57	\$ 3	\$ 0	\$ 177	\$ 237	\$ 38,314	\$ 253

	December 31, 2012							
	Current	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days - Accruing (in millions)	Greater Than 90 Days - Not Accruing	Total Past Due	Total Commercial Mortgage and Other Loans	Non Accrual Status
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 June 30, 2013, there were no commercial mortgage and other loans acquired, other than those through direct origination. Additionally, there were \$7 million of commercial mortgage and other loans sold, other than those classified as held-for-sale. For the three months ended June 30, 2012, there were no new commercial mortgage and other loans acquired, other than those through direct origination, and no commercial mortgage and other loans sold, other than those classified as held-for-sale.

The Company's commercial mortgage and other loans may occasionally be involved in a troubled debt restructuring. As of both June 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 both the three months and six months ended June 30, 2013 there were adjusted pre-modification outstanding recorded investments of \$100 million and post-modification outstanding recorded investments of \$99 million 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 six months ended June 30, 2013 and 2012 was from the following sources:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in millions)			
Fixed maturities, available-for-sale	\$ 2,641	\$ 2,416	\$ 5,292	\$ 4,817
Fixed maturities, held-to-maturity	30	34	61	68
Equity securities, available-for-sale	94	86	172	162
Trading account assets	234	220	472	451
Commercial mortgage and other loans	492	484	982	971
Policy loans	150	147	298	295
Short-term investments and cash equivalents	11	12	21	24
Other long-term investments	199	71	332	111
Gross investment income	3,851	3,470	7,630	6,899
Less: investment expenses	(140)	(112)	(281)	(221)
Net investment income	\$ 3,711	\$ 3,358	\$ 7,349	\$ 6,678

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

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in millions)			
Fixed maturities	\$ 291	\$ (32)	\$ 344	\$ (95)
Equity securities	94	(24)	171	(37)
Commercial mortgage and other loans	24	10	37	21
Investment real-estate	0	(70)	0	(67)
Joint ventures and limited partnerships	(5)	6	(6)	2
Derivatives(1)	(1,430)	1,874	(2,300)	555
Other	2	(1)	7	0

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Realized investment gains (losses), net	\$ (1,024)	\$ 1,763	\$ (1,747)	\$ 379
---	------------	----------	------------	--------

(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:

	June 30, 2013	December 31, 2012
	(in millions)	
Fixed maturity securities on which an OTTI loss has been recognized	\$ 52	\$ (194)
Fixed maturity securities, available-for-sale all other	18,749	23,876
Equity securities, available-for-sale	2,222	1,518
Derivatives designated as cash flow hedges(1)	(98)	(257)
Other investments(2)	(24)	14
Net unrealized gains (losses) on investments	\$ 20,901	\$ 24,957

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

(2) As of June 30, 2013, includes \$30 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		June 30, 2013 Twelve months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(in millions)					
<b>Fixed maturities(1)</b>						
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ 1,303	\$ 105	\$ 7	\$ 1	\$ 1,310	\$ 106
Obligations of U.S. states and their political subdivisions	1,183	113	0	0	1,183	113
Foreign government bonds	4,588	180	28	3	4,616	183
Corporate securities	46,781	3,613	3,974	345	50,755	3,958
Commercial mortgage-backed securities	3,697	177	104	2	3,801	179



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

Asset-backed securities	1,629	12	2,798	398	4,427	410
Residential mortgage-backed securities	2,225	65	185	6	2,410	71
<b>Total</b>	<b>\$ 61,406</b>	<b>\$ 4,265</b>	<b>\$ 7,096</b>	<b>\$ 755</b>	<b>\$ 68,502</b>	<b>\$ 5,020</b>
<b>Equity securities, available-for-sale</b>	<b>\$ 757</b>	<b>\$ 41</b>	<b>\$ 1</b>	<b>\$ 0</b>	<b>\$ 758</b>	<b>\$ 41</b>

(1) Includes \$421 million of fair value and \$37 million of gross unrealized losses at June 30, 2013, on securities classified as held-to-maturity, a portion of which are 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 Twelve months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(in millions)					
<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>
Equity securities, available-for-sale	\$ 961	\$ 55	\$ 0	\$ 0	\$ 961	\$ 55

(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 are not reflected in AOCL.

The gross unrealized losses at June 30, 2013 and December 31, 2012, are composed of \$4,576 million and \$1,866 million, respectively, related to high or highest quality securities based on NAIC or equivalent rating and \$444 million and \$677 million, respectively, related to other than high or highest quality securities based on NAIC or equivalent rating, respectively. At June 30, 2013, the \$755 million of gross unrealized losses of twelve months or more were concentrated in the finance, utility, and consumer 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 June 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 June 30, 2013, the Company does not intend to sell the securities and it is not more likely than not that the Company will be required to sell the securities before the anticipated recovery of its remaining amortized cost basis.

At June 30, 2013, \$5 million of the gross unrealized losses represented declines in value of greater than 20%, \$5 million 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 June 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.

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

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.

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

	June 30, 2013	December 31, 2012
	(in millions)	
Fixed maturities, available-for-sale	\$ 82	\$ 87
Other trading account assets	2,310	1,409
Commercial mortgage and other loans	62	127
Other long-term investments	0	22
Cash and cash equivalents	577	9
Accrued investment income	9	0
Other assets	124	1
Total assets of consolidated VIEs	\$ 3,164	\$ 1,655
Notes issued by consolidated VIEs	\$ 2,147	\$ 1,577
Other liabilities	571	0
Total liabilities of consolidated VIEs	\$ 2,718	\$ 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 June 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.

***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.

June 30, 2013	December 31, 2012
------------------	----------------------

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

	(in millions)	
Fixed maturities, available-for-sale	\$ 113	\$ 115
Fixed maturities, held-to-maturity	921	1,059
Trading account assets supporting insurance liabilities	11	8
Other long-term investments	80	53
Accrued investment income	4	3
Total assets of consolidated VIEs	\$ 1,129	\$ 1,238
Other liabilities	\$ 1	\$ 1
Total liabilities of consolidated VIEs	\$ 1	\$ 1

---

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

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

The funding agreements represent an intercompany transaction that is eliminated upon consolidation. However, in recognition of the security interest in such funding agreements, the trust's medium-term note liability of \$2,253 million and \$1,780 million at June 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 \$614 million and \$602 million at June 30, 2013 and December 31, 2012, respectively. These investments are reflected in Fixed maturities, available-for-sale, Other trading account assets, at fair value and Other long-term investments. The fair value of assets held within these unconsolidated VIEs was \$9,126 million and \$9,240 million as of June 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 \$58 million and \$64 million as of June 30, 2013 and December 31, 2012, respectively. 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 will invest 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 \$6,852 million and \$6,873 million as of June 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



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

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.

---

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

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 \$2.1 billion as of both June 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 \$318 million and \$314 million at June 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.

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

The excess of Closed Block Liabilities over Closed Block Assets at the date of the demutualization (adjusted to eliminate the impact of related amounts in 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



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

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 June 30, 2013 and December 31, 2012, the Company recognized a policyholder dividend obligation of \$861 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 \$3,725 million and \$5,478 million at June 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 six months ended June 30, 2013.

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:

	June 30, 2013	December 31, 2012
	(in millions)	
<b>Closed Block Liabilities</b>		
Future policy benefits	\$ 50,506	\$ 50,839
Policyholders dividends payable	883	887
Policyholders dividend obligation	4,586	6,363
Policyholders account balances	5,385	5,426
Other Closed Block liabilities	4,339	3,366
<b>Total Closed Block Liabilities</b>	<b>65,699</b>	<b>66,881</b>
<b>Closed Block Assets</b>		
Fixed maturities, available-for-sale, at fair value	39,977	41,980
Other trading account assets, at fair value	222	224
Equity securities, available-for-sale, at fair value	3,465	3,225
Commercial mortgage and other loans	8,831	8,747
Policy loans	5,061	5,120
Other long-term investments	2,170	2,094
Short-term investments	1,635	1,194
<b>Total investments</b>	<b>61,361</b>	<b>62,584</b>
Cash and cash equivalents	407	511
Accrued investment income	544	550
Other Closed Block assets	433	262
<b>Total Closed Block Assets</b>	<b>62,745</b>	<b>63,907</b>

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Excess of reported Closed Block Liabilities over Closed Block Assets	2,954	2,974
Portion of above representing accumulated other comprehensive income:		
Net unrealized investment gains (losses)	3,724	5,467
Allocated to policyholder dividend obligation	(3,725)	(5,478)
Future earnings to be recognized from Closed Block Assets and Closed Block Liabilities	\$ 2,953	\$ 2,963

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

Information regarding the policyholder dividend obligation is as follows:

	<b>Six Months Ended June 30, 2013 (in millions)</b>
Balance, January 1	\$ 6,363
Impact from earnings allocable to policyholder dividend obligation	(24)
Change in net unrealized investment gains (losses) allocated to policyholder dividend obligation	(1,753)
Balance, June 30	\$ 4,586

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

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
	<b>(in millions)</b>			
<b>Revenues</b>				
Premiums	\$ 711	\$ 743	\$ 1,358	\$ 1,414
Net investment income	714	734	1,421	1,467
Realized investment gains (losses), net	(20)	155	76	146
Other income	5	(21)	15	(1)
Total Closed Block revenues	1,410	1,611	2,870	3,026
<b>Benefits and Expenses</b>				
Policyholders' benefits	870	930	1,685	1,789
Interest credited to policyholders' account balances	34	35	68	69
Dividends to policyholders	408	572	911	976
General and administrative expenses	118	123	237	250
Total Closed Block benefits and expenses	1,430	1,660	2,901	3,084
Closed Block revenues, net of Closed Block benefits and expenses, before income taxes and discontinued operations	(20)	(49)	(31)	(58)
Income tax benefit	(25)	(53)	(41)	(65)
Closed Block revenues, net of Closed Block benefits and expenses and income taxes, before discontinued operations	5	4	10	7
Income (loss) from discontinued operations, net of taxes	0	(1)	0	(1)
	\$ 5	\$ 3	\$ 10	\$ 6

Closed Block revenues, net of Closed Block benefits and expenses, income taxes and discontinued operations

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

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

	Issued	Common Stock Held In Treasury	Outstanding (in millions)	Class B Stock Issued and Outstanding
Balance, December 31, 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	3.9	(3.9)	0.0
Stock-based compensation programs(1)	0.0	(3.9)	3.9	0.0
Balance, June 30, 2013	660.1	197.1	463.0	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. As of June 30, 2013, 6.6 million shares of the Company's common stock were repurchased under this authorization at a total cost of \$400 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. 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 six months ended June 30, 2013 and 2012 are as follows:



**Accumulated Other Comprehensive Income (Loss) Attributable to Prudential  
Financial, Inc.**

	Foreign Currency Translation Adjustment	Net Unrealized Investment Gains (Losses)(1)	Pension and Postretirement Unrecognized Net Periodic Benefit (Cost)	Total Accumulated Other Comprehensive Income (Loss)
	(in millions)			
Balance, December 31, 2012	\$ 928	\$ 11,402	\$ (2,116)	\$ 10,214
Change in other comprehensive income before reclassifications	(1,416)	(628)	30	(2,014)
Amounts reclassified from AOCI	0	(524)	63	(461)
Income tax benefit (expense)	401	342	(33)	710
Balance, June 30, 2013	\$ (87)	\$ 10,592	\$ (2,056)	\$ 8,449

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

	Accumulated Other Comprehensive Income (Loss) Attributable to Prudential Financial, Inc.			
	Foreign Currency Translation Adjustment	Net Unrealized Investment Gains (Losses)(1)	Pension and Postretirement Unrecognized Net Periodic Benefit (Cost)  (in millions)	Total Accumulated Other Comprehensive Income (Loss)
Balance, December 31, 2011	\$ 1,107	\$ 5,805	\$ (1,667)	\$ 5,245
Change in component during period(2)	5	2,798	49	2,852
Balance, June 30, 2012	\$ 1,112	\$ 8,603	\$ (1,618)	\$ 8,097

(1) Includes cash flow hedges of \$(98) million and \$(257) million as of June 30, 2013 and December 31, 2012, respectively, and \$(9) million and \$(86) million as of June 30, 2012 and December 31, 2011, respectively.

(2) Net of taxes.

**Reclassifications out of Accumulated Other Comprehensive Income (Loss)**

	Three Months Ended June 30, 2013	Six Months Ended June 30, 2013	Affected line item in Consolidated Statements of Operations
	(in millions)		
<b>Amounts reclassified from AOCI (1)(2):</b>			
Foreign currency translation adjustment:			
Foreign currency translation adjustment	\$ 1	\$ 0	Realized investment gains (losses), net
Foreign currency translation adjustment	0	0	Other income
Total foreign currency translation adjustment	1	0	
Net unrealized investment gains (losses):			
Cash flow hedges Interest Rate	(8)	(12)	(3)
Cash flow hedges Currency/Interest rate	(26)	(44)	(3)
Net unrealized investment gains (losses) on available-for-sale securities	384	514	
Net unrealized investment gains (losses) all other	0	66	
Total net unrealized investment gains (losses)	350	524	(4)
Amortization of defined benefit pension items:			
Prior service cost	5	11	(5)
Actuarial gain (loss)	(37)	(74)	(5)

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

Transition obligation	0	0	(5)
Total amortization of defined benefit pension items	(32)	(63)	
Total reclassifications for the period	\$ 319	\$ 461	

- (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 Gains (Losses) on Investments	Deferred Policy Acquisition Costs, Deferred Sales Inducements, and Value of Business Acquired	Future Policy Benefits	Policyholders Dividends	Deferred Income Tax (Liability) Benefit	Accumulated Other Comprehensive Income (Loss) Related To Net Unrealized Investment Gains (Losses)
	(in millions)					
Balance, December 31, 2012	\$ (194)	\$ 3	\$ 3	\$ 139	\$ 18	\$ (31)
Net investment gains (losses) on investments arising during the period	206				(72)	134
Reclassification adjustment for (gains) losses included in net income	42				(15)	27
Reclassification adjustment for OTTI losses excluded from net income(1)	(2)				1	(1)
Impact of net unrealized investment (gains) losses on deferred policy acquisition costs, deferred sales inducements and value of business acquired		(5)			2	(3)
Impact of net unrealized investment (gains) losses on future policy benefits			2		(1)	1
Impact of net unrealized investment (gains) losses on policyholders' dividends				(78)	27	(51)
Balance, June 30, 2013	\$ 52	\$ (2)	\$ 5	\$ 61	\$ (40)	\$ 76

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

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

	Net Unrealized Gains (Losses) on Investments(1)	Deferred Policy Acquisition Costs, Deferred Sales Inducements, and Value of Business Acquired	Future Policy Benefits	Policyholders Dividends	Deferred Income Tax (Liability) Benefit	Accumulated Other Comprehensive Income (Loss) Related To Net Unrealized Investment Gains (Losses)
(in millions)						
Balance, December 31, 2012	\$ 25,151	\$ (1,228)	\$ (1,144)	\$ (5,627)	\$ (5,719)	\$ 11,433
Net investment gains (losses) on investments arising during the period	(3,738)				1,249	(2,489)
Reclassification adjustment for (gains) losses included in net income	(566)				198	(368)
Reclassification adjustment for OTTI losses excluded from net income(2)	2				(1)	1
Impact of net unrealized investment (gains) losses on deferred policy acquisition costs, deferred sales inducements and value of business acquired		470			(165)	305
Impact of net unrealized investment (gains) losses on future policy benefits			681		(239)	442
Impact of net unrealized investment (gains) losses on policyholders dividends				1,833	(641)	1,192
Balance, June 30, 2013	\$ 20,849	\$ (758)	\$ (463)	\$ (3,794)	\$ (5,318)	\$ 10,516

(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.

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

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

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

premiums. To the extent reported administrative expenses vary from these cash flow amounts, the differences are recorded, on an after tax basis, as direct equity adjustments to the equity balances of the businesses.

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

**Common Stock**

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

	Income	Three Months Ended June 30,				Per Share Amount
		2013 Weighted Average Shares	Per Share Amount	Income	2012 Weighted Average Shares	
(in millions, except per share amounts)						
<b>Basic earnings per share</b>						
Income (loss) from continuing operations attributable to the Financial Services Businesses	\$ (491)			\$ 2,236		
Direct equity adjustment	1			8		
Less: Income attributable to noncontrolling interests	35			15		
Less: Dividends and undistributed earnings allocated to participating unvested share-based payment awards	2			21		
Income (loss) from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment	\$ (527)	464.1	\$ (1.14)	\$ 2,208	466.1	\$ 4.74
<b>Effect of dilutive securities and compensation programs(1)</b>						
Add: Dividends and undistributed earnings allocated to participating unvested share-based payment awards Basic	\$ 2			\$ 21		
Less: Dividends and undistributed earnings allocated to participating unvested share-based payment awards Diluted	2			21		
Stock options		0.0			1.8	
Deferred and long-term compensation programs		0.0			0.5	
Exchangeable Surplus Notes	0	0.0		5	5.1	
<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	\$ (527)	464.1	\$ (1.14)	\$ 2,213	473.5	\$ 4.67





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

	Income	Six Months Ended June 30,		Income	2012 Weighted Average Shares	Per Share Amount
		2013 Weighted Average Shares	Per Share Amount			
<b>Basic earnings per share</b>						
Income (loss) from continuing operations attributable to the Financial Services Businesses	\$ (1,171)			\$ 1,280		
Direct equity adjustment	5			16		
Less: Income attributable to noncontrolling interests	77			26		
Less: Dividends and undistributed earnings allocated to participating unvested share-based payment awards	4			13		
Income (loss) from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment	\$ (1,247)	464.2	\$ (2.69)	\$ 1,257	467.7	\$ 2.69
<b>Effect of dilutive securities and compensation programs(1)</b>						
Add: Dividends and undistributed earnings allocated to participating unvested share-based payment awards Basic	\$ 4			\$ 13		
Less: Dividends and undistributed earnings allocated to participating unvested share-based payment awards Diluted	4			13		
Stock options		0.0			2.2	
Deferred and long-term compensation programs		0.0			0.5	
Exchangeable Surplus Notes	0	0.0		9	5.1	
<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	\$ (1,247)	464.2	\$ (2.69)	\$ 1,266	475.5	\$ 2.66

(1) For the three and six months ended June 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 and six months ended June 30, 2013, all potential stock options and compensation programs were considered antidilutive.

Unvested share-based payment awards that contain nonforfeitable rights to dividends are participating securities and included in the computation of earnings per share pursuant to the two-class method. Under this method, earnings of the Financial Services Businesses attributable to Prudential Financial, Inc. are allocated between Common Stock and the participating awards, as if the awards were a second class of stock. For the three and six months ended June 30, 2013, undistributed earnings were not allocated to participating unvested share-

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

based payment awards as these awards do not participate in losses. Undistributed earnings allocated to participating unvested share-based payment awards for the three and six months ended June 30, 2012 were based on 4.4 million and 4.8 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.

For both the three and six months ended June 30, 2013, 20.4 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, are considered antidilutive and therefore excluded from the computation of diluted earnings per share. Included in these amounts are 11.3 million options and 5.2 million shares and 9.2 million options and 5.2 million shares for the three and six months ended June 30, 2013, respectively, that are antidilutive due to the loss from continuing operations available to holders of Common Stock after direct equity adjustment. The remaining options were considered antidilutive based on application of the treasury stock method. For the three and six months ended June 30, 2012, 14.3 million and 12.6 million options, respectively, weighted for the portion of the period they were outstanding, with a weighted average exercise price of \$69.05 and \$70.74 per share, respectively, were excluded from the computation of diluted earnings per share because the options, based on application of the treasury stock method, were antidilutive.

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

**Class B Stock**

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

	Income	2013 Weighted Average Shares	Three Months Ended June 30,		2012 Weighted Average Shares	Per Share Amount
			Per Share Amount	Income		
(in millions, except per share amounts)						
<b>Basic earnings per share</b>						
Income (loss) from continuing operations attributable to the Closed Block Business	\$ 3				\$ (4)	
Less: Direct equity adjustment	1			8		
	\$ 2	2.0	\$ 1.00	\$ (12)	2.0	\$ (6.00)

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Income (loss) from continuing operations attributable to the  
Closed Block Business available to holders of Class B Stock  
after direct equity adjustment

47

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

	Six Months Ended June 30,					
	Income	2013 Weighted Average Shares	Per Share Amount	Income	2012 Weighted Average Shares	Per Share Amount
	(in millions, except per share amounts)					
<b>Basic earnings per share</b>						
Income (loss) from continuing operations attributable to the Closed Block Business	\$ 18			\$ 17		
Less: Direct equity adjustment	5			16		
Income (loss) from continuing operations attributable to the Closed Block Business available to holders of Class B Stock after direct equity adjustment	\$ 13	2.0	\$ 6.50	\$ 1	2.0	\$ 0.50

**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:

	June 30, 2013	December 31, 2012
	(in millions)	
Commercial paper:		
Prudential Financial	\$ 201	\$ 113
Prudential Funding, LLC	792	359
Subtotal commercial paper	993	472
Other notes payable(1)	109	100
Current portion of long-term debt(2)	1,518	1,912
Total short-term debt(3)	\$ 2,620	\$ 2,484
<b>Supplemental short-term debt information:</b>		
Portion of commercial paper borrowings due overnight	\$ 315	\$ 156
Daily average commercial paper outstanding	\$ 1,220	\$ 1,194
Weighted average maturity of outstanding commercial paper, in days	30	21
Weighted average interest rate on outstanding short-term debt(4)	0.23 %	0.28 %

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

- (1) Includes collateralized borrowings from the Federal Home Loan Bank of New York of \$100 million at both June 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 June 30, 2013 and December 31, 2012.
- (3) Includes Prudential Financial debt of \$1,213 million and \$1,847 million at June 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.

---

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

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 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 \$6.6 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 June 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 June 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 June 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 \$2.9 billion as of June 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

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

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 June 30, 2013, PRIAC had no advances outstanding under the FHLBB facility.



**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

The Connecticut Department of Insurance, or CTDOI, permits PRIAC to pledge up to \$2.6 billion in qualifying assets to secure FHLBB borrowings through December 31, 2013. PRIAC must seek re-approval from CTDOI prior to borrowing additional funds after that date. Based on available eligible assets as of June 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 \$1.7 billion.

***Credit Facilities***

As of June 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 may be used for general corporate purposes, including as backup liquidity for the Company's commercial paper programs discussed above. As of June 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 June 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 June 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 June 30, 2013, the outstanding balance of medium-term notes under this program was \$12.1 billion, a decrease of \$1.1 billion from December 31, 2012, due to maturities during the first quarter.

*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 June 30, 2013, the outstanding balance of retail notes was \$297 million. This represents a decrease of \$610

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

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 %.

*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 (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 June 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*

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:

	Three Months Ended June 30,			
	Pension Benefits		Other Postretirement Benefits	
	2013	2012	2013	2012
	(in millions)			
<b>Components of net periodic (benefit) cost</b>				
Service cost	\$ 62	\$ 60	\$ 4	\$ 4
Interest cost	109	118	22	25
Expected return on plan assets	(192)	(202)	(21)	(22)
Amortization of prior service cost	(2)	4	(3)	(3)
Amortization of actuarial (gain) loss, net	23	11	14	13
<b>Net periodic (benefit) cost</b>	<b>\$ 0</b>	<b>\$ (9)</b>	<b>\$ 16</b>	<b>\$ 17</b>

	Six Months Ended June 30,			
	Pension Benefits		Other Postretirement Benefits	
	2013	2012	2013	2012
	(in millions)			
Service cost	\$ 127	\$ 121	\$ 8	\$ 7
Interest cost	219	237	44	51
Expected return on plan assets	(384)	(404)	(42)	(44)
Amortization of prior service cost	(5)	7	(6)	(6)
Amortization of actuarial (gain) loss, net	46	22	28	27
Special termination benefits	2	2	0	0
<b>Net periodic (benefit) cost</b>	<b>\$ 5</b>	<b>\$ (15)</b>	<b>\$ 32</b>	<b>\$ 35</b>

**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 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

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

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 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 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

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

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.

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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in millions)			
Net gains (losses) from:				
Terminated hedges of foreign currency earnings	\$ 67	\$ (21)	\$ 103	\$ (48)
Current period yield adjustments	\$ 103	\$ 78	\$ 205	\$ 146
Principal source of earnings	\$ 43	\$ (26)	\$ 69	\$ (23)



---

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

*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 June 30, 2013 and 2012, respectively, and \$36 million and \$30 million for the six months ended June 30, 2013 and 2012, respectively. Additionally, as of June 30, 2013, there was a \$539 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 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.

**Table of Contents****PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)***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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in millions)			
Net gains (losses) from:				
Other trading account assets	\$ 36	\$ (33)	\$ 85	\$ 33
Foreign currency exchange movements	\$ (1,560)	\$ 1,503	\$ (4,025)	\$ 124
Other activities	\$ 1	\$ 17	\$ 112	\$ 38

*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.

*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:

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

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 \$117 million in the first quarter of 2013 and \$12 million in the second quarter of 2012. These 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.

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

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 \$4 million and \$8 million for the three months ended June 30, 2013 and 2012, respectively, and net gains of \$2 million and \$34 million for the six months ended June 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 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

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

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. 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)*,

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

*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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in millions)			
Adjusted Operating Income before income taxes for Financial Services Businesses by Segment:				
Individual Annuities	\$ 400	\$ 107	\$ 772	\$ 528
Retirement	279	147	507	303
Asset Management	168	52	347	184
<b>Total U.S. Retirement Solutions and Investment Management Division</b>	<b>847</b>	<b>306</b>	<b>1,626</b>	<b>1,015</b>
Individual Life	141	61	278	173
Group Insurance	22	33	31	(7)
<b>Total U.S. Individual Life and Group Insurance Division</b>	<b>163</b>	<b>94</b>	<b>309</b>	<b>166</b>
<b>International Insurance</b>	<b>850</b>	<b>678</b>	<b>1,727</b>	<b>1,275</b>
<b>Total International Insurance Division</b>	<b>850</b>	<b>678</b>	<b>1,727</b>	<b>1,275</b>
<b>Corporate Operations</b>	<b>(347)</b>	<b>(225)</b>	<b>(661)</b>	<b>(552)</b>
<b>Total Corporate and Other</b>	<b>(347)</b>	<b>(225)</b>	<b>(661)</b>	<b>(552)</b>
<b>Adjusted Operating Income before income taxes for Financial Services Businesses</b>	<b>1,513</b>	<b>853</b>	<b>3,001</b>	<b>1,904</b>
Reconciling items:				
Realized investment gains (losses), net, and related adjustments	(2,698)	3,058	(6,003)	342
Charges related to realized investment gains (losses), net	468	(1,028)	770	(150)
Investment gains (losses) on trading account assets supporting insurance liabilities, net	(471)	4	(376)	238
Change in experience-rated contractholder liabilities due to asset value changes	471	54	328	(192)
Divested businesses	(84)	22	(55)	23
Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests	31	8	1	13
<b>Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures for Financial Services Businesses</b>	<b>(770)</b>	<b>2,971</b>	<b>(2,334)</b>	<b>2,178</b>
<b>Income from continuing operations before income taxes and equity in earnings of operating joint ventures for Closed Block Business</b>	<b>4</b>	<b>(2)</b>	<b>23</b>	<b>28</b>

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures	\$ (766)	\$ 2,969	\$ (2,311)	\$ 2,206
---	----------	----------	------------	----------



**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 June 30,		Six Months Ended June 30,		June 30,	December 31,
	2013	2012	2013	2012	2013	2012
	(in millions)					
<b>Financial Services Businesses:</b>						
Individual Annuities	\$ 1,119	\$ 968	\$ 2,187	\$ 1,926	\$ 148,625	\$ 146,893
Retirement	1,521	1,242	2,857	2,349	166,784	168,262
Asset Management	665	492	1,325	1,046	42,817	41,909
<b>Total U.S. Retirement Solutions and Investment Management Division</b>	<b>3,305</b>	<b>2,702</b>	<b>6,369</b>	<b>5,321</b>	<b>358,226</b>	<b>357,064</b>
Individual Life	1,212	803	2,367	1,579	60,749	47,371
Group Insurance	1,399	1,392	2,801	2,783	38,365	38,754
<b>Total U.S. Individual Life and Group Insurance Division</b>	<b>2,611</b>	<b>2,195</b>	<b>5,168</b>	<b>4,362</b>	<b>99,114</b>	<b>86,125</b>
International Insurance	5,940	6,406	12,290	12,223	166,132	183,794
<b>Total International Insurance Division</b>	<b>5,940</b>	<b>6,406</b>	<b>12,290</b>	<b>12,223</b>	<b>166,132</b>	<b>183,794</b>
Corporate Operations	(133)	(72)	(286)	(195)	13,609	12,325
<b>Total Corporate and Other</b>	<b>(133)</b>	<b>(72)</b>	<b>(286)</b>	<b>(195)</b>	<b>13,609</b>	<b>12,325</b>
<b>Total</b>	<b>11,723</b>	<b>11,231</b>	<b>23,541</b>	<b>21,711</b>	<b>637,081</b>	<b>639,308</b>
<b>Reconciling items:</b>						
Realized investment gains (losses), net, and related adjustments	(2,700)	3,058	(6,005)	341		
Charges related to realized investment gains (losses), net	(85)	(23)	(154)	(52)		
Investment gains (losses) on trading account assets supporting insurance liabilities, net	(471)	4	(376)	238		
Divested businesses	117	195	316	381		
Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests	(4)	(7)	(76)	(13)		

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Total Financial Services Businesses	8,580	14,458	17,246	22,606	637,081	639,308
Closed Block Business	1,464	1,678	2,983	3,153	68,534	69,990
Total per Unaudited Interim Consolidated Financial Statements	\$ 10,044	\$ 16,136	\$ 20,229	\$ 25,759	\$ 705,615	\$ 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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in millions)			
Asset Management segment intersegment revenues	\$ 152	\$ 135	\$ 303	\$ 266

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 February 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

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

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 six months of 2013.

For tax years 2007 through 2012, 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 Gibraltar</b>	<b>Star and Edison Businesses (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
Six 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 six 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 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

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

cash equivalents and short term investments, equity securities and derivative contracts that trade on an active exchange market.

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.

	Level 1	Level 2	As of June 30, 2013		Total
			Level 3	Netting(1)	
			(in millions)		
<b>Fixed maturities, available-for-sale:</b>					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	\$ 0	\$ 14,935	\$ 0	\$	\$ 14,935
Obligations of U.S. states and their political subdivisions	0	3,613	0		3,613
Foreign government bonds	0	78,799	13		78,812
Corporate securities	0	155,824	1,383		157,207
Asset-backed securities	0	6,892	4,009		10,901
Commercial mortgage-backed securities	0	12,615	243		12,858
Residential mortgage-backed securities	0	7,770	11		7,781
<b>Subtotal</b>	<b>0</b>	<b>280,448</b>	<b>5,659</b>		<b>286,107</b>
<b>Trading account assets:(2)</b>					
U.S. Treasury securities and obligations of U.S. government authorities and agencies	0	334	0		334
Obligations of U.S. states and their political subdivisions	0	229	0		229
Foreign government bonds	2	662	0		664
Corporate securities	0	14,691	90		14,781
Asset-backed securities	0	844	424		1,268
Commercial mortgage-backed securities	0	2,484	54		2,538
Residential mortgage-backed securities	0	1,754	2		1,756
Equity securities	1,114	210	884		2,208
All other(3)	736	9,962	14	(7,749)	2,963
<b>Subtotal</b>	<b>1,852</b>	<b>31,170</b>	<b>1,468</b>	<b>(7,749)</b>	<b>26,741</b>
Equity securities, available-for-sale	6,032	2,430	292		8,754
Commercial mortgage and other loans	0	282	21		303
Other long-term investments	92	210	1,082	8	1,392
Short-term investments	5,878	2,171	0		8,049
Cash equivalents	2,322	5,811	0		8,133
Other assets	3	218	6		227
<b>Subtotal excluding separate account assets</b>	<b>16,179</b>	<b>322,740</b>	<b>8,528</b>	<b>(7,741)</b>	<b>339,706</b>
Separate account assets(4)	45,330	197,052	21,672		264,054
<b>Total assets</b>	<b>\$ 61,509</b>	<b>\$ 519,792</b>	<b>\$ 30,200</b>	<b>\$ (7,741)</b>	<b>\$ 603,760</b>
Future policy benefits	\$ 0	\$ 0	\$ 365	\$	\$ 365
Other liabilities	3	7,541	6	(7,031)	519
Notes of consolidated VIEs	0	0	2,055		2,055



Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Total liabilities	\$	3	\$	7,541	\$	2,426	\$	(7,031)	\$	2,939
-------------------	----	---	----	-------	----	-------	----	---------	----	-------

**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 (in millions)	Netting(1)	
<b>Fixed maturities, available-for-sale:</b>					
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
<b>Subtotal</b>	<b>0</b>	<b>295,868</b>	<b>5,468</b>		<b>301,336</b>
<b>Trading account assets:(2)</b>					
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
<b>Subtotal</b>	<b>1,864</b>	<b>33,719</b>	<b>1,698</b>	<b>(10,363)</b>	<b>26,918</b>
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
<b>Subtotal excluding separate account assets</b>	<b>14,027</b>	<b>345,746</b>	<b>8,605</b>	<b>(10,117)</b>	<b>358,261</b>
Separate account assets(4)	39,362	192,760	21,132		253,254
<b>Total assets</b>	<b>\$ 53,389</b>	<b>\$ 538,506</b>	<b>\$ 29,737</b>	<b>\$ (10,117)</b>	<b>\$ 611,515</b>
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
<b>Total liabilities</b>	<b>\$ 0</b>	<b>\$ 8,121</b>	<b>\$ 4,754</b>	<b>\$ (8,031)</b>	<b>\$ 4,844</b>

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

- (1) Netting amounts represent cash collateral of \$710 million and \$2,086 million as of June 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.

