

PRUDENTIAL FINANCIAL INC

Form 10-Q

August 02, 2007

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, 2007

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)

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

New Jersey
(State or Other Jurisdiction of

22-3703799
(I.R.S. Employer

Incorporation or Organization)

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

As of July 31, 2007, 459 million shares of the registrant's Common Stock (par value \$0.01) were outstanding. In addition, 2 million shares of the registrant's Class B Stock, for which there is no established public trading market, were outstanding.

Table of Contents**TABLE OF CONTENTS**

| | Page Number |
|--|------------------------|
| PART I | |
| <u>FINANCIAL INFORMATION</u> | |
| Item 1. <u>Financial Statements:</u> | 1 |
| <u>Unaudited Interim Consolidated Statements of Financial Position as of June 30, 2007 and December 31, 2006</u> | 1 |
| <u>Unaudited Interim Consolidated Statements of Operations for the three and six months ended June 30, 2007 and 2006</u> | 2 |
| <u>Unaudited Interim Consolidated Statement of Stockholders' Equity for the six months ended June 30, 2007</u> | 3 |
| <u>Unaudited Interim Consolidated Statements of Cash Flows for the six months ended June 30, 2007 and 2006</u> | 4 |
| <u>Notes to Unaudited Interim Consolidated Financial Statements</u> | 5 |
| Unaudited Interim Supplemental Combining Financial Information: | |
| <u>Unaudited Interim Supplemental Combining Statements of Financial Position as of June 30, 2007 and December 31, 2006</u> | 34 |
| <u>Unaudited Interim Supplemental Combining Statements of Operations for the three months ended June 30, 2007 and 2006</u> | 35 |
| <u>Unaudited Interim Supplemental Combining Statements of Operations for the six months ended June 30, 2007 and 2006</u> | 36 |
| <u>Notes to Unaudited Interim Supplemental Combining Financial Information</u> | 37 |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 39 |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 122 |
| Item 4. <u>Controls and Procedures</u> | 122 |
| PART II | |
| <u>OTHER INFORMATION</u> | |
| Item 1. <u>Legal Proceedings</u> | 122 |
| Item 1A. <u>Risk Factors</u> | 123 |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 123 |
| Item 4. <u>Submission of Matters to a Vote of Security Holders</u> | 124 |
| Item 6. <u>Exhibits</u> | 125 |
| <u>SIGNATURES</u> | 126 |

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 stock, real estate and other financial markets; (2) interest rate fluctuations; (3) reestimates of our reserves for future policy benefits and claims; (4) differences between actual experience regarding mortality, morbidity, persistency, surrender experience, interest rates or market returns and the assumptions we use in pricing our products, establishing liabilities and reserves or for other purposes; (5) changes in our assumptions related to deferred policy acquisition costs, valuation of business acquired or goodwill; (6) changes in our claims-paying or credit ratings; (7) investment losses and defaults; (8) competition in our product lines and for personnel; (9) changes in tax law; (10) economic, political, currency and other risks relating to our international operations; (11) fluctuations in foreign currency exchange rates and foreign securities markets; (12) regulatory or legislative changes; (13) adverse determinations in litigation or regulatory matters and our exposure to contingent liabilities, including in connection with our divestiture or winding down of businesses; (14) 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; (15) ineffectiveness of risk management policies and procedures in identifying, monitoring and managing risks; (16) effects of acquisitions, divestitures and restructurings, including possible difficulties in integrating and realizing the projected results of acquisitions; (17) changes in statutory or U.S. GAAP accounting principles, practices or policies; (18) changes in assumptions for retirement expense; (19) Prudential Financial, Inc.'s primary reliance, as a holding company, on dividends or distributions from its subsidiaries to meet debt payment obligations and continue share repurchases, and the applicable regulatory restrictions on the ability of the subsidiaries to pay such dividends or distributions; and (20) risks due to the lack of legal separation between our Financial Services Businesses and our Closed Block Business. Prudential Financial, Inc. does not intend, and is under no obligation, to update any particular forward-looking statement included in this document. See Risk Factors included in the Annual Report on Form 10-K for the year ended December 31, 2006 for discussion of certain risks relating to our businesses and investment in our securities.

Table of Contents

Throughout this Quarterly Report on Form 10-Q, Prudential Financial and the Registrant refer to Prudential Financial, Inc., the ultimate holding company for all of our companies. Prudential Insurance refers to The Prudential Insurance Company of America, before and after its demutualization on December 18, 2001. Prudential, the Company, we and our refer to our consolidated operations before and after demutualization.

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

June 30, 2007 and December 31, 2006 (in millions, except share amounts)

| | June 30, 2007 | December 31, 2006 |
|---|-------------------|----------------------|
| ASSETS | | |
| Fixed maturities: | | |
| Available for sale, at fair value (amortized cost: 2007 \$156,119; 2006 \$158,828) | \$ 157,889 | \$ 162,816 |
| Held to maturity, at amortized cost (fair value: 2007 \$3,287; 2006 \$3,441) | 3,370 | 3,469 |
| Trading account assets supporting insurance liabilities, at fair value | 14,069 | 14,262 |
| Other trading account assets, at fair value | 2,113 | 2,209 |
| Equity securities, available for sale, at fair value (cost: 2007 \$7,209; 2006 \$6,824) | 8,685 | 8,103 |
| Commercial loans | 27,079 | 25,739 |
| Policy loans | 9,042 | 8,887 |
| Securities purchased under agreements to resell | 198 | 153 |
| Other long-term investments | 5,344 | 4,745 |
| Short-term investments | 7,797 | 5,034 |
| Total investments | 235,586 | 235,417 |
| Cash and cash equivalents | 6,471 | 8,589 |
| Accrued investment income | 2,104 | 2,142 |
| Reinsurance recoverables | 2,127 | 1,958 |
| Deferred policy acquisition costs | 11,395 | 10,863 |
| Other assets | 16,727 | 17,834 |
| Separate account assets | 187,403 | 177,463 |
| TOTAL ASSETS | \$ 461,813 | \$ 454,266 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| LIABILITIES | | |
| Future policy benefits | \$ 106,593 | \$ 106,951 |
| Policyholders' account balances | 81,158 | 80,652 |
| Policyholders' dividends | 3,325 | 3,982 |
| Reinsurance payables | 1,556 | 1,458 |
| Securities sold under agreements to repurchase | 9,781 | 11,481 |
| Cash collateral for loaned securities | 7,556 | 7,365 |
| Income taxes | 2,922 | 3,108 |
| Securities sold but not yet purchased | 267 | 277 |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

| | | |
|------------------------------|----------------|----------------|
| Short-term debt | 12,947 | 12,536 |
| Long-term debt | 11,151 | 11,423 |
| Other liabilities | 14,211 | 14,678 |
| Separate account liabilities | 187,403 | 177,463 |
| Total liabilities | 438,870 | 431,374 |

COMMITMENTS AND CONTINGENT LIABILITIES (See Note 9)

STOCKHOLDERS EQUITY

| | | |
|--|-------------------|-------------------|
| Preferred Stock (\$.01 par value; 10,000,000 shares authorized; none issued) | | |
| Common Stock (\$.01 par value; 1,500,000,000 shares authorized; 604,900,835 and 604,900,423 shares issued as of June 30, 2007 and December 31, 2006, respectively) | 6 | 6 |
| Class B Stock (\$.01 par value; 10,000,000 shares authorized; 2,000,000 shares issued and outstanding as of June 30, 2007 and December 31, 2006, respectively) | | |
| Additional paid-in capital | 20,742 | 20,666 |
| Common Stock held in treasury, at cost (143,327,236 and 133,795,373 shares as of June 30, 2007 and December 31, 2006, respectively) | (8,301) | (7,143) |
| Accumulated other comprehensive income (loss) | (148) | 519 |
| Retained earnings | 10,644 | 8,844 |
| Total stockholders equity | 22,943 | 22,892 |
| TOTAL LIABILITIES AND STOCKHOLDERS EQUITY | \$ 461,813 | \$ 454,266 |

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, 2007 and 2006 (in millions, except per share amounts)**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--|---------------|--------------------------------------|-----------------|
| | 2007 | 2006 | 2007 | 2006 |
| REVENUES | | | | |
| Premiums | \$ 3,629 | \$ 3,515 | \$ 7,188 | \$ 6,967 |
| Policy charges and fee income | 785 | 674 | 1,570 | 1,338 |
| Net investment income | 3,024 | 2,783 | 6,014 | 5,529 |
| Realized investment gains (losses), net | 117 | (318) | 537 | (143) |
| Asset management fees and other income | 870 | 659 | 1,891 | 1,409 |
| Total revenues | 8,425 | 7,313 | 17,200 | 15,100 |
| BENEFITS AND EXPENSES | | | | |
| Policyholders' benefits | 3,733 | 3,636 | 7,418 | 7,115 |
| Interest credited to policyholders' account balances | 725 | 582 | 1,568 | 1,205 |
| Dividends to policyholders | 605 | 525 | 1,316 | 1,148 |
| General and administrative expenses | 2,219 | 1,987 | 4,328 | 4,088 |
| Total benefits and expenses | 7,282 | 6,730 | 14,630 | 13,556 |
| INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES | | | | |
| | 1,143 | 583 | 2,570 | 1,544 |
| Income tax expense | 324 | 165 | 747 | 442 |
| INCOME FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES | | | | |
| | 819 | 418 | 1,823 | 1,102 |
| Equity in earnings of operating joint ventures, net of taxes | 56 | 45 | 133 | 96 |
| INCOME FROM CONTINUING OPERATIONS | | | | |
| | 875 | 463 | 1,956 | 1,198 |
| Income (loss) from discontinued operations, net of taxes | (29) | (10) | 10 | (12) |
| NET INCOME | \$ 846 | \$ 453 | \$ 1,966 | \$ 1,186 |
| EARNINGS PER SHARE (See Note 6) | | | | |
| Financial Services Businesses | | | | |
| Basic: | | | | |
| Income from continuing operations per share of Common Stock | \$ 1.89 | \$ 0.92 | \$ 4.04 | \$ 2.33 |
| Income (loss) from discontinued operations, net of taxes | (0.06) | (0.02) | 0.01 | (0.02) |
| Net income per share of Common Stock | \$ 1.83 | \$ 0.90 | \$ 4.05 | \$ 2.31 |
| Diluted: | | | | |
| Income from continuing operations per share of Common Stock | \$ 1.86 | \$ 0.91 | \$ 3.96 | \$ 2.29 |
| Income (loss) from discontinued operations, net of taxes | (0.06) | (0.02) | 0.02 | (0.02) |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

| | | | | |
|--------------------------------------|---------|---------|---------|---------|
| Net income per share of Common Stock | \$ 1.80 | \$ 0.89 | \$ 3.98 | \$ 2.27 |
|--------------------------------------|---------|---------|---------|---------|

Closed Block Business

Basic and Diluted:

| | | | | |
|---|-----------|---------|----------|----------|
| Income (loss) from continuing operations per share of Class B Stock | \$ (1.50) | \$ 6.50 | \$ 37.50 | \$ 26.00 |
| Income from discontinued operations, net of taxes | | | 1.00 | |
| Net income (loss) per share of Class B Stock | \$ (1.50) | \$ 6.50 | \$ 38.50 | \$ 26.00 |

See Notes to Unaudited Interim Consolidated Financial Statements

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Unaudited Interim Consolidated Statement of Stockholders Equity

Six Months Ended June 30, 2007 (in millions)

| | Common Stock | Class B Stock | Additional Paid-in Capital | Retained Earnings | Common Stock Held In Treasury | Accumulated Other Comprehensive Income (Loss) | Total Stockholders Equity |
|---|-----------------|---------------------|----------------------------------|----------------------|--|---|---------------------------------|
| Balance, December 31, 2006 | \$ 6 | \$ | \$ 20,666 | \$ 8,844 | \$ (7,143) | \$ 519 | \$ 22,892 |
| Common Stock acquired | | | | | (1,500) | | (1,500) |
| Stock-based compensation programs | | | 77 | (33) | 207 | | 251 |
| Conversion of Senior Notes | | | (1) | (90) | 135 | | 44 |
| Cumulative effect of changes in accounting principles, net of taxes | | | | (43) | | | (43) |
| Comprehensive income: | | | | | | | |
| Net income | | | | 1,966 | | | 1,966 |
| Other comprehensive loss, net of taxes | | | | | | (667) | (667) |
| Total comprehensive income | | | | | | | 1,299 |
| Balance, June 30, 2007 | \$ 6 | \$ | \$ 20,742 | \$ 10,644 | \$ (8,301) | \$ (148) | \$ 22,943 |

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, 2007 and 2006 (in millions)**

| | 2007 | 2006 |
|--|----------------|----------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | \$ 1,966 | \$ 1,186 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Realized investment (gains) losses, net | (537) | 143 |
| Policy charges and fee income | (473) | (437) |
| Interest credited to policyholders' account balances | 1,568 | 1,205 |
| Depreciation and amortization, including premiums and discounts | 97 | 136 |
| Change in: | | |
| Deferred policy acquisition costs | (518) | (455) |
| Future policy benefits and other insurance liabilities | 1,285 | 1,249 |
| Trading account assets supporting insurance liabilities and other trading account assets | (16) | (946) |
| Income taxes | 34 | 461 |
| Securities sold but not yet purchased | (10) | (119) |
| Other, net | (616) | (2,484) |
| Cash flows from (used in) operating activities | 2,780 | (61) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Proceeds from the sale/maturity/prepayment of: | | |
| Fixed maturities, available for sale | 44,192 | 52,798 |
| Fixed maturities, held to maturity | 135 | 164 |
| Equity securities, available for sale | 2,759 | 2,152 |
| Commercial loans | 2,474 | 2,383 |
| Policy loans | 640 | 537 |
| Other long-term investments | 536 | 778 |
| Short-term investments | 4,424 | 6,952 |
| Payments for the purchase/origination of: | | |
| Fixed maturities, available for sale | (42,845) | (56,344) |
| Fixed maturities, held to maturity | (122) | (290) |
| Equity securities, available for sale | (2,751) | (2,259) |
| Commercial loans | (3,003) | (2,780) |
| Policy loans | (628) | (642) |
| Other long-term investments | (943) | (629) |
| Short-term investments | (6,273) | (6,710) |
| Acquisition of businesses, net of cash acquired | | 724 |
| Other, net | (92) | (169) |
| Cash flows used in investing activities | (1,497) | (3,335) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Policyholders' account deposits | 10,404 | 11,576 |
| Policyholders' account withdrawals | (10,397) | (10,487) |
| Net change in securities sold under agreements to repurchase and cash collateral for loaned securities | (2,409) | 2,920 |
| Cash dividends paid on Common Stock | (80) | (51) |
| Net change in financing arrangements (maturities 90 days or less) | 578 | 142 |
| Common Stock acquired | (1,451) | (1,231) |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

| | | |
|---|-----------------|-----------------|
| Common Stock reissued for exercise of stock options | 137 | 79 |
| Proceeds from the issuance of debt (maturities longer than 90 days) | 2,450 | 1,642 |
| Repayments of debt (maturities longer than 90 days) | (3,042) | (604) |
| Cash payments to or in respect of eligible policyholders | | (93) |
| Excess tax benefits from share-based payment arrangements | 79 | 42 |
| Other, net | 355 | (6) |
| Cash flows from (used in) financing activities | (3,376) | 3,929 |
| Effect of foreign exchange rate changes on cash balances | (25) | 79 |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (2,118) | 612 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR | 8,589 | 7,799 |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | \$ 6,471 | \$ 8,411 |

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, mutual funds, pension and retirement-related services and administration, and investment management. In addition, the Company provides retail securities brokerage services indirectly through a minority ownership in a joint venture. The Company has organized its principal operations into the Financial Services Businesses and the Closed Block Business. The Financial Services Businesses operate through three operating divisions: Insurance, Investment, and International Insurance and Investments. The Company's real estate and relocation services business as well as businesses that are not sufficiently material to warrant separate disclosure and businesses to be divested are included in Corporate and Other operations within the Financial Services Businesses. The Closed Block Business, which includes the Closed Block (see Note 4), is managed separately from the Financial Services Businesses. The Closed Block Business was established on the date of demutualization and includes the Company's in force participating insurance and annuity products and assets that are used for the payment of benefits and 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 has ceased offering these participating products.