---

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

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.

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 June 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 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

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

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.

**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

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

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.

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

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

The majority of the Company's derivative positions are traded in the over-the-counter (OTC) derivative market and are classified within Level 2 in the fair value hierarchy. OTC derivatives classified within Level 2 are valued using models 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 London Interbank Offered Rate (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) with some significant unobservable market inputs or inputs (e.g., interest rates, equity indices, dividend yields, etc.) from less actively traded markets (e.g., model-specific input values, including volatility parameters, etc.). Level 3 methodologies are validated through periodic comparison of the Company's fair values to broker-dealer values.

**Cash Equivalents and Short-Term Investments** Cash equivalents and short-term investments include money market instruments, commercial paper and other highly liquid debt instruments. 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.

**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.

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

**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 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 historical experience giving consideration to any observable market data, including 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 June 30, 2013, \$50 million of separate account assets were transferred from Level 1 to Level 2 and \$6 million were transferred from Level 2 to Level 1. During the six months ended June 30, 2013, \$56 million were transferred from Level 1 to Level 2 and \$2.3 billion were transferred from Level 2 to Level 1. During the three months ended June 30, 2012, \$2.9 billion of separate account assets were transferred from Level 1 to Level 2. There were no transfers from Level 2 to Level 1. During the six months ended June 30, 2012, \$2.9 billion were transferred from Level 1 to Level 2 and \$31 million 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 June 30, 2013		
	Internal(1)	External(2) (in millions)	Total
Foreign government bonds	\$ 0	\$ 13	\$ 13
Corporate securities	711	762	1,473
Asset-backed securities	287	4,146	4,433
Commercial mortgage-backed securities	39	258	297
Residential mortgage-backed securities	4	9	13
Equity securities	114	1,062	1,176
Commercial mortgage and other loans	21	0	21
Other long-term investments	10	1,072	1,082
Other assets	20	0	20
Subtotal excluding separate account assets(3)	1,206	7,322	8,528
Separate account assets	20,771	901	21,672
Total assets	\$ 21,977	\$ 8,223	\$ 30,200
Future policy benefits	\$ 365	\$ 0	\$ 365
Other liabilities	6	0	6
Notes of consolidated VIEs	0	2,055	2,055
Total liabilities	\$ 371	\$ 2,055	\$ 2,426

	As of December 31, 2012		
	Internal(1)	External(2) (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 June 30, 2013

	Fair Value (in millions)	Valuation Techniques	Unobservable Inputs	Minimum	Maximum	Weighted Average	Impact of Increase in Input on Fair Value (1)
<b>Assets:</b>							
Corporate securities	\$ 711	Discounted cash flow	Discount rate	1.53%	- 15%	8.88%	Decrease
		Market comparables	EBITDA multiples(2)	5.5X	- 8.0X	6.55X	Increase
		Cap at call price	Call price	100%	- 117.77%	112.61%	Increase
		Liquidation	Liquidation value	20.95%	- 88.0%	66.16%	Increase
Asset-backed securities	\$ 287	Discounted cash flow	Prepayment rate(3)	2.82%	- 27.41%	4.17%	Increase
			Default rate(3)	0.49%	- 19.19%	2.78%	Decrease
			Loss severity(3)	16.36%	- 41.47%	29.37%	Decrease
			Liquidity premium	1.00%	- 2.00%	1.85%	Decrease
			Average life (years)	0.82	- 14.78	5.51	Increase
			Comparable spreads	0.50%	- 20.47%	3.72%	Decrease
			Comparable security yields	0.70%	- 12.88%	7.62%	Decrease
			Call price	100%	- 100%	100.0%	Increase
<b>Liabilities:</b>							
Future policy benefits(4)	\$ 365	Discounted cash flow	Lapse rate(5)	0%	- 14%		Decrease
			NPR spread(6)	0.11%	- 1.59%		Decrease
			Utilization rate(7)	70%	- 94%		Increase
			Withdrawal rate(8)	85%	- 100%		Increase
			Mortality rate(9)	0%	- 13%		Decrease
			Equity volatility curve	18%	- 33%		Increase

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

As of December 31, 2012

	Fair Value (in millions)	Valuation Techniques	Unobservable Inputs	Minimum	Maximum	Weighted Average	Impact of Increase in Input on Fair 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
			Withdrawal rate(8)	85%	- 100%		Increase
			Mortality rate(9)	0%	- 13%		Decrease
			Equity volatility curve	19%	- 34%		Increase

- (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 actuarially calculated guaranteed 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 guaranteed 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

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

to standard industry tables. A mortality improvement assumption is also incorporated into the overall mortality table.

---

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

**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 a long-term view of historical experience. While experience for these products is still emerging, the Company expects efficient benefit utilization and withdrawal rates to generally be correlated 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 guaranteed 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 \$19,892 million and \$19,518 million of investments in real estate as of June 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

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

included in the Level 3 classification. Key unobservable inputs to real estate valuation include capitalization rates, which ranged from 4.50% to 9.75% (6.34% weighted average) as of June 30, 2013 and 4.75% to 10.5% (6.49% weighted average) as of December 31, 2012 and discount rates, which ranged from 6.0% to 15.0% (7.71% weighted average) as of June 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 2.20% to 6.67% (4.17% weighted average) as of June 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% (2.19% weighted average) as of June 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 June 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 2.03% (1.65% weighted average) as of June 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 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 historical experience giving consideration to any observable market data, including 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 June 30, 2013						
	Fixed Maturities Available-For-Sale						
	U.S. Government	U.S. States	Foreign Government	Corporate	Asset- Backed	Commercial Mortgage- Backed	Residential Mortgage- Backed
	(in millions)						
Fair Value, beginning of period	\$ 0	\$ 0	\$ 1	\$ 1,582	\$ 3,797	\$ 175	\$ 10
Total gains (losses) (realized/unrealized):							
Included in earnings:							
Realized investment gains (losses), net	0	0	0	15	6	1	0
Included in other comprehensive income (loss)	0	0	(1)	(26)	(17)	0	0
Net investment income	0	0	0	1	9	0	0
Purchases	0	0	0	82	852	149	0
Sales	0	0	0	(18)	(186)	0	0
Issuances	0	0	0	0	0	0	0
Settlements	0	0	0	(211)	(409)	(4)	1
Foreign currency translation	0	0	0	(48)	(43)	(3)	0
Transfers into Level 3(2)	0	0	13	228	0	0	0
Transfers out of Level 3(2)	0	0	0	(222)	0	(75)	0
Fair Value, end of period	\$ 0	\$ 0	\$ 13	\$ 1,383	\$ 4,009	\$ 243	\$ 11
Unrealized gains (losses) for assets still held(3):							
Included in earnings:							
Realized investment gains (losses), net	\$ 0	\$ 0	\$ 0	\$ 0	\$ 1	\$ 0	\$ 0

	Three Months Ended June 30, 2013						
	Trading Account Assets						
	U.S Government	Corporate	Asset- Backed	Commercial Mortgage- Backed	Residential Mortgage- Backed	Equity	All Other Activity
	(in millions)						
Fair Value, beginning of period	\$ 0	\$ 102	\$ 385	\$ 31	\$ 2	\$ 998	\$ 15
Total gains (losses) (realized/unrealized):							
Included in earnings:							
Realized investment gains (losses), net	0	0	0	0	0	(1)	(1)
Asset management fees and other income	0	1	7	0	0	17	0
Net investment income	0	0	1	0	0	0	0
Purchases	0	3	118	49	0	(1)	0
Sales	0	(3)	0	0	0	(62)	0
Issuances	0	0	0	0	0	0	0
Settlements	0	(12)	(84)	0	0	(12)	0
Foreign currency translation	0	0	(3)	0	0	(55)	0

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Transfers into Level 3(2)	0	3	1	0	0	0	0
Transfers out of Level 3(2)	0	(4)	(1)	(26)	0	0	0
Fair Value, end of period	\$ 0	\$ 90	\$ 424	\$ 54	\$ 2	\$ 884	\$ 14
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	\$ 7	\$ 1	\$ 0	\$ 18	\$ 0

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

	Three Months Ended June 30, 2013			
	Equity Securities Available- For-Sale	Commercial Mortgage and Other Loans	Other Long-term Investments	Other Assets
	(in millions)			
Fair Value, beginning of period	\$ 302	\$ 48	\$ 1,037	\$ 6
Total gains (losses) (realized/unrealized):				
Included in earnings:				
Realized investment gains (losses), net	3	2	2	0
Asset management fees and other income	0	0	49	0
Included in other comprehensive income (loss)	7	0	0	0
Net investment income	0	0	(2)	0
Purchases	10	0	32	0
Sales	(9)	0	41	0
Issuances	0	0	6	0
Settlements	(3)	(29)	(37)	0
Foreign currency translation	(23)	0	20	0
Other(1)	0	0	(66)	0
Transfers into Level 3(2)	1	0	0	0
Transfers out of Level 3(2)	4	0	0	0
Fair Value, end of period	\$ 292	\$ 21	\$ 1,082	\$ 6

Unrealized gains (losses) for assets still held (3):				
Included in earnings:				
Realized investment gains (losses), net	\$ 0	\$ 0	\$ (3)	\$ 0
Asset management fees and other income	\$ 0	\$ 0	\$ 33	\$ 0

	Three Months Ended June 30, 2013			
	Separate Account Assets(4)	Future Policy Benefits	Other Liabilities	Notes of consolidated VIEs
	(in millions)			
Fair Value, beginning of period	\$ 20,984	\$ (1,900)	\$ 0	\$ (1,768)
Total gains (losses) (realized/unrealized):				
Included in earnings:				
Realized investment gains (losses), net	0	1,744	(4)	4
Interest credited to policyholders' account balances	600	0	0	0
Purchases	583	0	0	0
Sales	(257)	0	0	0
Issuances	0	(209)	0	(291)
Settlements	(419)	0	0	0
Other(1)	140	0	(2)	0
Transfers into Level 3(2)	57	0	0	0
Transfers out of Level 3(2)	(16)	0	0	0
Fair Value, end of period	\$ 21,672	\$ (365)	\$ (6)	\$ (2,055)

## 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	\$ 1,730	\$ 0	\$ 5
Interest credited to policyholders account	\$ 363	\$ 0	\$ 0	\$ 0

75

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

	Six Months Ended June 30, 2013						
	Fixed Maturities Available-For-Sale						
	U.S. Government States	U.S. Corporate	Foreign Government	Corporate (in millions)	Asset- Backed	Commercial Mortgage- Backed	Residential Mortgage- 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	6	11	1	0
Included in other comprehensive income (loss)	0	0	(1)	12	(1)	(1)	0
Net investment income	0	0	0	2	21	0	0
Purchases	0	0	4	302	1,383	237	0
Sales	0	0	(1)	(60)	(226)	(3)	0
Issuances	0	0	0	0	0	0	0
Settlements	0	0	(2)	(397)	(785)	(31)	0
Foreign currency translation	0	0	0	(111)	(105)	(9)	0
Transfers into Level 3(2)	0	0	13	233	8	0	0
Transfers out of Level 3(2)	0	0	0	(234)	0	(75)	0
Fair Value, end of period	\$ 0	\$ 0	\$ 13	\$ 1,383	\$ 4,009	\$ 243	\$ 11
Unrealized gains (losses) for assets still held(3):							
Included in earnings:							
Realized investment gains (losses), net	\$ 0	\$ 0	\$ 0	\$ 0	\$ 5	\$ 0	\$ 0

	Six Months Ended June 30, 2013						
	Trading Account Assets						
	U.S. Government	U.S. Corporate	Asset- Backed	Commercial Mortgage- Backed (in millions)	Residential Mortgage- Backed	Equity	All Other 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)	(12)
Asset management fees and other income	0	(1)	8	0	0	40	1
Net investment income	0	0	2	0	0	0	0
Purchases	0	3	165	76	0	3	0
Sales	0	(5)	(1)	(1)	0	(103)	0
Issuances	0	0	0	0	0	0	0
Settlements	0	(40)	(172)	(1)	0	(13)	0
Foreign currency translation	0	0	(8)	(1)	0	(140)	0
Transfers into Level 3(2)	0	3	2	0	0	0	0
Transfers out of Level 3(2)	0	(4)	(2)	(27)	0	0	0
Fair Value, end of period	\$ 0	\$ 90	\$ 424	\$ 54	\$ 2	\$ 884	\$ 14
Unrealized gains (losses) for assets still held(3):							

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Included in earnings:

Realized investment gains (losses), net	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ (13)
Asset management fees and other income	\$ 0	\$ (1)	\$ 9	\$ 1	\$ 0	\$ 38	\$ 1	



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

	Six Months Ended June 30, 2013			
	Equity Securities Available- For-Sale	Commercial Mortgage and Other Loans	Other Long-term Investments	Other 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	1	2	1	(2)
Asset management fees and other income	0	0	84	0
Included in other comprehensive income (loss)	43	0	0	0
Net investment income	0	0	(2)	0
Purchases	12	0	59	0
Sales	(23)	0	0	0
Issuances	0	0	6	0
Settlements	(3)	(29)	(98)	0
Foreign currency translation	(51)	0	19	0
Other(1)	(18)	0	(40)	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	\$ 292	\$ 21	\$ 1,082	\$ 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	\$ 82	\$ 0

	Six Months Ended June 30, 2013			
	Separate Account Assets(4)	Future Policy Benefits	Other Liabilities	Notes of consolidated 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	3,388	(4)	2
Interest credited to policyholders' account balances	1,148	0	0	0
Purchases	781	0	0	0
Sales	(317)	0	0	0
Issuances	0	(407)	0	(640)
Settlements	(1,221)	0	0	(11)
Foreign currency translation	0	2	0	0
Other(1)	140	0	(2)	0
Transfers into Level 3(2)	59	0	0	0
Transfers out of Level 3(2)	(50)	0	0	0
Fair Value, end of period	\$ 21,672	\$ (365)	\$ (6)	\$ (2,055)

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	\$ 3,346	\$ (3)	\$ 2
Interest credited to policyholders' account	\$ 681	\$ 0	\$ 0	\$ 0

77

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

	Three Months Ended June 30, 2012 Fixed Maturities Available-For-Sale						
	U.S. Government	U.S. States	Foreign Government	Corporate (in millions)	Asset- Backed	Commercial Mortgage- Backed	Residential Mortgage- Backed
Fair Value, beginning of period	\$ 68	\$ 10	\$ 26	\$ 1,633	\$ 2,665	\$ 161	\$ 14
Total gains (losses) (realized/unrealized):							
Included in earnings:							
Realized investment gains (losses), net	0	0	0	(27)	6	0	0
Included in other comprehensive income (loss)	0	0	0	26	(7)	(6)	0
Net investment income	0	0	0	3	8	(1)	1
Purchases	0	0	(1)	49	664	14	0
Sales	0	0	0	(8)	(35)	0	0
Issuances	0	0	0	0	0	0	0
Settlements	(2)	0	0	(78)	(213)	(1)	(2)
Foreign currency translation	0	0	0	18	19	2	0
Transfers into Level 3(2)	0	0	7	79	0	37	0
Transfers out of Level 3(2)	0	(10)	(11)	(60)	(38)	(20)	0
Fair Value, end of period	\$ 66	\$ 0	\$ 21	\$ 1,635	\$ 3,069	\$ 186	\$ 13
Unrealized gains (losses) for assets still held(3):							
Included in earnings:							
Realized investment gains (losses), net	\$ 0	\$ 0	\$ 0	\$ 0	\$ 1	\$ 0	\$ 0

	Three Months Ended June 30, 2012 Trading Account Assets						
	U.S. Government	Corporate	Asset- Backed	Commercial Mortgage- Backed (in millions)	Residential Mortgage- Backed	Equity	All Other Activity
Fair Value, beginning of period	\$ 11	\$ 142	\$ 446	\$ 14	\$ 3	\$ 1,262	\$ 48
Total gains (losses) (realized/unrealized):							
Included in earnings:							
Realized investment gains (losses), net	0	0	0	0	0	(1)	0
Asset management fees and other income	0	(1)	(3)	(1)	1	(10)	0
Net investment income	0	0	3	1	0	0	0
Purchases	0	14	39	16	0	11	0
Sales	0	(7)	(2)	(1)	0	(21)	0
Issuances	0	0	0	0	0	0	0
Settlements	(2)	(5)	(40)	0	(1)	(33)	0
Foreign currency translation	0	0	1	0	0	31	0
Other(1)	0	0	0	0	0	3	(3)
Transfers into Level 3(2)	0	1	0	39	0	0	0
Transfers out of Level 3(2)	0	(4)	0	0	0	(1)	0
Fair Value, end of period	\$ 9	\$ 140	\$ 444	\$ 68	\$ 3	\$ 1,241	\$ 45

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)	\$ 0
Asset management fees and other income	\$ 0	\$ (3)	\$ (2)	\$ (1)	\$ 0	\$ (5)	\$ 0	

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

	Equity Securities Available- For-Sale	Three Months Ended June 30, 2012			Short-term Investments
		Commercial Mortgage and Other Loans	Other Long-term Investments		
(in millions)					
Fair Value, beginning of period	\$ 422	\$ 75	\$ 1,086	\$ 0	
Total gains (losses) (realized/unrealized):					
Included in earnings:					
Realized investment gains (losses), net	0	2	4	(4)	
Asset management fees and other income	0	0	47	0	
Included in other comprehensive income (loss)	17	0	0	0	
Net investment income	0	0	2	0	
Purchases	(1)	0	73	9	
Sales	(4)	0	(2)	0	
Issuances	0	0	0	0	
Settlements	0	(40)	(143)	0	
Foreign currency translation	10	0	1	0	
Other(1)	0	0	(4)	0	
Transfers into Level 3(2)	0	0	0	0	
Transfers out of Level 3(2)	(89)	0	(22)	0	
Fair Value, end of period	\$ 355	\$ 37	\$ 1,042	\$ 5	
Unrealized gains (losses) for assets/liabilities still held(3):					
Included in earnings:					
Realized investment gains (losses), net	\$ 0	\$ 1	\$ 1	\$ (4)	
Asset management fees and other income	\$ 0	\$ 0	\$ 5	\$ 0	

	Other Assets	Three Months Ended June 30, 2012			Notes of consolidated VIEs
		Separate Account Assets(4)	Future Policy Benefits	Other Liabilities	
(in millions)					
Fair Value, beginning of period	\$ 8	\$ 19,935	\$ (1,709)	\$ (3)	\$ (296)
Total gains (losses) (realized/unrealized):					
Included in earnings:					
Realized investment gains (losses), net	0	0	(1,180)	(8)	0
Asset management fees and other income	0	466	0	0	0
Purchases	0	1,415	0	0	0
Sales	0	(289)	0	0	0
Issuances	0	0	(164)	0	0
Settlements	0	(771)	0	9	0
Foreign currency translation	0	0	(1)	0	0
Transfers into Level 3(2)	0	126	0	0	0
Transfers out of Level 3(2)	0	(184)	0	0	0
Fair Value, end of period	\$ 8	\$ 20,698	\$ (3,054)	\$ (2)	\$ (296)

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	\$ (1,194)	\$ (9)	0
Interest credited to policyholders account	\$ 0	\$ 295	\$ 0	\$ 0	0

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

	Six Months Ended June 30, 2012						
	Fixed Maturities Available-For-Sale						
	U.S. Government	U.S. States	Foreign Government	Corporate	Asset- Backed	Commercial Mortgage- Backed	Residential Mortgage- 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)	8	0	0
Included in other comprehensive income (loss)	0	0	0	130	30	11	0
Net investment income	0	0	0	4	15	(3)	1
Purchases	0	10	0	221	1,171	33	0
Sales	0	0	0	(39)	(44)	0	0
Issuances	0	0	0	0	0	0	0
Settlements	(2)	0	0	(186)	(345)	(4)	(4)
Foreign currency translation	0	0	0	(6)	(10)	(1)	0
Other(1)	2	0	0	(2)	0	0	0
Transfers into Level 3(2)	0	0	7	217	0	37	0
Transfers out of Level 3(2)	0	(10)	(11)	(129)	(284)	(32)	0
Fair Value, end of period	\$ 66	\$ 0	\$ 21	\$ 1,635	\$ 3,069	\$ 186	\$ 13
Unrealized gains (losses) for assets still held(3):							
Included in earnings:							
Realized investment gains (losses), net	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0

	Six Months Ended June 30, 2012						
	Trading Account Assets						
	U.S. Government	Corporate	Asset- Backed	Commercial Mortgage- Backed	Residential Mortgage- Backed	Equity	All Other 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	(1)	(49)
Asset management fees and other income	0	(5)	5	0	1	34	0
Net investment income	0	0	4	1	0	0	0
Purchases	0	18	128	16	0	13	0
Sales	0	(8)	(3)	(2)	(1)	(29)	0
Issuances	0	0	0	0	0	0	0
Settlements	(2)	(10)	(69)	(1)	(1)	(56)	4
Foreign currency translation	0	0	(1)	0	0	(18)	0
Other(1)	2	(2)	0	0	0	3	(3)
Transfers into Level 3(2)	0	3	0	39	0	0	0
Transfers out of Level 3(2)	0	(4)	(36)	(20)	0	(1)	0
Fair Value, end of period	\$ 9	\$ 140	\$ 444	\$ 68	\$ 3	\$ 1,241	\$ 45

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)	\$ (49)
Asset management fees and other income	\$ 0	\$ (8)	\$ 4	\$ 0	\$ 0	\$ 0	\$ 35	\$ 0



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

	Six Months Ended June 30, 2012			
	Equity Securities Available- For-Sale	Commercial Mortgage and Other Loans	Other Long-term Investments	Short-term 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	2	0	3	(4)
Asset management fees and other income	0	0	68	0
Included in other comprehensive income (loss)	27	0	0	0
Net investment income	0	0	6	0
Purchases	62	0	115	9
Sales	(8)	0	(20)	0
Issuances	0	0	0	0
Settlements	0	(49)	(216)	0
Foreign currency translation	(3)	0	2	0
Other(1)	0	0	(4)	0
Transfers into Level 3(2)	5	0	0	0
Transfers out of Level 3(2)	(90)	0	(22)	0
Fair Value, end of period	\$ 355	\$ 37	\$ 1,042	\$ 5
Unrealized gains (losses) for assets/liabilities still held(3):				
Included in earnings:				
Realized investment gains (losses), net	\$ 0	\$ (2)	\$ 1	\$ (4)
Asset management fees and other income	\$ 0	\$ 0	\$ 20	\$ 0

	Six Months Ended June 30, 2012				Notes of consolidated VIEs
	Other Assets	Separate Account Assets(4)	Future Policy Benefits	Other Liabilities	
	(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	153	(17)	0
Asset management fees and other income	2	0	0	0	0
Interest credited to policyholders' account balances	0	1,215	0	0	0
Purchases	0	1,844	0	0	0
Sales	(3)	(463)	0	0	0
Issuances	0	0	(321)	0	(11)
Settlements	0	(1,025)	0	18	0
Other(1)	0	0	0	0	(3)
Transfers into Level 3(2)	0	216	0	0	0
Transfers out of Level 3(2)	0	(447)	0	0	0
Fair Value, end of period	\$ 8	\$ 20,698	\$ (3,054)	\$ (2)	\$ (296)

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	\$ 109	\$ (18)	\$ 0
Interest credited to policyholders' account	\$ 0	\$ 773	\$ 0	\$ 0	\$ 0

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

- (1) Other primarily represents re-classes 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.

**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.

	Level 1	Level 2	As of June 30, 2013		Total
			Level 3	Netting(1)	
	(in millions)				
<b>Derivative assets:</b>					
Interest Rate	\$ 5	\$ 7,584	\$ 8	\$	\$ 7,597
Currency	0	583	0		583
Credit	0	9	0		9
Currency/Interest Rate	0	682	0		682
Equity	85	558	8		651
Netting(1)				(7,741)	(7,741)
<b>Total derivative assets</b>	<b>\$ 90</b>	<b>\$ 9,416</b>	<b>\$ 16</b>	<b>\$ (7,741)</b>	<b>\$ 1,781</b>
<b>Derivative liabilities:</b>					
Interest Rate	\$ 5	\$ 6,763	\$ 6	\$	\$ 6,774
Currency	0	246	0		246
Credit	0	74	0		74
Currency/Interest Rate	0	340	0		340
Equity	0	105	0		105
Netting(1)				(7,031)	(7,031)

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Total derivative liabilities	\$ 5	\$ 7,528	\$ 6	\$ (7,031)	\$ 508
------------------------------	------	----------	------	------------	--------

**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 six months ended June 30, 2013, as well as the portion of gains or losses included in income for the three and six months ended June 30, 2013, attributable to unrealized gains or losses related to those assets and liabilities still held at June 30, 2013.

	Three Months Ended June 30, 2013			Six Months Ended June 30, 2013		
	Derivative Assets - Equity	Derivative Assets - Credit	Derivative Assets - Interest Rate	Derivative Assets - Equity	Derivative Assets - Credit	Derivative Assets - Interest Rate
	(in millions)					
Fair Value, beginning of period	\$ 9	\$ 0	\$ 2	\$ 19	\$ 0	\$ 3
Total gains (losses) (realized/unrealized):						
Included in earnings:						
Realized investment gains (losses), net	(2)	0	0	(11)	0	(1)
Asset management fees and other income	0	0	0	0	0	0
Purchases	1	0	0	0	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	\$ 8	\$ 0	\$ 2	\$ 8	\$ 0	\$ 2
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	\$ (2)	\$ 0	\$ 0	\$ (11)	\$ 0	\$ (1)
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 June 30, 2012			Six Months Ended June 30, 2012		
	Derivative Assets - Equity	Derivative Assets - Credit	Derivative Assets - Interest Rate	Derivative Assets - Equity	Derivative Assets - Credit	Derivative Assets - Interest Rate
	(in millions)					
Fair Value, beginning of period	\$ 40	\$ 0	\$ (4)	\$ 83	\$ 1	\$ (1)
Total gains (losses) (realized/unrealized):						
Included in earnings:						
Realized investment gains (losses), net	0	0	6	(48)	(1)	3
Asset management fees and other income	0	0	0	0	0	0
Purchases	0	0	0	5	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	\$ 40	\$ 0	\$ 2	\$ 40	\$ 0	\$ 2
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	\$ 0	\$ 0	\$ 6	\$ (48)	\$ (1)	\$ 3
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. Nonrecurring fair value reserve adjustments resulted in \$1 million gain being recorded for the three months ended June 30, 2013 and \$0 million for six months ended June 30, 2013, on certain commercial mortgage loans. The carrying value of these loans as of June 30, 2013 was \$14 million. Similar commercial mortgage loan reserve adjustments of \$4 million and \$2 million in net losses were recorded for the three and six months ended June 30, 2012, respectively. The reserve adjustments were based on discounted cash flows utilizing market rates and were classified as Level 3 in the hierarchy.

Impairments of \$1 million and \$70 million were recorded for the three months ended June 30, 2013 and 2012, respectively, and \$1 million and \$71 million for the six months ended June 30, 2013 and 2012, respectively, for real estate and property and equipment related investments. These impairments were based primarily on appraised value. All impairments were classified as Level 3 in the valuation hierarchy. Impairments of \$7 million and \$1 million were recorded for the three months ended June 30, 2013 and 2012, respectively, and \$10 million and \$2 million for the six months ended June 30, 2013 and 2012, respectively, on certain cost method investments. These fair value adjustments were based on inputs classified as Level 3 in the valuation hierarchy. 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. Impairments of \$2 million and \$4 million were recorded for the three months ended June 30, 2013 and 2012 respectively, and \$1 million and \$7 million for the six months ended June 30, 2013 and 2012, respectively on mortgage servicing rights. These were 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)**

**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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in millions)			
<b>Assets:</b>				
Commercial mortgage loans:				
Changes in instrument-specific credit risk	\$ 0	\$ 1	\$ 0	\$ (1)
Other changes in fair value	\$ 2	\$ 0	\$ 2	\$ 0
Other long-term investments:				
Changes in fair value	\$ 9	\$ (3)	\$ 31	\$ 12
<b>Liabilities:</b>				
Notes issued by consolidated variable interest entities:				
Changes in fair value	\$ 0	\$ 0	\$ (2)	\$ (3)

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

Interest income on commercial mortgage loans is included in net investment income. The Company recorded \$2 million and \$1 million for the three months ended June 30, 2013 and 2012, respectively, and \$5 million and \$5 million for the six months ended June 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 \$303 million and \$295 million, respectively, as of June 30, 2013, and \$162 million and \$156 million, respectively, as of December 31, 2012. As of June 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 \$497 million as of June 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 \$2,055 million and \$2,067 million, respectively, as of June 30, 2013, and \$1,406 million and \$1,422 million, respectively as of December 31, 2012. Interest expense recorded for these liabilities was \$23 million and \$40 million, respectively, for the three and six months ended June 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.

	June 30, 2013				Carrying Amount (1) Total	December 31, 2012	
	Level 1	Fair Value Level 2    Level 3		Total (in millions)		Fair Value Total	Carrying Amount Total
<b>Assets:</b>							
Fixed maturities, held-to-maturity	\$ 0	\$ 2,264	\$ 1,505	\$ 3,769	\$ 3,562	\$ 4,511	\$ 4,268
Commercial mortgage and other loans	0	723	38,936	39,659	37,766	39,554	36,570
Policy loans	0	0	14,024	14,024	11,740	14,592	11,575
Short-term investments	0	26	0	26	26	57	57
Cash and cash equivalents	3,966	946	0	4,912	4,912	4,500	4,500
Accrued investment income	0	3,113	0	3,113	3,113	3,127	3,127
Other assets	59	2,635	271	2,965	2,965	2,601	2,601
<b>Total assets</b>	<b>\$ 4,025</b>	<b>\$ 9,707</b>	<b>\$ 54,736</b>	<b>\$ 68,468</b>	<b>\$ 64,084</b>	<b>\$ 68,942</b>	<b>\$ 62,698</b>
<b>Liabilities:</b>							
Policyholders' account balances -investment contracts	\$ 0	\$ 39,366	\$ 58,535	\$ 97,901	\$ 96,194	\$ 104,200	\$ 101,232
Securities sold under agreements to repurchase	0	6,947	0	6,947	6,947	5,818	5,818
Cash collateral for loaned securities	0	5,707	0	5,707	5,707	3,941	3,941
Short-term debt	0	2,645	0	2,645	2,620	2,506	2,484
Long-term debt	1,252	19,520	4,728	25,500	23,642	27,497	24,729
Notes of consolidated VIEs	0	0	86	86	101	149	171
Other liabilities	0	5,865	291	6,156	6,156	6,356	6,356
Separate account liabilities -investment contracts	0	77,660	21,420	99,080	99,080	96,561	96,561
<b>Total liabilities</b>	<b>\$ 1,252</b>	<b>\$ 157,710</b>	<b>\$ 85,060</b>	<b>\$ 244,022</b>	<b>\$ 240,447</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 used in a non-dealer or broker capacity*

*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 to post variation margin on a daily basis in an amount equal to the difference in the daily market values of those contracts. The Company enters into exchange-traded futures with regulated futures commission 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***

**TBAs.** The Company uses to be announced (TBA) forward contracts to gain exposure to the investment risk and return of mortgage-backed securities. TBA transactions can help the Company 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.

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

The derivatives may include, but are not limited to equity options, total return swaps, interest rate swaptions, caps, floors, and other instruments. In addition, some variable annuity products feature an automatic rebalancing element, also referred to as an asset transfer feature, to minimize risks inherent in the Company's guarantees which reduces the need for derivatives.

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-dealer or broker capacity by the primary underlying, excluding embedded derivatives which are recorded with the associated host, and proprietary derivatives whose fair value was not material. 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 \$1,781 million and \$3,075 million as of June 30, 2013 and December 31, 2012, respectively, and total derivative liabilities of \$508 million and \$307 million as of June 30, 2013 and December 31, 2012, respectively, reflected in the Unaudited Interim Consolidated Statement of Financial Position.