Basis of Presentation

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

In the opinion of management, all adjustments necessary for a fair statement of the financial position and results of operations have been made. All such adjustments are of a normal, recurring nature. Interim results are not necessarily indicative of the results that may be expected for the full year. These financial statements should be read in conjunction with the Company's audited Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

Use of Estimates

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

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

The most significant estimates include those used in determining deferred policy acquisition costs, goodwill, valuation of business acquired, valuation of investments including derivatives, future policy benefits including guarantees, pension and other postretirement benefits, provision for income taxes, reserves for contingent liabilities and reserves for losses in connection with unresolved legal matters.

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

Reclassifications

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

2. ACCOUNTING POLICIES AND PRONOUNCEMENTS

Share-Based Payments

The Company issues employee share-based compensation awards, under a plan authorized by the Board of Directors, that are subject to specific vesting conditions; generally the awards vest ratably over a three-year period, the nominal vesting period, or at the date the employee retires (as defined by the plan), if earlier. For awards granted between January 1, 2003 and January 1, 2006 that specify an employee vests in the award upon retirement, the Company accounts for those awards using the nominal vesting period approach. Under this approach, the Company records compensation expense over the nominal vesting period. If the employee retires before the end of the nominal vesting period, any remaining unrecognized compensation cost is recognized at the date of retirement.

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

If the Company had accounted for all share-based compensation awards granted after January 1, 2003 under the non-substantive vesting period approach, net income of the Financial Services Businesses for the three months ended June 30, 2007 would have been increased by \$2 million, which would not have changed reported net income per share of Common Stock. Net income of the Financial Services Businesses for the six months ended June 30, 2007 would have been increased by \$5 million, or \$0.01 per share of Common Stock, on both a basic and diluted basis. Net income of the Financial Services Businesses for the three and six months ended June 30, 2006 would have been increased by \$3 million and \$6 million, or \$0.01 and \$0.01 per share of Common Stock, respectively, on both a basic and diluted basis.

Accounting Pronouncements Adopted

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109. This interpretation prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that a company has taken or expects to take on a tax return. The Company adopted FIN No. 48 on January 1, 2007, which resulted in a decrease to its income tax liability and an increase to retained earnings of \$61 million as of January 1, 2007.

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

The Company had the following amounts of unrecognized tax benefits as of the date of adoption of FIN No. 48:

| | Unrecognized tax benefits | Unrecognized tax benefits that, if recognized, would favorably impact the effective tax rate (in millions) |
|--|---------------------------------|---|
| Amounts related to tax years prior to 2002 | \$ 389 | \$ 389 |
| Amounts related to tax years 2002 and forward. | 175 | 94 |
| Total Unrecognized Tax Benefits all years | \$ 564 | \$ 483 |

The Company classifies all interest and penalties related to tax uncertainties as income tax expense. As of the date of adoption of FIN No. 48, the Company had recorded \$23 million in liabilities for tax-related interest and penalties.

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 (Service) or other taxing jurisdictions. Audit periods remain open for review until the statute of limitations has passed. Generally, for tax years which produce net operating losses, capital losses or tax credit carryforwards (tax attributes), the statute of limitations does not close, to the extent of these tax attributes, until the 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 our liability for income taxes. Any such adjustment could be material to our results of operations for any given quarterly or annual period based, in part, upon the results of operations for the given period. The Company does not anticipate any significant changes to its total unrecognized tax benefits within the next 12 months.

On January 26, 2006, the Service officially closed the audit of the Company's consolidated federal income tax returns for the 1997 to 2001 periods. As a result of certain favorable resolutions, the Company's consolidated statement of operations for the year ended December 31, 2005 included an income tax benefit of \$720 million, reflecting a reduction in the Company's liability for income taxes. The statute of limitations has closed for these tax years; however, there were tax attributes which were utilized in subsequent tax years for which the statute of limitations remains open.

In December 2006, the Service completed all fieldwork with regards to its examination of the consolidated federal income tax returns for tax years 2002-2003. The final report was submitted to the Joint Committee on Taxation for their review in April 2007. The statute of limitations for the 2002-2003 tax years expires in 2008. In addition, certain tax years prior to 2002 have tax attributes for which the statute of limitations has not yet closed.

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

The Company's affiliates in Japan file separate tax returns and are subject to audits by the local taxing authority. For tax years after April 1, 2004 the general statute of limitations is 5 years from when the return is filed. For tax years prior to April 1, 2004 the general statute of limitations is 3 years from when the return is filed.

In July 2006, the FASB issued FASB Staff Position (FSP) SFAS 13-2, Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction, an amendment of FASB Statement No. 13. FSP SFAS 13-2 indicates that a change or projected change in the timing of cash flows relating to income taxes generated by a leveraged lease would require a recalculation of cumulative and prospective income recognition associated with the transaction. FSP SFAS 13-2

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

is effective for fiscal years beginning after December 15, 2006. The Company adopted FSP SFAS 13-2 on January 1, 2007 and the adoption resulted in a net after-tax reduction to retained earnings of \$84 million, as of January 1, 2007.

In September 2005, the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants issued Statement of Position (SOP) 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection With Modifications or Exchanges of Insurance Contracts. SOP 05-1 provides guidance on accounting by insurance enterprises for deferred acquisition costs on internal replacements of insurance and investment contracts other than those specifically described in SFAS No. 97. SOP 05-1 defines an internal replacement as a modification in product benefits, features, rights, or coverages that occurs by the exchange of a contract for a new contract, or by amendment, endorsement, or rider to a contract, or by the election of a feature or coverage within a contract, and is effective for internal replacements occurring in fiscal years beginning after December 15, 2006. The Company adopted SOP 05-1 on January 1, 2007 and the adoption resulted in a net after-tax reduction to retained earnings of \$20 million, as of January 1, 2007.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets. This statement requires that servicing assets or liabilities be initially measured at fair value, with subsequent changes in value reported based on either a fair value or amortized cost approach for each class of servicing assets or liabilities. Under previous guidance, such servicing assets or liabilities were initially measured at historical cost and the amortized cost method was required for subsequent reporting. The Company adopted this guidance effective January 1, 2007, and elected to continue reporting subsequent changes in value using the amortized cost approach. Adoption of this guidance had no material effect on the Company's consolidated financial position or results of operations.

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Instruments. This statement eliminates an exception from the requirement to bifurcate an embedded derivative feature from beneficial interests in securitized financial assets. The Company has used this exception for investments the Company has made in securitized financial assets in the normal course of operations, and thus has not previously had to consider whether such investments contain an embedded derivative. The new requirement to identify embedded derivatives in beneficial interests will be applied on a prospective basis only to beneficial interests acquired, issued, or subject to certain remeasurement conditions after the adoption of the guidance. This statement also provides an election, on an instrument by instrument basis, to measure at fair value an entire hybrid financial instrument that contains an embedded derivative requiring bifurcation, rather than measuring only the embedded derivative on a fair value basis. If the fair value election is chosen, changes in unrealized gains and losses are reflected in the Consolidated Statements of Operations. The Company adopted this guidance effective January 1, 2007. The Company's adoption of this guidance did not have a material effect on the Company's consolidated financial position or results of operations.

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This statement does not change which assets and liabilities are required to be recorded at fair value, but the application of this statement could change current practices in determining fair value. This statement is effective for fiscal years beginning after November 15, 2007 with early adoption permitted. The Company plans to adopt this guidance effective January 1, 2008. The Company is currently assessing the impact of SFAS No. 157 on the Company's consolidated financial position and results of operations.

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. This statement provides companies with an option to report selected financial assets and liabilities at fair value, with the associated changes in fair value reflected in the Consolidated Statements of Operations. This statement is effective for fiscal years beginning after November 15, 2007 with early adoption permitted. The Company plans to adopt this guidance effective January 1, 2008. The Company is currently assessing the impact of SFAS No. 159 on its consolidated financial position and results of operations.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* an amendment of FASB Statements No. 87, 88, 106 and 132(R). This statement requires an employer on a prospective basis to recognize the overfunded or underfunded status of its defined benefit pension and postretirement plans as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through other comprehensive income. The Company adopted this requirement, along with the required disclosures, on December 31, 2006. SFAS No. 158 also requires an employer on a prospective basis to measure the funded status of its plans as of its fiscal year-end. This requirement is effective for fiscal years ending after December 15, 2008. The Company expects to adopt this guidance on December 31, 2008 and is currently assessing the impact that changing from a September 30 measurement date to a December 31 measurement date will have on the Company's consolidated financial position and results of operations.

In June 2007, the AcSEC issued SOP 07-1, *Clarification of the Scope of the Audit and Accounting Guide Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies*. This SOP provides guidance for determining whether an entity should apply the specialized industry accounting for investment companies (referred to as investment company accounting) in the preparation of its stand-alone financial reporting. SOP 07-1 also provides guidance for determining whether investment company accounting should be retained in the consolidated financial statements of the investment company's parent, or in the application of the equity method to an equity interest in the investment company. The SOP is effective for fiscal years beginning after December 15, 2007, with early adoption permitted. The Company plans to adopt this guidance on January 1, 2008. The Company is currently assessing the impact of this SOP on its consolidated financial position and results of operations.

3. ACQUISITIONS AND DISPOSITIONS

Acquisition of The Allstate Corporation's Variable Annuity Business

On June 1, 2006 (the date of acquisition), the Company acquired the variable annuity business of The Allstate Corporation (Allstate) through a reinsurance transaction for \$635 million of total consideration, consisting primarily of a \$628 million ceding commission. The reinsurance arrangements with Allstate include a coinsurance arrangement associated with the general account liabilities assumed and a modified coinsurance arrangement associated with the separate account liabilities assumed. The assets acquired and liabilities assumed have been included in the Company's Consolidated Financial Statements as of the date of acquisition. The Company's results of operations include the results of the acquired variable annuity business beginning from the date of acquisition. Pro forma information for this acquisition is omitted as the impact is not material.

Acquisition of CIGNA Corporation's (CIGNA) Retirement Business

The Company acquired the retirement business of CIGNA for cash consideration of \$2.1 billion on April 1, 2004 and the results of this business have been included in the Company's consolidated results since the date of acquisition. As an element of the acquisition, the Company had the right, beginning two years after the acquisition, to commute the modified-coinsurance-with-assumption arrangement related to the acquired defined

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

benefit guaranteed-cost contracts in exchange for cash consideration from CIGNA. Effective April 1, 2006, the Company reached an agreement with CIGNA to convert the modified-coinsurance-with-assumption arrangement to an indemnity coinsurance arrangement, effectively retaining the economics of the defined benefit guaranteed-cost contracts for the life of the block of business. Upon conversion, the Company extinguished its reinsurance receivable and payable with CIGNA related to the modified-coinsurance-with-assumption arrangement. Concurrently, the Company assumed \$1.7 billion of liabilities from CIGNA under the indemnity coinsurance arrangement and received the related assets.

Discontinued Operations

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--|-------------|--------------------------------------|-------------|
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | | |
| Equity sales, trading, and research operations | \$ (105) | \$ 10 | \$ (103) | \$ 16 |
| Real estate investments sold or held for sale | 44 | | 62 | |
| Philippine insurance operations | | (15) | | (15) |
| Canadian intermediate weekly premium and individual health operations | | (2) | | (6) |
| Other | 4 | (5) | 6 | (9) |
| Income (loss) from discontinued operations before income taxes | (57) | (12) | (35) | (14) |
| Income tax benefit | (28) | (2) | (45) | (2) |
| Income (loss) from discontinued operations, net of taxes | \$ (29) | \$ (10) | \$ 10 | \$ (12) |

The six months ended June 30, 2007 includes a \$28 million tax benefit associated with a discontinued international business.

The Company's Unaudited Interim Consolidated Statements of Financial Position include total assets and total liabilities related to discontinued businesses of \$418 million and \$195 million, respectively, as of June 30, 2007 and \$450 million and \$215 million, respectively, as of December 31, 2006. Charges recorded in connection with the disposals of businesses include estimates that are subject to subsequent adjustment. It is possible that such adjustments might be material to future net results of operations of a particular quarterly or annual period.

On June 6, 2007, the Company announced its decision to exit the equity sales, trading and research operations of the Prudential Equity Group (PEG). PEG's operations were substantially wound down by June 30, 2007. Included within the table above for the three and six months ended June 30, 2007 is a \$106 million pre-tax loss in connection with this decision, primarily related to employee severance costs. The results of PEG, which were previously included in the Financial Advisory segment, are reflected in discontinued operations for all periods presented. The

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Company estimates it will incur approximately \$10 million in additional costs during 2007 in connection with this decision.