Primary Underlying/ Instrument Type	June 30, 2013			December 31, 2012		
	Notional Amount	Gross Fair Value		Notional Amount	Gross Fair Value	
		Assets	Liabilities		Assets	Liabilities
	(in millions)					
<b>Derivatives Designated as Hedge Accounting Instruments:</b>						
<b>Interest Rate</b>						
Interest Rate Swaps	\$ 2,917	\$ 18	\$ (292)	\$ 3,374	\$ 26	\$ (396)
<b>Foreign Currency</b>						
Foreign Currency Forwards	609	5	(61)	639	1	(35)
<b>Currency/Interest Rate</b>						
Foreign Currency Swaps	7,005	225	(205)	6,373	128	(342)
<b>Total Qualifying Derivatives</b>	<b>\$ 10,531</b>	<b>\$ 248</b>	<b>\$ (558)</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	June 30, 2013			December 31, 2012		
	Notional Amount	Gross Fair Value		Notional Amount	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	\$ 107,861	\$ 4,888	\$ (4,081)	\$ 108,581	\$ 7,779	\$ (3,301)
Interest Rate Futures	5,864	3	(5)	6,749	11	(12)
Interest Rate Options	24,592	592	(273)	25,250	895	(141)
Interest Rate Forwards	852	0	(11)	660	0	0
<b>Foreign Currency</b>						
Foreign Currency Forwards	12,550	569	(224)	14,638	371	(397)
Foreign Currency Options	75	5	0	92	13	0
<b>Currency/Interest Rate</b>						
Foreign Currency Swaps	6,508	428	(83)	5,304	239	(152)
<b>Credit</b>						
Credit Default Swaps	2,019	8	(75)	3,250	19	(84)
<b>Equity</b>						
Equity Futures	2,315	10	0	6,518	0	(165)
Equity Options	37,790	495	(15)	42,757	603	(40)
Total Return Swaps	9,065	161	(95)	5,779	8	(158)
Synthetic GICs	71,295	8	0	64,359	6	0
<b>Total Non-Qualifying Derivatives(1)</b>	<b>\$ 280,786</b>	<b>\$ 7,167</b>	<b>\$ (4,862)</b>	<b>\$ 283,937</b>	<b>\$ 9,944</b>	<b>\$ (4,450)</b>
<b>Total Derivatives(2)</b>	<b>\$ 291,317</b>	<b>\$ 7,415</b>	<b>\$ (5,420)</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 \$474 million as of June 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.

	Gross Amounts of Recognized Financial Instruments	Gross Amounts Offset in the Statement of Financial Position	June 30, 2013 Net Amounts Presented in the Statement of Financial Position (in millions)	Financial Instruments/ Collateral	Net Amount
<b>Offsetting of Financial Assets:</b>					
Derivatives	\$ 9,470	\$ (7,741)	\$ 1,729	\$ (1,404)	\$ 325
Securities purchased under agreement to resell	786	0	786	(786)	0
Total Assets	\$ 10,256	\$ (7,741)	\$ 2,515	\$ (2,190)	\$ 325
<b>Offsetting of Financial Liabilities:</b>					
Derivatives	\$ 7,518	\$ (7,031)	\$ 487	\$ (550)	\$ (63)
Securities sold under agreement to repurchase	6,947	0	6,947	(6,947)	0
Total Liabilities	\$ 14,465	\$ (7,031)	\$ 7,434	\$ (7,497)	\$ (63)

	Gross Amounts of Recognized Financial Instruments	Gross Amounts Offset in the Statement of Financial Position	December 31, 2012 Net Amounts Presented in the Statement of Financial Position (in millions)	Financial Instruments/ Collateral	Net 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

**Offsetting of Financial Liabilities:**

## 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 June 30, 2013					
	Realized Investment Gains/ (Losses)	Net Investment Income	Other Income	Interest Expense	Interest Credited To Policyholders Account Balances	Accumulated Other Comprehensive Income(1)
	(in millions)					
<b>Derivatives Designated as Hedge Accounting Instruments:</b>						
<b>Fair value hedges</b>						
Interest Rate	\$ 50	\$ (19)	\$ 0	\$ 0	\$ 5	\$ 0
Currency	(23)	0	0	0	0	0
Total fair value hedges	27	(19)	0	0	5	0
<b>Cash flow hedges</b>						
Interest Rate	0	0	0	(6)	0	11
Currency/Interest Rate	0	0	(20)	0	0	(31)
Total cash flow hedges	0	0	(20)	(6)	0	(20)
<b>Net investment hedges</b>						
Currency(2)	0	0	0	0	0	2
Currency/Interest Rate	0	0	0	0	0	51
Total net investment hedges	0	0	0	0	0	53
<b>Derivatives Not Qualifying as Hedge Accounting Instruments:</b>						
Interest Rate	(2,473)	0	0	0	0	0
Currency	(319)	0	0	0	0	0

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Currency/Interest Rate	55	0	0	0	0	0
Credit	(8)	0	0	0	0	0
Equity	(364)	0	0	0	0	0
Embedded Derivatives	1,691	0	0	0	0	0
<b>Total non-qualifying hedges</b>	<b>(1,418)</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Total</b>	<b>\$ (1,391)</b>	<b>(19)</b>	<b>\$ (20)</b>	<b>\$ (6)</b>	<b>\$ 5</b>	<b>\$ 33</b>

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

Six Months Ended June 30, 2013

	Realized Investment Gains/ (Losses)	Net Investment Income	Other Income	Interest Expense  (in millions)	Interest Credited To Policyholders Account Balances	Accumulated Other Comprehensive Income(1)
<b>Derivatives Designated as Hedge</b>						
<b>Accounting Instruments:</b>						
<b>Fair value hedges</b>						
Interest Rate	\$ 72	\$ (39)	\$ 0	\$ 0	\$ 12	\$ 0
Currency	(47)	0	0	0	0	0
Total fair value hedges	25	(39)	0	0	12	0
<b>Cash flow hedges</b>						
Interest Rate	0	0	0	(11)	0	16
Currency/Interest Rate	0	(1)	(35)	0	0	143
Total cash flow hedges	0	(1)	(35)	(11)	0	159
<b>Net investment hedges</b>						
Currency(2)	0	0	0	0	0	6
Currency/Interest Rate	0	0	0	0	0	157
Total net investment hedges	0	0	0	0	0	163
<b>Derivatives Not Qualifying as Hedge</b>						
<b>Accounting Instruments:</b>						
Interest Rate	(3,531)	0	0	0	0	0
Currency	(576)	0	0	0	0	0
Currency/Interest Rate	298	0	1	0	0	0
Credit	(10)	0	0	0	0	0
Equity	(1,809)	0	0	0	0	0
Embedded Derivatives	3,348	0	0	0	0	0
Total non-qualifying hedges	(2,280)	0	1	0	0	0
<b>Total</b>	<b>\$ (2,255)</b>	<b>\$ (40)</b>	<b>\$ (34)</b>	<b>\$ (11)</b>	<b>\$ 12</b>	<b>\$ 322</b>

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

	Three Months Ended June 30, 2012					
	Realized Investment Gains/ (Losses)	Net Investment Income	Other Income	Interest Expense  (in millions)	Interest Credited To Policyholders Account Balances	Accumulated Other Comprehensive Income(1)
<b>Derivatives Designated as Hedge Accounting Instruments:</b>						
<b>Fair value hedges</b>						
Interest Rate	\$ (40)	\$ (23)	\$ 0	\$ 1	\$ 10	\$ 0
Currency	34	(1)	0	0	0	0
<b>Total fair value hedges</b>	<b>(6)</b>	<b>(24)</b>	<b>0</b>	<b>1</b>	<b>10</b>	<b>0</b>
<b>Cash flow hedges</b>						
Interest Rate	0	0	0	(5)	0	(2)
Currency/Interest Rate	0	(2)	8	0	0	189
<b>Total cash flow hedges</b>	<b>0</b>	<b>(2)</b>	<b>8</b>	<b>(5)</b>	<b>0</b>	<b>187</b>
<b>Net investment hedges</b>						
Currency(2)	0	0	0	0	0	6
Currency/Interest Rate	0	0	0	0	0	(35)
<b>Total net investment hedges</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>(29)</b>
<b>Derivatives Not Qualifying as Hedge Accounting Instruments:</b>						
Interest Rate	2,644	0	0	0	0	0
Currency	121	0	0	0	0	0
Currency/Interest Rate	5	0	1	0	0	0
Credit	(25)	0	0	0	0	0
Equity	310	0	0	0	0	0
Embedded Derivatives	(1,190)	0	0	0	0	0
<b>Total non-qualifying hedges</b>	<b>1,865</b>	<b>0</b>	<b>1</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Total</b>	<b>\$ 1,859</b>	<b>\$ (26)</b>	<b>\$ 9</b>	<b>\$ (4)</b>	<b>\$ 10</b>	<b>\$ 158</b>

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

	Six Months Ended June 30, 2012					
	Realized Investment Gains/ (Losses)	Net Investment Income	Other Income	Interest Expense  (in millions)	Interest Credited To Policyholders Account Balances	Accumulated Other Comprehensive Income(1)
<b>Derivatives Designated as Hedge Accounting Instruments:</b>						
<b>Fair value hedges</b>						
Interest Rate	\$ (12)	\$ (48)	\$ 0	\$ 3	\$ 21	\$ 0
Currency	3	(2)	0	0	0	0
<b>Total fair value hedges</b>	<b>(9)</b>	<b>(50)</b>	<b>0</b>	<b>3</b>	<b>21</b>	<b>0</b>
<b>Cash flow hedges</b>						
Interest Rate	0	0	0	(9)	0	5
Currency/Interest Rate	0	(4)	(2)	0	0	72
<b>Total cash flow hedges</b>	<b>0</b>	<b>(4)</b>	<b>(2)</b>	<b>(9)</b>	<b>0</b>	<b>77</b>
<b>Net investment hedges</b>						
Currency(2)	0	0	0	0	0	(2)
Currency/Interest Rate	0	0	0	0	0	88
<b>Total net investment hedges</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>86</b>
<b>Derivatives Not Qualifying as Hedge Accounting Instruments:</b>						
Interest Rate	1,218	0	0	0	0	0
Currency	72	0	0	0	0	0
Currency/Interest Rate	115	0	1	0	0	0
Credit	(28)	0	0	0	0	0
Equity	(1,000)	0	0	0	0	0
Embedded Derivatives	177	0	0	0	0	0
<b>Total non-qualifying hedges</b>	<b>554</b>	<b>0</b>	<b>1</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Total</b>	<b>\$ 545</b>	<b>\$ (54)</b>	<b>\$ (1)</b>	<b>\$ (6)</b>	<b>\$ 21</b>	<b>\$ 163</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 six months ended June 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 June 30, 2013	103
Amount reclassified into current period earnings	56
Balance, June 30, 2013	\$ (98)

Using June 30, 2013 values, it is anticipated that a pre-tax loss of approximately \$30 million will be reclassified from Accumulated other comprehensive income (loss) to earnings during the subsequent twelve months ending June 30, 2014, offset by amounts pertaining to the hedged items. As of June 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 \$280 million and \$117 million as of June 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 June 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		June 30, 2013 Credit Default Index		Total	
	Notional	Fair Value	Notional	Fair Value (in millions)	Notional	Fair Value
1	\$ 5	\$ 0	\$ 0	\$ 0	\$ 5	\$ 0
2	0	0	0	0	0	0
Subtotal	5	0	0	0	5	0
3	0	0	0	0	0	0

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

	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 Credit Default Index		Total	
	Notional	Fair Value	Notional	Fair Value	Notional	Fair Value
	1	\$ 275	\$ 0	\$ 0	\$ 275	\$ 0
	2	45	0	0	45	0
Subtotal		320	0	0	320	0
	3	0	0	750	750	2
	4	0	0	0	0	0
	5	0	0	0	0	0
	6	0	0	0	0	0
Subtotal		0	0	750	750	2
Total		\$ 320	\$ 0	\$ 750	\$ 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	June 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 of this credit derivative is \$500 million and the fair value as of June 30, 2013 and December 31, 2012 was a liability of \$28 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 June 30, 2013 and December 31, 2012, the Company had \$1,514 million and \$1,680 million of outstanding notional amounts, respectively, reported at fair value as a liability of \$38 million and an asset of \$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 \$318 million and \$314 million at June 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 over-the-counter (OTC) derivative transactions is represented by the contracts with a positive fair value (market value) at the reporting date. To reduce credit exposures, the Company seeks to (i) enter into OTC derivative transactions pursuant to master agreements that provide for a netting of payments and receipts with a single counterparty, 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 \$62 million as of June 30, 2013. In the normal course of business the Company has posted collateral related to these instruments of \$79 million as of

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

June 30, 2013. If the credit-risk-related contingent features underlying these agreements had been triggered on June 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***

	<b>June 30, 2013</b>	<b>December 31, 2012</b>
	<b>(in millions)</b>	
Total outstanding mortgage loan commitments	\$ 3,557	\$ 2,552
Portion of commitment where prearrangement to sell to investor exists	\$ 921	\$ 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)***

	<b>June 30, 2013</b>	<b>December 31, 2012</b>
	<b>(in millions)</b>	
Expected to be funded from the general account and other operations outside the separate accounts(1)	\$ 5,146	\$ 3,410
Expected to be funded from separate accounts	\$ 700	\$ 757
Portion of separate account commitments with recourse to Prudential Insurance	\$ 0	\$ 7

(1) Includes a remaining commitment of \$91 million and \$200 million at June 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*

	June 30, 2013	December 31, 2012
	(in millions)	
Total guarantees of debt issued by entities in which the separate accounts have invested	\$ 2,311	\$ 2,178
Amount of above guarantee that is limited to separate account assets	\$ 2,311	\$ 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 June 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***

	June 30, 2013	December 31, 2012
	(in millions)	
Indemnification provided to mutual fund and separate account clients for securities lending	\$ 15,584	\$ 15,454
Fair value of related collateral associated with above indemnifications	\$ 16,011	\$ 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

	June 30, 2013	December 31, 2012
	(in millions)	
Guaranteed value of third parties' assets	\$ 71,349	\$ 64,424
Fair value of collateral supporting these assets	\$ 73,127	\$ 67,555
Asset associated with guarantee, carried at fair value	\$ 8	\$ 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***

	June 30, 2013	December 31, 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***

	June 30, 2013	December 31, 2012
	(in millions)	
Maximum exposure under indemnification agreements for mortgage loans serviced by the Company	\$ 1,187	\$ 1,147
First-loss exposure portion of above	\$ 376	\$ 369
Accrued liability associated with guarantees	\$ 18	\$ 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 \$8,937 million of mortgages subject to these loss-sharing arrangements as of June 30, 2013, all of which are collateralized by first priority liens on the underlying multi-family residential properties. As of June 30, 2013, these mortgages had an average debt service coverage ratio of 1.81 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 six months ended June 30, 2013 and 2012, respectively.

***Contingent Consideration***

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

	June 30, 2013	December 31, 2012
	(in millions)	
Maximum potential contingent consideration associated with acquisitions	\$ 0	\$ 52

104

**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 has been resolved as of June 30, 2013 and no additional consideration is required as the joint venture did not attain the defined operating objectives.

***Other Guarantees***

	June 30, 2013	December 31, 2012
	(in millions)	
Other guarantees where amount can be determined	\$ 456	\$ 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 \$313 million and \$299 million as of June 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 June 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 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 insureds and contract holders where a valid claim has not been made. In February 2012, a Regulatory Settlement

---

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

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 their summary judgment motions.

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

In January 2011, a purported state-wide class action, *Garcia v. The Prudential Insurance Company of America* was dismissed by the Second Judicial District Court, Washoe County, Nevada. The complaint was





---

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

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 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 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



---

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

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 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



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

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.

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. 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

**Table of Contents**

**PRUDENTIAL FINANCIAL, INC.**

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

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*, and *Morgan Stanley* have been denied, and the motions to dismiss filed by *Nomura*, *Credit Suisse*, *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****June 30, 2013 and December 31, 2012 (in millions)**

	June 30, 2013			December 31, 2012		
	Financial Services Businesses	Closed Block Business	Consolidated	Financial Services Businesses	Closed Block Business	Consolidated
<b>ASSETS</b>						
Fixed maturities, available-for-sale, at fair value	\$ 242,059	\$ 44,048	\$ 286,107	\$ 254,917	\$ 46,419	\$ 301,336
Fixed maturities, held-to-maturity, at amortized cost	3,562	0	3,562	4,268	0	4,268
Trading account assets supporting insurance liabilities, at fair value	20,658	0	20,658	20,590	0	20,590
Other trading account assets, at fair value	5,809	274	6,083	6,053	275	6,328
Equity securities, available-for-sale, at fair value	5,289	3,465	8,754	5,052	3,225	8,277
Commercial mortgage and other loans	28,320	9,749	38,069	27,125	9,608	36,733
Policy loans	6,679	5,061	11,740	6,455	5,120	11,575
Other long-term investments	7,847	2,102	9,949	8,016	2,012	10,028
Short-term investments	6,344	1,731	8,075	5,186	1,261	6,447
Total investments	326,567	66,430	392,997	337,662	67,920	405,582
Cash and cash equivalents	12,425	620	13,045	17,546	554	18,100
Accrued investment income	2,528	585	3,113	2,534	593	3,127
Deferred policy acquisition costs	14,547	421	14,968	13,688	412	14,100
Value of business acquired	3,846	0	3,846	3,248	0	3,248
Other assets	13,114	478	13,592	11,376	511	11,887
Separate account assets	264,054	0	264,054	253,254	0	253,254
<b>TOTAL ASSETS</b>	<b>\$ 637,081</b>	<b>\$ 68,534</b>	<b>\$ 705,615</b>	<b>\$ 639,308</b>	<b>\$ 69,990</b>	<b>\$ 709,298</b>
<b>LIABILITIES AND EQUITY</b>						
<b>LIABILITIES</b>						
Future policy benefits	\$ 153,683	\$ 50,507	\$ 204,190	\$ 165,212	\$ 50,838	\$ 216,050
Policyholders' account balances	131,222	5,385	136,607	128,987	5,426	134,413
Policyholders' dividends	161	5,469	5,630	257	7,250	7,507
Securities sold under agreements to repurchase	3,707	3,240	6,947	3,436	2,382	5,818
Cash collateral for loaned securities	4,927	780	5,707	2,864	1,077	3,941
Income taxes	5,619	(513)	5,106	9,058	(507)	8,551
Short-term debt	2,545	75	2,620	2,409	75	2,484
Long-term debt	21,967	1,675	23,642	23,054	1,675	24,729
Other liabilities	12,540	517	13,057	11,406	277	11,683
Notes issued by consolidated variable interest entities	2,147	0	2,147	1,577	0	1,577
Separate account liabilities	264,054	0	264,054	253,254	0	253,254
Total liabilities	602,572	67,135	669,707	601,514	68,493	670,007
<b>COMMITMENTS AND CONTINGENT LIABILITIES</b>						
<b>EQUITY</b>						
Accumulated other comprehensive income	8,326	123	8,449	9,990	224	10,214
Other attributed equity	25,423	1,276	26,699	27,088	1,273	28,361

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Total attributed equity	33,749	1,399	35,148	37,078	1,497	38,575
Noncontrolling interests	760	0	760	716	0	716
Total equity	34,509	1,399	35,908	37,794	1,497	39,291
<b>TOTAL LIABILITIES AND EQUITY</b>	\$ 637,081	\$ 68,534	\$ 705,615	\$ 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 June 30, 2013 and 2012 (in millions)**

	Three Months Ended June 30,					
	Financial Services Businesses	2013 Closed Block Business	Consolidated	Financial Services Businesses	2012 Closed Block Business	Consolidated
<b>REVENUES</b>						
Premiums	\$ 6,211	\$ 711	\$ 6,922	\$ 6,813	\$ 743	\$ 7,556
Policy charges and fee income	1,375	0	1,375	1,062	0	1,062
Net investment income	2,941	770	3,711	2,563	795	3,358
Asset management fees and other income	(945)	5	(940)	2,411	(14)	2,397
Realized investment gains (losses), net:						
Other-than-temporary impairments on fixed maturity securities	(125)	(55)	(180)	(221)	(125)	(346)
Other-than-temporary impairments on fixed maturity securities transferred to Other Comprehensive Income	102	45	147	147	106	253
Other realized investment gains (losses), net	(979)	(12)	(991)	1,683	173	1,856
Total realized investment gains (losses), net	(1,002)	(22)	(1,024)	1,609	154	1,763
Total revenues	8,580	1,464	10,044	14,458	1,678	16,136
<b>BENEFITS AND EXPENSES</b>						
Policyholders' benefits	6,154	870	7,024	6,497	930	7,427
Interest credited to policyholders' account balances	360	34	394	1,212	35	1,247
Dividends to policyholders	37	408	445	32	572	604
Amortization of deferred policy acquisition costs	211	9	220	1,229	8	1,237
General and administrative expenses	2,588	139	2,727	2,517	135	2,652
Total benefits and expenses	9,350	1,460	10,810	11,487	1,680	13,167
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES</b>						
	(770)	4	(766)	2,971	(2)	2,969
Income tax expense (benefit)	(274)	1	(273)	741	2	743
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES</b>						
	(496)	3	(493)	2,230	(4)	2,226
Equity in earnings of operating joint ventures, net of taxes	5	0	5	6	0	6
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS</b>						
	(491)	3	(488)	2,236	(4)	2,232
Income (loss) from discontinued operations, net of taxes	2	0	2	8	(1)	7

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

<b>NET INCOME (LOSS)</b>	(489)	3	(486)	2,244	(5)	2,239
Less: Income attributable to noncontrolling interests	35	0	35	15	0	15
<b>NET INCOME (LOSS) ATTRIBUTABLE TO PRUDENTIAL FINANCIAL, INC.</b>	\$ (524)	\$ 3	\$ (521)	\$ 2,229	\$ (5)	\$ 2,224

*See Notes to Unaudited Interim Supplemental Combining Financial Information*

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

	Six Months Ended June 30,					
	Financial Services Businesses	2013 Closed Block Business	Consolidated	Financial Services Businesses	2012 Closed Block Business	Consolidated
<b>REVENUES</b>						
Premiums	\$ 12,648	\$ 1,358	\$ 14,006	\$ 12,915	\$ 1,414	\$ 14,329
Policy charges and fee income	2,731	0	2,731	2,111	0	2,111
Net investment income	5,816	1,533	7,349	5,092	1,586	6,678
Asset management fees and other income	(2,127)	17	(2,110)	2,253	9	2,262
Realized investment gains (losses), net:						
Other-than-temporary impairments on fixed maturity securities	(334)	(154)	(488)	(532)	(387)	(919)
Other-than-temporary impairments on fixed maturity securities transferred to Other Comprehensive Income	252	133	385	376	338	714
Other realized investment gains (losses), net	(1,740)	96	(1,644)	391	193	584
Total realized investment gains (losses), net	(1,822)	75	(1,747)	235	144	379
Total revenues	17,246	2,983	20,229	22,606	3,153	25,759
<b>BENEFITS AND EXPENSES</b>						
Policyholders' benefits	12,558	1,685	14,243	12,081	1,789	13,870
Interest credited to policyholders' account balances	1,376	68	1,444	2,144	69	2,213
Dividends to policyholders	94	911	1,005	70	976	1,046
Amortization of deferred policy acquisition	418	20	438	992	20	1,012
General and administrative expenses	5,134	276	5,410	5,141	271	5,412
Total benefits and expenses	19,580	2,960	22,540	20,428	3,125	23,553
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES</b>						
	(2,334)	23	(2,311)	2,178	28	2,206
Income tax expense	(1,109)	5	(1,104)	911	11	922
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES</b>						
	(1,225)	18	(1,207)	1,267	17	1,284
Equity in earnings of operating joint ventures, net of taxes	54	0	54	13	0	13
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS</b>						
Income (loss) from discontinued operations, net of taxes	(1,171)	18	(1,153)	1,280	17	1,297
	3	0	3	15	(1)	14
<b>NET INCOME (LOSS)</b>						
	(1,168)	18	(1,150)	1,295	16	1,311
Less: Income attributable to noncontrolling interests	77	0	77	26	0	26

<b>NET INCOME (LOSS) ATTRIBUTABLE TO PRUDENTIAL FINANCIAL, INC.</b>	\$ (1,245)	\$ 18	\$ (1,227)	\$ 1,269	\$ 16	\$ 1,285
---	------------	-------	------------	----------	-------	----------

*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 Consolidated Financial Statements (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.

Holdings 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 June 30, 2013, compared with December 31, 2012, and its consolidated results of operations for the three and six months ended June 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 the demutualization, we ceased offering domestic participating products. The liabilities for our traditional domestic in force participating products were segregated, together with assets, in a regulatory mechanism referred to as the Closed Block. The Closed Block is designed generally to provide for the reasonable expectations for future policy dividends after demutualization of holders of participating



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

individual 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 \$1.044 trillion of assets under management as of June 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 June 3, 2013, Prudential Financial received notice of a proposed determination by the Financial Stability Oversight Council (the Council ) that it 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 July 2, 2013, Prudential Financial provided notice to the Council requesting a nonpublic written and oral evidentiary hearing before the Council to contest the Council's proposed determination. The written and oral evidentiary hearing was held and completed as of July 30, 2013. According to the regulations, the Council will make a final determination on the Company's status as a Covered Company within 60 days after the hearing. If Prudential Financial is designated by the Council as a Covered Company, it could be subject to stricter prudential standards under the Dodd-Frank Act, which may include requirements regarding risk-based capital and 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. 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.

On July 18, 2013, the Financial Stability Board ( FSB ), consisting of representatives of national financial authorities of the G20 nations, identified the Company as a global systemically important insurer ( G-SII ). U.S. financial regulators are thereby expected to enhance their regulation of Prudential Financial to achieve a number of regulatory objectives, including consolidated group-wide supervision, stricter regulation (including enhanced loss absorbency requirements), and development of risk reduction and resolution plans in the event of distress. We cannot predict the outcome of our identification as a G-SII on the regulation of our businesses.

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. 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. As of June 30, 2013, the Company purchased 6.6 million shares of our Common Stock 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 February 12, 2013 and May 14, 2013, Prudential Financial's Board of Directors declared a dividend of \$0.40 per share of Common Stock for the first and second quarters of 2013, respectively.

**Table of Contents****Impact of Low Interest Rate Environment***Domestic Financial Services Businesses*

Interest rates in the U.S. remain lower than historical levels, despite recent increases. As a result, our current reinvestment yields are 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 portfolio income yields are expected to continue to decline in future periods.

For the domestic Financial Services Businesses' general account, we expect annual scheduled payments and pre-payments 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 \$154 billion of such assets (based on net carrying value) as of June 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 \$154 billion of fixed maturity securities and commercial mortgage loans are approximately \$60 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 June 30, 2013, approximately 80% of these assets contain prepayment penalties.

The reinvestment of scheduled payments and pre-payments 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 June 30, 2013, our domestic Financial Services Businesses have approximately \$149 billion of insurance liabilities and policyholder account balances. Of this amount, approximately \$48 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 June 30, 2013 and the respective guaranteed minimums.

**Account Values with Crediting Rates:**

	<b>At guaranteed minimum</b>	<b>1 - 49 bps above guaranteed minimum</b>	<b>50 - 99 bps above guaranteed minimum</b>	<b>100 - 150 bps above guaranteed minimum</b>	<b>Greater than 150 bps above guaranteed minimum</b>	<b>Total</b>
	(\$ billions)					
<b>Range of Guaranteed Minimum Crediting Rates:</b>						
Less than 1%	\$ 0.6	\$ 0.0	\$ 0.0	\$ 0.0	\$ 0.0	\$ 0.6
1% - 1.99%	1.5	0.4	10.5	3.1	0.2	15.7
2% - 2.99%	2.7	0.0	0.1	0.4	1.3	4.5
3% - 4.00%	23.2	1.4	1.7	0.4	0.1	26.8
Greater than 4%	0.7	0.0	0.0	0.0	0.0	0.7
<b>Total</b>	<b>\$ 28.7</b>	<b>\$ 1.8</b>	<b>\$ 12.3</b>	<b>\$ 3.9</b>	<b>\$ 1.6</b>	<b>\$ 48.3</b>
Percentage of total	59%	4%	26%	8%	3%	100%

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

For the contracts above guaranteed minimum crediting rates, although we may have the ability to lower crediting rates, our willingness to do so may be limited by competitive pressures.

Our domestic Financial Services Businesses also have approximately \$13 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

## **Table of Contents**

based on the yield earned on the related assets. The remaining \$88 billion of the \$149 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 July 1, 2013 through December 31, 2014, and credit spreads remain unchanged from levels as of June 30, 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 \$8 million in the second half of 2013 and \$60 million in 2014. This impact is most significant in the Retirement, Individual Life and Individual Annuities segments. This hypothetical scenario only reflects the impact related to the approximately \$48 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.

### *Japan Insurance Operations*

Our Japan insurance operations have experienced a prolonged low interest rate environment for many years. As of June 30, 2013, these operations have \$125 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 \$125 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, the current crediting rates are substantially at or near contractual minimums. For the contracts above guaranteed minimum crediting rates, although we have the ability to lower crediting rates in some cases, the majority of this business has credited interest rates which are determined by formula. Our Japan 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, which 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 six months ended June 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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in millions)			
Adjusted operating income before income taxes for segments of the Financial Services Businesses:				
Individual Annuities	\$ 400	\$ 107	\$ 772	\$ 528
Retirement	279	147	507	303
Asset Management	168	52	347	184
<b>Total U.S. Retirement Solutions and Investment Management Division</b>	<b>847</b>	<b>306</b>	<b>1,626</b>	<b>1,015</b>
Individual Life	141	61	278	173
Group Insurance	22	33	31	(7)
<b>Total U.S. Individual Life and Group Insurance Division</b>	<b>163</b>	<b>94</b>	<b>309</b>	<b>166</b>
International Insurance	850	678	1,727	1,275
<b>Total International Insurance Division</b>	<b>850</b>	<b>678</b>	<b>1,727</b>	<b>1,275</b>
Corporate and Other	(347)	(225)	(661)	(552)
<b>Adjusted operating income before income taxes for the Financial Services Businesses</b>	<b>1,513</b>	<b>853</b>	<b>3,001</b>	<b>1,904</b>
Reconciling Items:				
Realized investment gains (losses), net, and related adjustments(1)	(2,698)	3,058	(6,003)	342
Charges related to realized investment gains (losses), net(2)	468	(1,028)	770	(150)
Investment gains on trading account assets supporting insurance liabilities, net(3)	(471)	4	(376)	238
Change in experience-rated contractholder liabilities due to asset value changes(4)	471	54	328	(192)
Divested businesses(5)	(84)	22	(55)	23
Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests(6)	31	8	1	13
<b>Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures for Financial Services Businesses</b>	<b>(770)</b>	<b>2,971</b>	<b>(2,334)</b>	<b>2,178</b>
<b>Income (loss) from continuing operations before income taxes for Closed Block Business</b>	<b>4</b>	<b>(2)</b>	<b>23</b>	<b>28</b>
<b>Consolidated income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures</b>	<b>\$ (766)</b>	<b>\$ 2,969</b>	<b>\$ (2,311)</b>	<b>\$ 2,206</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 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. Also includes charges that represent the impact of Realized investment gains (losses), net, on the amortization of deferred policy acquisition costs, and other costs.

(3) 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)

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

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.

121



## **Table of Contents**

- (5) See Divested Businesses.
- (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 second quarter and first six months of 2013 increased in comparison to the prior year periods. The increases for both periods include favorable comparative impacts from changes in the estimated profitability of the business, as well as higher asset-based fee income, driven by higher average variable annuity account values, net of an increased level of asset-based commissions, amortization costs and reserve provisions.

*Retirement.* Results for the second quarter and first six months of 2013 increased in comparison to the prior year periods primarily reflecting higher net investment spread results and a more favorable reserve benefit from case experience, primarily driven by significant pension risk transfer transactions that closed in the fourth quarter of 2012, as well as higher asset-based fee income resulting from increased account values.

*Asset Management.* Results for the second quarter and first six months of 2013 increased in comparison to the prior year periods. The increases for both periods include an improved contribution from the segment's incentive, transaction, strategic investing and commercial mortgage activities, and higher asset management fees, partially offset by increased expenses.

*Individual Life.* Results for the second quarter and first six months of 2013 increased in comparison to the prior year periods. The increases for both periods primarily reflect improved mortality experience and earnings from the in force Hartford Life Business acquired in January 2013.

*Group Insurance.* Results for the second quarter of 2013 decreased in comparison to the second quarter of 2012 primarily due to less favorable group life underwriting results partially offset by more favorable group disability underwriting results. Segment results for the first six months of 2013 increased in comparison to the first six months of 2012 primarily due to more favorable group disability and life underwriting results.

*International Insurance.* Results for the second quarter and first six months of 2013 increased in comparison to the prior year periods. Results for both periods benefited from business growth, additional synergies and lower integration costs associated with our acquisition of the former Star and Edison businesses, and greater contributions from investment results. In addition, the current six month period benefited from a gain on the sale of our remaining indirect investment in China Pacific Group.

*Corporate and Other operations.* Results for both the second quarter and first six months of 2013 compared to the prior year periods reflect an increased loss primarily driven by higher levels of expenses and greater interest expense including the impact of debt prefunding activities.

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

*Closed Block Business.* Income from continuing operations before income taxes for the second quarter and first six months of 2013 was relatively unchanged from the prior year periods as the decrease in net realized investment gains was mostly offset by the decrease in the policyholder dividend obligation expense.

**Table of Contents**

**Accounting Policies & Pronouncements**

**Application of Critical Accounting Estimates**

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

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

Goodwill;

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

Policyholder liabilities;

Pension and other postretirement benefits;

Taxes on income; and

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

The near-term future equity rate of return assumption used in evaluating DAC and deferred sales inducements for our domestic variable annuity and variable life insurance products is derived using a reversion to the mean approach, 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

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

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. As of June 30, 2013, our variable annuities and variable life insurance businesses assume an 8.0% long-term equity expected rate of return and a 6.7% near-term mean reversion equity rate of return.

Additional information on our policies for our critical accounting estimates listed above may be found 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' 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.

**Table of Contents****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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
(in millions)				
<b>Financial Services Businesses:</b>				
Revenues	\$ 8,580	\$ 14,458	\$ 17,246	\$ 22,606
Benefits and expenses	9,350	11,487	19,580	20,428
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures for Financial Services Businesses	(770)	2,971	(2,334)	2,178
Income tax expense (benefit)	(274)	741	(1,109)	911
Income (loss) from continuing operations before equity in earnings of operating joint ventures for Financial Services Businesses	(496)	2,230	(1,225)	1,267
Equity in earnings of operating joint ventures, net of taxes	5	6	54	13
Income (loss) from continuing operations for Financial Services Businesses	(491)	2,236	(1,171)	1,280
Income (loss) from discontinued operations, net of taxes	2	8	3	15
Net income (loss) Financial Services Businesses	(489)	2,244	(1,168)	1,295
Less: Income attributable to noncontrolling interests	35	15	77	26
Net income (loss) of Financial Services Businesses attributable to Prudential Financial, Inc.	\$ (524)	\$ 2,229	\$ (1,245)	\$ 1,269
<b>Closed Block Business:</b>				
Revenues	\$ 1,464	\$ 1,678	\$ 2,983	\$ 3,153
Benefits and expenses	1,460	1,680	2,960	3,125
Income (loss) from continuing operations before income taxes for Closed Block Business	4	(2)	23	28
Income tax expense	1	2	5	11
Income (loss) from continuing operations for Closed Block Business	3	(4)	18	17
Income (loss) from discontinued operations, net of taxes	0	(1)	0	(1)
Net income (loss) Closed Block Business	3	(5)	18	16
Less: Income attributable to noncontrolling interests	0	0	0	0
Net income (loss) of Closed Block Business attributable to Prudential Financial, Inc.	\$ 3	\$ (5)	\$ 18	\$ 16
<b>Consolidated:</b>				
Net income (loss) attributable to Prudential Financial, Inc.	\$ (521)	\$ 2,224	\$ (1,227)	\$ 1,285

**Results of Operations Financial Services Businesses**

*2013 to 2012 Three Month Comparison.* Income (loss) from continuing operations for the Financial Services Businesses decreased \$2,727 million, from income of \$2,236 million in the second quarter of 2012 to a loss of

---

**Table of Contents**

\$491 million in the second quarter of 2013. Results for the second quarter of 2013 compared to the second quarter of 2012 reflect the following:

Lower net pre-tax earnings of \$2,962 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 (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 \$1,828 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, primarily driven by the impact of non-performance risk, partially offset by the impact of amortization of deferred policy acquisition and other costs (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

\$962 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 driven by the weakening of the Japanese yen.

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

More favorable results of \$1,606 million, on a pre-tax basis, associated with our Capital Protection Framework driven by an increase in interest rates reflecting our decision to hold capital against a portion of our interest rate exposure rather than fully hedging the risk (see Results of Operations for Financial Services Businesses by Segment Corporate and Other Capital Protection Framework for additional information);

A \$1,015 decrease in income tax expense reflecting the decrease in pre-tax income from continuing operations; and

A \$199 million favorable variance, before taxes, from adjustments to deferred policy acquisition and other costs and the reserves for guaranteed minimum death and income benefit features of our variable annuity products, reflecting updates to the estimated profitability of the business, primarily resulting from market performance (see Results of Operations for Financial Services Businesses by Segment U.S. Retirement Solutions and Investment Management Division Individual Annuities Adjusted Operating Income for additional information).

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, 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).

*2013 to 2012 Six Month Comparison.* Income from continuing operations for the Financial Services Businesses decreased \$2,451 million, from income of \$1,280 million in the first six months of 2012 to a loss of \$1,171 million in the first six months of 2013. Results for the first six months of 2013 compared to the first six months of 2012 reflect the following:

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

Lower net pre-tax earnings of \$4,131 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 (see



---

**Table of Contents**

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 \$1,688 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, primarily driven by the impact of non-performance risk, partially offset by the impact of amortization of deferred policy acquisition and other costs (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);

\$964 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 offsetting these decreases in income from continuing operations were the following items:

A \$2,020 decrease in income tax expense reflecting a decrease in pre-tax income from continuing operations and use of the loss limitation method in 2013 partially offset by the effect of a double tax recognized for U.S. GAAP purposes (see Income Taxes for additional information);

More favorable results of \$1,450 million, on a pre-tax basis, associated with our Capital Protection Framework driven by an increase in interest rates reflecting our decision to hold capital against a portion of our interest rate exposure rather than fully hedging the risk (see Results of Operations for Financial Services Businesses by Segment Corporate and Other Capital Protection Framework for additional information);

A \$117 million pre-tax gain in the current period associated with the estimated recovery of prior losses related to derivative transactions previously held with Lehman Brothers and its affiliates (see Note 11 to our Unaudited Interim Consolidated Financial Statements for additional information);

A \$66 million pre-tax gain from the sale of our remaining indirect investment in China Pacific Group; and

A \$65 million favorable variance, before taxes, from adjustments to deferred policy acquisition and other costs and the reserves for guaranteed minimum death and income benefit features of our variable annuity products, reflecting updates to the estimated profitability of the business, primarily resulting from market performance (see Results of Operations for Financial Services Businesses by Segment U.S. Retirement Solutions and Investment Management Division Individual Annuities Adjusted Operating Income for additional information).

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, 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**

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

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

## **Table of Contents**

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

## **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 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

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

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

**Table of Contents**

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 derivative liabilities. 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 these 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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in millions)			
<b>Total Individual Annuities(1):</b>				
Beginning total account value	\$ 142,748	\$ 124,054	\$ 135,342	\$ 113,535
Sales	2,453	5,358	6,677	10,317
Surrenders and withdrawals	(1,936)	(1,660)	(3,753)	(3,379)
Net sales	517	3,698	2,924	6,938
Benefit payments	(422)	(350)	(803)	(718)
Net flows	95	3,348	2,121	6,220
Change in market value, interest credited and other activity	(561)	(2,669)	5,555	5,598
Policy charges	(808)	(639)	(1,544)	(1,259)
Ending total account value(2)	\$ 141,474	\$ 124,094	\$ 141,474	\$ 124,094

- (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 \$137.8 billion and \$120.3 billion as of June 30, 2013 and 2012, respectively. Fixed annuity account values were \$3.7 billion and \$3.8 billion as of June 30, 2013 and 2012, respectively.
- (2) As of June 30, 2013, includes variable annuity account values of \$81 billion, or 59%, invested in equity portfolios, \$43 billion, or 31%, 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.

As shown above, our account values are significantly impacted by net sales and the impact of market performance on contractholders' accounts. The declines in sales for the three and six months ended June 30, 2013 compared to the prior year periods primarily reflect the impacts of our actions in the second half of 2012 and the first quarter of 2013 to implement variable annuity product modifications for new sales to scale back benefits, increase pricing, reduce commissions and close a share class. We also suspended additional contractholder deposits for variable annuities with certain optional living benefit riders that are no longer being offered. The six months ended June 30, 2013 reflect a partial offset

to these declines from a temporary increase in sales in the first

**Table of Contents**

quarter in advance of the product modifications in that period. The increases in surrenders and withdrawals for the three and six months ended June 30, 2013 compared to the prior year periods are primarily driven by the higher overall level of account values. The change in market value, interest credited and other activity primarily reflects changes in the market value of contractholder funds. The decline in market value for the three months ended June 30, 2013 was driven by unfavorable fund investment performance, primarily due to the unfavorable impact of rising interest rates on bond funds, while the decline for the three months ended June 30, 2012 was primarily driven by equity market depreciation. The increases in market value for the six months ended June 30, 2013 and 2012 were driven by significant equity market appreciation in the first quarter of both years, which more than offset the respective declines in the second quarters. The increases in policy charges for the three and six months ended June 30, 2013 compared to the prior year periods primarily reflect 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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in millions)			
<b>Operating results:</b>				
Revenues	\$ 1,119	\$ 968	\$ 2,187	\$ 1,926
Benefits and expenses	719	861	1,415	1,398
Adjusted operating income	400	107	772	528
Realized investment gains (losses), net, and related adjustments	(1,169)	2,193	(2,249)	390
Related charges	392	(1,052)	754	(132)
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures	\$ (377)	\$ 1,248	\$ (723)	\$ 786

*Adjusted Operating Income*

*Three Month Comparison.* Adjusted operating income increased \$293 million. Excluding the impacts of changes in the estimated profitability of the business, discussed below, adjusted operating income increased \$94 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 the level of asset-based commissions, amortization costs and reserve provisions.

The impacts of changes in the estimated profitability of the business include adjustments to the reserves for the GMDB and GMIB features of our variable annuity products and to the amortization of DAC and other costs. These adjustments resulted in a net benefit of \$75 million and a net charge of \$124 million in the second quarter of 2013 and 2012, respectively. The net benefit in the second quarter of 2013 primarily reflects the impact of higher interest rates, which increased future expected fixed income returns on contractholder accounts and lowered future expected claims relative to our assumptions. The net charge in the second quarter of 2012 primarily reflects negative equity market performance on contractholder accounts relative to our assumptions. For weighted average rate of return assumptions as of June 30, 2013, see *Accounting Policies & Pronouncements* Application of Critical Accounting Estimates.

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

In addition to these current period impacts, changes to the estimated profitability of our business also drive changes in our future accrual rates for GMDB and GMIB reserves and amortization rates for DAC and other costs, which will impact results in future periods. We also include certain results of our living benefits hedging



**Table of Contents**

program in our best estimate of gross profits used to determine amortization rates, which drives changes in the amortization of DAC and other costs in future periods as the new rates are applied to actual gross profits that are included in adjusted operating income. However, the impacts described above exclude the current quarter impact of resetting the amortization rates for this item, as both the results of our living benefits hedging program and related amortization of DAC and other costs are excluded from adjusted operating income in the quarter realized, as described below in *Variable Annuity Living Benefits Hedging Program Results*. For additional information on our policy for amortizing DAC and other costs, and for estimating future expected claims costs associated with the GMDB and GMIB features of our variable annuity products, 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*.

*Six Month Comparison.* Adjusted operating income increased \$244 million. Excluding the impacts of changes in the estimated profitability of the business, discussed below, adjusted operating income increased \$179 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 the level of asset-based commissions, amortization costs and reserve provisions.

The impacts of changes in the estimated profitability of the business include adjustments to the reserves for the GMDB and GMIB features of our variable annuity products and to the amortization of DAC and other costs. These adjustments resulted in net benefits of \$137 million and \$72 million in the first six months of 2013 and 2012, respectively. The net benefit in the first six months of 2013 primarily reflects the impact of higher interest rates in the second quarter, as discussed above, and positive equity market performance on contractholder accounts in the first quarter relative to our assumptions. The net benefit in the first six months of 2012 primarily reflects the impact of overall positive equity market performance on contractholder accounts relative to our assumptions.

*Revenues, Benefits and Expenses*

*Three Month Comparison.* Revenues, as shown in the table above under *Operating Results*, increased \$151 million, primarily driven by a \$159 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.

Benefits and expenses, as shown in the table above under *Operating Results*, decreased \$142 million. Absent the \$199 million net decrease related to the impacts of certain changes in our estimated profitability of the business, discussed above, benefits and expenses increased \$57 million. General and administrative expenses, net of capitalization, increased \$32 million, driven by higher asset-based commissions and asset management costs, reflecting business and account value growth. The amortization of DAC increased \$18 million, primarily driven by higher gross profits related to the increase in fee income discussed above.

*Six Month Comparison.* Revenues increased \$261 million, primarily driven by a \$293 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 \$31 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 increased \$17 million. Absent the \$65 million net decrease related to the impacts of certain changes in our estimated profitability of the business, discussed above, benefits and expenses increased \$82 million. General and administrative expenses, net of

capitalization, increased \$57 million, driven by higher

## **Table of Contents**

asset-based commissions and asset management costs, reflecting business and account value growth. The amortization of DAC increased \$30 million, primarily driven by higher gross profits related to the increase in fee income discussed above. These increases were partially offset by a \$19 million decline in interest credited to policyholders' account balances driven by lower average account values in the general account, as discussed above.

### *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, recognizing that, under the terms of the contracts, we do not expect to begin substantial payment of such claims until at least five years in the future. For additional information regarding this program see [Variable Annuities Living Benefits Hedging Program Results](#) below.

For our optional living benefits features, claims will primarily be paid in the form of lifetime contractholder withdrawal payments. These payments commence only after the cumulative withdrawals have first exhausted the contractholder account value. Due to the age of the block, no such claims payments have occurred to date, nor are they expected to occur within the next five years, based upon current market 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.



**Table of Contents**

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.

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 mortality and longevity 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.

	June 30, 2013		December 31, 2012		June 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)	\$ 95,646	69%	\$ 89,167	68%	\$ 77,688	63%
Hedging program only	11,655	9%	11,744	9%	11,651	10%
Automatic rebalancing only	2,473	2%	2,787	2%	3,123	3%
Neither risk mitigant	3,616	2%	3,556	3%	3,603	3%
Total optional living benefit/GMDB features	\$ 113,390		\$ 107,254		\$ 96,065	
<b>GMDB features only(3):</b>						
Neither risk mitigant	24,385	18%	24,354	18%	24,261	21%
Total variable annuity account value	\$ 137,775		\$ 131,608		\$ 120,326	

(1) Contracts with both risk mitigants have optional living benefits that are included in our living benefits hedging program, and have an automatic rebalancing element.

(2) All contracts with optional living benefit guarantees also contain GMDB features, covering the same insured life.

(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 June 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 that is grounded in a U.S. GAAP/capital markets valuation framework, with three notable modifications:

- (1) 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.
- (2) A credit spread is added to the risk-free rate of return assumption used under U.S. GAAP to estimate future growth of bond investments in the contractholder separate account funds in order to better replicate the projected returns within those funds.
- (3) The equity volatility assumption is adjusted to remove certain risk margins required under U.S. GAAP valuation which are used in the projection of contractholder account values, as we believe the impact of these margins is highly sensitive to short-term market conditions and does not reflect the long-term nature of these guarantees.

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 June 30, 2013	As of December 31, 2012
	(in billions)	
Embedded derivative liability as defined by U.S. GAAP	\$ 0.4	\$ 3.3
Less: NPR Adjustment	(2.7)	(4.8)
Embedded derivative liability as defined by U.S. GAAP, excluding NPR	3.1	8.1
Less: Portion of embedded derivative liability, excluding NPR, excluded from hedge target liability	1.9	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 other 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 June 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	\$ 2.3	\$ 0.0	\$ 0.0	\$ 0.0	\$ 6.5	\$ (0.2)	\$ 0.0	\$ 0.0
Swaps	8.8	0.1	57.9	(0.6)	5.5	(0.1)	54.1	3.0
Options	9.3	0.4	24.3	0.3	10.7	0.5	25.3	0.8
Total	\$ 20.4	\$ 0.5	\$ 82.2	\$ (0.3)	\$ 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 contractholder behavior assumptions which are generally not hedged and typically occur annually in the third quarter, 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



**Table of Contents**

the derivatives held as part of the hedging program, we have cash, other invested assets and affiliated receivables available to cover the future claims payable under these guarantees and other 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 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 tradeable 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.

**Liability Basis** We make assumptions about expected changes in the hedge target, and attempt to replicate capital market changes 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.

**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 long-term volatility assumptions.

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 are included in [Realized investment gains \(losses\), net, and related adjustments](#) and the related impact to the amortization of DAC and other costs is included in [Related charges](#), both of which are excluded from adjusted operating income. The following table shows the net impact of changes in the embedded derivative and related hedge positions, as well as the related amortization of DAC and other costs, for the periods indicated.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(1) (in millions)			
<b>Hedge Program Results:</b>				
Change in fair value of hedge positions	\$ (2,835)	\$ 2,430	\$ (5,536)	\$ (89)
Change in value of hedge target	2,673	(2,617)	5,073	186
Net hedging impact(2)	\$ (162)	\$ (187)	\$ (463)	\$ 97
<b>Reconciliation of Hedge Program Results to U.S. GAAP Results:</b>				
Net hedging impact(2) (from above)	\$ (162)	\$ (187)	\$ (463)	\$ 97
Change in portions of U.S. GAAP liability, before NPR, excluded from hedge target(3)	98	(693)	357	(473)
Change in the NPR adjustment	(1,048)	3,023	(2,084)	729
Net impact from changes in the U.S. GAAP embedded derivative and hedge positions reported in Individual Annuities(2)	(1,112)	2,143	(2,190)	353
Related benefit (charge) to amortization of DAC and other costs(4)	389	(1,038)	752	(103)

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 reported in Individual Annuities(2)	\$ (723)	\$ 1,105	\$ (1,438)	\$ 250
--	----------	----------	------------	--------

**Table of Contents**

- (1) Positive amount represents income; negative amount represents a loss.
- (2) Excludes \$591 million and \$(876) million for the three months ended June 30, 2013 and 2012, respectively, and \$909 million and \$(294) million for the six months ended June 30, 2013 and 2012, respectively representing the impact of managing interest rate risk by holding capital against a portion of the interest rate exposure associated with these contracts. 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.
- (3) 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.
- (4) Includes \$(24) million and \$(29) million for the three months ended June 30, 2013 and 2012, respectively, and \$(58) million and \$13 million for the six months ended June 30, 2013 and 2012, respectively, representing the current period impact of incorporating the net hedging impact into our best estimate of gross profits used to set amortization rates.

The total net impacts shown in the table above were primarily driven by changes in the NPR adjustment in all periods. Favorable capital markets conditions in 2013, primarily driven by rising interest rates, drove decreases in the base embedded derivative liability before NPR, and corresponding declines in the NPR adjustment for both the three and six months ended June 30, 2013. Net unfavorable capital markets conditions in 2012, primarily driven by declining interest rates, drove increases in the base embedded derivative liability before NPR, and corresponding increases in the NPR adjustment for both the three and six months ended June 30, 2012. To a lesser extent, results for all periods also reflect the net impacts of changes in the value of our hedge target and related hedge positions. Fund underperformance relative to indices and rebalancing costs and volatility, partially offset by favorable liability basis, drove net charges for the three and six months ended June 30, 2013 and for the three months ended June 30, 2012, while the net impact for the six months ended June 30, 2012 was relatively flat due to fund outperformance in the first quarter of that year. The changes in the NPR adjustment and the net hedging impacts were partially offset by related impacts to the amortization of DAC and other costs in all periods.

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.

**Retirement****Operating Results**

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in millions)			
<b>Operating results:</b>				
Revenues	\$ 1,521	\$ 1,242	\$ 2,857	\$ 2,349
Benefits and expenses	1,242	1,095	2,350	2,046
Adjusted operating income	279	147	507	303
Realized investment gains (losses), net, and related adjustments	(242)	159	(359)	(1)
Related charges	0	2	1	0
Investment gains on trading account assets supporting insurance liabilities, net	(544)	87	(666)	168
Change in experience-rated contract holder liabilities due to asset value changes	544	(29)	618	(122)

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Income from continuing operations before income taxes and equity in earnings of operating joint ventures	\$ 37	\$ 366	\$ 101	\$ 348
--	-------	--------	--------	--------

**Table of Contents***Adjusted Operating Income*

*Three Month Comparison.* Adjusted operating income increased \$132 million primarily driven by higher net investment spread results and a more favorable reserve benefit 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 pension risk transfer transactions that closed in the fourth quarter of 2012 as well as higher income from non-coupon investments. The more favorable reserve benefit from case experience also reflects the impact of these pension risk transfer transactions, which experienced favorable mortality in the current quarter, 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 first quarter of 2013.

*Six Month Comparison.* Adjusted operating income increased \$204 million reflecting higher net investment spread results and a more favorable reserve benefit 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 pension risk transfer transactions that closed in the fourth quarter of 2012 and higher income from non-coupon investments. The more favorable reserve benefit from case experience also reflects the impact of these pension risk transfer transactions, which experienced favorable mortality in the current year, 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 first quarter of 2013.

*Revenues, Benefits and Expenses*

*Three Month Comparison.* Revenues, as shown in the table above under Operating Results, increased \$279 million. Net investment income increased \$258 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. Policy charges and fee income, and asset management fees and other income increased \$15 million, primarily from higher asset-based fees driven by increases in investment-only stable value and full service account values, as discussed above. Premiums increased \$6 million reflecting a net increase related to the significant pension risk transfer transactions, which included amortization of deferred profits, partially offset by a net decline in sales of other group annuities and structured settlements.

Benefits and expenses, as shown in the table above under Operating Results, increased \$147 million. Policyholders benefits, including the change in policy reserves, increased \$177 million, primarily driven by the pension risk transfer transactions discussed above, reflecting an increase from interest credited on account values, partially offset by a more favorable reserve benefit from case experience, partially resulting from a change in benefit administration. General and administrative expenses increased \$13 million, driven by higher compensation costs and strategic initiatives. Partially offsetting the increases above was a \$44 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.

*Six Month Comparison.* Revenues increased \$508 million. Net investment income increased \$445 million driven primarily by higher income on institutional investment products account values, driven by the significant



**Table of Contents**

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 \$38 million reflecting a net increase related to the significant pension risk transfer transactions, which included amortization of deferred profits. Policy charges and fee income, and asset management fees and other income, increased \$25 million, primarily from higher asset-based fees that were driven by increases in investment-only stable value and full service account values, as discussed above.

Benefits and expenses increased \$304 million. Policyholders' benefits, including the change in policy reserves, increased \$363 million, primarily driven by the pension risk transfer transactions discussed above, reflecting an increase from interest credited on account values, partially offset by a more favorable reserve benefit from case experience, partially resulting from a change in benefit administration. General and administrative expenses, net of capitalization, increased \$20 million, driven by higher compensation and strategic initiatives. Partially offsetting the increase above was an \$83 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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in millions)			
<b>Full Service(1):</b>				
Beginning total account value	\$ 156,380	\$ 145,991	\$ 148,405	\$ 139,430
Deposits and sales	3,697	4,363	9,376	9,009
Withdrawals and benefits	(3,622)	(3,671)	(8,298)	(10,774)
Change in market value, interest credited and interest income and other activity(2)	1,283	(4,278)	8,255	4,740
Ending total account value	\$ 157,738	\$ 142,405	\$ 157,738	\$ 142,405
Net additions (withdrawals)	\$ 75	\$ 692	\$ 1,078	\$ (1,765)
<b>Institutional Investment Products(3):</b>				
Beginning total account value	\$ 143,011	\$ 93,853	\$ 141,435	\$ 90,089
Additions	4,360	8,457	8,205	12,856
Withdrawals and benefits(4)	(2,462)	(2,832)	(4,781)	(4,370)
Change in market value, interest credited and interest income	(662)	1,562	(460)	2,490
Other(4)	(146)	1,403	(298)	1,378
Ending total account value(5)(6)	\$ 144,101	\$ 102,443	\$ 144,101	\$ 102,443
Net additions(7)	\$ 1,898	\$ 5,625	\$ 3,424	\$ 8,486





**Table of Contents**

- (1) Ending total account value for the full service business includes assets of Prudential's retirement plans of \$7.1 billion and \$6.3 billion as of June 30, 2013 and 2012, respectively.
- (2) Change in market value, interest credited and interest income and other activity includes \$(1.4) billion for the three and six months ended June 30, 2012 representing the divestiture of bank deposits held by PB&T, 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 \$5.6 billion and \$5.8 billion as of June 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 June 30, 2013 and 2012, respectively related to collateralized funding agreements issued to the Federal Home Loan Bank of New York (FHLBNY). For additional information, see Note 9 to the Unaudited Interim Consolidated Financial Statements.
- (4) Withdrawals and benefits includes (\$6) million and (\$10) million for the three and six months ended June 30, 2013, respectively, and (\$886) million and (\$900) million for the three and six months ended June 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 \$66.3 billion and \$53.2 billion as of June 30, 2013 and 2012, respectively.
- (6) Ending total account value for the institutional investment products business includes \$32.6 billion as of June 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 \$2.8 billion and \$6.3 billion for the three and six months ended June 30, 2013, respectively, and \$7.8 billion and \$10.9 billion for the three and six months ended June 30, 2012, respectively.

The increases in full service account values as of June 30, 2013 compared to the prior periods shown above primarily reflect the impact of equity market appreciation on the market value of customer funds. The decrease in net additions (withdrawals) for the three months ended June 30, 2013 compared to the prior year period was primarily due to a lower volume of large plan sales partially offset by a lower volume of large plan lapses. The increase in net additions (withdrawals) for the six months ended June 30, 2013 compared to the prior year period is primarily driven by a lower volume of large plan lapses.

The increases in institutional investment products account values as of June 30, 2013 compared to the prior periods primarily reflect net additions of our fee-based investment-only stable value product, partially offset by declines in the market value of customer funds driven by increases in fixed income yields during the second quarter of 2013. The increase compared to June 30, 2012 also reflects net additions, driven by significant pension risk transfer transactions in the fourth quarter of 2012. The decrease in net additions for the three and six months ended June 30, 2013 compared to the prior year periods 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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in millions)			
<b>Operating results:</b>				
Revenues	\$ 665	\$ 492	\$ 1,325	\$ 1,046
Expenses	497	440	978	862

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Adjusted operating income	168	52	347	184
Realized investment gains (losses), net, and related adjustments	(6)	0	(12)	(5)
Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests	31	10	64	20
Income from continuing operations before income taxes and equity in earnings of operating joint ventures	\$ 193	\$ 62	\$ 399	\$ 199

**Table of Contents***Adjusted Operating Income*

*Three Month Comparison.* Adjusted operating income increased \$116 million. The increase reflects improved strategic investing results, as the prior year quarter included a \$75 million impairment and other declines in values of certain real estate-related investments. Also contributing to the increase were higher asset management fees, driven by higher average asset values due to positive net flows and market appreciation since the second quarter of 2012. These increases were partially offset by higher compensation costs.

*Six Month Comparison.* Adjusted operating income increased \$163 million. The increase reflects higher asset management fees, driven by higher average asset values due to positive net flows and market appreciation since the second quarter of 2012. Also contributing to the increase were improved strategic investing results, as the prior year period included a \$75 million impairment and other declines in values of certain real estate-related investments, as well as higher performance-based incentive fees, net of direct expenses, driven by outperformance in public equity and fixed income 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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in millions)			
<b>Revenues by type:</b>				
Asset management fees by source:				
Institutional customers	\$ 207	\$ 190	\$ 410	\$ 380
Retail customers(1)	154	124	299	245
General account	106	93	209	185
Total asset management fees	467	407	918	810
Incentive fees(2)	17	9	33	0
Transaction fees	9	13	14	21
Strategic investing	(2)	(89)	13	(78)
Commercial mortgage(3)	36	42	65	62
Other related revenues(4)	60	(25)	125	5
Service, distribution and other revenues(5)	138	110	282	231
Total revenues	\$ 665	\$ 492	\$ 1,325	\$ 1,046

(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.

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

- (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 June 30, 2013, \$87 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) 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 \$16 million for the three months ended June 30, 2013 and 2012, respectively, and \$36 million and \$31 million for the six months ended June 30, 2013 and 2012, respectively.

**Table of Contents**

*Three Month Comparison.* Revenues, as shown in the table above, increased \$173 million. Strategic investing revenues increased \$87 million, as the prior year quarter included a \$75 million impairment and other declines in values of certain real estate-related investments. Asset management fees increased \$60 million, driven by higher average asset values due to positive net flows and market appreciation since the second quarter of 2012. Service, distribution and other revenues increased \$28 million, which primarily reflects higher revenues from certain consolidated funds, which were fully offset by higher expenses related to noncontrolling interests in these funds.

Expenses, as shown in the table above under Operating Results, increased \$57 million, primarily driven by higher compensation costs, and higher expenses related to revenues associated with certain consolidated funds, as discussed above.

*Six Month Comparison.* Revenues increased \$279 million. Asset management fees increased \$108 million, driven by higher average asset values due to positive net flows and market appreciation since the second quarter of 2012. Strategic investing revenues increased \$91 million, as the prior year period included a \$75 million impairment and other declines in values of certain real estate-related investments. Service, distribution and other revenues increased \$51 million, which primarily reflects higher revenues from certain consolidated funds, which were fully offset by higher expenses related to noncontrolling interests in these funds. Performance-based incentive fee revenues increased \$33 million, driven by outperformance in public equity and fixed income accounts.

Expenses increased \$116 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.

	June 30, 2013	December 31, 2012 (in billions)	June 30, 2012
<b>Assets Under Management (at fair market value):</b>			
Institutional customers:			
Equity	\$ 57.1	\$ 51.7	\$ 48.0
Fixed income	229.3	230.8	211.1
Real estate	32.7	31.2	30.1
Institutional customers(1)(2)	319.1	313.7	289.2
Retail customers:			
Equity	98.9	86.6	80.9
Fixed income	51.3	50.3	49.5
Real estate	2.2	1.8	1.3
Retail customers(3)	152.4	138.7	131.7
General account:			
Equity	7.9	9.4	8.5
Fixed income	345.2	363.7	321.4

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

Real estate	1.4	1.5	1.5
General account	354.5	374.6	331.4
Total assets under management	\$ 826.0	\$ 827.0	\$ 752.3

- (1) Consists of third-party institutional assets and group insurance contracts.
- (2) As of June 30, 2013, December 31, 2012 and June 30, 2012, includes \$37.4 billion, \$37.2 billion and \$33.7 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 June 30,		Six Months Ended June 30,		Twelve Months Ended June 30,
	2013	2012	2013 (in billions)	2012	2013
<b>Institutional Customers:</b>					
Beginning Assets Under Management	\$ 323.2	\$ 286.1	\$ 313.7	\$ 271.8	\$ 289.2
Net additions (withdrawals), excluding money market activity:					
Third party(1)	3.1	0.0	10.0	5.4	21.8
Affiliated(2)	(0.2)	(1.4)	0.0	(1.5)	0.0
Total	2.9	(1.4)	10.0	3.9	21.8
Market appreciation	(6.7)	4.3	(3.8)	13.1	9.4
Other increases (decreases)(4)	(0.3)	0.2	(0.8)	0.4	(1.3)
Ending Assets Under Management	\$ 319.1	\$ 289.2	\$ 319.1	\$ 289.2	\$ 319.1
<b>Retail Customers:</b>					
Beginning Assets Under Management	\$ 143.8	\$ 125.1	\$ 138.7	\$ 119.3	\$ 131.7
Net additions (withdrawals), excluding money market activity:					
Third party	2.5	3.6	4.3	6.9	10.2
Affiliated	6.8	7.5	3.4	(2.0)	(0.8)
Total	9.3	11.1	7.7	4.9	9.4
Market appreciation	(0.3)	(4.3)	6.7	7.0	13.1
Other increases (decreases)(4)	(0.4)	(0.2)	(0.7)	0.5	(1.8)
Ending Assets Under Management	\$ 152.4	\$ 131.7	\$ 152.4	\$ 131.7	\$ 152.4
<b>General Account:</b>					
Beginning Assets Under Management	\$ 373.3	\$ 321.3	\$ 374.6	\$ 326.7	\$ 331.4
Net additions (withdrawals), excluding money market activity:					
Third party	0.0	0.0	0.0	0.0	0.0
Affiliated(3)	(1.1)	1.5	5.6	0.9	42.3
Total	(1.1)	1.5	5.6	0.9	42.3
Market appreciation	(9.4)	3.8	(5.7)	7.7	1.8
Other increases (decreases)(4)	(8.3)	4.8	(20.0)	(3.9)	(21.0)
Ending Assets Under Management	\$ 354.5	\$ 331.4	\$ 354.5	\$ 331.4	\$ 354.5

(1) Includes net additions into fixed income accounts related to investment-only stable value products of \$0.1 billion and \$2.5 billion for the three months ended June 30, 2013 and 2012, respectively, \$0.9 billion and \$3.5 billion for the six months ended June 30, 2013 and 2012, respectively, and \$3.8 billion for the twelve months ended June 30, 2013.

(2) Includes \$1.0 billion from the acquisition of the Hartford Life Business for the six and twelve months ended June 30, 2013.

(3) Includes \$7.9 billion for the six and twelve months ended June 30, 2013 from the acquisition of the Hartford Life Business on January 2, 2013, and \$31.0 billion for the twelve months ended June 30, 2013 from two significant pension risk transfer transactions in the Retirement segment that occurred in 2012.

(4)

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

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.

	June 30, 2013      2012 (in millions)	
<b>Co-Investments:</b>		
Real estate	\$ 378	\$ 448
Fixed income	63	24
<b>Seed Investments:</b>		
Real estate	29	22
Public equity	164	231
Fixed income	203	219
<b>Loans Secured by Investor Equity Commitments or Fund Assets:</b>		
Real estate secured by investor equity	0	0
Private equity secured by investor equity	0	23
Real estate secured by fund assets	0	4
<b>Total</b>	<b>\$ 837</b>	<b>\$ 971</b>

The \$134 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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in millions)			
<b>Operating results:</b>				

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Revenues	\$ 1,212	\$ 803	\$ 2,367	\$ 1,579
Benefits and expenses	1,071	742	2,089	1,406
Adjusted operating income	141	61	278	173
Realized investment gains (losses), net, and related adjustments	(283)	(7)	(444)	23
Related charges	147	0	149	0
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures	\$ 5	\$ 54	\$ (17)	\$ 196

On January 2, 2013, we acquired the Hartford Life Business through a reinsurance transaction. We expect pre-tax integration costs of approximately \$125 million to be incurred over a two to three year period, including approximately \$50 million during 2013, of which \$19 million was incurred during the first six months of 2013.