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

Table of Contents**PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)****4. CLOSED BLOCK**

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

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

The excess of Closed Block Liabilities over Closed Block Assets at the date of the demutualization (adjusted to eliminate the impact of related amounts in Accumulated other comprehensive income (loss)) represented the estimated maximum future earnings at that date from the Closed Block expected to result from operations attributed to the Closed Block after income taxes. In establishing the Closed Block, the Company developed an actuarial calculation of the timing of such maximum future earnings. If actual cumulative earnings of the Closed Block from inception through the end of any given period are greater than the expected cumulative earnings, only the expected earnings will be recognized in income. Any excess of actual cumulative earnings over expected cumulative earnings will represent undistributed accumulated earnings attributable to policyholders, which are recorded as a policyholder dividend obligation. The policyholder dividend obligation represents amounts to be paid to Closed Block policyholders as an additional policyholder dividend unless otherwise offset by future Closed Block performance that is less favorable than originally expected. If the actual cumulative earnings of the Closed Block from its inception through the end of any given period are less than the expected cumulative earnings of the Closed Block, the Company will recognize only the actual earnings in income. However, the Company may reduce policyholder dividend scales in the future, which would be intended to increase future actual earnings until the actual cumulative earnings equaled the expected cumulative earnings. The Company recognized a policyholder dividend obligation of \$550 million and \$483 million as of June 30, 2007 and December 31, 2006, respectively, to Closed Block policyholders for the excess of actual cumulative earnings over the expected cumulative earnings. Additionally, net unrealized investment gains that have arisen subsequent to the establishment of the Closed Block were reflected as a policyholder dividend obligation of \$1.116 billion and \$1.865 billion as of June 30, 2007 and December 31, 2006, respectively, to be paid to Closed Block policyholders unless otherwise offset by future experience, with an offsetting amount reported in Accumulated other comprehensive income (loss). See the table below for changes in the components of the policyholder dividend obligation for the six months ended June 30, 2007.

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

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

| | June 30, 2007 | December 31, 2006 |
|---|------------------|----------------------|
| | (in millions) | |
| Closed Block Liabilities | | |
| Future policy benefits | \$ 50,901 | \$ 50,705 |
| Policyholders' dividends payable | 1,107 | 1,108 |
| Policyholder dividend obligation | 1,666 | 2,348 |
| Policyholders' account balances | 5,552 | 5,562 |
| Other Closed Block liabilities | 9,302 | 10,800 |
| Total Closed Block Liabilities | 68,528 | 70,523 |
| Closed Block Assets | | |
| Fixed maturities, available for sale, at fair value | 44,297 | 46,707 |
| Other trading account assets, at fair value | 13 | |
| Equity securities, available for sale, at fair value | 4,010 | 3,684 |
| Commercial loans | 6,696 | 6,794 |
| Policy loans | 5,400 | 5,415 |
| Other long-term investments | 927 | 922 |
| Short-term investments | 2,298 | 1,765 |
| Total investments | 63,641 | 65,287 |
| Cash and cash equivalents | 848 | 1,275 |
| Accrued investment income | 623 | 662 |
| Other Closed Block assets | 379 | 277 |
| Total Closed Block Assets | 65,491 | 67,501 |
| Excess of reported Closed Block Liabilities over Closed Block Assets | 3,037 | 3,022 |
| Portion of above representing accumulated other comprehensive income: | | |
| Net unrealized investment gains | 1,059 | 1,844 |
| Allocated to policyholder dividend obligation | (1,116) | (1,865) |
| Future earnings to be recognized from Closed Block Assets and Closed Block Liabilities | \$ 2,980 | \$ 3,001 |

Information regarding the policyholder dividend obligation is as follows:

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

| | Six Months Ended June 30, 2007 (in millions) |
|---|---|
| Balance, January 1, 2007 | \$ 2,348 |
| Impact on income before gains allocable to policyholder dividend obligation | 67 |
| Change in unrealized investment gains | (749) |
| Balance, June 30, 2007 | \$ 1,666 |

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

Closed Block revenues and benefits and expenses for the three and six months ended June 30, 2007 and 2006 were as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|--------|------------------------------|----------|
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | | |
| Revenues | | | | |
| Premiums | \$ 945 | \$ 957 | \$ 1,783 | \$ 1,803 |
| Net investment income | 866 | 836 | 1,725 | 1,700 |
| Realized investment gains (losses), net | (7) | (23) | 193 | 36 |
| Other income | 11 | 14 | 24 | 27 |
| Total Closed Block revenues | 1,815 | 1,784 | 3,725 | 3,566 |
| Benefits and Expenses | | | | |
| Policyholders' benefits | 1,074 | 1,072 | 2,023 | 2,004 |
| Interest credited to policyholders' account balances | 35 | 35 | 71 | 71 |
| Dividends to policyholders | 576 | 503 | 1,259 | 1,106 |
| General and administrative expenses | 177 | 186 | 348 | 369 |
| Total Closed Block benefits and expenses | 1,862 | 1,796 | 3,701 | 3,550 |
| Closed Block revenues, net of Closed Block benefits and expenses, before income taxes and discontinued operations | (47) | (12) | 24 | 16 |
| Income tax expense (benefit) | (58) | (48) | 5 | (33) |
| Closed Block revenues, net of Closed Block benefits and expenses and income taxes, before discontinued operations | 11 | 36 | 19 | 49 |
| Income from discontinued operations, net of taxes | | | 2 | |
| Closed Block revenues, net of Closed Block benefits and expenses, income taxes and discontinued operations | \$ 11 | \$ 36 | \$ 21 | \$ 49 |

5. STOCKHOLDERS' 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:

| | |
|---------------------|--------------------------|
| Common Stock | Class B Stock |
|---------------------|--------------------------|

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

| | Issued | Held In Treasury | Outstanding (in millions) | Issued and Outstanding |
|--------------------------------------|--------|---------------------|------------------------------|---------------------------|
| Balance, December 31, 2006 | 604.9 | 133.8 | 471.1 | 2.0 |
| Common Stock issued | | | | |
| Common Stock acquired | | 16.0 | (16.0) | |
| Stock-based compensation programs(1) | | (4.1) | 4.1 | |
| Convertible senior notes(2) | | (2.4) | 2.4 | |
| Balance, June 30, 2007 | 604.9 | 143.3 | 461.6 | 2.0 |

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

(2) Represents shares issued in conjunction with the conversion of the November 2005 convertible senior notes, as discussed in Note 6 to the Unaudited Interim Consolidated Financial Statements.

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

In November 2006, Prudential Financial's Board of Directors authorized the Company to repurchase up to \$3.0 billion of its outstanding Common Stock in calendar year 2007. The timing and amount of any repurchases under this authorization will be determined by management based upon market conditions and other considerations, and the repurchases may be effected in the open market, through derivative, accelerated repurchase and other negotiated transactions and through prearranged trading plans complying with Rule 10b5-1(c) of the Exchange Act. The 2007 stock repurchase program supersedes all previous repurchase programs. During the six months ended June 30, 2007, the Company acquired 16.0 million shares of its Common Stock at a total cost of \$1.5 billion.

Comprehensive Income

The components of comprehensive income are as follows:

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|----------|------------------|----------|
| | June 30, | | June 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | | |
| Net income | \$ 846 | \$ 453 | \$ 1,966 | \$ 1,186 |
| Other comprehensive income (loss), net of taxes: | | | | |
| Change in foreign currency translation adjustments | (111) | 136 | (151) | 198 |
| Change in net unrealized investments gains (losses)(1) | (741) | (873) | (540) | (1,573) |
| Change in pension and postretirement unrecognized net periodic benefit (cost) | 12 | | 24 | |
| Additional minimum pension liability adjustment | | (3) | | (4) |
| Other comprehensive loss(2) | (840) | (740) | (667) | (1,379) |
| Comprehensive income | \$ 6 | \$ (287) | \$ (1,299) | \$ (193) |

- (1) Includes cash flow hedges of \$(5) million and \$(34) million for the three months ended June 30, 2007 and 2006, respectively, and \$(2) million and \$(41) million for the six months ended June 30, 2007 and 2006, respectively.
- (2) Amounts are net of taxes of \$(344) million and \$(452) million for the three months ended June 30, 2007 and 2006, respectively, and \$(214) million and \$(797) million for the six months ended June 30, 2007 and 2006, respectively.

The balance of and changes in each component of Accumulated other comprehensive income (loss) for the six months ended June 30, 2007 are as follows (net of taxes):

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

| | Accumulated Other Comprehensive Income (Loss) | | | Total Accumulated Other Comprehensive Income (Loss) |
|-----------------------------------|---|--|--|--|
| | Foreign Currency Translation Adjustments | Net Unrealized Investment Gains (Losses)(1) | Pension and Postretirement Unrecognized Net Periodic Benefit (Cost) | |
| Balance, December 31, 2006 | \$ 122 | \$ 1,171 | \$ (774) | \$ 519 |
| Change in component during period | (151) | (540) | 24 | (667) |
| Balance, June 30, 2007 | \$ (29) | \$ 631 | \$ (750) | \$ (148) |

(in millions)

(1) Includes cash flow hedges of \$(126) million and \$(124) million as of June 30, 2007 and December 31, 2006, respectively.

Table of Contents**PRUDENTIAL FINANCIAL, INC.****Notes to Unaudited Interim Consolidated Financial Statements (Continued)****6. EARNINGS PER SHARE**

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

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

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

Common Stock

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

| | Three Months Ended June 30, | | | | | |
|---|-----------------------------|-------------------------|------------------|--------|-------------------------|------------------|
| | 2007 | | 2006 | | | |
| | Income | Weighted Average Shares | Per Share Amount | Income | Weighted Average Shares | Per Share Amount |
| (in millions, except per share amounts) | | | | | | |
| Basic earnings per share | | | | | | |
| Income from continuing operations attributable to the Financial Services Businesses | \$ 864 | | | \$ 434 | | |
| Direct equity adjustment | 14 | | | 16 | | |
| Income from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment | \$ 878 | 463.7 | \$ 1.89 | \$ 450 | 488.2 | \$ 0.92 |
| Effect of dilutive securities and compensation programs | | | | | | |
| Stock options | | 5.8 | | | 6.1 | |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

| | | |
|--|-----|-----|
| Deferred and long-term compensation programs | 2.5 | 2.8 |
| Convertible senior notes | 0.8 | |

Diluted earnings per share

| | | | | | | |
|---|--------|-------|---------|--------|-------|---------|
| Income from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment | \$ 878 | 472.8 | \$ 1.86 | \$ 450 | 497.1 | \$ 0.91 |
|---|--------|-------|---------|--------|-------|---------|

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

| | Six Months Ended June 30, | | | | | |
|---|---------------------------|---------------------------------------|------------------------|----------|---------------------------------------|------------------------|
| | Income | 2007 Weighted Average Shares | Per Share Amount | Income | 2006 Weighted Average Shares | Per Share Amount |
| (in millions, except per share amounts) | | | | | | |
| Basic earnings per share | | | | | | |
| Income from continuing operations attributable to the Financial Services Businesses | \$ 1,852 | | | \$ 1,111 | | |
| Direct equity adjustment | 29 | | | 35 | | |
| Income from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment | \$ 1,881 | 466.0 | \$ 4.04 | \$ 1,146 | 491.4 | \$ 2.33 |
| Effect of dilutive securities and compensation programs | | | | | | |
| Stock options | | 5.8 | | | 6.3 | |
| Deferred and long-term compensation programs | | 2.7 | | | 2.9 | |
| Convertible senior notes | | 0.4 | | | | |
| Diluted earnings per share | | | | | | |
| Income from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment | \$ 1,881 | 474.9 | \$ 3.96 | \$ 1,146 | 500.6 | \$ 2.29 |

For the three months ended June 30, 2007 and 2006, 1.6 million and 2.2 million options, respectively, weighted for the portion of the period they were outstanding, with a weighted average exercise price of \$91.72 and \$76.12 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. For the six months ended June 30, 2007 and 2006, 1.4 million and 1.8 million options, respectively, weighted for the portion of the period they were outstanding, with a weighted average exercise price of \$91.42 and \$76.07 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.

Convertible Senior Notes

The Company's convertible senior notes provide for the Company to issue shares of its Common Stock as a component of the conversion of the notes. The \$2 billion November 2005 issuance was called for redemption in May 2007, as discussed below. These notes were dilutive to earnings per share for the three and six months ended June 30, 2007 by 0.8 million and 0.4 million shares, respectively, for the period prior to the conversion date, as the average market price of the Common Stock was above \$90.00, the initial conversion price. The \$2 billion December 2006 issuance will be dilutive to earnings per share if the average market price of the Common Stock for a particular period is above \$104.21.

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

On May 21, 2007, the Company called for redemption the \$2 billion of outstanding floating rate convertible senior notes issued in 2005. Prior to redemption by the Company, substantially all holders elected to convert their senior notes as provided under their terms. The senior notes required net settlement in shares; therefore, upon conversion, the holders received cash equal to the par amount of the senior notes surrendered for conversion plus accrued interest and shares of Prudential Financial Common Stock for the portion of the settlement amount in excess of the par amount. The settlement amount in excess of the par amount was based upon the excess of the

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

closing market price of Prudential Financial Common Stock for a 10-day period defined under the terms of the senior notes, or \$100.80 per share, over the initial conversion price of \$90 per share. Accordingly, at conversion the Company issued 2,367,887 shares of Common Stock from treasury. The conversion had no impact on our results of operations and resulted in a net increase to shareholders' equity of \$44 million, reflecting the tax benefit associated with the conversion of the senior notes.

Class B Stock

Income (loss) from continuing operations per share of Class B Stock was \$(1.50) and \$6.50 for the three months ended June 30, 2007 and 2006, respectively, and \$37.50 and \$26.00 for the six months ended June 30, 2007 and 2006, respectively.