## **Table of Contents**

After integration is complete, we expect annual cost savings of approximately \$90 million to be achieved by 2015. 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 \$80 million, including \$11 million of current quarter integration costs associated with the Hartford Life acquisition. Excluding integration costs, adjusted operating income increased \$91 million primarily reflecting an earnings benefit of approximately \$42 million from the acquired in force business and a favorable \$68 million mortality variance. Mortality experience, net of reinsurance, was favorable in the current quarter, compared to unfavorable in the year ago quarter, relative to expected levels. These favorable variances were partially offset by higher distribution costs reflecting expanded third party distribution and increased sales as well as higher compensation expenses. Net investment spread results were relatively unchanged from the year ago quarter as the impact from lower reinvestment rates was offset by higher income from non-coupon investments.

*Six Month Comparison.* Adjusted operating income increased \$105 million. Excluding the impact of integration costs discussed above, adjusted operating income increased \$124 million driven by approximately \$74 million of earnings from the acquired in force business and a favorable \$90 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 \$409 million. Policy charges and fees and asset management fees and other income increased \$290 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 \$98 million driven by business growth, including the impact of higher asset balances from the acquisition of the Hartford Life Business, as well as higher income from non-coupon investments, partially offset by the impact of lower reinvestment rates.

Benefits and expenses, as shown in the table above under Operating Results, increased \$329 million. Insurance and annuity benefits, including interest credited to policyholders account balances, increased \$180 million primarily reflecting business growth in our universal life block of business, including the impact of insurance liabilities acquired from the Hartford Life Business, partially offset by a favorable impact from mortality experience, as discussed above. General and administrative expenses, net of capitalization, increased \$109 million primarily driven by Hartford Life Business operating expenses, higher distribution costs reflecting expanded third party distribution and increased sales as well as higher compensation expenses.

*Six Month Comparison.* Revenues increased \$788 million. Policy charges and fees and asset management fees and other income increased \$575 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 investment income increased \$174 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.

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

Benefits and expenses increased \$683 million driven by a \$413 million increase in insurance and annuity benefits, including interest credited to policyholders' account balances. This increase primarily reflects growth of our universal life block of business, including the impact of insurance liabilities acquired from the Hartford Life

**Table of Contents**

Business, partly offset by more favorable mortality experience, as discussed above. General and administrative expenses, net of capitalization, increased \$198 million primarily driven by Hartford Life Business operating expenses, higher distribution costs and higher compensation expenses, partly offset by the absence of a charge incurred in the year ago period related to the correction of a delay in the execution of certain client mutual fund transactions.

*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, we do not expect to sustain this level of sales 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 June 30, 2013			Three Months Ended June 30, 2012		
	Prudential Agents	Third Party	Total	Prudential Agents	Third Party	Total
	(in millions)					
Variable Life	\$ 4	\$ 3	\$ 7	\$ 4	\$ 1	\$ 5
Universal Life(1)	10	114	124	10	32	42
Term Life	11	42	53	10	34	44
Total	\$ 25	\$ 159	\$ 184	\$ 24	\$ 67	\$ 91

	Six Months Ended June 30, 2013			Six Months Ended June 30, 2012		
	Prudential Agents	Third Party	Total	Prudential Agents	Third Party	Total
	(in millions)					
Variable Life	\$ 7	\$ 9	\$ 16	\$ 7	\$ 2	\$ 9
Universal Life(1)	21	260	281	17	59	76
Term Life	22	81	103	20	65	85
Total	\$ 50	\$ 350	\$ 400	\$ 44	\$ 126	\$ 170

(1) Single pay life annualized new business premiums, which include 10% of excess (unscheduled) premiums, represented approximately 33% and 25% of Universal Life annualized new business premiums for the three months ended June 30, 2013 and 2012, respectively, and approximately 36% and 23% of Universal Life annualized new business premiums for the six months ended June 30, 2013 and 2012, respectively.

Annualized new business premiums for the second quarter and first six 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 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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in millions)			
<b>Operating results:</b>				
Revenues	\$ 1,399	\$ 1,392	\$ 2,801	\$ 2,783
Benefits and expenses	1,377	1,359	2,770	2,790
Adjusted operating income	22	33	31	(7)
Realized investment gains (losses), net, and related adjustments	(1)	0	(4)	(6)
Related charges	(1)	0	(1)	0
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures	\$ 20	\$ 33	\$ 26	\$ (13)

*Adjusted Operating Income*

*Three Month Comparison.* Adjusted operating income decreased \$11 million reflecting less favorable underwriting results in the second quarter of 2013 in our group life business as well as higher operating expenses, including those related to business and strategic initiatives. Results for group life reflect unfavorable mortality on retrospectively experience-rated contracts for which the maximum allowable premiums have been collected. Partially offsetting these unfavorable items is more favorable underwriting results in the group disability business, higher net investment spread results reflecting improved investment income from non-coupon investments and a reduction of costs related to updates to premium tax estimates. Group disability's more favorable underwriting results are driven by lower new claims and an increase in claim resolutions in long-term disability, partially offset by the impact of a lower discount rate on newly incurred claims.

*Six Month Comparison.* Adjusted operating income increased \$38 million reflecting more favorable underwriting results in the first six months of 2013 in both our group life and disability businesses. Results for group life reflect more favorable claims experience primarily driven by the absence of the adverse fluctuation in claims severity on non-retrospectively experience-rated contracts that occurred in the first quarter of 2012. Group disability's more favorable underwriting results are driven by lower new claims severity and an increase in claim resolutions in long-term disability, partially offset by the impact of a lower discount rate on newly incurred claims. Partially offsetting these favorable items is higher operating expenses, including those related to business and strategic initiatives. These higher operating expenses are partly offset by the absence of legal costs incurred in the prior year period and a reduction of costs associated with updates to premium tax estimates.

*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, increased \$7 million. Group life premiums and policy charges and fee income increased \$12 million reflecting an increase from retrospectively experience-rated contracts with a corresponding increase in policyholder benefits. Investment income increased primarily driven by income from non-coupon investments, partially offset by a decline in reinvestment rates. These favorable items were partially offset by a decrease of \$12 million in group disability premiums and policy charges and fee income reflecting a decrease in premiums on retrospectively experience-rated contracts with a corresponding decrease in policyholder benefits.



**Table of Contents**

Benefits and expenses, as shown in the table above under Operating Results, increased \$18 million. This increase reflects a \$10 million increase in policyholders' benefits, including changes in reserves. Our group life business reflects an increase in benefit costs from retrospectively experience-rated contracts with a corresponding increase in premiums and policy charges, as discussed above. General and administrative expenses increased driven by higher costs, including those related to business and strategic initiatives, partially offset by a reduction of costs related to updates to premium tax estimates. Partially offsetting these increases to benefits and expenses were lower policyholders' benefits in our group disability business primarily from favorable claims experience due to a decrease in new claims and an increase in claim resolutions in long-term disability.

*Six Month Comparison.* Revenues increased \$18 million. Group life premiums and policy charges and fee income increased \$19 million reflecting an increase from retrospectively experience-rated contracts with a corresponding increase in policyholder benefits, partially offset by lower premiums from non-retrospectively experience-rated contracts primarily due to a decline in this block of business. Investment income increased primarily driven by income from non-coupon investments, partially offset by a decline in reinvestment rates. These favorable items were partially offset by a decrease of \$11 million in group disability premiums and policy charges and fee income reflecting a decrease in premiums on retrospectively experience-rated contracts with a corresponding decrease in policyholder benefits.

Benefits and expenses decreased \$20 million. This decrease reflects a \$32 million decrease in policyholders' benefits, including changes in reserves. Our group disability business reflects a decrease in policyholders' benefits primarily from favorable claims experience due to lower new claims severity and an increase in claim resolutions in long-term disability, as discussed above. Policyholders' benefits for our group life business declined due to lower average claim size from non-retrospectively experience-rated contracts. Partially offsetting this decrease were higher benefit costs in our group life business from retrospectively experience-rated contracts, with a corresponding increase in premiums and policy charges, as discussed above. The decrease to benefits and expenses was also partially offset by higher general and administrative expenses including higher costs related to business and strategic initiatives, partly offset by the absence of legal costs incurred in the prior year period and a reduction in costs associated with updates to premium tax estimates.

*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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
<b>Benefits ratio(1):</b>				
Group life	90.6%	88.6%	91.4%	92.0%
Group disability	93.2%	97.4%	93.8%	99.8%
<b>Administrative operating expense ratio(2):</b>				
Group life	9.6%	9.9%	9.4%	9.5%
Group disability	25.6%	23.3%	26.1%	24.5%

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

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

*Three Month Comparison.* The group life benefits ratio deteriorated 2.0 percentage points primarily driven by unfavorable mortality on retrospectively experience-rated contracts, as discussed above. The group disability benefits ratio improved 4.2 percentage points primarily due to lower new claims and an increase in claim resolutions in long-term disability. The group life administrative operating expense ratio remained

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

relatively unchanged. The group disability administrative operating expense ratio deteriorated 2.3 percentage points reflecting higher costs invested in our claims management process.

**Table of Contents**

*Six Month Comparison.* The group life benefits ratio improved 0.6 percentage points primarily due to lower average claim costs on non-retrospectively experience-related contracts, partially offset by unfavorable mortality on retrospectively experience-rated contracts, as discussed above. The group disability benefits ratio improved 6.0 percentage points primarily due to lower new claims severity and an increase in claim resolutions in long-term disability. The group life administrative operating expense ratio remained relatively unchanged. The group disability administrative operating expense ratio deteriorated 1.6 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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in millions)			
<b>Annualized new business premiums(1):</b>				
Group life	\$ 15	\$ 24	\$ 163	\$ 235
Group disability(2)	7	19	52	100
Total	\$ 22	\$ 43	\$ 215	\$ 335

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

(2) Includes dental products.

Annualized new business premiums for the second quarter and first six months of 2013 decreased in comparison to the prior year periods primarily driven by a change in our pricing discipline for both group life and group disability products, which has an immediate impact on our 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 their U.S. dollar-equivalent earnings from period to period, even if earnings on a local currency basis are relatively constant. We enter into forward currency derivative contracts, and hold dual currency and synthetic dual currency investments, as part of our strategy to effectively fix the currency exchange rates for a portion of our prospective non-U.S. dollar-denominated earnings streams, thereby reducing earnings volatility from foreign currency exchange rate movements. The forward currency hedging program is primarily associated with our insurance operations in Japan and Korea. In addition, our Japanese insurance operations offer a variety of non-yen denominated products which are supported by investments in corresponding currencies. While these non-yen denominated assets and liabilities are economically hedged, the accounting for changes in the value of these assets and liabilities due to changes in foreign currency exchange rate movements differs, resulting in volatility in reported U.S. GAAP earnings. For further information on the various hedging strategies used to mitigate the risks of foreign currency exchange rate movements on earnings, see [Impact of foreign currency exchange rate movements on earnings](#).

**Table of Contents**

We 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 U.S. dollar-denominated assets held locally by 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.

	June 30, 2013	December 31, 2012 (in billions)
<b>Instruments hedging foreign currency exchange rate exposure on U.S. dollar-equivalent earnings:</b>		
Forward currency hedging program(1)	\$ 2.8	\$ 2.9
Dual currency and synthetic dual currency investments(2)	0.8	0.9
	3.6	3.8
<b>Instruments hedging foreign currency exchange rate exposure on U.S. dollar-equivalent equity:</b>		
Available-for-sale U.S. dollar-denominated investments, at amortized cost	7.5	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(3)	7.8	7.4
Yen-denominated liabilities held in U.S. dollar-based entities(4)	0.8	0.8
	8.6	8.2
<b>Total hedges</b>	<b>\$ 12.2</b>	<b>\$ 12.0</b>

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

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

(3) Excludes \$28.0 billion and \$26.8 billion as of June 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.

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

**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.

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

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-yen denominated earnings that will be generated by non-yen denominated products and investments. As of June 30, 2013, we have hedged 100% of expected yen-based earnings for 2013 and 92%, 50%, and 8% of expected yen-based earnings for 2014, 2015, and 2016, respectively. To the extent currently unhedged, our

**Table of Contents**

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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in millions)			
<b>International Insurance Segment:</b>				
Impact of intercompany arrangement(1)	\$ 68	\$ (22)	\$ 108	\$ (43)
<b>Corporate and Other operations:</b>				
Impact of intercompany arrangement(1)	(68)	22	(108)	43
Settlement gains (losses) on forward currency contracts	67	(21)	103	(48)
Net benefit (detriment) to Corporate and Other operations	(1)	1	(5)	(5)
<b>Net impact on consolidated revenues and adjusted operating income</b>	<b>\$ 67</b>	<b>\$ (21)</b>	<b>\$ 103</b>	<b>\$ (48)</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 June 30, 2013 and December 31, 2012, the notional amounts of these forward currency contracts were \$3.4 billion and \$3.5 billion, respectively, of which \$2.8 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 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

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

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 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



**Table of Contents**

denominated assets, are excluded from adjusted operating income and included in Realized investment gains (losses), net, and related adjustments. For the six months ended June 30, 2013, Realized investment gains (losses), net, and related adjustments includes net losses of \$3,938 million 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 within our international insurance operations as of June 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 June 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 May 31, 2013 and Gibraltar Life's current period assets and liabilities represent balances as of May 31, 2013.

	Balances subject to remeasurement, as of June 30, 2013			Hypothetical increase (decrease) in pre-tax GAAP earnings(2)	
	Assets(1)	Liabilities	Net Liabilities(1) (in billions)	5% depreciation	5% appreciation
U.S. dollar-denominated products(3)	\$ 3.3	\$ 19.8	\$ 16.5	\$ (0.8)	\$ 0.8
Australian dollar-denominated products	0.5	8.5	8.0	(0.3)	0.3
Euro-denominated products	0.1	0.3	0.2	(0.0)	0.0
Total	\$ 3.9	\$ 28.6	\$ 24.7	\$ (1.1)	\$ 1.1

- (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 \$28.5 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 June 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 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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
(in millions)				
<b>Operating results:</b>				
Revenues:				
Life Planner operations	\$ 2,158	\$ 2,192	\$ 4,601	\$ 4,509
Gibraltar Life and Other operations	3,782	4,214	7,689	7,714
	5,940	6,406	12,290	12,223
Benefits and expenses:				
Life Planner operations	1,790	1,818	3,811	3,753
Gibraltar Life and Other operations	3,300	3,910	6,752	7,195
	5,090	5,728	10,563	10,948
Adjusted operating income:				
Life Planner operations	368	374	790	756
Gibraltar Life and Other operations	482	304	937	519
	850	678	1,727	1,275
Realized investment gains (losses), net, and related adjustments(1)	(1,762)	1,504	(4,304)	40
Related charges	(58)	(11)	(109)	(21)
Investment gains (losses) on trading account assets supporting insurance liabilities, net	73	(83)	290	70
Change in experience-rated contractholder liabilities due to asset value changes	(73)	83	(290)	(70)
Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests	0	0	(65)	0
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures	\$ (970)	\$ 2,171	\$ (2,751)	\$ 1,294

(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, \$321 million has been incurred to date. After integration is complete, we continue to expect annual cost savings of approximately \$250 million and, as of June 30, 2013, have already achieved approximately 90% of this annual savings on a run rate basis. Actual integration costs may exceed, and actual cost savings may fall short of, such expectations.

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 decreased \$6 million including a net favorable impact of \$13 million from currency fluctuations, inclusive of the currency

## **Table of Contents**

hedging program discussed above. Results for the year ago quarter benefited from lower benefits and expenses in our Korean operations as well as a distribution from the Japan Financial Stability Fund. Absent these items, adjusted operating income was relatively unchanged as the impact from growth of business in force and strong persistency in our Japanese Life Planner operation was offset by less favorable mortality experience relative to expected levels.

Adjusted operating income from our Gibraltar Life and Other operations increased \$178 million including a favorable impact of \$11 million from currency fluctuations. The current quarter benefited from lower integration costs relating to the acquisition of the Star and Edison Businesses, for which we incurred \$38 million in the year ago quarter compared to \$6 million in the current quarter.

Excluding the effect of the items discussed above, adjusted operating income from our Gibraltar Life and Other operations increased \$135 million, primarily reflecting business growth and favorable results from non-coupon investments. The current quarter also benefited from accelerated earnings resulting from surrenders of fixed annuities denominated in Australian and U.S. dollars caused by the appreciation of these currencies relative to the Japanese yen. In addition, cost savings resulting from Star and Edison integration synergies were \$56 million in the current quarter, an increase of \$18 million from the year ago quarter.

*Six Month Comparison.* Adjusted operating income from Life Planner operations increased \$34 million including a net favorable impact of \$27 million from currency fluctuations. Excluding currency fluctuations, adjusted operating income increased \$7 million, primarily reflecting the growth of business in force driven by sales results and continued strong persistency, partly offset by the current period absence of certain benefits that occurred in the year ago period, as discussed above.

Adjusted operating income from our Gibraltar Life and Other operations increased \$418 million including a favorable impact of \$17 million from currency fluctuations. Adjusted operating income in current year period includes a \$66 million gain on our investment, through a consortium, in China Pacific Group, for which our remaining shares were sold in January 2013. The current period also benefited from lower integration costs relating to the acquisition of the Star and Edison Businesses, for which we incurred \$95 million in the year ago period compared to \$9 million in the current period.

Excluding the effect of the items discussed above, adjusted operating income from our Gibraltar Life and Other operations increased \$249 million, primarily reflecting business growth, favorable results from non-coupon investments, and \$110 million of cost savings resulting from Star and Edison integration synergies, compared to \$72 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, as discussed above.

### *Revenues, Benefits and Expenses*

*Three Month Comparison.* Revenues from our Life Planner operations, as shown in the table above under Operating Results, decreased \$34 million including a net unfavorable impact of \$173 million from currency fluctuations. Excluding the impact of currency fluctuations, revenues increased \$139 million. This increase in revenues came primarily from increases in premiums and policy charges and fee income of \$121 million driven by growth of business in force in our Japanese Life Planner operation. Net investment income increased \$38 million driven by investment portfolio growth.

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

Benefits and expenses of our Life Planner operations, as shown in the table above under Operating Results, decreased \$28 million including a net favorable impact of \$186 million from currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased \$158 million, of which \$113 million was in our Japanese Life Planner operation. This increase primarily reflects a \$105 million increase in policyholder benefits, including changes in reserves, driven by the growth in business in force. In addition, general and administrative expenses, net of capitalization, increased driven by distribution growth and technology expenditures as well as lower benefits and expenses in our Korean operations in the year ago quarter.

---

**Table of Contents**

Revenues from our Gibraltar Life and Other operations decreased \$432 million including a net unfavorable impact of \$445 million from currency fluctuations. Excluding the impact of currency fluctuations, revenues increased \$13 million. This increase is driven by a \$73 million increase in net investment income reflecting business growth and favorable results from non-coupon investments, partly offset by the impact of lower reinvestment rates. Premiums and policy charges and fee income were relatively unchanged from the year ago quarter as increased premiums from growth in the Independent Agency and Life Consultant distribution channels were offset by lower premiums from reduced sales of yen-denominated single premium reduced death benefit whole life policies in the bank channel, as discussed further below. Asset management fees and other income declined from the year ago quarter driven by the absence of a \$33 million distribution received from the Japan Financial Stability Fund.

Benefits and expenses of our Gibraltar Life and Other operations decreased \$610 million including a net favorable impact of \$456 million from currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses decreased \$154 million. Policyholder benefits, including changes in reserves, decreased \$85 million primarily driven by lower sales of yen-denominated single premium reduced death benefit whole life policies, as discussed further below. 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, as well as the absence of a \$34 million charge in the year ago quarter associated with our life insurance joint venture in India.

*Six Month Comparison.* Revenues from our Life Planner operations increased \$92 million including a net unfavorable impact of \$318 million from currency fluctuations. Excluding the impact of currency fluctuations, revenues increased \$410 million. This increase in revenues came primarily from increases in premiums and policy charges and fee income of \$356 million driven by growth of business in force in our Japanese Life Planner operation. In addition, net investment income increased \$79 million primarily reflecting investment portfolio growth.

Benefits and expenses of our Life Planner operations increased \$58 million including a net favorable impact of \$345 million from currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased \$403 million primarily driven by a \$320 million increase in policyholder benefits, including changes in reserves, reflecting growth in business in force. In addition, general and administrative expenses, net of capitalization, increased driven by distribution growth and technology expenditures as well as lower benefits and expenses in our Korean operations in the year ago period.

Revenues from our Gibraltar Life and Other operations decreased \$25 million including an unfavorable impact of \$819 million from currency fluctuations. Excluding the impact of currency fluctuations, revenues for Gibraltar Life increased \$794 million driven by a \$621 million increase in premiums and policy charges and fee income primarily reflecting higher sales of yen-denominated single premium and recurring premium whole life products. In addition, net investment income increased \$187 million primarily reflecting favorable results from non-coupon investments and investment portfolio growth, partially offset by the impact of lower reinvestment rates. Also contributing to the increase in revenues is the impact of a \$66 million gain from the sale of our investment in China Pacific Group, as discussed above, partly offset by the absence of a \$33 million distribution received from the Japan Financial Stability Fund.

Benefits and expenses of our Gibraltar Life and Other operations decreased \$443 million including a net favorable impact of \$836 million from currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased \$393 million. Policyholder benefits, including changes in reserves, increased \$506 million primarily reflecting higher sales of yen-denominated single premium and recurring premium whole life products. This increase is partly offset by lower general and administrative expenses, net of capitalization, reflecting \$86 million of lower integration costs and \$38 million of higher integration synergies relating to the acquisition of the Star and Edison Businesses, and the absence of a \$34 million charge in the year ago period associated with our life insurance joint venture in India.

**Table of Contents***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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
(in millions)				
<b>Annualized new business premiums:</b>				
On an actual exchange rate basis:				
Life Planner operations	\$ 255	\$ 402	\$ 600	\$ 796
Gibraltar Life	498	762	957	1,231
<b>Total</b>	<b>\$ 753</b>	<b>\$ 1,164</b>	<b>\$ 1,557</b>	<b>\$ 2,027</b>
On a constant exchange rate basis:				
Life Planner operations	\$ 285	\$ 402	\$ 657	\$ 793
Gibraltar Life	565	769	1,053	1,228
<b>Total</b>	<b>\$ 850</b>	<b>\$ 1,171</b>	<b>\$ 1,710</b>	<b>\$ 2,021</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.

Recently, growth in annualized new business premiums has been driven by increased average premium per new policy resulting in part from expanded distribution through third party channels, especially banks. 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, we recently made pricing changes and product modifications on the yen-denominated single premium reduced death benefit whole life product sold through the bank distribution channel and will suspend sales of this product in September 2013.

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 June 30, 2013					Three Months Ended June 30, 2012				
	Life	Health & Accident	Retirement(1)	Annuity	Total	Life	Health & Accident	Retirement(1)	Annuity	Total
Life Planners	\$ 138	\$ 27	\$ 112	\$ 8	\$ 285	\$ 113	\$ 77	\$ 197	\$ 15	\$ 402
Gibraltar Life:										
Life Consultants	154	29	33	49	265	125	60	76	57	318



Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Banks(2)	192	0	2	28	222	198	26	4	33	261
Independent Agency	34	17	18	9	78	17	147	19	7	190
Subtotal	380	46	53	86	565	340	233	99	97	769
Total	\$ 518	\$ 73	\$ 165	\$ 94	\$ 850	\$ 453	\$ 310	\$ 296	\$ 112	\$ 1,171

(1) Includes retirement income, endowment and savings variable universal life.

**Table of Contents**

- (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 39% and 45%, respectively, of total bank distribution channel annualized new business premiums, excluding annuity products, for the three months ended June 30, 2013, and 51% and 32%, respectively, of total bank distribution channel annualized new business premiums, excluding annuity products, for the three months ended June 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 \$117 million, including a \$106 million decline in Japan. The decline in our Japanese Life Planner operation is driven by accelerated sales of U.S. dollar-denominated retirement income and cancer whole life products in the year ago quarter. The increased sales of U.S. dollar-denominated retirement income products in the year ago quarter were in advance of a crediting rate change effective June 2012 and the increased sales of cancer products in the year ago quarter were in advance of a tax law change in April 2012. These unfavorable variances were partly offset by increased sales of yen-denominated retirement income and protection products in the current quarter.

Annualized new business premiums, on a constant exchange rate basis, from our Gibraltar Life operations decreased \$204 million. Sales in the Independent Agency and Life Consultant channels declined \$112 million and \$53 million, respectively, driven by accelerated sales of cancer whole life products in the year ago quarter in advance of a tax law change as well as accelerated sales of U.S. dollar-denominated retirement income and whole life products in the year ago quarter in advance of a crediting rate change. Bank channel sales declined \$39 million driven by lower sales from yen-denominated single premium reduced death benefit whole life products following a pricing change in January 2013, partly offset by increased sales of yen-denominated recurring premium whole life products.

	Six Months Ended June 30, 2013					Six Months Ended June 30, 2012				
	Life	Health	Retirement(1)	Annuity	Total	Life	Health	Retirement(1)	Annuity	Total
	(in millions)									
Life Planners	\$ 312	\$ 60	\$ 263	\$ 22	\$ 657	\$ 238	\$ 149	\$ 372	\$ 34	\$ 793
Gibraltar Life:										
Life Consultants	277	56	77	72	482	215	95	115	82	507
Banks(2)	394	1	4	46	445	344	36	8	63	451
Independent Agency	55	23	33	15	126	40	186	25	19	270
Subtotal	726	80	114	133	1,053	599	317	148	164	1,228
Total	\$ 1,038	\$ 140	\$ 377	\$ 155	\$ 1,710	\$ 837	\$ 466	\$ 520	\$ 198	\$ 2,021

- (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 49% and 38%, respectively, of total bank distribution channel annualized new business premiums, excluding annuity products, for the six months ended June 30, 2013, and 50% and 34%, respectively, of total bank distribution channel annualized new business premiums, excluding annuity products, for the six months ended June 30, 2012. Single pay and limited pay products generally have less death benefit protection per premium paid than more traditional recurring premium products.

*Six Month Comparison.* Annualized new business premiums, on a constant exchange rate basis, from our Life Planner operations decreased \$136 million, including a \$132 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, as discussed above. These items were partially offset by higher sales of yen-denominated retirement income and protection products.

**Table of Contents**

Annualized new business premiums, on a constant exchange rate basis, from our Gibraltar Life operations decreased \$175 million. Independent Agency, Life Consultant, and Bank channel sales declined \$144 million, \$25 million, and \$6 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, as discussed above. These decreases were partially offset by higher sales of yen-denominated recurring premium whole life products in the bank channel.

**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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in millions)			
<b>Operating results:</b>				
Capital debt interest expense	\$ (170)	\$ (172)	\$ (339)	\$ (343)
Operating debt interest expense, net of investment income	(39)	(10)	(82)	(25)
Pension and employee benefits	67	53	134	105
Other corporate activities(1)	(205)	(96)	(374)	(289)
Adjusted operating income	(347)	(225)	(661)	(552)
Realized investment gains (losses), net, and related adjustments	765	(791)	1,369	(99)
Related charges	(12)	33	(24)	3
Divested businesses	(84)	22	(55)	23
Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests	0	(2)	2	(7)
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures	\$ 322	\$ (963)	\$ 631	\$ (632)

(1) Includes consolidating adjustments.

*Three Month Comparison.* The loss from Corporate and Other operations, on an adjusted operating income basis, increased \$122 million. Higher net charges of \$109 million from other corporate activities was primarily driven by increased retained corporate expenses including higher compensation costs due to improvement in company earnings and favorable equity market performance, and from recognition of the deferred bond issuance costs related to capital and operating debt redeemed in the second quarter of 2013. Operating debt interest expense, net of investment income, increased \$29 million, primarily driven by higher levels of operating debt proceeds held in cash driven by debt prefunding activities.

Results from pension and employee benefits increased \$14 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.

*Six Month Comparison.* The loss from Corporate and Other operations, on an adjusted operating income basis, increased \$109 million. Operating debt interest expense, net of investment income, increased \$57 million,

## Table of Contents

primarily driven by higher levels of operating debt proceeds held in cash driven by debt prefunding activities. Higher net charges of \$85 million from other corporate activities were driven by increased retained corporate expenses reflecting higher compensation costs and recognition of the deferred bond issuance costs, as discussed above, were partially offset by a favorable comparative impact of our estimate of payments arising from use of new Social Security Master Death File matching criteria to identify deceased policy and contract holders.

Results from pension and employee benefits increased \$29 million. Income from our qualified pension plan decreased \$10 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 among other things, the capital hedge program. The capital hedge program broadly addresses the equity market exposure of the statutory capital of the Company as a whole, under stress scenarios, as described 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 \$12 million and \$10 million for the three months ended June 30, 2013 and 2012, respectively, and \$25 million and \$17 million for the six months ended June 30, 2013 and 2012, respectively.

In addition to hedging equity market exposure, we may choose to manage the interest rate risk associated with various operations of the Financial Services Businesses by holding capital against a portion of the interest rate exposure rather than fully hedging the risk. Realized investment gains (losses), net and related adjustments includes net gains of \$737 million and net losses of \$876 million for the three months ended June 30, 2013 and 2012, respectively, and net gains of \$1,166 million and net losses of \$294 million for the six months ended June 30, 2013 and 2012, respectively, resulting from our decision to utilize this strategy to manage a portion of our interest rate risk. The capital consequences associated with our decision to hold capital against a portion of our interest rate exposure have been factored into our Capital Protection Framework.

In addition, we 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. Through our Capital Protection Framework, we maintain access to on-balance sheet capital and contingent sources of capital that are available to meet capital needs that may arise related to this hedging program.

We assess the composition of our hedging program on an ongoing basis, and we may change it from time to time based on our evaluation of 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

**Table of Contents**

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 June 30, 2013, the excess of actual cumulative earnings over the expected cumulative earnings was \$861 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 \$3,725 million at June 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.

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
	<b>(in millions)</b>			
<b>U.S. GAAP results:</b>				
Revenues	\$ 1,464	\$ 1,678	\$ 2,983	\$ 3,153
Benefits and expenses	1,460	1,680	2,960	3,125
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures	\$ 4	\$ (2)	\$ 23	\$ 28

*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 \$6 million, from \$2 million of a loss in the second quarter of 2012 to \$4 million of income in the second quarter of 2013. Results for the second quarter of 2013 include a benefit from the absence of a \$45 million increase in reserves in the year ago quarter for estimated payments arising from the use of new Social Security Master Death File matching criteria to identify deceased policy and contract holders. This favorable item was more than offset by a decrease of \$176 million in net realized investment gains, from gains of \$154 million in the second quarter of 2012, to losses of \$22 million in the second quarter of 2013. The decrease in net realized investment gains was primarily driven by unfavorable changes in the value of derivatives and lower trading gains on fixed maturities, partially offset by higher trading gains on equity securities and lower impairments. For a discussion of Closed Block Business realized investment gains (losses), net, see Realized Investment Gains and Losses. As a result of the above and other variances, a \$59 million policyholder dividend obligation benefit was recorded in the second quarter of 2013,

compared to a \$93 million expense in the second



---

**Table of Contents**

quarter of 2012. As noted above, as of June 30, 2013, the excess of actual cumulative earnings over the expected cumulative earnings was \$861 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.

*Six Month Comparison.* Income from continuing operations before income taxes and equity in earnings of operating joint ventures decreased \$5 million. Results for the first six months of 2013 include a decrease of \$69 million in net realized investment gains, primarily due to unfavorable changes in the value of derivatives partially offset by higher trading gains on equity investments, as well as lower impairments. For a discussion of Closed Block Business realized investment gains (losses), net, see Realized Investment Gains and Losses. Also contributing to the decline in results was a \$53 million decrease in net investment income primarily due to lower reinvestment rates. Partially offsetting these unfavorable items was a benefit from the absence of a \$76 million increase in reserves in the prior year for estimated payments arising from the use of new Social Security Master Death File matching criteria to identify deceased policy and contract holders. As a result of the above and other variances, a \$24 million policyholder dividend obligation benefit was recorded in the first six months of 2013, compared to a \$17 million expense in the first six months of 2012.

*Revenues, Benefits and Expenses*

*Three Month Comparison.* Revenues, as shown in the table above under Operating Results, decreased \$214 million principally driven by the \$176 million decrease in net realized investment gains, as discussed above. In addition, premiums declined by \$32 million, with a related decrease in changes in reserves, primarily due to the expected in force decline as policies terminate.

Benefits and expenses, as shown in the table above under Operating Results, decreased \$220 million principally driven by a \$164 million decrease in dividends to policyholders. The decrease in dividends to policyholders includes a \$152 million decrease in the policyholder dividend obligation expense reflecting lower cumulative earnings and a \$12 million decrease in dividends paid and accrued to policyholders primarily due to a decline in policies in force. In addition, policyholders' benefits, including changes in reserves, decreased \$60 million reflecting the absence of a \$45 million increase in reserves in the second quarter of 2012 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 a decrease due to the in force decline as policies terminate.

*Six Month Comparison.* Revenues decreased \$170 million principally driven by the \$69 million decrease in net realized investment gains, as discussed above. Premiums declined by \$56 million, with a related decrease in changes in reserves, primarily due to the expected in force decline as policies terminate. Also contributing to the decline in revenues was a \$53 million decrease in net investment income primarily reflecting the impact of lower reinvestment rates and lower asset balances as the business runs off.

Benefits and expenses decreased \$165 million principally driven by a \$104 million decrease in policyholders' benefits, including changes in reserves. The decrease in policyholders' benefits, including change in reserves reflects the absence of a \$76 million increase in reserves in the first six months of 2012 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 a decrease due to the in force decline as policies terminate, as discussed above. Also contributing to the decrease in benefits and expenses was a \$65 million decrease in dividends to policyholders. The decrease in dividends to policyholders includes a \$41 million decrease in the policyholder dividend obligation expense reflecting lower cumulative earnings and a \$24 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 benefit of \$273 million in the second quarter of 2013 compared to an expense of \$743 million in the second quarter of 2012. The decrease in income tax expense primarily reflects the decrease in pre-tax net income from continuing operations before income taxes and equity in earnings of operating joint ventures from the second quarter of 2012 to the second quarter of 2013.

Our income tax provision, on a consolidated basis, amounted to an income tax benefit of \$1,104 million in the first six months of 2013 compared to an expense of \$922 million in the first six months of 2012. The first six months of 2013 and 2012 include \$108 million and \$337 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 six months of 2013 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 six 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'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 only one incidence of tax expense will actually be paid.

Excluding the impact of the double tax, the benefit associated with income taxes increased \$1,797 million, driven in part by higher pre-tax losses in the first six months of 2013 in comparison to the first six months of 2012. In addition, the tax rate for the first six months of 2013 is limited to the tax benefit based on the first six months loss, certain adjustments for discrete items and expected full year permanent differences, while the tax rate for the first six 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 \$2 million and \$7 million for the three months ended June 30, 2013 and 2012, respectively, and \$3 million and \$14 million for the six months ended June 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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(in millions)			
Long-Term Care	\$ (72)	\$ 15	\$ (60)	\$ 18
Wealth Management Solutions	(6)	(2)	(10)	(5)
Real Estate and Relocation Services	2	10	28	14
Individual Health Insurance	(5)	(2)	(9)	(6)
Financial Advisory	(1)	(1)	(2)	(3)
Other(1)	(2)	2	(2)	5
<b>Total divested businesses excluded from adjusted operating income</b>	<b>\$ (84)</b>	<b>\$ 22</b>	<b>\$ (55)</b>	<b>\$ 23</b>

(1) Primarily includes Property and Casualty Insurance and Prudential Securities Capital Markets.

*Long-Term Care.* Results for the second quarter and first six months of 2013 decreased in comparison to the prior year periods. The decreases for both periods primarily reflect the comparative impact of losses in the second quarter and first six months of 2013 compared to gains in the prior year periods resulting from changes in the market value of derivatives used to manage duration in our general account investment portfolios due to an increase in interest rates. The decrease in results for both periods is also driven by unfavorable underwriting results.

*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

**Table of Contents**

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

Our Retirement segment has two types of experience-rated products that are supported by TAASIL and other related investments. Fully participating products are those for which the entire return on underlying investments is passed back to the policyholders through a corresponding adjustment to the related liability. The adjustment to the liability is based on changes in the fair value of all of the related assets, including commercial mortgage and other loans, which are carried at amortized cost, less any valuation allowance. Partially 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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
(in millions)				
<b>Retirement Segment:</b>				
Investment gains (losses) on:				
Trading account assets supporting insurance liabilities, net	\$ (544)	\$ 87	\$ (666)	\$ 168
Derivatives	28	(52)	65	(41)
Commercial mortgages and other loans	4	(1)	2	0
Change in experience-rated contractholder liabilities due to asset value changes(1)(2)	544	(29)	618	(122)
Net gains (losses)	\$ 32	\$ 5	\$ 19	\$ 5
<b>International Insurance Segment:</b>				
Investment gains (losses) on trading account assets supporting insurance liabilities, net				
	\$ 73	\$ (83)	\$ 290	\$ 70
Change in experience-rated contractholder liabilities due to asset value changes	(73)	83	(290)	(70)
Net gains (losses)	\$ 0	\$ 0	\$ 0	\$ 0
<b>Total:</b>				
Investment gains (losses) on:				
Trading account assets supporting insurance liabilities, net	\$ (471)	\$ 4	\$ (376)	\$ 238
Derivatives	28	(52)	65	(41)
Commercial mortgages and other loans	4	(1)	2	0
Change in experience-rated contractholder liabilities due to asset value changes(1)(2)	471	54	328	(192)
Net gains (losses)	\$ 32	\$ 5	\$ 19	\$ 5

- (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 \$21 million and \$6 million as of June 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 an increase of \$54 million and a decrease of \$4 million for the three months ended June 30, 2013 and 2012, respectively, and increases of \$42 million and less than \$1 million for the six months ended June 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.

As shown in the table above, the net impacts for the Retirement segment of changes in experience-rated contractholder liabilities and investment gains and losses on trading account assets supporting insurance liabilities and other related investments were net gains of \$32 million and \$5 million for the three months ended June 30, 2013 and 2012, respectively, and net gains of \$19 million and \$5 million for the six months ended June 30, 2013 and 2012, respectively. These impacts primarily reflect timing differences between the recognition of the mark-to-market adjustments and the recognition of the recovery of these adjustments in future periods through subsequent increases in asset values or reductions in crediting rates on contractholder liabilities for partially participating products. These impacts also reflect the difference between the fair value of the underlying commercial mortgage and other loans and the amortized cost, less any valuation allowance, of these loans, as described above.





**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 June 30, 2013				As of December 31, 2012			
	Financial Services Businesses		Closed Block Business		Financial Services Businesses		Closed Block Business	
	Total at Fair Value	Total Level 3(1)	Total at Fair Value	Total Level 3(1)	Total at Fair Value	Total Level 3(1)	Total at Fair Value	Total Level 3(1)
	(in millions)							
Fixed maturities, available-for-sale	\$ 242,059	\$ 4,536	\$ 44,048	\$ 1,123	\$ 254,917	\$ 4,261	\$ 46,419	\$ 1,207
Trading account assets:								
Fixed maturities	21,416	560	154	10	20,605	565	139	10
Equity securities	2,088	771	120	113	2,341	987	136	111
All other(2)	2,963	14	0	0	3,697	25	0	0
Subtotal	26,467	1,345	274	123	26,643	1,577	275	121
Equity securities, available-for-sale	5,289	284	3,465	8	5,052	321	3,225	9
Commercial mortgage and other loans	303	21	0	0	162	48	0	0
Other long-term investments	1,392	1,082	0	0	1,478	1,053	(95)	0
Short-term investments	6,318	0	1,731	0	5,130	0	1,260	0
Cash equivalents	7,569	0	564	0	13,063	0	537	0
Other assets	134	6	93	0	98	8	97	0
Subtotal excluding separate account assets	289,531	7,274	50,175	1,254	306,543	7,268	51,718	1,337
Separate account assets	264,054	21,672	0	0	253,254	21,132	0	0
Total assets	\$ 553,585	\$ 28,946	\$ 50,175	\$ 1,254	\$ 559,797	\$ 28,400	\$ 51,718	\$ 1,337
Future policy benefits	\$ 365	\$ 365	\$ 0	\$ 0	\$ 3,348	\$ 3,348	\$ 0	\$ 0
Other liabilities	519	6	0	0	90	0	0	0
Notes of consolidated VIEs	2,055	2,055	0	0	1,406	1,406	0	0
Total liabilities	\$ 2,939	\$ 2,426	\$ 0	\$ 0	\$ 4,844	\$ 4,754	\$ 0	\$ 0

## 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 June 30, 2013 and December 31, 2012, respectively, for the Financial Services Businesses, and 2.5% and 2.6% as of June 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 June 30, 2013 and December 31, 2012, respectively, of public fixed maturities, with values primarily based on indicative broker quotes, and approximately \$1.3 billion and \$1.5 billion as of June 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 June 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 June 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



**Table of Contents**

some significant unobservable market inputs or inputs from less actively traded markets. We validate these values through periodic comparison of our fair values to broker-dealer values. The fair values of OTC derivative assets classified as Level 3 totaled approximately \$8 million and \$19 million as of June 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 \$0.4 billion and \$3.3 billion as of June 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

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

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

**Table of Contents**

net changes in the allowance for losses, certain restructurings and foreclosures on commercial mortgage and other loans

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 (except those derivatives used in our capacity as a broker or dealer).

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.

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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
(in millions)				
<b>Realized investment gains (losses), net:</b>				
Financial Services Businesses	\$ (1,002)	\$ 1,609	\$ (1,822)	\$ 235
Closed Block Business	(22)	154	75	144
Consolidated realized investment gains (losses), net	\$ (1,024)	\$ 1,763	\$ (1,747)	\$ 379
<b>Financial Services Businesses:</b>				
Realized investment gains (losses), net:				
Fixed maturity securities	\$ 254	\$ (76)	\$ 295	\$ (109)
Equity securities	31	(14)	65	(69)
Commercial mortgage and other loans	24	12	36	22
Derivative instruments	(1,310)	1,751	(2,222)	455
Other	(1)	(64)	4	(64)
Total	\$ (1,002)	\$ 1,609	\$ (1,822)	\$ 235
Related adjustments	(1,696)	1,449	(4,181)	107
Realized investment gains (losses), net, and related adjustments	(2,698)	3,058	(6,003)	342
Related charges	468	(1,028)	770	(150)
Realized investment gains (losses), net, and related charges and adjustments	\$ (2,230)	\$ 2,030	\$ (5,233)	\$ 192
<b>Closed Block Business:</b>				
Realized investment gains (losses), net:				
Fixed maturity securities	\$ 37	\$ 44	\$ 49	\$ 14
Equity securities	63	(10)	106	32
Commercial mortgage and other loans	1	(2)	2	(1)
Derivative instruments	(120)	123	(78)	100
Other	(3)	(1)	(4)	(1)
Total	\$ (22)	\$ 154	\$ 75	\$ 144

**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 in the second quarter of 2013 were \$1,002 million, compared to net realized investment gains of \$1,609 million in the second quarter of 2012.

**Table of Contents**

Net realized gains on fixed maturity securities were \$254 million in the second quarter of 2013, compared to net realized losses of \$76 million in the second quarter of 2012, as set forth in the following table:

	Three Months Ended June 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)	\$ 325	\$ 58
Private bond prepayment premiums	19	8
<b>Total gross realized investment gains</b>	<b>344</b>	<b>66</b>
Gross realized investment losses:		
Net other-than-temporary impairments recognized in earnings(2)	(23)	(74)
Gross losses on sales and maturities(1)	(62)	(53)
Credit related losses on sales	(5)	(15)
<b>Total gross realized investment losses</b>	<b>(90)</b>	<b>(142)</b>
<b>Realized investment gains (losses), net Fixed Maturity Securities</b>	<b>\$ 254</b>	<b>\$ (76)</b>
<b>Net gains (losses) on sales and maturities Fixed Maturity Securities(1)</b>	<b>\$ 263</b>	<b>\$ 5</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 in the second quarter of 2013 of \$263 million were primarily due to sales within our International Insurance segment resulting from surrenders of fixed annuities denominated in Australian and U.S. dollars. Net gains on sales and maturities of fixed maturity securities in the second quarter of 2012 of \$5 million were primarily due to sales within our Retirement segment. See below for additional information regarding the other-than-temporary impairments of fixed maturity securities in the second quarter of 2013 and 2012.

Net realized gains on equity securities were \$31 million in the second quarter of 2013, which included net trading gains on sales of equity securities of \$32 million, primarily due to sales within our International Insurance segment, partially offset by other-than-temporary impairments of \$1 million. Net realized losses on equity securities were \$14 million in the second quarter of 2012, which included other-than-temporary impairments of \$24 million, partially offset by net trading gains on sales of equity securities of \$10 million, primarily due to sales within Corporate and Other operations. See below for additional information regarding the other-than-temporary impairments of equity securities in the second quarter of 2013 and 2012.

Net realized gains on commercial mortgage and other loans in the second quarter of 2013 were \$24 million, primarily related to higher servicing revenue within our Asset Management businesses of \$17 million and a net decrease in the loan loss reserve of \$7 million. Net realized gains on commercial mortgage and other loans in the second quarter of 2012 were \$12 million, primarily related to a net decrease in the loan loss reserve of \$7 million and higher servicing revenue within our commercial mortgage operations, which was partially offset by realized losses related to

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

restructurings and sales within our Asset Management businesses. For additional information regarding our commercial mortgage and other loan loss reserves see [General Account Investments](#) [Commercial Mortgage and Other Loans](#) [Commercial Mortgage and Other Loan Quality](#).

Net realized losses on derivatives were \$1,310 million in the second quarter of 2013, compared to net realized gains of \$1,751 million in the second quarter of 2012. The net derivative losses in 2013 primarily reflect

**Table of Contents**

net losses of \$524 million on product related embedded derivatives and related hedge positions mainly associated with certain variable annuity contracts as well as net mark-to-market losses of \$504 million on interest rate derivatives used to manage duration as interest rates increased. Also, contributing to the net derivative losses were \$332 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 \$140 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 gains in the second quarter of 2012 primarily reflect net gains of \$1,282 million on product related embedded derivatives and related hedge positions mainly associated with certain variable annuity contracts. Also, contributing to the net derivative gains were net mark-to-market gains of \$337 million on interest rate derivatives used to manage duration as interest rates decreased, and net gains of \$175 million on foreign currency derivatives used to hedge portfolio assets in our Japan business primarily due to the strengthening of the Japanese yen against the U.S. dollar and other currencies. Partially offsetting these gains were net losses of \$83 million on foreign currency forward contracts used to hedge the future income of non-U.S. businesses, predominantly in Japan, due to the weakening of the U.S. dollar against the Japanese yen. See Results of Operations for Financial Services Businesses by Segment U.S. Retirement Solutions and Investment Management Division Individual Annuities for additional information.

Net realized losses on other investments were \$1 million in the second quarter of 2013, which included other-than-temporary-impairments of \$5 million, offset by net trading gains of \$4 million. Net realized losses on other investments were \$64 million in the second quarter of 2012, which included other-than-temporary impairments of \$72 million on real estate and joint ventures and partnerships investments, of which \$58 million is related to prior periods, partially offset by net trading gains of \$8 million primarily from our Corporate and Other segment.

Related adjustments include that portion of Realized investment gains (losses), net that are included in adjusted operating income and that portion of Asset management fees and other income and Net investment income that are excluded from adjusted operating income. 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 negative related adjustment of \$1,696 million for the second quarter of 2013 and a net positive related adjustment of \$1,449 million for the second 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.

Charges that relate to Realized investment gains (losses), net are also excluded from adjusted operating income, and may be reflected as net charges or net benefits. Results include a net related benefit of \$468 million for the second quarter of 2013 and a net related charge of \$1,028 million for the second quarter of 2012. The impacts in both periods were primarily driven by that 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.

**Table of Contents**

During the second quarter of 2013, we recorded other-than-temporary impairments of \$28 million in earnings, compared to other-than-temporary impairments of \$170 million recorded in earnings in the second 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 June 30,	
	2013	2012
(in millions)		
<b>Other-than-temporary impairments recorded in earnings Financial Services Businesses(1)</b>		
Public fixed maturity securities	\$ 19	\$ 64
Private fixed maturity securities	4	10
Total fixed maturity securities	23	74
Equity securities	1	24
Other invested assets(2)	4	72
<b>Total</b>	<b>\$ 28</b>	<b>\$ 170</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 and real estate investments.

	Three Months Ended June 30, 2013		Total Fixed Maturity Securities
	Asset-Backed Securities Collateralized By Sub-Prime Mortgages	All Other Fixed Maturity Securities (in millions)	
<b>Other-than-temporary impairments on fixed maturity securities recorded in earnings Financial Services Businesses(1)</b>			
Due to credit events or adverse conditions of the respective issuer(2)	\$ 4	\$ 7	\$ 11
Due to other accounting guidelines(3)	0	12	12
<b>Total</b>	<b>\$ 4</b>	<b>\$ 19</b>	<b>\$ 23</b>

	Three Months Ended June 30, 2012		Total Fixed Maturity Securities
	Asset-Backed Securities Collateralized By Sub-Prime Mortgages	All Other Fixed Maturity Securities (in millions)	
<b>Other-than-temporary impairments on fixed maturity securities recorded in earnings Financial Services Businesses(1)</b>			
Due to credit events or adverse conditions of the respective issuer(2)	\$ 13	\$ 13	\$ 26
Due to other accounting guidelines(3)	1	47	48
<b>Total</b>	<b>\$ 14</b>	<b>\$ 60</b>	<b>\$ 74</b>

(1)

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

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.

**Table of Contents**

- (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 other-than-temporary impairments in the second quarter of 2013 were concentrated in foreign government securities, asset-backed securities collateralized by sub-prime mortgages, and the consumer cyclical and capital goods sectors of our 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, which have caused, or we believe will lead to, a deficiency in the contractual cash flows related to the investment. Fixed maturity other-than-temporary impairments in the second quarter of 2012 were concentrated in the consumer non-cyclical and technology sectors of our 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, which have caused, or we believe will lead to, a deficiency in the contractual cash flows related to the investment.

Equity security other-than-temporary impairments in the second 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 intend to sell the security.

*Closed Block Business*

For the Closed Block Business, net realized investment losses in the second quarter of 2013 were \$22 million, compared to net realized investment gains of \$154 million in the second quarter of 2012.

Net realized gains on fixed maturity securities were \$37 million in the second quarter of 2013, compared to net realized gains of \$44 million in the second quarter of 2012, as set forth in the following table:

	<b>Three Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>
	<b>(in millions)</b>	
<b>Realized investment gains (losses), net Fixed Maturity Securities Closed Block Business</b>		
Gross realized investment gains:		
Gross gains on sales and maturities(1)	\$ 63	\$ 73
Private bond prepayment premiums	5	2
<b>Total gross realized investment gains</b>	<b>68</b>	<b>75</b>
Gross realized investment losses:		
Net other-than-temporary impairments recognized in earnings(2)	(10)	(19)
Gross losses on sales and maturities(1)	(21)	(4)
Credit related losses on sales	0	(8)
<b>Total gross realized investment losses</b>	<b>(31)</b>	<b>(31)</b>

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

Realized investment gains (losses), net Fixed Maturity Securities	\$ 37	\$ 44
Net gains (losses) on sales and maturities Fixed Maturity Securities(1)	\$ 42	\$ 69

- (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.



**Table of Contents**

Net realized gains on equity securities were \$63 million in the second quarter of 2013, primarily driven by net trading gains on sales of equity securities. Net realized losses on equity securities were \$10 million in the second quarter of 2012 and included other-than-temporary-impairments of \$16 million, partially offset by net trading gains on sales of equity securities of \$6 million.

Net realized gains on commercial mortgage and other loans were \$1 million in the second quarter of 2013, primarily related to a net decrease in the loan loss reserve. Net realized losses on commercial mortgage and other loans in the second quarter of 2012 of \$2 million were primarily related to a net increase in the loan loss reserve. For additional information regarding our loan loss reserves, see General Account Investments Commercial Mortgage and Other Loans Commercial Mortgage and Other Loan Quality.

Net realized losses on derivatives were \$120 million in the second quarter of 2013, compared to net realized gains of \$123 million in the second quarter of 2012. Derivative losses in the second quarter of 2013 primarily reflect net losses of \$93 million on interest rate derivatives primarily used to manage duration as interest rates increased. Also, contributing to the net derivative losses were \$15 million on currency derivatives used to hedge foreign denominated investments as the U.S. dollar weakened against the Euro and other currencies. Derivative gains in the second quarter of 2012 primarily reflect net derivative gains of \$65 million on currency derivatives used to hedge foreign denominated investments as the U.S. dollar strengthened against the Euro and net mark-to-market gains of \$54 million on interest rate derivatives primarily used to manage duration as interest rates declined.

During the second quarter of 2013, we recorded other-than-temporary impairments of \$12 million in earnings, compared to other-than-temporary impairments of \$35 million recorded in earnings in the second 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 June 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	\$ 9	\$ 12
Private fixed maturity securities	1	7
Total fixed maturity securities	10	19
Equity securities	0	16
Other invested assets(2)	2	0
<b>Total</b>	<b>\$ 12</b>	<b>\$ 35</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.

**Table of Contents**

	Three Months Ended June 30, 2013		
	Asset-Backed Securities Collateralized By Sub-Prime Mortgages	All Other Fixed Maturity Securities (in millions)	Total Fixed Maturity Securities
<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)	\$ 3	\$ 5	\$ 8
Due to other accounting guidelines	0	2	2
Total	\$ 3	\$ 7	\$ 10

	Three Months Ended June 30, 2012		
	Asset-Backed Securities Collateralized By Sub-Prime Mortgages	All Other Fixed Maturity Securities (in millions)	Total Fixed Maturity Securities
<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)	\$ 6	\$ 12	\$ 18
Due to other accounting guidelines	1	0	1
Total	\$ 7	\$ 12	\$ 19

- (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 other-than-temporary impairments in the second quarter of 2013 were concentrated in asset-backed securities collateralized by sub-prime mortgages and in the communications, basic industry, and utility sectors of our corporate securities. Fixed maturity other-than-temporary impairments in the second quarter of 2012 were concentrated in asset-backed securities collateralized by sub-prime mortgages and in the capital goods and consumer cyclical sectors of our corporate securities. These other-than-temporary impairments reflect adverse financial conditions of the respective issuers.

Equity security other-than-temporary impairments in the second quarter of 2013 and 2012 were primarily due to circumstances where the decline in value was maintained for one year or greater.

**Table of Contents****2013 to 2012 Six Month Comparison***Financial Services Businesses*

The Financial Services Businesses net realized investment losses in the first six months of 2013 were \$1,822 million, compared to net realized investment gains of \$235 million in the first six months of 2012.

Net realized gains on fixed maturity securities were \$295 million in the first six months of 2013, compared to net realized losses of \$109 million in the first six months of 2012, as set forth in the following table:

	<b>Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>
	<b>(in millions)</b>	
<b>Realized investment gains (losses), net Fixed Maturity Securities Financial Services Businesses</b>		
Gross realized investment gains:		
Gross gains on sales and maturities(1)	\$ 505	\$ 164
Private bond prepayment premiums	29	8
<b>Total gross realized investment gains</b>	<b>534</b>	<b>172</b>
Gross realized investment losses:		
Net other-than-temporary impairments recognized in earnings(2)	(82)	(156)
Gross losses on sales and maturities(1)	(132)	(104)
Credit related losses on sales	(25)	(21)
<b>Total gross realized investment losses</b>	<b>(239)</b>	<b>(281)</b>
<b>Realized investment gains (losses), net Fixed Maturity Securities</b>	<b>\$ 295</b>	<b>\$ (109)</b>
<b>Net gains (losses) on sales and maturities Fixed Maturity Securities(1)</b>	<b>\$ 373</b>	<b>\$ 60</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 six months of 2013 were \$373 million primarily due to sales within our International Insurance segment 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 six months of 2012 were \$60 million primarily due to sales within our Retirement, Individual Annuities and International Insurance segments. See below for additional information regarding the other-than-temporary impairments of fixed maturity securities in the first six months of 2013 and 2012.

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

Net realized gains on equity securities were \$65 million in the first six months of 2013. The first six months of 2013 included net trading gains on sales of equity securities of \$73 million, partially offset by other-than-temporary equity securities impairments of \$8 million. Net realized losses on equity securities were \$69 million in the first six months of 2012. The first six months of 2012 included other-than-temporary equity securities impairments of \$72 million, partially offset by net trading gains on sales of equity securities of \$3 million, which were primarily due to sales within our Corporate and Other operations. See below for additional information regarding the other-than-temporary impairments of equity securities in the first six months of 2013 and 2012.

Net realized gains on commercial mortgage and other loans in the first six months of 2013 were \$36 million, primarily related to a net decrease in the loan loss reserve of \$15 million and higher servicing revenue within our Asset Management business, partially offset by realized losses on foreclosures, restructurings and sales. Net realized gains on commercial mortgage and other loans in the first six months of 2012 were \$22 million,

---

**Table of Contents**

primarily related to a net decrease in the loan loss reserve of \$21 million, partially offset by realized losses on foreclosures, restructurings and sales within our commercial mortgage operations in International Insurance business. For additional information regarding our commercial mortgage and other loan loss reserves, see [General Account Investments](#) [Commercial Mortgage and Other Loans](#) [Commercial Mortgage and Other Loan Quality](#).

Net realized losses on derivatives were \$2,222 million in the first six months of 2013, compared to net realized gains of \$455 million in the first six months of 2012. The net derivative losses in the first six months of 2013 primarily reflect net losses of \$1,282 million on product related embedded derivatives and related hedge positions mainly associated with certain variable annuity contracts as well as net losses of \$699 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. Also contributing to the net derivative losses were net mark-to-market losses of \$610 million on interest rate derivatives used to manage duration as interest rates increased. Partially offsetting these losses were net gains of \$373 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 gains in the first six months of 2012 primarily reflect net mark-to-market gains of \$143 million on interest rate derivatives used to manage duration as interest rates declined. Also contributing to these gains were net gains of \$131 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, net gains of \$63 million on product related embedded derivatives and related hedge positions primarily associated with certain variable annuity contracts and gains of \$56 million primarily representing fees earned on fee-based synthetic guaranteed investment contracts which are accounted for as derivatives. See [Results of Operations for Financial Services Businesses by Segment](#) [U.S. Retirement Solutions and Investment Management Division](#) [Individual Annuities](#) for additional information

Net realized gains on other investments were \$4 million in the first six months of 2013, which included net trading gains of \$10 million, primarily from our Corporate and Other segment, partially offset by other-than-temporary impairments of \$6 million on real estate and joint ventures and partnerships investments. Net realized losses on other investments were \$64 million in the first six months of 2012, which included a \$74 million impairment on real estate and joint ventures and partnerships investments, of which \$58 million relates to prior periods, partially offset by net trading gains of \$10 million, primarily from our Corporate and Other segment.

Related adjustments include a net negative adjustment of \$4,181 million for the first six months of 2013 and a net positive adjustment of \$107 million for the first six months 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. See [Results of Operations for Financial Services Businesses by Segment](#) [International Insurance Division](#) for additional information.

Related charges include a net related benefit of \$770 million for the first six months of 2013 and a net related charge of \$150 million for the first six months of 2012. The impacts in both periods were primarily driven by that 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 six months of 2013, we recorded other-than-temporary impairments of \$95 million in earnings, compared to total other-than-temporary impairments of \$302 million recorded in earnings in the first

**Table of Contents**

six 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.

	Six Months Ended June 30, 2013      2012 (in millions)	
	<b>Other-than-temporary impairments recorded in earnings Financial Services Businesses(1)</b>	
Public fixed maturity securities	\$ 69	\$ 129
Private fixed maturity securities	13	27
Total fixed maturity securities	82	156
Equity securities	8	72
Other invested assets(2)	5	74
<b>Total</b>	<b>\$ 95</b>	<b>\$ 302</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 and real estate investments.

	Six Months Ended June 30, 2013		
	Asset-Backed Securities Collateralized By Sub-Prime Mortgages	All Other Fixed Maturity Securities (in millions)	Total Fixed Maturity Securities
<b>Other-than-temporary impairments on fixed maturity securities recorded in earnings Financial Services Businesses(1)</b>			
Due to credit events or adverse conditions of the respective issuer(2)	\$ 12	\$ 18	\$ 30
Due to other accounting guidelines(3)	0	52	52
Total	\$ 12	\$ 70	\$ 82

	Six Months Ended June 30, 2012		
	Asset-Backed Securities Collateralized By Sub-Prime Mortgages	All Other Fixed Maturity Securities (in millions)	Total Fixed Maturity Securities
<b>Other-than-temporary impairments on fixed maturity securities recorded in earnings Financial Services Businesses(1)</b>			
Due to credit events or adverse conditions of the respective issuer(2)	\$ 32	\$ 30	\$ 62
Due to other accounting guidelines(3)	2	92	94
Total	\$ 34	\$ 122	\$ 156

(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.

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

- (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.

**Table of Contents**

Fixed maturity other-than-temporary impairments in the first six months of 2013 were concentrated in the communications and utility sectors of our corporate securities, and asset-backed securities collateralized by sub-prime mortgages. 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, which have caused, or we believe will lead to a deficiency in the contractual cash flows related to the investment. During the first six 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 other-than-temporary impairments in the first six months of 2012 were concentrated in asset-backed securities collateralized by sub-prime mortgages and in the consumer non-cyclical, technology, and consumer cyclical sectors of our corporate securities. 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, which have caused, or we believe will lead to, a deficiency in the contractual cash flows related to the investment.

Equity security other-than-temporary impairments in the first six 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 intend to sell the security.

*Closed Block Business*

For the Closed Block Business, net realized investment gains in the first six months of 2013 were \$75 million, compared to net realized investment gains of \$144 million in the first six months of 2012.

Net realized gains on fixed maturity securities were \$49 million in the first six months of 2013, compared to net realized gains of \$14 million in the first six months of 2012, as set forth in the following table:

	<b>Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>
	<b>(in millions)</b>	
<b>Realized investment gains (losses), net Fixed Maturity Securities Closed Block Business</b>		
Gross realized investment gains:		
Gross gains on sales and maturities(1)	\$ 95	\$ 93
Private bond prepayment premiums	13	3
<b>Total gross realized investment gains</b>	<b>108</b>	<b>96</b>
Gross realized investment losses:		
Net other-than-temporary impairments recognized in earnings(2)	(21)	(49)
Gross losses on sales and maturities(1)	(32)	(25)
Credit related losses on sales	(6)	(8)
<b>Total gross realized investment losses</b>	<b>(59)</b>	<b>(82)</b>
<b>Realized investment gains (losses), net Fixed Maturity Securities</b>	<b>\$ 49</b>	<b>\$ 14</b>
<b>Net gains (losses) on sales and maturities Fixed Maturity Securities(1)</b>	<b>\$ 63</b>	<b>\$ 68</b>



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

- (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 \$106 million in the first six months of 2013, resulting from net trading gains on sales of equity securities. Net realized gains on equity securities were \$32 million in the first six

**Table of Contents**

months of 2012, which include net trading gains on sales of equity securities of \$50 million, partially offset by other-than-temporary impairments of \$18 million. See below for additional information regarding the other-than-temporary impairments of equity securities in the first six months of 2013 and 2012.

Net realized gains on commercial mortgage and other loans in the first six months of 2013 were \$2 million, primarily related to a net decrease in the loan loss reserves. Net realized losses on commercial mortgage and other loans of \$1 million in the first six months of 2012 were primarily related to a net increase in the loan loss reserve. For additional information regarding our loan loss reserves see General Account Investments Commercial Mortgage and Other Loans Commercial Mortgage and Other Loan Quality.

Net realized losses on derivatives were \$78 million in the first six months of 2013, compared to net realized gains of \$100 million in the first six months of 2012. Derivative losses in the first six months of 2013 primarily reflect net losses of \$97 million on interest rate derivatives primarily used to manage duration as interest rates increased, partially offset by net gains of \$31 million on currency derivatives used to hedge foreign denominated investments as the U.S. dollar strengthened against the Euro. Derivative gains of \$100 million in the first six months of 2012 primarily reflect net gains of \$71 million on interest rate derivatives primarily used to manage duration as interest rates declined, and net gains of \$23 million on currency derivatives used to hedge foreign denominated investments as the U.S. dollar strengthened against the Euro.

Net realized losses on other investments were \$4 million and \$1 million in the first six months of 2013 and 2012, respectively, driven by other-than-temporary impairments on joint ventures and partnership investments in both periods.

During the first six months of 2013, we recorded other-than-temporary impairments of \$25 million in earnings, compared to other-than-temporary impairments of \$68 million recorded in earnings in the first six 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.

	Six Months Ended June 30,	
	2013	2012
	(in millions)	
<b>Other-than-temporary impairments recorded in earnings Closed Block Business(1)</b>		
Public fixed maturity securities	\$ 15	\$ 40
Private fixed maturity securities	6	9
Total fixed maturity securities	21	49
Equity securities	0	18
Other invested assets(2)	4	1
<b>Total</b>	<b>\$ 25</b>	<b>\$ 68</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.

**Table of Contents**

	Six Months Ended June 30, 2013		
	Asset-Backed Securities Collateralized By Sub-Prime Mortgages	All Other Fixed Maturity Securities (in millions)	Total Fixed Maturity Securities
<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)	\$ 7	\$ 10	\$ 17
Due to other accounting guidelines	0	4	4
Total	\$ 7	\$ 14	\$ 21

	Six Months Ended June 30, 2012		
	Asset-Backed Securities Collateralized By Sub-Prime Mortgages	All Other Fixed Maturity Securities (in millions)	Total Fixed Maturity Securities
<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)	\$ 25	\$ 23	\$ 48
Due to other accounting guidelines	1	0	1
Total	\$ 26	\$ 23	\$ 49

- (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 other-than-temporary impairments in the first six months of 2013 were concentrated in asset-backed securities collateralized by sub-prime mortgages and in the communications, utility, and consumer non-cyclical sectors of our corporate securities. Other-than-temporary impairments in the first six months of 2012 were concentrated in asset-backed securities collateralized by sub-prime mortgages and in the utility and communications sectors of our corporate securities. These other-than-temporary impairments reflect adverse financial conditions of the respective issuers.

Equity security other-than-temporary impairments in the first six months 2012 were primarily due to circumstances where the decline in value was maintained for one year or greater.

**General Account Investments***Portfolio Composition*

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

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.

**Table of Contents**

On January 2, 2013, we completed the acquisition of the Hartford Life Business. Our Financial Services Businesses' general account portfolio, as of June 30, 2013, includes \$7.5 billion of invested assets at carrying value from this acquisition, which primarily consists of \$6.6 billion of fixed maturity securities, \$0.6 billion of commercial mortgage and other loans, and \$0.3 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.