The income (loss) from continuing operations attributable to the Closed Block Business available to holders of Class B Stock after direct equity adjustment for the three months ended June 30, 2007 and 2006 amounted to \$(3) million and \$13 million, respectively. The direct equity adjustment resulted in a decrease in the income from continuing operations attributable to the Closed Block Business applicable to holders of Class B Stock for earnings per share purposes of \$14 million and \$16 million for the three months ended June 30, 2007 and 2006, respectively. The income from continuing operations attributable to the Closed Block Business available to holders of Class B Stock after direct equity adjustment for the six months ended June 30, 2007 and 2006 amounted to \$75 million and \$52 million, respectively. The direct equity adjustment resulted in a decrease in the income from continuing operations attributable to the Closed Block Business applicable to holders of Class B Stock for earnings per share purposes of \$29 million and \$35 million for the six months ended June 30, 2007 and 2006, respectively. For the three and six months ended June 30, 2007 and 2006, the weighted average number of shares of Class B Stock used in the calculation of earnings per share amounted to two million. There are no potentially dilutive shares associated with the Class B Stock.

7. EMPLOYEE BENEFIT 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 | |
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | | |
| Components of net periodic (benefit) cost | | | | |
| Service cost | \$ 42 | \$ 40 | \$ 3 | \$ 3 |
| Interest cost | 108 | 104 | 34 | 32 |
| Expected return on plan assets | (192) | (185) | (23) | (22) |
| Amortization of prior service cost | 7 | 6 | (1) | (2) |
| Amortization of actuarial (gain) loss, net | 7 | 12 | 4 | 5 |
| Special termination benefits | 2 | 1 | | |
| Net periodic (benefit) cost | \$ (26) | \$ (22) | \$ 17 | \$ 16 |

| | Six Months Ended June 30, | | | |
|--|----------------------------------|-------------|--------------------------------------|-------------|
| | Pension Benefits | | Other Postretirement Benefits | |
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | | |
| Components of net periodic (benefit) cost | | | | |
| Service cost | \$ 84 | \$ 80 | \$ 6 | \$ 6 |
| Interest cost | 216 | 208 | 68 | 64 |
| Expected return on plan assets | (384) | (370) | (46) | (44) |
| Amortization of prior service cost | 14 | 12 | (2) | (4) |
| Amortization of actuarial (gain) loss, net | 14 | 24 | 7 | 9 |
| Special termination benefits | 2 | 3 | | |
| Net periodic (benefit) cost | \$ (54) | \$ (43) | \$ 33 | \$ 31 |

On April 30, 2007, the Company transferred \$1 billion of assets within the qualified pension plan under Section 420 of the Internal Revenue Code from assets supporting pension benefits to assets supporting retiree medical benefits. The transfer resulted in a reduction to the prepaid benefit for the qualified pension plan and an offsetting decrease in the accrued benefit liability for the postretirement plan with no net effect on stockholders' equity on the Company's consolidated financial position. The transfer had no impact on the Company's consolidated results of operations, but will reduce the future cash contributions required to be made to the postretirement plan.

The Company made cash contributions during the six months ended June 30, 2007 of \$50 million to its postretirement plans and anticipates that it will make cash contributions for the remainder of 2007 of approximately \$10 million. The Company does not anticipate making any contributions to the qualified pension plan in 2007 and continues to anticipate contributing approximately \$80 million in 2007 to the

non-qualified pension plans.

In July 2007, the Company established an irrevocable trust, commonly referred to as a rabbi trust, for the purpose of holding assets of the Company to be used to satisfy its obligations with respect to certain

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

non-qualified retirement plans. Assets held in a rabbi trust are available to the general creditors of the Company in the event of insolvency or bankruptcy. The Company may from time to time in its discretion make contributions to the trust to fund accrued benefits payable to participants in one or more of the plans, and, in the case of a change in control of the Company, as defined in the trust agreement, the Company will be required to make contributions to the plans to fund the accrued benefits, vested and unvested, payable on a pretax basis to participants in the plans. The Company made a discretionary payment to the trust fund in July 2007 in the amount of \$95 million.

8. SEGMENT INFORMATION

Segments

The Company has organized its principal operations into the Financial Services Businesses and the Closed Block Business. Within the Financial Services Businesses, the Company operates through three divisions, which together encompass eight reportable segments. The Company's real estate and relocation services business as well as businesses that are not sufficiently material to warrant separate disclosure and businesses to be divested 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 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 SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, is the measure of segment performance presented below.

Adjusted operating income is calculated by adjusting each segment's income from continuing operations before income taxes and 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;

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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

equity in earnings of operating joint ventures.

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.

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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

Charges that relate to realized investment gains (losses), net, are also excluded from adjusted operating income. The related charges relate to: policyholder dividends; amortization of deferred policy acquisition costs, valuation of business acquired (VOBA), unearned revenue reserves and deferred sales inducements; interest credited to policyholders' account balances; reserves for future policy benefits; payments associated with the market value adjustment features related to certain of the annuity products we sell; and minority interest in consolidated operating subsidiaries. The related charges associated with policyholder dividends include a percentage of net realized investment gains on specified Gibraltar Life assets that is required to be paid as dividends to Gibraltar Life policyholders. Deferred policy acquisition costs, VOBA, unearned revenue reserves and deferred sales inducements for certain products are amortized based on estimated gross profits, which include net realized investment gains and losses on the underlying invested assets. The related charge for these items represent the portion of this amortization associated with net realized investment gains and losses. The related charges for interest credited to policyholders' account balances relate to certain group life policies that pass back certain realized investment gains and losses to the policyholder. The reserves for certain policies are adjusted when cash flows related to these policies are affected by net realized investment gains and losses, and the related charge for reserves for future policy benefits represents that adjustment. Certain of our annuity products contain a market value adjustment feature that requires us to pay to the contractholder or entitles us to receive from the contractholder, upon surrender, a market value adjustment based on the crediting rates on the contract surrendered compared to crediting rates on newly issued contracts or based on an index rate at the time of purchase compared to an index rate at time of surrender, as applicable. These payments mitigate the net realized investment gains or losses incurred upon the disposition of the underlying invested assets. The related charge represents the payments or receipts associated with these market value adjustment features. Minority interest expense is recorded for the earnings of consolidated subsidiaries owed to minority investors. The related charge for minority interest in consolidated operating subsidiaries represents the portion of these earnings associated with net realized investment gains and losses.

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

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

Adjusted operating income of the International Insurance segment and International Investments segment, excluding the global commodities group, reflect the impact of an intercompany arrangement with Corporate and Other operations pursuant to which the segments' 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 segments' U.S. dollar equivalent earnings. Pursuant to this program, the

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

Company's Corporate and Other operations execute forward currency contracts with third parties to sell the hedged currency in exchange for U.S. dollars at a specified exchange rate. The maturities of these contracts correspond with the future periods in which the identified non-U.S. dollar denominated earnings are expected to be generated. These contracts do not qualify for hedge accounting under U.S. GAAP and, as noted above, all resulting profits or losses from such contracts are included in Realized investment gains (losses), net. When the contracts are terminated in the same period that the expected earnings emerge, the resulting positive or negative cash flow effect is included in adjusted operating income (gains of \$25 million and \$8 million for the three months ended June 30, 2007 and 2006, respectively, and gains of \$46 million and \$14 million for the six months ended June 30, 2007 and 2006, respectively). As of June 30, 2007 and December 31, 2006, the fair value of open contracts used for this purpose was a net asset of \$148 million and a net asset of \$105 million, respectively.

The Company uses interest and currency swaps and other derivatives to manage interest and currency exchange rate exposures arising from mismatches between assets and liabilities, including duration mismatches. For the derivative contracts that do not qualify for hedge accounting treatment, mark-to-market adjustments of open contracts as well as periodic settlements are included in Realized investment gains (losses), net. However, the periodic swap settlements, as well as other derivative related yield adjustments, are included in adjusted operating income to reflect the after-hedge yield of the underlying instruments. Adjusted operating income includes gains of \$20 million and \$15 million for the three months ended June 30, 2007 and 2006, respectively, and gains of \$43 million and \$20 million for the six months ended June 30, 2007 and 2006, respectively, due to periodic settlements and yield adjustments of such contracts.

Certain products the Company sells are accounted for as freestanding derivatives or contain embedded derivatives. Changes in the fair value of these derivatives, along with any fees received or payments made relating to the derivative, are recorded in Realized investment gains (losses), net. These Realized investment gains (losses), net are included in adjusted operating income in the period in which the gain or loss is recorded. In addition, the changes in fair value of any associated derivative portfolio that is part of an economic hedging program related to the risk of these products (but which do not qualify for hedge accounting treatment under U.S. GAAP) are also included in adjusted operating income in the period in which the gains or losses on the derivative portfolio are recorded. Adjusted operating income includes gains of \$13 million and losses of \$13 million for the three months ended June 30, 2007 and 2006, respectively, and gains of \$28 million and losses of \$10 million for the six months ended June 30, 2007 and 2006, respectively related to these products and any associated derivative portfolio.

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 that are marked to market through Realized investment gains (losses), net, based upon the change in value of the underlying portfolio. Adjusted operating income includes a portion of the cumulative realized investment gains on these embedded derivatives on an amortizing basis over the remaining life of the securities. However, adjusted operating income includes any cumulative realized investment losses immediately. Adjusted operating income includes gains of \$2 million and losses of \$8 million for the three months ended June 30, 2007 and 2006, respectively, and gains of \$3 million and losses of \$9 million for the six months ended June 30, 2007 and 2006, respectively, related to these embedded derivatives.

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

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Within the Company's Asset Management segment, its commercial mortgage operations originate loans for sale, including through securitization transactions. The Realized investment gains (losses), net associated with

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

these loans, including related derivative results and retained mortgage servicing rights, are a principal source of earnings for this business and are included in adjusted operating income. Also within the Company's Asset Management segment, its proprietary investing business makes investments for sale or syndication to other investors or for placement or co-investment in the Company's managed funds and structured products. The Realized investment gains (losses), net associated with the sale of these proprietary investments are a principal source of earnings for this business and are included in adjusted operating income. In addition, Realized investment gains (losses), net from derivatives used to hedge certain foreign currency-denominated proprietary investments are included in adjusted operating income. Net realized investment gains of \$39 million and \$29 million related to these businesses were included in adjusted operating income for the three months ended June 30, 2007 and 2006, respectively. Net realized investment gains of \$58 million and \$72 million related to these businesses were included in adjusted operating income for the six months ended June 30, 2007 and 2006, respectively.

The Company's Japanese insurance operations invest in dual currency fixed maturities and loans, which pay interest in U.S. dollars, while the principal is payable in Japanese yen. For fixed maturities that are categorized as held to maturity, and loans where the Company's intent is to hold them to maturity, the change in value related to foreign currency fluctuations associated with the U.S. dollar interest payments is recorded in Asset management fees and other income. Since these investments will be held until maturity, the foreign exchange impact will ultimately be realized as net investment income as earned. Therefore, the change in value related to foreign currency fluctuations recorded within Asset management fees and other income is excluded from adjusted operating income and is reflected as an adjustment to Realized investment gains (losses), net. These adjustments were a net gain of \$14 million and a net loss of \$13 million for the three months ended June 30, 2007 and 2006, respectively, and a net gain of \$20 million and a net loss of \$22 million for the six months ended June 30, 2007 and 2006, respectively.

In addition, the Company has certain other assets and liabilities for which, under GAAP, the change in value due to changes in foreign currency exchange rates is recorded in Asset management fees and other income. To the extent the foreign currency exposure on these assets and liabilities is economically hedged, the change in value included in Asset management fees and other income is excluded from adjusted operating income and is reflected as an adjustment to Realized investment gains (losses), net. These adjustments were a net loss of \$1 million and net gain of \$5 million for the three and six months ended June 30, 2007, respectively. There were no adjustments for the three and six months ended June 30, 2006.

Investment gains and losses on trading account assets supporting insurance liabilities and changes in experience-rated contractholder liabilities due to asset value changes. Certain products included in the retirement business acquired from CIGNA, as well as certain products included in the International Insurance segment, are experience-rated in that investment results associated with these products will ultimately accrue to contractholders. The investments supporting these experience-rated products, excluding mortgage loans, are classified as trading. These trading investments are reflected on the statements of financial position as Trading account assets supporting insurance liabilities, at fair value. Realized and unrealized gains and losses for these investments are reported in Asset management fees and other income. Investment income for these investments is reported in Net investment income. Mortgage loans that support these experience-rated products are carried at unpaid principal, net of unamortized discounts and an allowance for losses, and are reflected on the statements of financial position as Commercial loans.

Adjusted operating income excludes net investment gains and losses on trading account assets supporting insurance liabilities. This is consistent with the exclusion of realized investment gains and losses with respect to other investments supporting insurance liabilities managed on a consistent basis, as discussed above. In addition,

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

to be consistent with the historical treatment of charges related to realized investment gains and losses on available for sale securities, adjusted operating income also excludes the change in contractholder liabilities due to asset value changes in the pool of investments (including mortgage loans) supporting these experience-rated contracts, which are reflected in Interest credited to policyholders account balances. The result of this approach is that adjusted operating income for these products includes only net fee revenue and interest spread the Company earns on these experience-rated contracts, and excludes changes in fair value of the pool of investments, both realized and unrealized, that accrue to the contractholders.