	June 30, 2013			% of Total
	Financial Services Businesses	Closed Block Business	Total	
	(\$ in millions)			
<b>Fixed maturities:</b>				
Public, available-for-sale, at fair value	\$ 212,418	\$ 27,489	\$ 239,907	62.1%
Public, held-to-maturity, at amortized cost	2,693	0	2,693	0.7
Private, available-for-sale, at fair value	29,287	16,559	45,846	11.9
Private, held-to-maturity, at amortized cost	869	0	869	0.2
Trading account assets supporting insurance liabilities, at fair value	20,658	0	20,658	5.4
Other trading account assets, at fair value	1,401	274	1,675	0.4
Equity securities, available-for-sale, at fair value	5,289	3,465	8,754	2.3
Commercial mortgage and other loans, at book value	27,830	9,749	37,579	9.7
Policy loans, at outstanding balance	6,679	5,061	11,740	3.0
Other long-term investments(1)	6,562	2,102	8,664	2.2
Short-term investments	6,184	1,731	7,915	2.1
<b>Total general account investments</b>	<b>319,870</b>	<b>66,430</b>	<b>386,300</b>	<b>100.0%</b>
Invested assets of other entities and operations(2)	6,697	0	6,697	
<b>Total investments</b>	<b>\$ 326,567</b>	<b>\$ 66,430</b>	<b>\$ 392,997</b>	

	December 31, 2012			% of Total
	Financial Services Businesses	Closed Block Business	Total	
	(\$ in millions)			
<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>

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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>

**Table of Contents**

- (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 non-dealer derivative trading 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 six 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 six 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 June 30, 2013 and December 31, 2012, respectively.

The following table sets forth the composition of the investments of our Japanese insurance operations general account as of the dates indicated.

	June 30, 2013	December 31, 2012
	(in millions)	
<b>Fixed Maturities:</b>		
Public, available-for-sale, at fair value	\$ 111,802	\$ 124,710
Public, held-to-maturity, at amortized cost	2,693	3,116
Private, available-for-sale, at fair value	6,306	6,252
Private, held-to-maturity, at amortized cost	869	1,152
Trading account assets supporting insurance liabilities, at fair value	1,798	1,838
Other trading account assets, at fair value	915	1,195
Equity securities, available-for-sale, at fair value	2,363	2,126
Commercial mortgage and other loans, at book value	5,950	6,156
Policy loans, at outstanding balance	2,314	2,665
Other long-term investments(1)	1,576	2,215
Short-term investments	330	318
<b>Total Japanese general account investments(2)</b>	<b>\$ 136,916</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.
- (2) Excludes assets classified as Separate accounts assets on our balance sheet.

The decrease in general account investments related to our Japanese insurance operations in the first six 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.



**Table of Contents**

As of June 30, 2013, our Japanese insurance operations had \$44.3 billion, at fair value, of investments denominated in U.S. dollars, including \$3.8 billion that were hedged to yen through third party derivative contracts and \$31.4 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 \$0.6 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 June 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, 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 June 30, 2013.

**Eurozone Gross Direct Exposure Financial Services Businesses**

Country	Amortized Cost			June 30, 2013		Fair Value		
	Financial	All	Total	Total	Financial	All	Total	
	Sovereigns(6)	Other			Amortized	Sovereigns(6)		Other
Institutions(7)	Exposure	Cost	Institutions(7)	Exposure	Fair Value			
(in millions)								
<b>Non-peripheral countries:</b>								
France	\$ 250	\$ 581	\$ 2,060	\$ 2,891	\$ 320	\$ 593	\$ 2,321	\$ 3,234
Netherlands	11	543	2,675	3,229	14	601	2,896	3,511
Germany	441	197	928	1,566	567	223	971	1,761
Luxembourg	0	254	1,095	1,349	0	277	1,120	1,397
Other non-peripheral(1)	107	27	545	679	129	28	562	719
<b>Total non-peripheral exposure</b>	<b>809</b>	<b>1,602</b>	<b>7,303</b>	<b>9,714</b>	<b>1,030</b>	<b>1,722</b>	<b>7,870</b>	<b>10,622</b>
<b>Peripheral countries:</b>								
Italy(2)	836	21	295	1,152	877	23	282	1,182
Ireland	0	87	489	576	0	97	511	608
Spain	25	15	116	156	31	15	119	165
Other peripheral(3)	0	0	0	0	0	0	0	0

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Total peripheral exposure	861	123	900	1,884	908	135	912	1,955
International agencies(4)	0	97	1,117	1,214	0	102	1,407	1,509
Total exposure(5)	\$ 1,670	\$ 1,822	\$ 9,320	\$ 12,812	\$ 1,938	\$ 1,959	\$ 10,189	\$ 14,086

**Table of Contents**

- (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 \$12,812 million of amortized cost represented above, 87% is related to fixed maturities, 9% is related to trading account assets supporting insurance liabilities, 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 \$4,096 million of amortized cost (fair value, \$4,371 million), as of June 30, 2013, of which \$3,538 million (fair value, \$3,784 million) represented non-peripheral exposure and \$558 million (fair value, \$587 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% each of the non-peripheral and peripheral exposures was related to sovereigns. Of the \$4,096 million of amortized cost represented above, 94% was related to fixed maturities, and the remaining 6% was related to all other asset types.

**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 June 30, 2013					
	Financial Services Businesses		Closed Block Business		Combined	
	Yield(1)	Amount	Yield(1)	Amount	Yield(1)	Amount
	(\$ in millions)					
Fixed maturities	3.74%	\$ 2,136	5.24%	\$ 510	3.96%	\$ 2,646
Trading account assets supporting insurance liabilities	3.71	192	0.00	0	3.71	192
Equity securities	6.82	69	3.97	25	5.74	94
Commercial mortgage and other loans	5.03	348	5.64	136	5.19	484
Policy loans	4.65	78	5.74	72	5.11	150
Short-term investments and cash equivalents	0.22	8	1.24	1	0.25	9
Other investments	8.39	165	10.51	62	8.88	227
Gross investment income before investment expenses	3.89	2,996	5.48	806	4.15	3,802
Investment expenses	(0.12)	(77)	(0.25)	(37)	(0.14)	(114)
Investment income after investment expenses	3.77%	2,919	5.23%	769	4.01%	3,688
Investment results of other entities and operations(2)		22		0		22
Total investment income		\$ 2,941		\$ 769		\$ 3,710



**Table of Contents**

	Three Months Ended June 30, 2012					
	Financial Services Businesses		Closed Block Business		Combined	
	Yield(1)	Amount	Yield(1)	Amount	Yield(1)	Amount
	(\$ in millions)					
Fixed maturities	3.76%	\$ 1,872	5.44%	\$ 541	4.04%	\$ 2,413
Trading account assets supporting insurance liabilities	3.95	194	0.00	0	3.95	194
Equity securities	6.07	62	3.69	23	5.16	85
Commercial mortgage and other loans	5.25	332	5.95	142	5.44	474
Policy loans	4.61	71	5.91	76	5.20	147
Short-term investments and cash equivalents	0.27	9	1.34	2	0.27	11
Other investments	4.25	65	8.42	49	5.40	114
Gross investment income before investment expenses	3.82	2,605	5.58	833	4.14	3,438
Investment expenses	(0.11)	(64)	(0.25)	(38)	(0.14)	(102)
Investment income after investment expenses	3.71%	2,541	5.33%	795	4.00%	3,336
Investment results of other entities and operations(2)		22		0		22
Total investment income		\$ 2,563		\$ 795		\$ 3,358

- (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 non-dealer derivative trading 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 June 30, 2013, compared to the three months ended June 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.

**Table of Contents**

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.

	Six Months Ended June 30, 2013					
	Financial Services Businesses		Closed Block Business		Combined	
	Yield(1)	Amount	Yield(1)	Amount	Yield(1)	Amount
	(\$ in millions)					
Fixed maturities	3.73%	\$ 4,283	5.28%	\$ 1,020	3.95%	\$ 5,303
Trading account assets supporting insurance liabilities	3.82	392	0.00	0	3.82	392
Equity securities	6.27	128	3.57	44	5.26	172
Commercial mortgage and other loans	5.09	689	5.75	274	5.26	963
Policy loans	4.68	154	5.75	144	5.14	298
Short-term investments and cash equivalents	0.20	16	1.16	3	0.23	19
Other investments	6.41	253	10.66	123	7.37	376
Gross investment income before investment expenses	3.81	5,915	5.50	1,608	4.08	7,523
Investment expenses	(0.12)	(157)	(0.26)	(76)	(0.14)	(233)
Investment income after investment expenses	3.69%	5,758	5.24%	1,532	3.94%	7,290
Investment results of other entities and operations(2)		58		0		58
Total investment income		\$ 5,816		\$ 1,532		\$ 7,348

	Six Months Ended June 30, 2012					
	Financial Services Businesses		Closed Block Business		Combined	
	Yield(1)	Amount	Yield(1)	Amount	Yield(1)	Amount
	(\$ in millions)					
Fixed maturities	3.75%	\$ 3,713	5.50%	\$ 1,087	4.04%	\$ 4,800
Trading account assets supporting insurance liabilities	4.04	393	0.00	0	4.04	393
Equity securities	5.82	118	3.33	43	4.85	161
Commercial mortgage and other loans	5.31	664	6.06	281	5.52	945
Policy loans	4.60	142	5.96	153	5.22	295
Short-term investments and cash equivalents	0.27	17	1.39	4	0.30	21
Other investments	3.51	111	8.28	94	4.79	205
Gross investment income before investment expenses	3.80	5,158	5.61	1,662	4.13	6,820
Investment expenses	(0.12)	(125)	(0.25)	(76)	(0.14)	(201)
Investment income after investment expenses	3.68%	5,033	5.36%	1,586	3.99%	6,619
Investment results of other entities and operations(2)		59		0		59
Total investment income		\$ 5,092		\$ 1,586		\$ 6,678

(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



**Table of Contents**

corresponding to securities lending activity. Yields exclude investment income on assets other than those included in invested assets. Prior period yields are presented on a basis consistent with the current period presentation.

- (2) Includes invested assets of our asset management and non-dealer derivative trading 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 six months ended June 30, 2013, compared to the six months ended June 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 June 30, 2013		Three Months Ended June 30, 2012	
	Yield(1)	Amount (\$ in millions)	Yield(1)	Amount
Fixed maturities	4.49%	\$ 1,316	5.25%	\$ 1,054
Trading account assets supporting insurance liabilities	3.95	186	4.21	188
Equity securities	7.83	46	9.27	50
Commercial mortgage and other loans	5.27	284	5.58	275
Policy loans	5.18	57	5.47	46
Short-term investments and cash equivalents	0.24	7	0.31	7
Other investments	10.30	130	3.92	22
Gross investment income before investment expenses	4.51	2,026	4.88	1,642
Investment expenses	(0.12)	(41)	(0.09)	(15)
Investment income after investment expenses	4.39%	1,985	4.79%	1,627
Investment results of other entities and operations(2)		22		22
Total investment income		\$ 2,007		\$ 1,649

- (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 yields are presented on a basis consistent with the current period presentation.

- (2) Includes invested assets of our asset management and non-dealer derivative trading 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 June 30, 2013, compared to the three months ended June 30, 2012, was primarily the result of lower interest rates on floating rate investments due to rate resets, lower fixed maturity reinvestment rates, and the addition of assets from the pension risk transfer and Hartford transactions at current market yields, partially offset by higher income from our 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.

	Six Months Ended June 30, 2013		Six Months Ended June 30, 2012	
	Yield(1)	Amount (\$ in millions)	Yield(1)	Amount
Fixed maturities	4.60%	\$ 2,630	5.27%	\$ 2,101
Trading account assets supporting insurance liabilities	4.00	374	4.24	375
Equity securities	7.46	86	8.67	90
Commercial mortgage and other loans	5.33	560	5.68	552
Policy loans	5.37	111	5.55	94
Short-term investments and cash equivalents	0.21	14	0.30	14
Other investments	6.98	171	3.34	37
Gross investment income before investment expenses	4.45	3,946	4.88	3,263
Investment expenses	(0.12)	(79)	(0.10)	(32)
Investment income after investment expenses	4.33%	3,867	4.78%	3,231
Investment results of other entities and operations(2)		58		59
Total investment income		\$ 3,925		\$ 3,290

- (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 non-dealer derivative trading operations.

The decrease in net investment income yield attributable to the Financial Services Businesses general account, excluding the Japanese operations portfolio, for the six months ended June 30, 2013, compared to the six months ended June 30, 2012, was primarily the result of lower interest rates on floating rate investments due to rate resets, lower fixed maturity reinvestment rates, and the addition of assets from the pension risk transfer and Hartford transactions at current market yields, partially offset by higher income from our 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 June 30, 2013		Three Months Ended June 30, 2012	
	Yield(1)	Amount (\$ in millions)	Yield(1)	Amount
Fixed maturities	2.95%	\$ 820	2.75%	\$ 818
Trading account assets supporting insurance liabilities	1.21	6	1.36	6
Equity securities	5.42	23	2.46	12
Commercial mortgage and other loans	4.20	64	4.08	57
Policy loans	3.66	21	3.53	25
Short-term investments and cash equivalents	0.17	1	0.16	2
Other investments	4.93	35	4.44	43
Gross investment income before investment expenses	3.03	970	2.79	963
Investment expenses	(0.11)	(36)	(0.14)	(49)
Total investment income	2.92%	\$ 934	2.65%	\$ 914

(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 June 30, 2013, compared to the three months ended June 30, 2012, was primarily attributable to more favorable results from non-coupon investments and asset growth 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 for the three months ended June 30, 2013 and 2012, was approximately \$32.2 billion and \$29.2 billion, 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 for the three months ended June 30, 2013 and 2012, was approximately \$7.7 billion and \$6.5 billion, 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.

	Six Months Ended June 30, 2013		Six Months Ended June 30, 2012	
	Yield(1)	Amount (\$ in millions)	Yield(1)	Amount
Fixed maturities	2.87%	\$ 1,653	2.72%	\$ 1,612
Trading account assets supporting insurance liabilities	1.97	18	2.09	18
Equity securities	4.72	42	2.79	28
Commercial mortgage and other loans	4.26	129	4.03	112
Policy loans	3.52	43	3.44	48
Short-term investments and cash equivalents	0.15	2	0.17	3
Other investments	5.46	82	3.60	74
Gross investment income before investment expenses	2.97	1,969	2.75	1,895
Investment expenses	(0.12)	(78)	(0.13)	(93)
Total investment income	2.85%	\$ 1,891	2.62%	\$ 1,802

- (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 six months ended June 30, 2013, compared to the six months ended June 30, 2012, was primarily attributable to more favorable results from non-coupon investments and asset growth 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 for the six months ended June 30, 2013 and 2012, was approximately \$32.1 billion and \$28.9 billion, 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 for the six months ended June 30, 2013 and 2012, was approximately \$7.8 billion and \$6.5 billion, 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)	June 30, 2013			Fair Value	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	\$ 20,592	\$ 1,399	\$ 434	\$ 21,557	\$ 21,772	\$ 1,279	\$ 285	\$ 22,766
Consumer non-cyclical	22,789	1,984	784	23,989	21,727	1,898	269	23,356
Utility	18,393	1,444	662	19,175	17,993	1,601	344	19,250
Capital goods	10,447	928	304	11,071	10,251	896	144	11,003
Consumer cyclical	10,198	801	326	10,673	9,927	756	147	10,536
Foreign agencies	4,826	1,044	56	5,814	5,706	732	8	6,430
Energy	8,784	689	331	9,142	7,923	745	83	8,585
Communications	7,119	631	259	7,491	7,552	610	119	8,043
Basic industry	6,605	421	256	6,770	6,215	416	69	6,562
Transportation	5,428	445	101	5,772	5,288	478	43	5,723
Technology	4,411	309	152	4,568	4,656	279	77	4,858
Industrial other	2,399	194	37	2,556	2,261	196	3	2,454
Total corporate securities	121,991	10,289	3,702	128,578	121,271	9,886	1,591	129,566
Foreign government(3)	73,143	6,527	174	79,496	82,376	6,782	65	89,093
Residential mortgage-backed	6,805	383	64	7,124	8,360	435	30	8,765
Asset-backed securities(4)	7,653	204	219	7,638	8,209	202	407	8,004
Commercial mortgage-backed	8,527	470	99	8,898	7,413	595	14	7,994
U.S. Government	8,554	2,272	82	10,744	10,525	2,474	34	12,965
State & Municipal(5)	2,807	294	106	2,995	2,303	378	5	2,676
Total(6)	\$ 229,480	\$ 20,439	\$ 4,446	\$ 245,473	\$ 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 \$244 million of gross unrealized gains and \$37 million of gross unrealized losses as of June 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 both June 30, 2013 and December 31, 2012, based on amortized cost, 81% 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)

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

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 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 June 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)	June 30, 2013				December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(in millions)								
Corporate securities:								
Utility	\$ 4,763	\$ 562	\$ 50	\$ 5,275	\$ 4,773	\$ 862	\$ 12	\$ 5,623
Consumer non-cyclical	4,570	508	44	5,034	4,419	750	5	5,164
Finance	4,153	288	26	4,415	3,728	442	17	4,153
Consumer cyclical	3,067	319	23	3,363	3,003	477	10	3,470
Capital goods	2,487	259	13	2,733	2,523	376	1	2,898
Energy	1,790	184	12	1,962	1,879	305	0	2,184
Communications	1,463	156	17	1,602	1,513	268	4	1,777
Basic industry	1,329	98	25	1,402	1,324	186	3	1,507
Transportation	1,258	121	7	1,372	1,386	186	4	1,568
Industrial other	1,039	47	17	1,069	1,074	110	2	1,182
Technology	695	63	17	741	626	103	7	722
Foreign agencies	400	42	5	437	355	68	0	423
Total corporate securities	27,014	2,647	256	29,405	26,603	4,133	65	30,671
Asset-backed securities(2)	4,138	60	189	4,009	4,592	71	320	4,343
Commercial mortgage-backed	4,150	83	79	4,154	4,029	179	2	4,206
U.S. Government	3,589	574	24	4,139	3,401	966	0	4,367
Residential mortgage-backed	1,248	66	6	1,308	1,520	97	3	1,614
Foreign government(3)	362	63	8	417	345	103	2	446
State & Municipal	558	65	7	616	647	126	1	772
Total(4)	\$ 41,059	\$ 3,558	\$ 569	\$ 44,048	\$ 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 both June 30, 2013 and December 31, 2012, based on amortized cost, no individual foreign country represented more than 13%.

(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 June 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 lenders' foreclosure documentation, causing delays in the foreclosure process. From the perspective of an

**Table of Contents**

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	June 30, 2013 Lowest Rating Agency Rating					Total Amortized Cost	Total December 31, 2012
	AAA	AA	A	BBB (in millions)	BB and below		
Collateralized by sub-prime mortgages:							
2013 2008	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
2007	0	0	0	0	387	387	430
2006	3	0	35	51	623	712	828
2005	0	2	8	19	252	281	293
2004 & Prior	0	4	30	36	580	650	691
<b>Total collateralized by sub-prime mortgages</b>	<b>3</b>	<b>6</b>	<b>73</b>	<b>106</b>	<b>1,842</b>	<b>2,030</b>	<b>2,242</b>
Other asset-backed securities:							
Collateralized loan obligations	1,855	468	14	0	0	2,337	1,858
Collateralized by non-sub-prime mortgages	1,028	49	6	16	5	1,104	1,444
Collateralized by credit cards	438	0	56	50	0	544	695
Collateralized by auto loans	476	0	0	0	1	477	694
Other asset-backed securities(1)	168	629	112	136	116	1,161	1,276
<b>Total asset-backed securities(2)</b>	<b>\$ 3,968</b>	<b>\$ 1,152</b>	<b>\$ 261</b>	<b>\$ 308</b>	<b>\$ 1,964</b>	<b>\$ 7,653</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 96% of the \$409 million of education loans included above carry a Department of Education guaranty as of June 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	June 30, 2013 Lowest Rating Agency Rating					Total Fair Value	Total December 31, 2012
	AAA	AA	A	BBB (in millions)	BB and below		
Collateralized by sub-prime mortgages:							
2013 2008	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
2007	0	0	0	0	333	333	339
2006	3	0	34	44	605	686	698
2005	0	2	8	19	238	267	251
2004 & Prior	0	3	29	35	535	602	594
<b>Total collateralized by sub-prime mortgages</b>	<b>3</b>	<b>5</b>	<b>71</b>	<b>98</b>	<b>1,711</b>	<b>1,888</b>	<b>1,882</b>
Other asset-backed securities:							
Collateralized loan obligations	1,859	472	14	0	6	2,351	1,871
Collateralized by non-sub-prime mortgages	1,077	49	6	15	5	1,152	1,524
Collateralized by credit cards	453	0	56	50	0	559	714
Collateralized by auto loans	479	0	0	0	1	480	702
Other asset-backed securities(1)	171	649	118	151	119	1,208	1,311
<b>Total asset-backed securities(2)</b>	<b>\$ 4,042</b>	<b>\$ 1,175</b>	<b>\$ 265</b>	<b>\$ 314</b>	<b>\$ 1,842</b>	<b>\$ 7,638</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 96% of the \$412 million of education loans included above carry a Department of Education guaranty as of June 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 June 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 \$2.030 billion as of June 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 \$207 million as of June 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.

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

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 June 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 June 30, 2013, based on amortized cost, approximately 57% 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 40% 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 \$2.030 billion of asset-backed securities collateralized by sub-prime mortgages attributable to the Financial Services Businesses as of June 30, 2013, were \$347 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	June 30, 2013 Lowest Rating Agency Rating					Total Amortized Cost	Total December 31, 2012
	AAA	AA	A	BBB (in millions)	BB and below		
Collateralized by sub-prime mortgages:							
2013 2008	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
2007	0	5	0	20	258	283	324
2006	5	83	0	1	543	632	711
2005	8	19	63	17	103	210	233
2004 & Prior	0	2	14	19	434	469	503
<b>Total collateralized by sub-prime mortgages</b>	<b>13</b>	<b>109</b>	<b>77</b>	<b>57</b>	<b>1,338</b>	<b>1,594</b>	<b>1,771</b>
Other asset-backed securities:							
Collateralized by auto loans	833	0	0	0	0	833	892
Collateralized loan obligations	424	160	1	0	0	585	599
Collateralized by credit cards	251	0	0	24	2	277	450
Collateralized by education loans(1)	17	423	0	0	0	440	450
Other asset-backed securities(2)	72	57	55	209	16	409	430
<b>Total asset-backed securities(3)</b>	<b>\$ 1,610</b>	<b>\$ 749</b>	<b>\$ 133</b>	<b>\$ 290</b>	<b>\$ 1,356</b>	<b>\$ 4,138</b>	<b>\$ 4,592</b>

(1) Approximately 95% of the \$440 million of education loans included above carry a Department of Education guaranty as of June 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	June 30, 2013 Lowest Rating Agency Rating					Total Fair Value	Total December 31, 2012
	AAA	AA	A	BBB (in millions)	BB and below		
Collateralized by sub-prime mortgages:							
2013 2008	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
2007	0	5	0	18	227	250	269
2006	5	81	0	1	453	540	543
2005	8	18	60	17	92	195	205
2004 & Prior	0	1	14	18	398	431	442
<b>Total collateralized by sub-prime mortgages</b>	<b>13</b>	<b>105</b>	<b>74</b>	<b>54</b>	<b>1,170</b>	<b>1,416</b>	<b>1,459</b>
Other asset-backed securities:							
Collateralized by auto loans	833	0	0	0	0	833	896
Collateralized by credit cards	253	0	0	24	2	279	454
Collateralized loan obligations	427	161	1	0	0	589	605
Collateralized by education loans(1)	17	428	0	0	0	445	453
Other asset-backed securities(2)	73	58	59	234	23	447	476
<b>Total asset-backed securities(3)</b>	<b>\$ 1,616</b>	<b>\$ 752</b>	<b>\$ 134</b>	<b>\$ 312</b>	<b>\$ 1,195</b>	<b>\$ 4,009</b>	<b>\$ 4,343</b>

(1) Approximately 96% of the \$445 million of education loans included above carry a Department of Education guaranty as of June 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 \$1.594 billion as of June 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 \$184 million as of June 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 32% as of June 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 June 30, 2013, based on amortized cost, approximately 68% 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 47% have estimated credit subordination percentages of 30% or more.

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

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

over other securities in the structure, including longer duration senior securities. Included within the \$1.594 billion of asset-backed securities collateralized by sub-prime mortgages attributable to the Closed Block Business as of June 30, 2013, were \$263 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>June 30, 2013</b>			
	<b>Financial Services Businesses</b>		<b>Closed Block Business</b>	
	<b>Amortized Cost</b>	<b>% of Total</b>	<b>Amortized Cost</b>	<b>% of Total</b>
	(\$ in millions)			
<b>By security type:</b>				
Agency pass-through securities(1)	\$ 6,683	98.2%	\$ 1,109	88.9%
Collateralized mortgage obligations(2)(3)	122	1.8	139	11.1
<b>Total residential mortgage-backed securities</b>	<b>\$ 6,805</b>	<b>100.0%</b>	<b>\$ 1,248</b>	<b>100.0%</b>
<b>Portion rated AA or higher(4)</b>	<b>\$ 6,708</b>	<b>98.6%</b>	<b>\$ 1,109</b>	<b>88.9%</b>
	<b>December 31, 2012</b>			
	<b>Financial Services Businesses</b>		<b>Closed Block Business</b>	
	<b>Amortized Cost</b>	<b>% of Total</b>	<b>Amortized Cost</b>	<b>% of 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
<b>Total residential mortgage-backed securities</b>	<b>\$ 8,360</b>	<b>100.0%</b>	<b>\$ 1,520</b>	<b>100.0%</b>
<b>Portion rated AA or higher(4)</b>	<b>\$ 8,247</b>	<b>98.7%</b>	<b>\$ 1,364</b>	<b>89.7%</b>

- (1) As of June 30, 2013, of these securities, for the Financial Services Businesses, \$5.237 billion are supported by U.S. government and \$1.446 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 June 30, 2013 and December 31, 2012.
- (2) Includes alternative residential mortgage loans of \$32 million and \$36 million in the Financial Services Businesses, and \$68 million and \$76 million in the Closed Block Business, as of June 30, 2013 and December 31, 2012, respectively.
- (3) As of June 30, 2013, of these collateralized mortgage obligations, for the Financial Services Businesses, 41% have credit ratings of A or above, 5% have BBB credit ratings and the remaining 54% 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 June 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.

Although there are positive signs in commercial real estate, there are still some significant challenges for this market, including numerous future loan workouts, a large wave of refinancings for over-leveraged properties

**Table of Contents**

and numerous legislative changes. To ensure our investment objectives and asset strategies are maintained, we consider these market factors in making our investment decisions on commercial mortgage-backed securities.

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>	June 30, 2013 Lowest Rating Agency Rating(1)					Total Amortized Cost	Total December 31, 2012
	AAA	AA	A	BBB (in millions)	BB and below		
2013 2008	\$ 1,217	\$ 473	\$ 12	\$ 8	\$ 1	\$ 1,711	\$ 566
2007	979	44	26	5	1	1,055	1,196
2006	2,802	148	6	4	0	2,960	2,781
2005	2,122	66	8	4	0	2,200	2,113
2004 & Prior	474	84	28	7	8	601	757
Total commercial mortgage-backed securities(2)(3)(4)	\$ 7,594	\$ 815	\$ 80	\$ 28	\$ 10	\$ 8,527	\$ 7,413

- (1) The table above provides ratings as assigned by nationally recognized rating agencies as of June 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 June 30, 2013, are downgraded super senior securities with amortized cost of \$172 million in AA and \$61 million in A.
- (4) Included in the table above, as of June 30, 2013, are agency commercial mortgage-backed securities with amortized cost of \$508 million, all rated AA.

**Commercial Mortgage-Backed Securities at Fair Value Financial Services Businesses**

<u>Vintage</u>	June 30, 2013 Lowest Rating Agency Rating(1)					Total Fair Value	Total December 31, 2012
	AAA	AA	A	BBB (in millions)	BB and below		
2013 2008	\$ 1,152	\$ 480	\$ 11	\$ 8	\$ 1	\$ 1,652	\$ 609
2007	1,008	47	27	5	16	1,103	1,275
2006	2,982	155	6	4	0	3,147	3,062
2005	2,220	75	10	5	0	2,310	2,261
2004 & Prior	534	104	33	7	8	686	787
Total commercial mortgage-backed securities(2)(3)	\$ 7,896	\$ 861	\$ 87	\$ 29	\$ 25	\$ 8,898	\$ 7,994



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

- (1) The table above provides ratings as assigned by nationally recognized rating agencies as of June 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 June 30, 2013, are agency commercial mortgage-backed securities with fair value of \$517 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



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

2005	771	25	0	0	0	796	1,091
2004 & Prior	161	11	0	7	0	179	238
Total commercial mortgage-backed securities(2)(3)	\$ 3,188	\$ 942	\$ 0	\$ 16	\$ 4	\$ 4,150	\$ 4,029

- (1) The table above provides ratings as assigned by nationally recognized rating agencies as of June 30, 2013, including Standard & Poor's, Moody's, Fitch and Realpoint.
- (2) Included in the table above, as of June 30, 2013, are downgraded super senior securities with amortized cost of \$150 million in AA.
- (3) Included in the table above, as of June 30, 2013, are agency commercial mortgage-backed securities with amortized cost of \$37 million in AAA and \$780 million in AA.

**Table of Contents****Commercial Mortgage-Backed Securities at Fair Value Closed Block Business**

<u>Vintage</u>	June 30, 2013 Lowest Rating Agency Rating(1)					Total Fair Value	Total December 31, 2012
	AAA	AA	A	BBB (in millions)	BB and below		
2013 2008	\$ 709	\$ 711	\$ 0	\$ 8	\$ 0	\$ 1,428	\$ 869
2007	447	42	0	0	13	502	579
2006	1,096	128	0	0	0	1,224	1,375
2005	793	27	0	0	0	820	1,141
2004 & Prior	162	11	0	7	0	180	242
Total commercial mortgage-backed securities(2)	\$ 3,207	\$ 919	\$ 0	\$ 15	\$ 13	\$ 4,154	\$ 4,206

- (1) The table above provides ratings as assigned by nationally recognized rating agencies as of June 30, 2013, including Standard & Poor's, Moody's, Fitch and Realpoint.
- (2) Included in the table above, as of June 30, 2013, are agency commercial mortgage-backed securities with fair value of \$34 million in AAA and \$753 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>	June 30, 2013							Total AAA Securities at Amortized Cost
	Super Senior AAA Structures			Other AAA				
	Super Senior (shorter duration tranches)	Super Senior (longest duration tranches)	Mezzanine	Junior	Other Senior	Other Subordinate	Other	
	(in millions)							
2013 2008	\$ 712	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 712
2007	439	0	0	0	0	0	0	439
2006	400	668	0	0	0	0	0	1,068
2005	419	352	0	0	0	0	0	771
2004 & Prior	37	13	0	0	93	18	0	161
Total(1)	\$ 2,007	\$ 1,033	\$ 0	\$ 0	\$ 93	\$ 18	\$ 0	\$ 3,151

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

(1) Excluded from the table above, as of June 30, 2013, are agency commercial mortgage-backed securities with amortized cost of \$37 million.

### *Fixed Maturity Securities Credit Quality*

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, 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) NAIC Designation	June 30, 2013			December 31, 2012			Fair Value (in millions)	Fair Value
	Amortized Cost	Gross Unrealized Gains(3)	Gross Unrealized Losses(3)(4)	Amortized Cost	Gross Unrealized Gains(3)	Gross Unrealized Losses(3)(4)		
1	\$ 176,046	\$ 16,212	\$ 3,017	\$ 189,241	\$ 189,129	\$ 16,564	\$ 1,037	\$ 204,656
2	44,046	3,589	1,137	46,498	42,424	3,688	656	45,456
Subtotal High or Highest Quality Securities(5)	220,092	19,801	4,154	235,739	231,553	20,252	1,693	250,112
3	6,538	384	158	6,764	6,086	301	233	6,154
4	2,169	181	87	2,263	1,982	133	129	1,986
5	522	43	39	526	650	27	74	603
6	159	30	8	181	186	39	17	208
Subtotal Other Securities(6)(7)	9,388	638	292	9,734	8,904	500	453	8,951
Total Fixed Maturities	\$ 229,480	\$ 20,439	\$ 4,446	\$ 245,473	\$ 240,457	\$ 20,752	\$ 2,146	\$ 259,063

(1) Reflects equivalent ratings for investments of the international insurance operations.