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

Equity in earnings of operating joint ventures. 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 GAAP basis on an after-tax 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, | |
|--|--------------------------------|------------|------------------------------|------------|
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | | |
| Adjusted Operating Income before income taxes for Financial Services Businesses by Segment: | | | | |
| Individual Life | \$ 141 | \$ 96 | \$ 242 | \$ 229 |
| Individual Annuities | 180 | 122 | 346 | 240 |
| Group Insurance | 69 | 29 | 120 | 76 |
| Total Insurance Division | 390 | 247 | 708 | 545 |
| Asset Management | 190 | 137 | 374 | 306 |
| Financial Advisory | 72 | 30 | 169 | (77) |
| Retirement | 138 | 142 | 286 | 279 |
| Total Investment Division | 400 | 309 | 829 | 508 |
| International Insurance | 412 | 324 | 825 | 662 |
| International Investments | 43 | 34 | 105 | 78 |
| Total International Insurance and Investments Division | 455 | 358 | 930 | 740 |
| Corporate Operations | (26) | 11 | (14) | 17 |
| Real Estate and Relocation Services | 18 | 29 | 15 | 39 |
| Total Corporate and Other | (8) | 40 | 1 | 56 |
| Adjusted Operating Income before income taxes for Financial Services Businesses | 1,237 | 954 | 2,468 | 1,849 |
| Reconciling items: | | | | |
| Realized investment gains (losses), net, and related adjustments | 39 | (334) | 185 | (284) |
| Charges related to realized investment gains (losses), net | (7) | 23 | (13) | 23 |
| Investment gains (losses) on trading account assets supporting insurance liabilities, net | (108) | (151) | (26) | (265) |
| Change in experience-rated contractholder liabilities due to asset value changes | 72 | 130 | 10 | 196 |
| Divested businesses | (5) | (10) | 14 | 48 |
| Equity in earnings of operating joint ventures | (100) | (67) | (220) | (145) |
| Income from continuing operations before income taxes and equity in earnings of operating joint ventures for Financial Services Businesses | 1,128 | 545 | 2,418 | 1,422 |
| Income from continuing operations before income taxes and equity in earnings of operating joint ventures for Closed Block Business | 15 | 38 | 152 | 122 |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

| | | | | |
|--|----------|--------|----------|----------|
| Income from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ 1,143 | \$ 583 | \$ 2,570 | \$ 1,544 |
|--|----------|--------|----------|----------|

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

The 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 for the Company's reportable segments:

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|------------------|------------------|------------------|
| | June 30, 2007 | June 30, 2006 | June 30, 2007 | June 30, 2006 |
| | (in millions) | | | |
| Financial Services Businesses: | | | | |
| Individual Life | \$ 629 | \$ 585 | \$ 1,260 | \$ 1,144 |
| Individual Annuities | 632 | 469 | 1,236 | 922 |
| Group Insurance | 1,211 | 1,117 | 2,416 | 2,226 |
| Total Insurance Division | 2,472 | 2,171 | 4,912 | 4,292 |
| Asset Management | 617 | 469 | 1,174 | 971 |
| Financial Advisory | 94 | 68 | 205 | 144 |
| Retirement | 1,150 | 1,049 | 2,313 | 2,103 |
| Total Investment Division | 1,861 | 1,586 | 3,692 | 3,218 |
| International Insurance | 2,057 | 1,934 | 4,111 | 3,883 |
| International Investments | 169 | 146 | 346 | 296 |
| Total International Insurance and Investments Division | 2,226 | 2,080 | 4,457 | 4,179 |
| Corporate Operations | 58 | 74 | 158 | 178 |
| Real Estate and Relocation Services | 81 | 85 | 140 | 153 |
| Total Corporate and Other | 139 | 159 | 298 | 331 |
| Total | 6,698 | 5,996 | 13,359 | 12,020 |
| Reconciling items: | | | | |
| Realized investment gains (losses), net, and related adjustments | 39 | (334) | 185 | (284) |
| Charges related to realized investment gains (losses), net | 2 | 7 | 3 | 9 |
| Investment gains (losses) on trading account assets supporting insurance liabilities, net | (108) | (151) | (26) | (265) |
| Divested businesses | 1 | 13 | 15 | 65 |
| Equity in earnings of operating joint ventures | (100) | (67) | (220) | (145) |
| Total Financial Services Businesses | 6,532 | 5,464 | 13,316 | 11,400 |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

| | | | | |
|--|-----------------|-----------------|------------------|------------------|
| Closed Block Business | 1,893 | 1,849 | 3,884 | 3,700 |
| Total per Unaudited Interim Consolidated Financial Statements | \$ 8,425 | \$ 7,313 | \$ 17,200 | \$ 15,100 |

The Asset Management segment revenues include intersegment revenues of \$75 million and \$85 million for the three months ended June 30, 2007 and 2006, respectively, and \$159 million and \$176 million for the six months ended June 30, 2007 and 2006, respectively, primarily consisting of asset-based management and administration fees. Management has determined the intersegment revenues with reference to market rates. Intersegment revenues are eliminated in consolidation in Corporate and Other.

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

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

| | June 30, 2007 | December 31, 2006 |
|---|------------------|----------------------|
| | (in millions) | |
| Individual Life | \$ 34,567 | \$ 33,041 |
| Individual Annuities | 73,560 | 69,153 |
| Group Insurance | 30,218 | 29,342 |
| Total Insurance Division | 138,345 | 131,536 |
| Asset Management | 42,255 | 38,524 |
| Financial Advisory | 1,412 | 1,342 |
| Retirement | 127,289 | 125,604 |
| Total Investment Division | 170,956 | 165,470 |
| International Insurance | 58,726 | 59,211 |
| International Investments | 7,704 | 6,191 |
| Total International Insurance and Investments Division | 66,430 | 65,402 |
| Corporate Operations | 13,017 | 16,479 |
| Real Estate and Relocation Services | 1,140 | 1,380 |
| Total Corporate and Other | 14,157 | 17,859 |
| Total Financial Services Businesses | 389,888 | 380,267 |
| Closed Block Business | 71,925 | 73,999 |
| Total per Unaudited Interim Consolidated Financial Statements | \$ 461,813 | \$ 454,266 |

9. CONTINGENT LIABILITIES AND LITIGATION AND REGULATORY MATTERS*Contingent Liabilities*

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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.

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

Litigation and Regulatory Matters

The Company is subject to legal and regulatory actions in the ordinary course of its businesses. Pending legal and regulatory actions include proceedings relating to aspects of businesses and operations that are specific to the Company and proceedings that are typical of the businesses in which the Company operates, including in

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

both cases businesses that have either been divested or placed in wind-down status. Some of these proceedings have been brought on behalf of various alleged classes of complainants. In certain of these matters, the plaintiffs are seeking large and/or indeterminate amounts, including punitive or exemplary damages.

Insurance and Annuities

In August 2000, plaintiffs filed a purported national class action in the District Court of Valencia County, New Mexico, *Azar, et al. v. Prudential Insurance*, based upon the alleged failure to adequately disclose the increased costs associated with payment of life insurance premiums on a modal basis, *i.e.*, more frequently than once a year. Similar actions have been filed in New Mexico against over a dozen other insurance companies. The complaint asserts claims for breach of the common law duty to disclose material information, breach of the implied covenant of good faith and fair dealing, breach of fiduciary duty, unjust enrichment and fraudulent concealment and seeks injunctive relief, compensatory and punitive damages, both in unspecified amounts, restitution, treble damages, interest, costs and attorneys' fees. In March 2001, the court entered an order granting partial summary judgment to plaintiffs as to liability. In January 2003, the New Mexico Court of Appeals reversed this finding and dismissed the claims for breach of the covenant of good faith and fair dealing and breach of fiduciary duty. The case was remanded to the trial court and in November 2004, it held that, as to the named plaintiffs, the non-disclosure was material. In July 2005, the court certified a class of New Mexico only policyholders denying plaintiffs' motion to include purchasers from 35 additional states. In September 2005, plaintiffs sought to amend the court's order on class certification with respect to eight additional states. In March 2006, the court reiterated its denial of a multi-state class and maintained the certification of a class of New Mexico resident purchasers of Prudential life insurance. The court also indicated it would enter judgment on liability against Prudential for the New Mexico class. In May 2007, the matter settled. The settlement, which is subject to final approval by the court, provides that Prudential Insurance will pay the difference between the annualized modal premium and the annual premium and attorneys' fees.

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. The cases were consolidated for pre-trial proceedings in New Jersey Superior Court, Essex County and captioned *Lederman v. Prudential Financial, Inc., et al.* The complaints allege that an alternative dispute resolution agreement entered into among Prudential Insurance, over 350 claimants who are current and former Prudential Insurance employees, and Leeds Morelli & Brown (the law firm representing the claimants) was illegal and that Prudential Insurance conspired with Leeds Morelli & Brown to commit fraud, malpractice, breach of contract, and violate federal racketeering laws by advancing legal fees to the law firm with the purpose of limiting Prudential's liability to the claimants. In 2004, the Superior Court sealed these lawsuits and compelled them to arbitration. In May 2006, the Appellate Division reversed the trial court's decisions, held that the cases were improperly sealed, and should be heard in court rather than arbitrated. In November 2006, plaintiffs filed a motion seeking to permit over 200 individuals to join the cases as additional plaintiffs, to authorize a joint trial on liability issues for all plaintiffs, and to add a claim under the New Jersey discrimination law. In March 2007, the court granted plaintiffs' motion to amend the complaint to add over 200 additional plaintiffs and a claim under the New Jersey discrimination law but denied without prejudice plaintiffs' motion for a joint trial on liability issues. In April 2007, the amended complaint was filed. In June 2007, the Company moved to dismiss the complaint. The motion is pending.

The Company, along with a number of other insurance companies, received formal requests for information from the State of New York Attorney General's Office (NYAG), the Securities and Exchange Commission (SEC), the Connecticut Attorney General's Office, the Massachusetts Office of the Attorney General, the Department of Labor, the United States Attorney for the Southern District of California, the District Attorney of the County of San Diego, and various state insurance departments relating to payments to insurance

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

intermediaries and certain other practices that may be viewed as anti-competitive. The Company may receive additional requests from these and other regulators and governmental authorities concerning these and related subjects. The Company is cooperating with these inquiries and has had discussions with certain authorities in an effort to resolve the inquiries into this matter. In December 2006, Prudential Insurance reached a resolution of the NYAG investigation. Under the terms of the settlement, Prudential Insurance paid a \$2.5 million penalty and established a \$16.5 million fund for policyholders, adopted business reforms and agreed, among other things, to continue to cooperate with the NYAG in any litigation, ongoing investigations or other proceedings. Prudential Insurance also settled the litigation brought by the California Department of Insurance and agreed to business reforms and disclosures as to group insurance contracts insuring customers or residents in California and to pay certain costs of investigation. These matters are also the subject of litigation brought by private plaintiffs, including purported class actions that have been consolidated in the multidistrict litigation in the United States District Court for the District of New Jersey, *In re Employee Benefit Insurance Brokerage Antitrust Litigation*, and two shareholder derivative actions, *Gillespie v. Ryan* and *Kahn v. Agnew*. Both derivative actions were dismissed without prejudice. In *Gillespie*, the plaintiff entered into a tolling agreement with the Company to permit a Special Evaluation Committee of the Board of Directors to investigate and evaluate his demand that the Company take action regarding these matters. The Committee has completed its investigation and has informed counsel for Mr. Gillespie that it has determined to refuse his demand. The regulatory settlement may adversely affect the existing litigation or cause additional litigation and result in adverse publicity and other potentially adverse impacts to the Company's business.

In April 2005, the Company voluntarily commenced a review of the accounting for its reinsurance arrangements to confirm that it complied with applicable accounting rules. This review included an inventory and examination of current and past arrangements, including those relating to the Company's wind down and divested businesses and discontinued operations. Subsequent to commencing this voluntary review, the Company received a formal request from the Connecticut Attorney General for information regarding its participation in reinsurance transactions generally and a formal request from the SEC for information regarding certain reinsurance contracts entered into with a single counterparty since 1997 as well as specific contracts entered into with that counterparty in the years 1997 through 2002 relating to the Company's property and casualty insurance operations that were sold in 2003. These investigations are ongoing and not yet complete and it is possible that the Company may receive additional requests from regulators relating to reinsurance arrangements. The Company intends to cooperate with all such requests.

The Company's subsidiary, American Skandia Life Assurance Corporation, has commenced a remediation program to correct errors in the administration of approximately 11,000 annuity contracts issued by that company. The owners of these contracts did not receive notification that the contracts were approaching or past their designated annuitization date or default annuitization date (both dates referred to as the contractual annuity date) and the contracts were not annuitized at their contractual annuity dates. Some of these contracts also were affected by data integrity errors resulting in incorrect contractual annuity dates. The lack of notice and data integrity errors, as reflected on the annuities administrative system, all occurred before the acquisition of the American Skandia entities by the Company. The remediation and administrative costs of the remediation program are subject to the indemnification provisions of the acquisition agreement pursuant to which the Company purchased the American Skandia entities in May 2003 from Skandia.

Securities

Prudential Securities has been named as a defendant in a number of industry-wide purported class actions in the United States District Court for the Southern District of New York relating to its former securities underwriting business. Plaintiffs in one consolidated proceeding, captioned *In re: Initial Public Offering*

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

Securities Litigation, allege, among other things, that the underwriters engaged in a scheme involving tying agreements, undisclosed compensation arrangements and research analyst conflicts to manipulate and inflate the prices of shares sold in initial public offerings in violation of the federal securities laws. Certain issuers of these securities and their current and former officers and directors have also been named as defendants. In October 2004, the district court granted plaintiffs' motion for class certification in six focus cases. In December 2006, the United States Court of Appeals for the Second Circuit vacated that decision. Plaintiffs have petitioned the Court of Appeals for rehearing and rehearing *en banc*. In June 2004, plaintiffs entered into a settlement agreement with the issuers, officers and directors named as defendants in the lawsuits, which the district court preliminarily approved in February 2005. In August 2000, Prudential Securities was named as a defendant, along with other underwriters, in a purported class action, captioned *CHS Electronics Inc. v. Credit Suisse First Boston Corp. et al.*, which alleges on behalf of issuers of securities in initial public offerings that the defendants conspired to fix at 7% the discount that underwriting syndicates receive from issuers in violation of federal antitrust laws. Plaintiffs moved for class certification in September 2004 and for partial summary judgment in November 2005. The summary judgment motion has been deferred pending disposition of the class certification motion. In April 2006, the court denied class certification. In August 2006, the United States Court of Appeals for the Second Circuit granted plaintiffs' petition for review of that decision. In a related action, captioned *Gillet v. Goldman Sachs et al.*, plaintiffs allege substantially the same antitrust claims on behalf of investors, though only injunctive relief is currently being sought.