(2) Includes, as of June 30, 2013 and December 31, 2012, 134 securities with amortized cost of \$1,032 million (fair value, \$1,040 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 \$243 million of gross unrealized gains and \$37 million gross unrealized losses as of June 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 June 30, 2013, includes gross unrealized losses of \$230 million on public fixed maturities and \$62 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 June 30, 2013, includes \$195,458 million of public fixed maturities and \$24,634 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 June 30, 2013, includes \$5,935 million of public fixed maturities and \$3,453 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 June 30, 2013, securities considered below investment grade based on lowest of external rating agency ratings, total \$11.3 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) NAIC Designation	June 30, 2013				December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses(2)	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses(2)	Fair Value
	(in millions)							
1	\$ 23,301	\$ 2,054	\$ 267	\$ 25,088	\$ 23,197	\$ 3,353	\$ 114	\$ 26,436
2	14,726	1,362	152	15,936	14,581	2,091	58	16,614
Subtotal High or Highest Quality Securities(3)	38,027	3,416	419	41,024	37,778	5,444	172	43,050
3	1,923	88	61	1,950	1,989	156	94	2,051
4	853	22	66	809	1,015	35	92	958
5	191	12	21	182	271	13	34	250
6	65	20	2	83	84	27	1	110
Subtotal Other Securities(4)(5)	3,032	142	150	3,024	3,359	231	221	3,369
<b>Total Fixed Maturities</b>	<b>\$ 41,059</b>	<b>\$ 3,558</b>	<b>\$ 569</b>	<b>\$ 44,048</b>	<b>\$ 41,137</b>	<b>\$ 5,675</b>	<b>\$ 393</b>	<b>\$ 46,419</b>

- (1) Includes, as of June 30, 2013 and December 31, 2012, 68 securities with amortized cost of \$1,048 million (fair value, \$1,052 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 June 30, 2013, includes gross unrealized losses of \$128 million on public fixed maturities and \$22 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 June 30, 2013, includes \$24,303 million of public fixed maturities and \$13,724 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 June 30, 2013, includes \$1,439 million public fixed maturities and \$1,593 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 June 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 an index's 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 \$1 million and \$3 million for the three and six months ended June 30, 2013, respectively, and \$1 million and \$2 million for the three and six months ended June 30, 2012, respectively, and is included in adjusted operating income as an adjustment to Realized investment gains (losses), net.

## **Table of Contents**

As of June 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 June 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, including exposures relating to certain guarantees from monoline bond insurers. As of June 30, 2013 and December 31, 2012, the Financial Services Businesses had \$1.233 billion and \$1.370 billion of outstanding notional amounts, reported at fair value as a liability of \$30 million and of \$27 million, respectively. As of June 30, 2013 and December 31, 2012, the Closed Block Business had \$281 million and \$309 million of outstanding notional amounts, each reported at fair value as a liability of \$8 million. The premium paid for the credit derivatives we purchase attributable to the Financial Services Businesses was \$7 million and \$15 million for the three and six months ended June 30, 2013, and \$10 million and \$20 million for the three and six months ended June 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 \$23 million and \$74 million for the three months ended June 30, 2013 and 2012, respectively, and \$82 million and \$156 million for the six months ended June 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 June 30, 2013 and 2012, were \$4 million and \$14 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



**Table of Contents**

attributable to the Financial Services Businesses for the six months ended June 30, 2013 and 2012 include \$12 million and \$34 million, respectively, of other-than-temporary impairments on asset-backed securities collateralized by sub-prime mortgages.

Other-than-temporary impairments of fixed maturity securities attributable to the Closed Block Business that were recognized in earnings were \$10 million and \$19 million for the three months ended June 30, 2013, and 2012, respectively, and \$21 million and \$49 million for the six months ended June 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 June 30, 2013, and 2012, were \$3 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 six months ended June 30, 2013 and 2012 include \$7 million and \$26 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.

	June 30, 2013		December 31, 2012	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(in millions)			
Short-term investments and cash equivalents	\$ 1,281	\$ 1,281	\$ 938	\$ 938
Fixed maturities:				
Corporate securities	11,493	12,013	11,076	12,107
Commercial mortgage-backed securities	2,439	2,481	2,096	2,229
Residential mortgage-backed securities	1,761	1,756	1,965	2,026
Asset-backed securities	1,075	1,086	1,179	1,116
Foreign government bonds	594	611	683	708
U.S. government authorities and agencies and obligations of U.S. states	342	383	369	426
Total fixed maturities	17,704	18,330	17,368	18,612
Equity securities	825	1,047	943	1,040
Total trading account assets supporting insurance liabilities	\$ 19,810	\$ 20,658	\$ 19,249	\$ 20,590

As a percentage of amortized cost, 77% and 75% of the portfolio was publicly-traded as of June 30, 2013 and December 31, 2012, respectively. As of both June 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 June 30, 2013, \$1.677 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

**Table of Contents**

of A or higher. Collateralized mortgage obligations, including approximately \$66 million secured by ALT-A mortgages, represented the remaining \$83 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.

**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.

	June 30, 2013				December 31, 2012			
	Financial Services Businesses		Closed Block Business		Financial Services Businesses		Closed Block Business	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(in millions)							
Short-term investments and cash equivalents	\$ 1	\$ 1	\$ 0	\$ 0	\$ 1	\$ 1	\$ 0	\$ 0
Fixed maturities	646	622	147	154	533	452	127	139
Equity securities(1)	708	778	106	120	933	973	123	136
Total other trading account assets	\$ 1,355	\$ 1,401	\$ 253	\$ 274	\$ 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 \$646 million of fixed maturities attributable to the Financial Services Businesses as of June 30, 2013, on an amortized cost basis, are \$196 million of asset-backed securities, 62% of which have credit ratings of A or above, 20% have BBB credit ratings, and the remaining 18% have BB and below credit ratings. Included in the \$147 million of fixed maturities attributable to the Closed Block Business as of June 30, 2013, on an amortized cost basis, are \$11 million of asset-backed securities, all of which have credit ratings of A or above.

**Commercial Mortgage and Other Loans****Investment Mix**

As of June 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 \$234 million and \$244 million allowance for losses as of June 30, 2013 and

December 31, 2012, respectively.

**Table of Contents**

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.

	June 30, 2013		December 31, 2012	
	Financial Services Businesses	Closed Block Business	Financial Services Businesses	Closed Block Business
	(in millions)			
Commercial and agricultural mortgage loans	\$ 25,874	\$ 9,778	\$ 24,139	\$ 9,666
Uncollateralized loans	1,485	24	1,833	0
Residential property loans	619	0	790	0
Other collateralized loans	33	0	47	0
<b>Total commercial mortgage and other loans(1)</b>	<b>\$ 28,011</b>	<b>\$ 9,802</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.

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 \$32 million and \$45 million of collateralized consumer loans as of June 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 the highest 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 tightened, generally, despite some recent weakness. These conditions have led to greater competition for portfolio lenders such as our general account, though underwriting remains conservative. While there is still some weakness in commercial real estate fundamentals that are dependent on employment recovery, delinquency rates on our commercial mortgage loans remain low from a historic standpoint and 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.

	June 30, 2013				December 31, 2012			
	Financial Services Businesses		Closed Block Business		Financial Services Businesses		Closed Block Business	
	Gross Carrying Value	% of Total	Gross Carrying Value	% of Total	Gross Carrying Value	% of Total	Gross Carrying Value	% of Total
(\$ in millions)								
<b>Commercial and agricultural mortgage loans</b>								
<b>by region:</b>								
U.S. Regions:								
Pacific	\$ 7,922	30.6%	\$ 3,421	35.0%	\$ 7,600	31.5%	\$ 3,423	35.4%
South Atlantic	5,265	20.4	1,729	17.7	4,846	20.1	1,814	18.8
Middle Atlantic	3,880	15.0	2,053	21.0	3,706	15.3	2,050	21.2
East North Central	2,414	9.3	672	6.9	2,000	8.3	570	5.9
West South Central	2,495	9.6	782	8.0	2,220	9.2	730	7.6
Mountain	1,133	4.4	302	3.1	1,254	5.2	350	3.6
New England	882	3.4	391	4.0	638	2.6	323	3.3
West North Central	496	1.9	111	1.1	466	1.9	137	1.4
East South Central	328	1.3	139	1.4	305	1.3	142	1.5
Subtotal-U.S.	24,815	95.9	9,600	98.2	23,035	95.4	9,539	98.7
Asia	601	2.3	0	0.0	648	2.7	0	0.0
Other	458	1.8	178	1.8	456	1.9	127	1.3
Total commercial and agricultural mortgage loans	\$ 25,874	100.0%	\$ 9,778	100.0%	\$ 24,139	100.0%	\$ 9,666	100.0%

	June 30, 2013				December 31, 2012			
	Financial Services Businesses		Closed Block Business		Financial Services Businesses		Closed Block Business	
	Gross Carrying Value	% of Total	Gross Carrying Value	% of Total	Gross Carrying Value	% of Total	Gross Carrying Value	% of Total
(\$ in millions)								
<b>Commercial and agricultural mortgage loans by property type:</b>								
Industrial	\$ 5,811	22.5%	\$ 1,705	17.4%	\$ 5,832	24.1%	\$ 1,804	18.7%
Retail	5,530	21.4	2,514	25.7	5,449	22.6	2,658	27.5
Office	4,954	19.2	2,541	26.0	4,459	18.5	2,363	24.4
Apartments/Multi-Family	4,841	18.7	1,278	13.1	3,879	16.1	1,159	12.0
Other	2,156	8.3	602	6.2	2,203	9.1	598	6.2
Agricultural properties	1,510	5.8	634	6.5	1,468	6.1	645	6.7
Hospitality	1,072	4.1	504	5.1	849	3.5	439	4.5
Total commercial and agricultural mortgage loans	\$ 25,874	100.0%	\$ 9,778	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 compares a property's net operating income to its debt service payments. Debt service coverage

**Table of Contents**

ratios less than 1.0 times indicate that property operations do not generate enough income to cover the loans' current debt payments. A larger debt service coverage ratio indicates a greater excess of net operating income over the debt service payments.

As of June 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 2.18 times, and a weighted average loan-to-value ratio of 56%. As of June 30, 2013, approximately 97% of commercial and agricultural mortgage loans attributable to the Financial Services Businesses were fixed rate loans. As of June 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 2.07 times, and a weighted average loan-to-value ratio of 53%. As of June 30, 2013, approximately 99% of 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 2.67 times and the weighted average loan-to-value ratio was 60%.

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 \$0.4 billion and \$0.5 billion of such loans as of June 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 June 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. As of June 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.

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	June 30, 2013 Debt Service Coverage Ratio			Total Commercial and Agricultural Mortgage Loans
	Greater than 1.2x	1.0x to < 1.2x	Less than 1.0x	
	(in millions)			
0%-59.99%	\$ 12,596	\$ 537	\$ 224	\$ 13,357
60%-69.99%	6,881	373	185	7,439
70%-79.99%	3,549	520	119	4,188
Greater than 80%	125	241	524	890

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Total commercial and agricultural mortgage loans	\$ 23,151	\$ 1,671	\$ 1,052	\$ 25,874
--	-----------	----------	----------	-----------

**Table of Contents****Commercial and Agricultural Mortgage Loans by Loan-to-Value and Debt Service Coverage Ratios - Closed Block Business**

Loan-to-Value Ratio	June 30, 2013 Debt Service Coverage Ratio			Total Commercial and Agricultural Mortgage Loans
	Greater than 1.2x	1.0x to < 1.2x	Less than 1.0x	
	(in millions)			
0%-59.99%	\$ 5,335	\$ 333	\$ 44	\$ 5,712
60%-69.99%	2,701	69	81	2,851
70%-79.99%	836	193	60	1,089
Greater than 80%	12	62	52	126
<b>Total commercial and agricultural mortgage loans</b>	<b>\$ 8,884</b>	<b>\$ 657</b>	<b>\$ 237</b>	<b>\$ 9,778</b>

The following table sets forth the breakdown of our commercial and agricultural mortgage loans by year of origination as of June 30, 2013.

Year of Origination	June 30, 2013 Financial Services Businesses		June 30, 2013 Closed Block Business	
	Gross Carrying Value	% of Total	Gross Carrying Value	% of Total
	(\$ in millions)			
2013	\$ 3,399	13.1%	\$ 766	7.8%
2012	4,934	19.1	1,806	18.5
2011	4,863	18.8	1,427	14.6
2010	3,054	11.8	1,055	10.8
2009	1,130	4.4	395	4.0
2008	2,422	9.3	919	9.4
2007 & prior	6,072	23.5	3,410	34.9
<b>Total commercial and agricultural mortgage loans</b>	<b>\$ 25,874</b>	<b>100.0%</b>	<b>\$ 9,778</b>	<b>100.0%</b>

*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

**Table of Contents**

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 \$28.011 billion and \$26.809 billion as of June 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 \$9.802 billion and \$9.666 billion as of June 30, 2013 and December 31, 2012, respectively. As a percentage of recorded investment gross of allowance, 100% and more than 99% of the assets were current as of June 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:

	June 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	9	(2)	(11)	(2)
Charge-offs, net of recoveries	(9)	(3)	(51)	0
Change in foreign exchange	(5)	0	(2)	0
Allowance, end of period	\$ 181	\$ 53	\$ 186	\$ 58
Loan specific reserve	35	4	41	7
Portfolio reserve	146	49	145	51

**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.





**Table of Contents****Equity Securities Financial Services Businesses**

	June 30, 2013				December 31, 2012			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (in millions)	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Non-redeemable preferred stocks	\$ 19	\$ 2	\$ 0	\$ 21	\$ 15	\$ 2	\$ 0	\$ 17
Mutual fund common stocks(1)	2,144	498	4	2,638	1,874	516	0	2,390
Other common stocks	1,939	705	14	2,630	2,392	274	42	2,624
Total equity securities(2)	\$ 4,102	\$ 1,205	\$ 18	\$ 5,289	\$ 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**

	June 30, 2013				December 31, 2012			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (in millions)	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Non-redeemable preferred stocks	\$ 7	\$ 0	\$ 0	\$ 7	\$ 10	\$ 2	\$ 0	\$ 12
Mutual fund common stocks	14	6	0	20	0	0	0	0
Other common stocks	2,409	1,052	23	3,438	2,447	779	13	3,213
Total equity securities	\$ 2,430	\$ 1,058	\$ 23	\$ 3,465	\$ 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 \$24 million for the three months ended June 30, 2013, and 2012, respectively, and \$8 million and \$72 million for the six months ended June 30, 2013, and 2012, respectively.

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

Impairments of equity securities attributable to the Closed Block Business were \$0 million and \$16 million for the three months ended June 30, 2013, and 2012, respectively, and \$0 million and \$18 million for the six months ended June 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**

Other long-term investments are comprised as follows:

	June 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	\$ 317	\$ 463	\$ 320	\$ 504
Non-real estate-related	3,874	1,625	3,861	1,538
Real estate held through direct ownership(1)	1,486	2	1,602	0
Other(2)	885	12	882	(30)
Total other long-term investments	\$ 6,562	\$ 2,102	\$ 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 trading operations. Our derivative trading operation acts on behalf of affiliates and not in a dealer capacity. To the extent a derivative trading position is on behalf of the general account, the investment is included in Other long-term investments; otherwise, the investment is included in Invested Assets of Other Entities and Operations. 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.

	June 30, 2013	December 31, 2012
	(in millions)	
Fixed Maturities:		
Public, available-for-sale, at fair value	\$ 266	\$ 272
Private, available-for-sale, at fair value	88	93
Other trading account assets, at fair value(1)	4,408	4,627
Equity securities, available-for-sale, at fair value	0	21
Commercial mortgage and other loans, at book value(2)	490	502
Other long-term investments	1,285	1,351
Short-term investments	160	62

Total investments	\$ 6,697	\$ 6,928
-------------------	----------	----------

- (1) Primarily represents trading positions held by our non-dealer derivative trading operation to manage interest rate, 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.

**Table of Contents***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.

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.

	June 30, 2013	December 31, 2012
	(\$ in millions)	
<b>Interim Loan Portfolio:</b>		
Principal balance of loans outstanding	\$ 83	\$ 239
Allowance for credit or valuation-related losses	\$ 8	\$ 14
Weighted average loan-to-value ratio(1)	88%	91%
Weighted average debt service coverage ratio(1)	1.18	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 June 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 primarily 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.

**Liquidity and Capital Resources**

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

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**

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.

**Table of Contents**

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 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. Furthermore, we employ a Capital Protection Framework to ensure the availability of sufficient capital resources to maintain adequate capitalization on a consolidated basis and competitive risk-based capital ratios and solvency margins for our insurance subsidiaries under reasonably foreseeable stress scenarios.

The Financial Stability Oversight Council has made a proposed determination that Prudential Financial should be subject to stricter prudential regulatory standards and supervision by the Board of Governors of the Federal Reserve System under the Dodd-Frank Act. This stricter prudential regulation may include new capital and liquidity standards, including requirements regarding risk-based capital, leverage, liquidity, stress-testing and other matters. 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 above, as well as Business Regulation and Risk Factors included in our 2012 Annual Report on Form 10-K.

During the six months ended June 30, 2013, we took the following significant actions that impacted our liquidity and capital position:

We repositioned our capital structure and achieved an overall reduction in leverage through the redemption or maturity of an aggregate of \$1.56 billion of senior notes, the redemption at par of our \$920 million 9.0% Junior Subordinated Notes due 2068 and the issuance of an aggregate of \$1.2 billion of junior subordinated debt in public offerings;

We repurchased \$250 million of shares of our Common Stock and declared aggregate Common Stock dividends of \$376 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 June 30, 2013 the Financial Services Businesses had \$36.3 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.

	June 30, 2013	December 31, 2012
	(in millions)	
Attributed Equity(1)	\$ 25,423	\$ 27,088
Junior subordinated debt (i.e. hybrid securities)	4,884	4,594
Other capital debt	5,948	6,049
Total capital	\$ 36,255	\$ 37,731



- (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

**Table of Contents**

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).

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>:

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, their most recent statutory fiscal year-end:

Prudential of Japan	749%
Gibraltar Life consolidated(1)	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 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 reasonably foreseeable stress scenarios. The Capital Protection Framework incorporates the potential impacts from market related stresses, including equity markets, 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 sufficient resources to maintain

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

adequate capitalization and competitive RBC ratios and solvency margins under reasonably foreseeable stress scenarios.

We use captive reinsurance companies in our domestic insurance operations to more effectively manage our capital on an economic basis and to enable the aggregation and transfer of risks. To support the risks they assume, our captives are capitalized to a level 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 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

**Table of Contents**

governing their activities. In the normal course of business, Prudential Financial provides support to these captives through net worth maintenance agreements and/or guarantees of certain of the captives' obligations. Recently, the NAIC and the New York State Department of Financial Services have examined 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/or we may need to increase prices on certain products or find alternate financing sources, which could adversely affect our competitiveness, capital and financial position and results of operations. For further information on our specific uses of captive reinsurance companies, see 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.

**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, which 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 and June 30, 2013:

Three months ended:	Dividend Amount		Shares Repurchased	
	Per Share	Aggregate (in millions, except per share data)	Shares	Total Cost
March 31, 2013	\$ 0.40	\$ 188		\$
June 30, 2013	\$ 0.40	\$ 188	3.9	\$ 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.

**Table of Contents**

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 June 30, 2013, Prudential Financial had cash and short-term investments of \$5,056 million, a decrease of \$3,507 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 \$4,181 million as of June 30, 2013, a decrease of \$1,246 million from December 31, 2012.

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>Six Months Ended June 30, 2013 (in millions)</b>
<b>Sources:</b>	
Dividends and/or returns of capital from subsidiaries(1)	\$ 1,102
Proceeds from the issuance of junior subordinated debt (hybrid securities)	1,210
Net receipts under intercompany loan agreements(2)	512
Proceeds from stock-based compensation and exercise of stock options	218
Interest income from subsidiaries on intercompany agreements, net of interest paid	102
Proceeds from short-term debt, net of repayments	88
Other, net(3)	362
<b>Total sources</b>	<b>3,594</b>
<b>Uses:</b>	
Maturities of long term senior debt, excluding retail medium-term notes	1,090
Capital contributions to subsidiaries(4)	977
Repayments of junior subordinated debt (hybrid securities)	920
Repayment of retail medium-term notes	610
Interest paid on external debt	546
Common Stock dividends(5)	397
Share repurchases(6)	237
Net income tax payments(7)	53
Class B Stock dividends	10
<b>Total uses</b>	<b>4,840</b>
<b>Net decrease in cash and short-term investments</b>	<b>\$ 1,246</b>

(1) Includes dividends and/or returns of capital of \$566 million from international subsidiaries, \$270 million from asset management subsidiaries, \$184 million from Prudential Annuities Life Assurance Corporation and \$82 million from other subsidiaries.

(2) Includes net repayments of \$198 million by Pruco Re, net repayments of \$50 million by Pruco Life Insurance Company, net repayments of \$28 million by asset management subsidiaries, net proceeds of \$205 million from the issuance of debt to Gibraltar Life and net repayments of \$31 million by other subsidiaries.

(3) Includes \$400 million related to a short-term investment trade that settled in July 2013.

(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, \$228 million to Pruco Re, \$25 million to asset management subsidiaries, \$10 million to international insurance subsidiaries and \$2

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

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 July 2013.
- (7) 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.

**Table of Contents***Restrictions on Dividends and Returns of Capital from Subsidiaries*

In May 2013, Prudential Insurance paid an ordinary dividend of \$232 million to its parent, Prudential Holdings, LLC, which amount remained at Prudential Holdings, LLC. 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. 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 addition, the payment of dividends by any of our subsidiaries is subject to declaration by 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.

*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.

	June 30, 2013			Total	December 31, 2012
	Prudential Insurance	PRIAC	Other(1) (in billions)		
Cash and short-term investments	\$ 7.2	\$ 1.3	\$ 0.6	\$ 9.1	\$ 7.4
Fixed maturity investments:					
High or highest quality	123.9	18.5	9.4	151.8	158.6
Other than high or highest quality	8.3	1.3	0.6	10.2	10.0



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

Subtotal	132.2	19.8	10.0	162.0	168.6
Public equity securities	3.8	0.0	0.0	3.8	3.6
Total	\$ 143.2	\$ 21.1	\$ 10.6	\$ 174.9	\$ 179.6

(1) Includes PALAC and Pruco Life insurance companies.

**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.

	June 30, 2013			Total	December 31, 2012
	Prudential of Japan	Gibraltar Life(1)	All Other(2) (in billions)		
Cash and short-term investments	\$ 1.0	\$ 3.1	\$ 0.1	\$ 4.2	\$ 5.2
Fixed maturity investments:					
High or highest quality(3)	26.4	83.6	11.3	121.3	134.9
Other than high or highest quality	0.4	2.3	0.1	2.8	2.5
Subtotal	26.8	85.9	11.4	124.1	137.4
Public equity securities	1.5	2.2	0.3	4.0	3.8
Total(4)	\$ 29.3	\$ 91.2	\$ 11.8	\$ 132.3	\$ 146.4

(1) Includes Prudential Gibraltar.

(2) Represents our international insurance operations, excluding Japan.

(3) Of the \$121.3 billion of fixed maturity investments that are not designated as held to-maturity and considered high or highest quality as of June 30, 2013, \$86.4 billion, or 71%, 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**

We reinsure living benefit guarantees on certain variable annuity and retirement products from our domestic life insurance companies to a domestic captive reinsurance company, Pruco Reinsurance, Ltd. ( Pruco Re ). This enables us to execute our living benefit hedging program primarily within one legal entity, Pruco Re. 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 rate and equity market exposures. 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 to meet 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.

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. We satisfy this requirement 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 relevant insurance regulators. Reinsurance reserve credit requirements can move materially in either direction due to changes in equity markets, interest rates, actuarial assumptions and other factors. Higher reinsurance reserve credit requirements would

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

necessitate depositing additional assets in the statutory reserve credit trusts, while lower reserve credit requirements would allow assets to be removed from the statutory reserve credit trusts. As of June 30, 2013, for the applicable domestic insurance entities, the statutory reserve credit trusts required collateral of \$1.4 billion, a decrease of \$0.8 billion from December 31, 2012. The decrease was primarily driven by favorable equity markets, partially offset by a decline in the long term interest rate assumptions we are required to use to calculate the associated reserve requirements.

## **Table of Contents**

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 notional amount of the exposures hedged. Depending on market conditions, the collateral posting requirements can result in material liquidity needs. As of June 30, 2013 and December 31, 2012, these derivatives were in a net receive position of \$1.5 billion and \$4.6 billion, respectively, for which collateral was posted by external counterparties. The decline in the collateral position was primarily driven by rising interest rates and equity market appreciation.

### *Foreign exchange hedging activities*

We employ various hedging strategies to manage potential exposure to foreign currency exchange rate movements, including the strategies discussed in Results of Operations for Financial Services Businesses by Segment International Insurance Division. These hedging strategies include both internal and external hedging programs and 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 a portion of the value of U.S. dollar-denominated investments held on the books of these yen-based entities. These U.S. dollar-denominated investments are part of our hedging strategy to mitigate the impact of foreign currency exchange rate movements on the value of our U.S. dollar-equivalent investment in our Japanese subsidiaries. Absent an internal hedge, however, the 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 six months of 2013, Prudential Financial received \$547 million of net cash settlements related to the internal hedge program, which were paid by the yen-based subsidiaries. As of June 30, 2013, the market value of the internal hedges was an asset of \$579 million due from the yen-based subsidiaries. Absent any changes in forward exchange rates from those expected as of June 30, 2013, the \$579 million internal hedge asset represents the present value of the net cash flows to Prudential Financial from these entities over the life of the hedging instruments, up to 30 years. A 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 foreign currency-denominated future income of our foreign subsidiaries and equity investments in certain of these subsidiaries. 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 six months of 2013, the Company paid \$18 million for these external hedge settlements. As of June 30, 2013, the net asset related to these external foreign currency hedges was \$659 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*

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 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.



## **Table of Contents**

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, LLC 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 June 30, 2013, Prudential Insurance had an estimated maximum borrowing capacity of \$6.6 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 June 30, 2013, Prudential Insurance and PRIAC had qualifying assets available but not pledged with fair value of \$2.9 billion and \$1.7 billion, respectively.

Commercial paper programs maintained at Prudential Financial and Prudential Funding, LLC, a wholly-owned subsidiary of Prudential Insurance, with authorized issuance capacity of \$3.0 billion and \$7.0 billion, respectively, of which \$201 million and \$792 million, respectively, were outstanding as of June 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 June 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 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.

	June 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	\$ 3,707	\$ 3,240	\$ 6,947	\$ 3,436	\$ 2,382	\$ 5,818
Cash collateral for loaned securities	4,927	780	5,707	2,864	1,077	3,941
Securities sold but not yet purchased	13	0	13	0	0	0
Total(1)	\$ 8,647	\$ 4,020	\$ 12,667	\$ 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	\$ 6,830	\$ 2,262	\$ 9,092	\$ 4,536	\$ 1,566	\$ 6,102
Weighted average maturity, in days(2)	37	63		25	67	

(1) The daily weighted average outstanding for the three and six months ended June 30, 2013 was \$6,475 million and \$6,515 million for the Financial Services Businesses and \$4,126 million and \$3,938 for the Closed Block Business, respectively.

(2) Excludes securities that may be returned to the Company overnight.

Outstanding liabilities under these programs increased \$2.9 billion, as recent growth in our portfolio of invested assets was utilized to take advantage of attractive financing and investment opportunities.

As of June 30, 2013, our domestic insurance entities had assets eligible for the asset-based or secured financing programs of \$78.5 billion, of which \$9.9 billion were on loan. Taking into account market conditions and outstanding loan balances as of June 30, 2013, we believe approximately \$22.1 billion of the remaining eligible assets are readily lendable, of which approximately \$15.5 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 June 30, 2013, our Closed Block Business had outstanding mortgage dollar rolls, under which we are committed to repurchase \$542 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 June 30, 2013, total short- and long-term debt of the Company on a consolidated basis was \$26.3 billion, a decrease of \$1 billion from December 31, 2012. The following table sets forth total consolidated borrowings of the Company as of the dates indicated.

	Prudential Financial	June 30, 2013 Other Subsidiaries	Consolidated	Prudential Financial	December 31, 2012 Other Subsidiaries	Consolidated
	(in millions)					
<b>General obligation short-term debt:</b>						
Commercial paper	\$ 201	\$ 792	\$ 993	\$ 113	\$ 359	\$ 472
Current portion of long-term debt and other (1)(2)	1,012	540	1,552	1,734	203	1,937
<b>Subtotal</b>	<b>1,213</b>	<b>1,332</b>	<b>2,545</b>	<b>1,847</b>	<b>562</b>	<b>2,409</b>
<b>General obligation long-term debt:</b>						
Senior debt(2)(3)	11,426	1,516	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
<b>Subtotal</b>	<b>16,310</b>	<b>5,657</b>	<b>21,967</b>	<b>16,998</b>	<b>6,056</b>	<b>23,054</b>
<b>Total general obligations</b>	<b>17,523</b>	<b>6,989</b>	<b>24,512</b>	<b>18,845</b>	<b>6,618</b>	<b>25,463</b>
<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
<b>Total limited recourse borrowings</b>	<b>0</b>	<b>1,750</b>	<b>1,750</b>	<b>0</b>	<b>1,750</b>	<b>1,750</b>
<b>Total borrowings</b>	<b>\$ 17,523</b>	<b>\$ 8,739</b>	<b>\$ 26,262</b>	<b>\$ 18,845</b>	<b>\$ 8,368</b>	<b>\$ 27,213</b>

- (1) Includes collateralized borrowings from the Federal Home Loan Bank of New York of \$100 million at both June 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 \$2,253 million and \$1,774 million of medium-term notes of consolidated trust entities secured by funding agreements purchased with the proceeds of such notes as of June 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 June 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 9 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 June 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 June 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 June 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 Operations

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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 \$17.5 billion decreased \$1.3 billion from December 31, 2012 driven by \$1.1 billion of maturities of medium-term notes, the redemption of all of our \$920 million 9.0% Junior Subordinated Notes due 2068 and the redemption of \$462 million aggregate principal amount of retail notes, partially offset by the issuance of \$1.2 billion of junior subordinated debt. As of June 30, 2013, \$297 million of retail notes remained outstanding with no option to redeem at par.

Borrowings of our subsidiaries of \$8.7 billion increased \$0.4 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 statutory 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; however, based on the increased level of guaranteed universal life sales, we are evaluating solutions to address additional Guideline AXXX financing needs for the remainder of 2013 and beyond. During the six months ended June 30, 2013, an existing captive reinsurance subsidiary issued \$750 million of surplus notes to an affiliate in order to finance non-economic reserves required under Guideline AXXX. Additionally, \$250 million of ten-year fixed rate surplus notes were issued to support non-economic reserves required under Regulation XXX.

## **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. 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 June 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 \$21 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 \$13 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 change 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 material changes in our market risk exposures from December 31, 2012, a description of which may be found in

**Table of Contents**

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 generally 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 June 30, 2013. Based on such evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of June 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 June 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 June 3, 2013, Prudential Financial received notice of a proposed determination by the Financial Stability Oversight Council (the **Council** ) that it 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 July 2, 2013, Prudential Financial provided notice to the Council requesting a nonpublic written and oral evidentiary hearing before the Council to contest the Council's proposed determination. The written and oral evidentiary hearing was held and completed as of July 30, 2013. According to the regulations, the Council will make a final determination on the Company's status as a Covered Company within 60 days after the hearing.

In addition, the risk factor titled **Foreign governmental actions could subject us to additional regulation** is hereby updated to note that on July 18, 2013, the Financial Stability Board, consisting of representatives of national financial authorities of the G20 nations, identified the Company as a global systemically important insurer ( **G-SII** ).

For additional information, see **Management's Discussion and Analysis of Financial Condition and Results of Operations** Executive Summary.

**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 June 30, 2013, of its Common Stock:

<b>Period</b>	<b>Total Number of Shares Purchased(1)</b>	<b>Average Price Paid</b>	<b>Total Number of Shares Purchased as Part</b>	<b>Approximate Dollar Value of</b>
---------------	--	---------------------------	---	------------------------------------

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

		per Share	of Publicly Announced Program(2)	Shares that May Yet be Purchased under the Program(3)
April 1, 2013 through April 30, 2013	1,455,155	\$ 57.33	1,453,568	
May 1, 2013 through May 31, 2013	1,254,104	\$ 66.55	1,252,178	
June 1, 2013 through June 30, 2013	1,174,708	\$ 71.02	1,173,421	
Total	3,883,967	\$ 64.44	3,879,167	\$

229

**Table of Contents**

- (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 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.
- (3) The stock repurchase program authorized in June 2012 expired on June 30, 2013 and, therefore, the Company can no longer purchase any additional shares of Common Stock under this authorization. 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**

- |      |   |
|------|---|
| 10.1 | Revised Form of Terms and Conditions relating to awards to executive officers in 2012 under the Omnibus Incentive Plan of stock options, performance shares and performance units and book value units. Incorporated by reference to Exhibit 10.1 to the Registrants June 11, 2013 Current Report on Form 8-K.* |
| 10.2 | Revised Form of Terms and Conditions relating to awards to executive officers in 2013 under the Omnibus Incentive Plan of stock options, performance shares and performance units and book value units. Incorporated by reference to Exhibit 10.2 to the Registrants June 11, 2013 Current Report on Form 8-K.* |
| 10.3 | The Prudential Insurance Company of America Deferred Compensation Plan, as amended and restated effective as of June 20, 2013.*   |
| 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.   |

\* This exhibit is a management contract or compensatory plan or arrangement.

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**

**EXHIBIT INDEX**

- 10.1 Revised Form of Terms and Conditions relating to awards to executive officers in 2012 under the Omnibus Incentive Plan of stock options, performance shares and performance units and book value units. Incorporated by reference to Exhibit 10.1 to the Registrants June 11, 2013 Current Report on Form 8-K.\*
- 10.2 Revised Form of Terms and Conditions relating to awards to executive officers in 2013 under the Omnibus Incentive Plan of stock options, performance shares and performance units and book value units. Incorporated by reference to Exhibit 10.2 to the Registrants June 11, 2013 Current Report on Form 8-K.\*
- 10.3 The Prudential Insurance Company of America Deferred Compensation Plan, as amended and restated effective as of June 20, 2013.\*
- 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.

\* This exhibit is a management contract or compensatory plan or arrangement.