Other Matters*Mutual Fund Market Timing Practices*

In August 2006, Prudential Equity Group, LLC (PEG), a wholly owned subsidiary of the Company, reached a resolution of the previously disclosed regulatory and criminal investigations into deceptive market related activities involving PEG's former Prudential Securities operations. The settlements relate to conduct that generally occurred between 1999 and 2003 involving certain former Prudential Securities brokers in Boston and certain other branch offices in the U.S., their supervisors, and other members of the Prudential Securities control structure with responsibilities that related to the market timing activities, including certain former members of Prudential Securities senior management. The Prudential Securities operations were contributed to a joint venture with Wachovia Corporation in July 2003, but PEG retained liability for the market timing related activities. In connection with the resolution of the investigations, PEG entered into separate settlements with each of the United States Attorney for the District of Massachusetts (USAO), the Secretary of the Commonwealth of Massachusetts, Securities Division, the SEC, the National Association of Securities Dealers, the New York Stock Exchange, the New Jersey Bureau of Securities and the NYAG. These settlements resolve the investigations by the above named authorities into these matters as to all Prudential entities without further regulatory proceedings or filing of charges so long as the terms of the settlement are followed and provided, in the case of the settlement agreement reached with the USAO, that the USAO has reserved the right to prosecute PEG if there is a material breach by PEG of that agreement during its five year term and in certain other specified events. Under the terms of the settlements, PEG paid \$270 million into a Fair Fund administered by the SEC to compensate those harmed by the market timing activities. In addition, \$330 million was paid in fines and penalties. Pursuant to the settlements, PEG retained, at PEG's ongoing cost and expense, the services of an Independent Distribution Consultant acceptable to certain of the authorities to develop a proposed distribution plan for the distribution of Fair Fund amounts according to a methodology developed in consultation with and acceptable to certain of the authorities. In addition, as part of the settlements, PEG has agreed, among other things, to continue to cooperate with the above named authorities in any litigation, ongoing investigations or other proceedings relating to or arising from their investigations into these matters. In connection with the settlements, the Company has agreed with the USAO, among other things, to cooperate with the USAO and to maintain and periodically report on the

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

effectiveness of its compliance procedures. The settlement documents include findings and admissions that may adversely affect existing litigation or cause additional litigation and result in adverse publicity and other potentially adverse impacts to the Company's businesses.

In addition to the regulatory proceedings described above that were settled in 2006, in October 2004, the Company and Prudential Securities were named as defendants in several class actions brought on behalf of purchasers and holders of shares in a number of mutual fund complexes. The actions are consolidated as part of a multi-district proceeding, *In re: Mutual Fund Investment Litigation*, pending in the United States District Court for the District of Maryland. The complaints allege that the purchasers and holders were harmed by dilution of the funds' values and excessive fees, caused by market timing and late trading, and seek unspecified damages. In August 2005, the Company was dismissed from several of the actions, without prejudice to repleading the state claims, but remains a defendant in other actions in the consolidated proceeding. In July 2006, in one of the consolidated mutual fund actions, *Saunders v. Putnam American Government Income Fund, et al.*, the United States District Court for the District of Maryland granted plaintiffs leave to refile their federal securities law claims against Prudential Securities. In August 2006, the second amended complaint was filed alleging federal securities law claims on behalf of a purported nationwide class of mutual fund investors seeking compensatory and punitive damages in unspecified amounts. Motions to dismiss the other actions are pending.

Commencing in 2003, the Company received formal requests for information from the SEC and NYAG relating to market timing in variable annuities by certain American Skandia entities. In connection with these investigations, with the approval of Skandia Insurance Company Ltd. (publ) (Skandia), an offer was made by American Skandia to the authorities investigating its companies, the SEC and NYAG, to settle these matters by paying restitution and a civil penalty of \$95 million in the aggregate. While not assured, the Company believes these discussions are likely to lead to settlements with these authorities. Any regulatory settlement involving an American Skandia entity would be subject to the indemnification provisions of the acquisition agreement pursuant to which the Company purchased the American Skandia entities in May 2003 from Skandia. If achieved, settlement of the matters relating to American Skandia also could involve continuing monitoring, changes to and/or supervision of business practices, findings that may adversely affect existing or cause additional litigation, adverse publicity and other adverse impacts to the Company's businesses.

Other

In November 2003, an action was commenced in the United States Bankruptcy Court for the Southern District of New York, *Enron Corp. v. J.P. Morgan Securities, Inc., et al.*, against approximately 100 defendants, including Prudential Insurance and related entities, which invested in Enron's commercial paper. The complaint alleges that Enron's October 2001 prepayment of its commercial paper is a voidable preference under the bankruptcy laws and constitutes a fraudulent conveyance and that the Company and related entities received prepayment of \$125 million. A motion by all defendants to dismiss the complaint was denied in June 2005. Defendants' motions for leave to appeal are pending. In April 2007, the Prudential defendants and Enron agreed to a tentative settlement of the adversary proceeding. The settlement terms are yet to be documented and the final agreement will be subject to court approval before the matter is concluded. In July 2007, the settlement, which involves Prudential and certain other defendants, was submitted to the court for approval. The agreement provides that the Prudential defendants will pay \$16.3 million.

In August 1999, a Prudential Insurance employee and several Prudential Insurance retirees filed an action in the United States District Court for the Southern District of Florida, *Dupree, et al., v. Prudential Insurance, et al.*, against Prudential Insurance and its Board of Directors in

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

connection with a group annuity contract entered into in 1989 between the Prudential Retirement Plan and Prudential Insurance. The suit alleged that the

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

annuitization of certain retirement benefits violated ERISA and that, in the event of demutualization, Prudential Insurance would retain shares distributed under the annuity contract in violation of ERISA's fiduciary duty requirements. In July 2001, plaintiffs filed an amended complaint dropping three counts, and the Company filed an answer denying the essential allegations of the complaint. The amended complaint seeks injunctive and monetary relief, including the return of what are claimed to be excess investment and advisory fees paid by the Retirement Plan to Prudential. In March 2002, the court dismissed certain of the claims against the individual defendants. A non-jury trial was concluded in January 2005. The court has not yet issued its decision.

In September and October 2005, five purported class action lawsuits were filed against the Company, PSI and PEG claiming that stockbrokers were improperly classified as exempt employees under state and federal wage and hour laws, were improperly denied overtime pay and that improper deductions were made from the stockbrokers' wages. Two of the stockbrokers' complaints, *Janowsky v. Wachovia Securities, LLC* and *Prudential Securities Incorporated and Goldstein v. Prudential Financial, Inc.*, were filed in the United States District Court for the Southern District of New York. The *Goldstein* complaint purports to have been filed on behalf of a nationwide class. The *Janowsky* complaint alleges a class of New York brokers. Motions to dismiss and compel arbitration were filed in the *Janowsky and Goldstein* matters, which have been consolidated for pre-trial purposes. The three stockbrokers complaints filed in California Superior Court, *Dewane v. Prudential Equity Group, Prudential Securities Incorporated, and Wachovia Securities LLC*; *DiLustro v. Prudential Securities Incorporated, Prudential Equity Group Inc. and Wachovia Securities*; and *Carayanis v. Prudential Equity Group LLC and Prudential Securities Inc.*, purport to have been brought on behalf of classes of California brokers. The *Carayanis* complaint was subsequently withdrawn without prejudice in May 2006. In June 2006, a purported New York state class action complaint was filed in the United States District Court for the Eastern District of New York, *Panesenko v. Wachovia Securities, et al.*, alleging that the Company failed to pay overtime to stockbrokers in violation of state and federal law and that improper deductions were made from the stockbrokers' wages in violation of state law. In September 2006, Prudential Securities was sued in *Badain v. Wachovia Securities, et al.*, a purported nationwide class action filed in the United States District Court for the Western District of New York. The complaint alleges that Prudential Securities failed to pay overtime to stockbrokers in violation of state and federal law and that improper deductions were made from the stockbrokers' wages in violation of state law. 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 the Company failed to pay overtime to insurance agents who were registered representatives in violation of federal and state law, and that improper deductions were made from these agents' wages in violation of state law. In December 2006, the stockbrokers' cases were transferred to the United States District Court for the Central District of California by the Judicial Panel on Multidistrict Litigation for coordinated or consolidated pre-trial proceedings. The complaints seek back overtime pay and statutory damages, recovery of improper deductions, interest, and attorneys' fees.

In November 1996, plaintiffs filed a purported class action lawsuit against Prudential Insurance, the Prudential Home Mortgage Company, Inc. and several other subsidiaries in the Superior Court of New Jersey, Essex County, *Capitol Life Insurance Company v. Prudential Insurance, et al.*, in connection with the sale of certain subordinated mortgage securities sold by a subsidiary of Prudential Home Mortgage. In May 2000, plaintiffs filed a second amended complaint that alleges violations of the New Jersey securities and RICO statutes, fraud, conspiracy and negligent misrepresentation, and seeks compensatory as well as treble and punitive damages. In 2002, class certification was denied. In August 2005, the court dismissed the New Jersey Securities Act and RICO claims and the negligent misrepresentation claim. In February 2007, the matter settled in principle. In April 2007, the matter settled for \$7.5 million.

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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 results of operations or cash flow of the Company in a particular quarterly or annual period could be materially affected by an ultimate unfavorable resolution of pending litigation and regulatory matters depending, in part, upon the results of operations or cash flow for such period. Management believes, however, that the ultimate outcome of all pending litigation and regulatory matters, after consideration of applicable reserves and rights to indemnification, should not have a material adverse effect on the Company's financial position.

10. SUBSEQUENT EVENTS

Sale of Oppenheim Joint Ventures

On July 12, 2007, the Company sold its 50% interest in its operating joint ventures Oppenheim Pramerica Fonds Trust GmbH and Oppenheim Pramerica Asset Management S.a.r.l., which the Company accounts for under the equity method, to its partner Oppenheim S.C.A. for \$121 million. These businesses establish, package and distribute mutual fund products to German and other European retail investors. The Company estimates it will record a pre-tax gain on sale of \$38 million and related taxes of \$23 million, of which \$9 million was recorded in the second quarter of 2007 related to a change in the repatriation assumptions for this investment. The gain on sale will be reflected in the results of operation of our International Investment segment in the third quarter of 2007.

Election of the Lookback Option in relation to Wachovia Securities pending acquisition of A.G. Edwards

On July 1, 2003, the Company combined its retail securities brokerage and clearing operations with those of Wachovia Corporation (Wachovia) and formed Wachovia Securities Financial Holdings, LLC (Wachovia Securities), a joint venture headquartered in Richmond, Virginia. The Company currently has a 38% ownership interest in the joint venture, while Wachovia owns the remaining 62%. The Company accounts for its 38% ownership of the joint venture under the equity method of accounting.

On May 31, 2007, Wachovia announced an agreement under which Wachovia proposes to acquire, among other things, the retail securities brokerage business of A.G. Edwards, Inc. (A.G. Edwards), which would be combined with the retail securities brokerage business of Wachovia Securities. Wachovia has stated that under the agreement A.G. Edwards shareholders would receive a combination of Wachovia common stock and cash which, based on Wachovia's share price at the close of business on May 30, 2007, would be valued at \$6.9 billion. Wachovia has stated that it plans to complete the acquisition of the A.G. Edwards business in the fourth quarter of 2007.

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

On July 6, 2007, the Board of Directors of the Company approved the election by the Company of the lookback option under the terms of the agreements relating to the joint venture. The lookback option permits the Company to delay for two years following the combination of the A.G. Edwards business with Wachovia Securities the Company's decision to make or not to make an additional capital contribution to the joint venture or other payments to avoid or limit dilution of its ownership interest in the joint venture. During this lookback period, the Company's share in the earnings of the joint venture and one-time costs associated with the combination of A.G. Edwards with Wachovia Securities will be based on the Company's diluted ownership level. Any capital contribution or other payment at the end of the lookback period to restore all or part of the Company's ownership interest in the joint venture would be based on the appraised value of the existing joint venture and the A.G. Edwards business as of the date of the combination of the A.G. Edwards business with

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

Wachovia Securities. In such event, the Company would also need to make a true-up payment of one-time costs to reflect the incremental increase in its ownership interest in the joint venture. Alternatively, the Company may at the end of the lookback period put its joint venture interests to Wachovia based on the appraised value of the joint venture, excluding the A.G. Edwards business, as of the date of the combination of the A.G. Edwards business with Wachovia Securities.

At the time of the combination of the A.G. Edwards business with Wachovia Securities, the Company expects to adjust the carrying value for accounting purposes of its ownership interest in the joint venture to reflect the addition of that business and the initial dilution of its ownership level and to record the initial value of the above described rights under the lookback option. The Company expects that the value to be recognized for the foregoing items will be credited net of tax directly to Additional paid-in capital.

The Company also retains its separate right to put its joint venture interests to Wachovia at any time after July 1, 2008 based on the appraised value of the joint venture, including the A.G. Edwards business, determined pursuant to appraisal procedures carried out following a decision by the Company to exercise this put. However, if in connection with the lookback option the Company elects at the end of the lookback period to make an additional capital contribution or other payment to avoid or limit dilution, the Company may not exercise this put option prior to the first anniversary of the end of the lookback period.

Table of Contents**PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Supplemental Combining Statements of Financial Position****June 30, 2007 and December 31, 2006 (in millions)**

| | June 30, 2007 | | | December 31, 2006 | | |
|--|-------------------------------------|-----------------------------|-------------------|-------------------------------------|-----------------------------|-------------------|
| | Financial Services Businesses | Closed Block Business | Consolidated | Financial Services Businesses | Closed Block Business | Consolidated |
| ASSETS | | | | | | |
| Fixed maturities: | | | | | | |
| Available for sale, at fair value | \$ 109,665 | \$ 48,224 | \$ 157,889 | \$ 112,043 | \$ 50,773 | \$ 162,816 |
| Held to maturity, at amortized cost | 3,370 | | 3,370 | 3,469 | | 3,469 |
| Trading account assets supporting insurance liabilities, at fair value | 14,069 | | 14,069 | 14,262 | | 14,262 |
| Other trading account assets, at fair value | 2,100 | 13 | 2,113 | 2,209 | | 2,209 |
| Equity securities, available for sale, at fair value | 4,588 | 4,097 | 8,685 | 4,331 | 3,772 | 8,103 |
| Commercial loans | 19,852 | 7,227 | 27,079 | 18,421 | 7,318 | 25,739 |
| Policy loans | 3,642 | 5,400 | 9,042 | 3,472 | 5,415 | 8,887 |
| Securities purchased under agreements to resell | 198 | | 198 | 153 | | 153 |
| Other long-term investments | 4,430 | 914 | 5,344 | 3,780 | 965 | 4,745 |
| Short-term investments | 5,421 | 2,376 | 7,797 | 3,183 | 1,851 | 5,034 |
| Total investments | 167,335 | 68,251 | 235,586 | 165,323 | 70,094 | 235,417 |
| Cash and cash equivalents | 5,584 | 887 | 6,471 | 7,243 | 1,346 | 8,589 |
| Accrued investment income | 1,432 | 672 | 2,104 | 1,429 | 713 | 2,142 |
| Reinsurance recoverables | 2,127 | | 2,127 | 1,958 | | 1,958 |
| Deferred policy acquisition costs | 10,404 | 991 | 11,395 | 9,854 | 1,009 | 10,863 |
| Other assets | 15,603 | 1,124 | 16,727 | 16,997 | 837 | 17,834 |
| Separate account assets | 187,403 | | 187,403 | 177,463 | | 177,463 |
| TOTAL ASSETS | \$ 389,888 | \$ 71,925 | \$ 461,813 | \$ 380,267 | \$ 73,999 | \$ 454,266 |
| LIABILITIES AND ATTRIBUTED EQUITY | | | | | | |
| LIABILITIES | | | | | | |
| Future policy benefits | \$ 55,692 | \$ 50,901 | \$ 106,593 | \$ 56,245 | \$ 50,706 | \$ 106,951 |
| Policyholders' account balances | 75,606 | 5,552 | 81,158 | 75,090 | 5,562 | 80,652 |
| Policyholders' dividends | 552 | 2,773 | 3,325 | 526 | 3,456 | 3,982 |
| Reinsurance payables | 1,556 | | 1,556 | 1,458 | | 1,458 |
| Securities sold under agreements to repurchase | 5,146 | 4,635 | 9,781 | 5,747 | 5,734 | 11,481 |
| Cash collateral for loaned securities | 4,497 | 3,059 | 7,556 | 4,082 | 3,283 | 7,365 |
| Income taxes | 2,746 | 176 | 2,922 | 2,920 | 188 | 3,108 |
| Securities sold but not yet purchased | 267 | | 267 | 277 | | 277 |
| Short-term debt | 11,533 | 1,414 | 12,947 | 10,798 | 1,738 | 12,536 |
| Long-term debt | 9,401 | 1,750 | 11,151 | 9,673 | 1,750 | 11,423 |
| Other liabilities | 13,771 | 440 | 14,211 | 14,298 | 380 | 14,678 |
| Separate account liabilities | 187,403 | | 187,403 | 177,463 | | 177,463 |
| Total liabilities | 368,170 | 70,700 | 438,870 | 358,577 | 72,797 | 431,374 |
| COMMITMENTS AND CONTINGENT LIABILITIES | | | | | | |
| ATTRIBUTED EQUITY | | | | | | |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

| | | | | | | |
|--|-------------------|------------------|-------------------|-------------------|------------------|-------------------|
| Accumulated other comprehensive income (loss) | (117) | (31) | (148) | 496 | 23 | 519 |
| Other attributed equity | 21,835 | 1,256 | 23,091 | 21,194 | 1,179 | 22,373 |
| Total attributed equity | 21,718 | 1,225 | 22,943 | 21,690 | 1,202 | 22,892 |
| TOTAL LIABILITIES AND ATTRIBUTED EQUITY | \$ 389,888 | \$ 71,925 | \$ 461,813 | \$ 380,267 | \$ 73,999 | \$ 454,266 |

See Notes to Unaudited Interim Supplemental Combining Financial Information

Table of Contents**PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Supplemental Combining Statements of Operations****For the three months ended June 30, 2007 and 2006 (in millions)**

| | Three Months Ended June 30, | | | | | |
|---|-------------------------------------|-------------------------------------|---------------|-------------------------------------|-------------------------------------|---------------|
| | Financial Services Businesses | 2007 Closed Block Business | Consolidated | Financial Services Businesses | 2006 Closed Block Business | Consolidated |
| REVENUES | | | | | | |
| Premiums | \$ 2,684 | \$ 945 | \$ 3,629 | \$ 2,558 | \$ 957 | \$ 3,515 |
| Policy charges and fee income | 785 | | 785 | 674 | | 674 |
| Net investment income | 2,078 | 946 | 3,024 | 1,877 | 906 | 2,783 |
| Realized investment gains, net | 125 | (8) | 117 | (290) | (28) | (318) |
| Asset management fees and other income | 860 | 10 | 870 | 645 | 14 | 659 |
| Total revenues | 6,532 | 1,893 | 8,425 | 5,464 | 1,849 | 7,313 |
| BENEFITS AND EXPENSES | | | | | | |
| Policyholders' benefits | 2,659 | 1,074 | 3,733 | 2,564 | 1,072 | 3,636 |
| Interest credited to policyholders' account balances | 690 | 35 | 725 | 547 | 35 | 582 |
| Dividends to policyholders | 29 | 576 | 605 | 22 | 503 | 525 |
| General and administrative expenses | 2,026 | 193 | 2,219 | 1,786 | 201 | 1,987 |
| Total benefits and expenses | 5,404 | 1,878 | 7,282 | 4,919 | 1,811 | 6,730 |
| INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES | | | | | | |
| | 1,128 | 15 | 1,143 | 545 | 38 | 583 |
| Income tax expense | 320 | 4 | 324 | 156 | 9 | 165 |
| INCOME FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES | | | | | | |
| | 808 | 11 | 819 | 389 | 29 | 418 |
| Equity in earnings of operating joint ventures, net of taxes | 56 | | 56 | 45 | | 45 |
| INCOME FROM CONTINUING OPERATIONS | | | | | | |
| | 864 | 11 | 875 | 434 | 29 | 463 |
| Loss from discontinued operations, net of taxes | (29) | | (29) | (10) | | (10) |
| NET INCOME | \$ 835 | \$ 11 | \$ 846 | \$ 424 | \$ 29 | \$ 453 |

See Notes to Unaudited Interim Supplemental Combining Financial Information

Table of Contents**PRUDENTIAL FINANCIAL, INC.****Unaudited Interim Supplemental Combining Statements of Operations**

For the six months ended June 30, 2007 and 2006 (in millions)

| | Six Months Ended June 30, | | | | | |
|---|-------------------------------------|-------------------------------------|-----------------|-------------------------------------|-------------------------------------|-----------------|
| | Financial Services Businesses | 2007 Closed Block Business | Consolidated | Financial Services Businesses | 2006 Closed Block Business | Consolidated |
| REVENUES | | | | | | |
| Premiums | \$ 5,405 | \$ 1,783 | \$ 7,188 | \$ 5,164 | \$ 1,803 | \$ 6,967 |
| Policy charges and fee income | 1,570 | | 1,570 | 1,338 | | 1,338 |
| Net investment income | 4,135 | 1,879 | 6,014 | 3,691 | 1,838 | 5,529 |
| Realized investment gains, net | 338 | 199 | 537 | (175) | 32 | (143) |
| Asset management fees and other income | 1,868 | 23 | 1,891 | 1,382 | 27 | 1,409 |
| Total revenues | 13,316 | 3,884 | 17,200 | 11,400 | 3,700 | 15,100 |
| BENEFITS AND EXPENSES | | | | | | |
| Policyholders' benefits | 5,395 | 2,023 | 7,418 | 5,111 | 2,004 | 7,115 |
| Interest credited to policyholders' account balances | 1,497 | 71 | 1,568 | 1,134 | 71 | 1,205 |
| Dividends to policyholders | 57 | 1,259 | 1,316 | 42 | 1,106 | 1,148 |
| General and administrative expenses | 3,949 | 379 | 4,328 | 3,691 | 397 | 4,088 |
| Total benefits and expenses | 10,898 | 3,732 | 14,630 | 9,978 | 3,578 | 13,556 |
| INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES | | | | | | |
| | 2,418 | 152 | 2,570 | 1,422 | 122 | 1,544 |
| Income tax expense | 699 | 48 | 747 | 407 | 35 | 442 |
| INCOME FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES | | | | | | |
| | 1,719 | 104 | 1,823 | 1,015 | 87 | 1,102 |
| Equity in earnings of operating joint ventures, net of taxes | 133 | | 133 | 96 | | 96 |
| INCOME FROM CONTINUING OPERATIONS | | | | | | |
| Income (loss) from discontinued operations, net of taxes | 1,852 | 104 | 1,956 | 1,111 | 87 | 1,198 |
| | 8 | 2 | 10 | (12) | | (12) |
| NET INCOME | \$ 1,860 | \$ 106 | \$ 1,966 | \$ 1,099 | \$ 87 | \$ 1,186 |

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 4 to the Unaudited Interim Consolidated Financial Statements for a description of the Closed Block). It also includes assets held outside the Closed Block necessary to meet insurance regulatory capital requirements related to products included within the Closed Block; deferred policy acquisition costs related to the Closed Block policies; the principal amount of the IHC debt (as discussed in Note 2 below) and related unamortized debt issuance costs, as well as an interest rate swap related to the IHC debt; and certain other related assets and liabilities. The Financial Services Businesses consist of the Insurance, Investment, and International Insurance and Investments divisions and Corporate and Other operations.

2. ALLOCATION OF RESULTS

This supplemental combining financial information reflects the assets, liabilities, revenues and expenses directly attributable to the Financial Services Businesses and the Closed Block Business, as well as allocations deemed reasonable by management in order to fairly present the financial position and results of operations of 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.

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

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Supplemental Combining Financial Information (Continued)

business. If a business generates benefits, such as net operating losses, it is entitled to record such tax benefits to the extent they are expected to be utilized on a consolidated basis.

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

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

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

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) addresses the consolidated financial condition of Prudential Financial as of June 30, 2007, compared with December 31, 2006, and its consolidated results of operations for the three and six months ended June 30, 2007 and June 30, 2006. 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, 2006, as well as the statements under Forward-Looking Statements and the Unaudited Interim Consolidated Financial Statements included elsewhere in this Quarterly Report on Form 10-Q.

Overview

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

Financial Services Businesses

Our Financial Services Businesses consist of three operating divisions, which together encompass eight segments, and our Corporate and Other operations. The Insurance division consists of our Individual Life, Individual Annuities and Group Insurance segments. The Investment division consists of our Asset Management, Financial Advisory and Retirement segments. The International Insurance and Investments division consists of our International Insurance and International Investments segments. Our Corporate and Other operations include our real estate and relocation services business, as well as corporate items and initiatives that are not allocated to business segments. Corporate and Other operations also include businesses that have been or will be divested and businesses that we have placed in wind-down status.

We attribute financing costs to each segment based on the amount of financing used by each segment, excluding financing costs associated with corporate debt. The net investment income of each segment includes earnings on the amount of equity that management believes is necessary to support the risks of that segment.

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

Closed Block Business

In connection with the demutualization, we ceased offering domestic participating products. The liabilities for our traditional domestic in force participating products were segregated, together with assets, in a regulatory mechanism referred to as the Closed Block. The Closed Block is

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

designed generally to provide for the reasonable expectations for future policy dividends after demutualization of holders of participating individual life insurance policies and annuities included in the Closed Block by allocating assets that will be used exclusively for payment of benefits, including policyholder dividends, expenses and taxes with respect to these products. See Note 4 to the Unaudited Interim Consolidated Financial Statements for more information on the Closed Block. At the time of demutualization, we determined the amount of Closed Block assets so that the Closed Block assets initially had a lower book value than the Closed Block liabilities. We expect that the Closed Block assets will generate sufficient cash flow, together with anticipated revenues from the Closed Block policies, over the life of the Closed Block to fund payments of all expenses, taxes, and policyholder benefits to be paid to, and the reasonable dividend expectations of, holders of the Closed Block policies. We also segregated for accounting purposes the assets that we need to hold outside the Closed Block to meet capital requirements related

Table of Contents

to the Closed Block policies. No policies sold after demutualization will be added to the Closed Block, and its in force business is expected to ultimately decline as we pay policyholder benefits in full. We also expect the proportion of our business represented by the Closed Block to decline as we grow other businesses.

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

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

Executive Summary

Prudential Financial, one of the largest financial services companies in the U.S., offers individual and institutional clients a wide array of financial products and services, including life insurance, annuities, mutual funds, pension and retirement-related services and administration, investment management, banking and trust services, real estate brokerage and relocation services, and, through a joint venture, retail securities brokerage services. We offer these products and services through one of the largest distribution networks in the financial services industry.

The first six months of 2007 reflect our continued efforts to redeploy capital effectively to seek enhanced returns, including the continuation of our share repurchase program. In the first six months of 2007, we repurchased 16.0 million shares of Common Stock at a total cost of \$1.5 billion and are authorized, under a stock repurchase program authorized by Prudential Financial's Board of Directors in November 2006, to repurchase up to an additional \$1.5 billion of Common Stock during 2007.

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 for a definition of adjusted operating income and a discussion of 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, 2007 and 2006 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, | |
|--|--------------------------------|--------|------------------------------|----------|
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | | |
| Adjusted operating income before income taxes for segments of the Financial Services Businesses: | | | | |
| Individual Life | \$ 141 | \$ 96 | \$ 242 | \$ 229 |
| Individual Annuities | 180 | 122 | 346 | 240 |
| Group Insurance | 69 | 29 | 120 | 76 |
| Asset Management | 190 | 137 | 374 | 306 |
| Financial Advisory | 72 | 30 | 169 | (77) |
| Retirement | 138 | 142 | 286 | 279 |
| International Insurance | 412 | 324 | 825 | 662 |
| International Investments | 43 | 34 | 105 | 78 |
| Corporate and Other | (8) | 40 | 1 | 56 |
| Reconciling Items: | | | | |
| Realized investment gains (losses), net, and related adjustments | 39 | (334) | 185 | (284) |
| Charges related to realized investment gains (losses), net | (7) | 23 | (13) | 23 |
| Investment gains (losses) on trading account assets supporting insurance liabilities, net | (108) | (151) | (26) | (265) |
| Change in experience-rated contractholder liabilities due to asset value changes | 72 | 130 | 10 | 196 |
| Divested businesses | (5) | (10) | 14 | 48 |
| Equity in earnings of operating joint ventures | (100) | (67) | (220) | (145) |
| Income from continuing operations before income taxes and equity in earnings of operating joint ventures for Financial Services Businesses | 1,128 | 545 | 2,418 | 1,422 |
| Income from continuing operations before income taxes and equity in earnings of operating joint ventures for Closed Block Business | 15 | 38 | 152 | 122 |
| Consolidated income from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ 1,143 | \$ 583 | \$ 2,570 | \$ 1,544 |

Results for the three and six months ended June 30, 2007 presented above reflect the following:

Individual Life segment results for the second quarter of 2007 increased from the second quarter of 2006 primarily due to more favorable mortality experience, net of reinsurance, as well as a net reduction in amortization of deferred policy acquisition costs and other costs reflecting more favorable separate account fund performance and policy persistency as compared to the prior year period. Results for the first six months of 2007 increased from the first six months of 2006 primarily due to a net reduction in amortization of deferred policy acquisition costs and other costs reflecting more favorable separate account fund performance and policy persistency.

Individual Annuities segment results increased in both the second quarter and the first six months of 2007 due to higher fee income reflecting higher average variable annuity asset balances as well as a greater contribution from the variable annuity business acquired from The Allstate Corporation, for which prior year period results reflect operations from the June 1, 2006 date of acquisition.

Table of Contents

Group Insurance segment results increased in both the second quarter and first six months of 2007 primarily driven by more favorable claims experience in our group life business.

Asset Management segment results increased in both the second quarter and the first six months of 2007 primarily reflecting higher asset management fees as a result of increased asset values due to market appreciation and net asset flows and increased performance-based fees primarily related to real estate investment management. Results for the second quarter of 2007 also benefited from increased income from the segment's commercial mortgage operations.

Financial Advisory segment results for the second quarter of 2007 increased from the second quarter of 2006 primarily due to higher income from our 38% share of the retail brokerage joint venture with Wachovia reflecting the venture's greater income from commissions and fees. Results for the first six months of 2007 increased from the first six months of 2006 due to lower expenses related to obligations and costs we retained in connection with businesses contributed to the joint venture, as well as higher income from our share of the joint venture.

Retirement segment results for the second quarter and first six months of 2007 were relatively unchanged from the corresponding prior year periods. The effect of a lower benefit from reserve refinements due to updates of client census data and lower mortgage prepayment income in the 2007 periods largely offset improved investment results from a larger base of invested assets in our institutional investment products business. Growth in fee income due to higher full service retirement account balances was largely offset by increased expenses to expand our full service retirement capabilities.

International Insurance segment results for the second quarter and first six months of 2007 improved in comparison to the corresponding prior year periods, with increases in adjusted operating income from the segment's Life Planner and Gibraltar Life operations. Life Planner results benefited from continued business growth, increased investment income margins, and more favorable foreign currency exchange rates. Results from the segment's Gibraltar Life operation benefited from improved investment income margins reflecting investment portfolio strategies and growth in our U.S. dollar denominated annuity product, together with income of \$14 million from a single investment joint venture transaction in the second quarter of 2007, while results for the second quarter and first half of 2006 reflected refinements of policy liabilities which resulted in a \$17 million reduction of adjusted operating income.

International Investments segment results improved in both the second quarter and first six months of 2007 primarily due to more favorable results in our asset management businesses, principally in our Korean operations.

Realized investment gains (losses), net, and related adjustments for the Financial Services Businesses in the second quarter and first six months of 2007 amounted to \$39 million and \$185 million, respectively, reflecting in both periods net gains on sales of equity securities primarily by our Japanese and Korean insurance operations.

Income from continuing operations before income taxes and equity in earnings of operating joint ventures in the Closed Block Business decreased \$23 million in the second quarter of 2007 compared to the second quarter of 2006, reflecting an increase in net investment income and net realized investment gains, which was more than offset by the resulting increase in the cumulative earnings policyholder dividend obligation expense. Income from continuing operations before income taxes and equity in earnings of operating joint ventures in the Closed Block Business increased \$30 million for the first six months of 2007 compared to the first six months of 2006, reflecting an increase in net realized investment gains, partially offset by the resulting increase in the cumulative earnings policyholder dividend obligation expense.

Table of Contents

Accounting Policies & Pronouncements

Application of Critical Accounting Estimates

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

Management believes the accounting policies relating to the following areas are most dependent on the application of estimates and assumptions:

Valuation of investments;

Policyholder liabilities;

Deferred policy acquisition costs;

Goodwill;

Pension and other postretirement benefits;

Taxes on income; and

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

A discussion of each of these critical accounting estimates may be found in our Annual Report on Form 10-K for the year ended December 31, 2006, under Management's Discussion and Analysis of Financial Condition and Results of Operations Accounting Policies and Pronouncements Application of Critical Accounting Estimates.

Accounting Pronouncements Adopted

See Note 2 to the Unaudited Interim Consolidated Financial Statements for a discussion of recently adopted accounting pronouncements, including the effect of adopting FASB Staff Position No. 13-2, Accounting for a Change or Projected Change in the Timing of Cash Flows

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Relating to Income Taxes Generated by a Leveraged Lease Transaction , AICPA Statement of Position 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection With Modifications or Exchanges of Insurance Contracts, and FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes.

Recent Accounting Pronouncements

See Note 2 to the Unaudited Interim Consolidated Financial Statements for a discussion of recently issued accounting pronouncements.

Table of Contents**Consolidated Results of Operations**

The following table summarizes income from continuing operations for the Financial Services Businesses and the Closed Block Business as well as other components comprising net income.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|---------------|------------------------------|-----------------|
| | 2007 | 2006 | 2007 | 2006 |
| (in millions) | | | | |
| Financial Services Businesses by segment: | | | | |
| Individual Life | \$ 145 | \$ 63 | \$ 234 | \$ 181 |
| Individual Annuities | 180 | 92 | 338 | 204 |
| Group Insurance | 67 | 11 | 132 | 65 |
| Total Insurance Division | 392 | 166 | 704 | 450 |
| Asset Management | 186 | 137 | 372 | 306 |
| Financial Advisory | (21) | (30) | (35) | (206) |
| Retirement | 48 | 42 | 206 | 126 |
| Total Investment Division | 213 | 149 | 543 | 226 |
| International Insurance | 430 | 278 | 977 | 642 |
| International Investments | 34 | 27 | 87 | 63 |
| Total International Insurance and Investments Division | 464 | 305 | 1,064 | 705 |
| Corporate and Other | 59 | (75) | 107 | 41 |
| Income from continuing operations before income taxes and equity in earnings of operating joint ventures for Financial Services Businesses | 1,128 | 545 | 2,418 | 1,422 |
| Income tax expense | 320 | 156 | 699 | 407 |
| Income from continuing operations before equity in earnings of operating joint ventures for Financial Services Businesses | 808 | 389 | 1,719 | 1,015 |
| Equity in earnings of operating joint ventures, net of taxes | 56 | 45 | 133 | 96 |
| Income from continuing operations for Financial Services Businesses | 864 | 434 | 1,852 | 1,111 |
| Income (loss) from discontinued operations, net of taxes | (29) | (10) | 8 | (12) |
| Net income - Financial Services Businesses | \$ 835 | \$ 424 | \$ 1,860 | \$ 1,099 |
| Basic income from continuing operations per share - Common Stock | \$ 1.89 | \$ 0.92 | \$ 4.04 | \$ 2.33 |
| Diluted income from continuing operations per share - Common Stock | \$ 1.86 | \$ 0.91 | \$ 3.96 | \$ 2.29 |
| Basic net income per share - Common Stock | \$ 1.83 | \$ 0.90 | \$ 4.05 | \$ 2.31 |
| Diluted net income per share - Common Stock | \$ 1.80 | \$ 0.89 | \$ 3.98 | \$ 2.27 |
| Closed Block Business: | | | | |
| Income from continuing operations before income taxes for Closed Block Business | \$ 15 | \$ 38 | \$ 152 | \$ 122 |
| Income tax expense | 4 | 9 | 48 | 35 |
| Income from continuing operations for Closed Block Business | 11 | 29 | 104 | 87 |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

| | | | | |
|---|-----------|---------|----------|----------|
| Income (loss) from discontinued operations, net of taxes | | | | 2 |
| Net income Closed Block Business | \$ 11 | \$ 29 | \$ 106 | \$ 87 |
| Basic and diluted income from continuing operations per share Class B Stock | \$ (1.50) | \$ 6.50 | \$ 37.50 | \$ 26.00 |
| Basic and diluted net income per share Class B Stock | \$ (1.50) | \$ 6.50 | \$ 38.50 | \$ 26.00 |
| Consolidated: | | | | |
| Net income | \$ 846 | \$ 453 | \$ 1,966 | \$ 1,186 |

Table of Contents**Results of Operations Financial Services Businesses**

2007 to 2006 Three Month Comparison. Income from continuing operations attributable to the Financial Services Businesses increased \$430 million, from \$434 million in the second quarter of 2006 to \$864 million in the second quarter of 2007. This increase resulted primarily from continued growth of our international insurance operations and improved results from our domestic businesses, including the benefit of higher asset based fees and improved investment results. On a diluted per share basis, income from continuing operations attributable to the Financial Services Businesses for the three months ended June 30, 2007 of \$1.86 per share of Common Stock increased from \$0.91 per share of Common Stock for the three months ended June 30, 2006. This increase reflects the growth in earnings discussed above, in addition to the benefit of a lower number of shares of Common Stock outstanding due to our share repurchase program. We analyze the operating performance of the segments included in the Financial Services Businesses using adjusted operating income as described in Segment Measures, below. For a discussion of our segment results on this basis see Results of Operations for Financial Services Businesses by Segment, below. In addition, for a discussion of the realized investment gains (losses), net attributable to the Financial Services Businesses, see Realized Investment Gains and General Account Investments Realized Investment Gains, below.

The direct equity adjustment increased income from continuing operations available to holders of the Common Stock for earnings per share purposes by \$14 million for the three months ended June 30, 2007, compared to \$16 million for the three months ended June 30, 2006. The direct equity adjustment modifies earnings available to holders of the Common Stock and the Class B Stock for earnings per share purposes. The holders of the Common Stock will benefit from the direct equity adjustment as long as reported administrative expenses of the Closed Block Business are less than the cash flows for administrative expenses determined by the policy servicing fee arrangement that is based upon insurance and policies in force and statutory cash premiums. As statutory cash premiums and policies in force in the Closed Block Business decline, we expect the benefit to the Common Stock holders from the direct equity adjustment to decline accordingly. If the reported administrative expenses of the Closed Block Business exceed the cash flows for administrative expenses determined by the policy servicing fee arrangement, the direct equity adjustment will reduce income available to holders of the Common Stock for earnings per share purposes.

2007 to 2006 Six Month Comparison. Income from continuing operations attributable to the Financial Services Businesses increased \$741 million, from \$1.111 billion in the first six months of 2006 to \$1.852 billion in the first six months of 2007. This increase resulted primarily from continued growth of our international insurance operations and improved results from our domestic businesses, including the benefit of higher asset based fees, improved investment results, and a greater contribution from the variable annuity business acquired from The Allstate Corporation, for which the prior year period includes results from only the June 1, 2006 date of acquisition. In addition, the first six months of 2007 include lower retained costs in connection with our joint venture with Wachovia.

The direct equity adjustment increased income from continuing operations available to holders of the Common Stock for earnings per share purposes by \$29 million for the six months ended June 30, 2007, compared to \$35 million for the six months ended June 30, 2006.

Results of Operations Closed Block Business

2007 to 2006 Three Month Comparison. Income from continuing operations attributable to the Closed Block Business for the three months ended June 30, 2007, was \$11 million, or \$(1.50) per share of Class B Stock, compared to \$29 million, or \$6.50 per share of Class B Stock, for the three months ended June 30, 2006. The direct equity adjustment decreased income from continuing operations available to the Class B Stock holders for earnings per share purposes by \$14 million for the three months ended June 30, 2007, compared to \$16 million

Table of Contents

for the three months ended June 30, 2006. For a discussion of the results of operations for the Closed Block Business, see Results of Operations of Closed Block Business, below.

2007 to 2006 Six Month Comparison. Income from continuing operations attributable to the Closed Block Business for the six months ended June 30, 2007, was \$104 million, or \$37.50 per share of Class B stock, compared to \$87 million, or \$26.00 per share of Class B Stock, for the six months ended June 30, 2006. The direct equity adjustment decreased income from continuing operations available to the Class B Stock holders for earnings per share purposes by \$29 million for the six months ended June 30, 2007, compared to \$35 million for the six months ended June 30, 2006.

Segment Measures

In managing our business, we analyze operating performance separately for our Financial Services Businesses and our Closed Block Business. For the Financial Services Businesses, we analyze our segments' operating performance using adjusted operating income. Results of the Closed Block Business for all periods are evaluated and presented only in accordance with U.S. GAAP. Adjusted operating income does not equate to income 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 SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, is our measure of segment performance. Adjusted operating income is calculated for the segments of the Financial Services Businesses by adjusting each segment's income from continuing operations before income taxes and equity in earnings of operating joint ventures for the following items:

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

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

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

equity in earnings of operating joint ventures.

The items above 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. Adjusted operating income excludes Realized investment gains (losses), net, except as indicated below, and related charges and adjustments. A significant element of realized investment gains and losses are impairments and credit-related and interest rate-related gains and losses. Impairments and losses from sales of credit-impaired securities, the timing of which depends largely on market credit cycles, can vary considerably across periods. The timing of other sales that would result in gains or losses, such as interest rate-related gains or losses, is largely subject to our discretion and influenced by market opportunities, as well as our tax profile. Trends in the underlying profitability of our businesses can be more clearly identified without the fluctuating effects of these transactions. Similarly, adjusted operating income excludes investment gains and losses on trading account assets supporting insurance liabilities and changes in experience-rated contractholder liabilities due to asset value changes, because these recorded changes in asset and liability values will ultimately accrue to the contractholders. Adjusted operating income excludes the results of divested businesses because they are not relevant to understanding our ongoing operating results. The contributions to income/loss of wind-down businesses that we have not divested remain in adjusted operating income. See Note 8 to the

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Unaudited Interim Consolidated Financial Statements for further information on the presentation of segment results.

Table of Contents

As noted above, certain Realized investment gains (losses), net, are included in adjusted operating income. We include in adjusted operating income the portion of our realized investment gains and losses on derivatives that arise from the termination of contracts used to hedge our foreign currency earnings in the same period that the expected earnings emerge. Similarly, we include in adjusted operating income the portion of our realized investment gains and losses on derivatives that represent current period yield adjustments. The realized investment gains or losses from products that are free standing derivatives, or contain embedded derivatives, along with the realized investment gains or losses from associated derivative portfolios that are part of an economic hedging program related to the risk of these products, are included in adjusted operating income. Adjusted operating income also includes for certain embedded derivatives, as current period yield adjustments, a portion of the cumulative realized investment gains, on an amortized basis over the remaining life of the related security, or cumulative realized investment losses in the period incurred. Adjusted operating income also includes those realized investment gains and losses that represent profit or loss of certain of our businesses which primarily originate investments for sale or syndication to unrelated investors.

Results of Operations for Financial Services Businesses by Segment**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, | |
|--|--------------------------------|--------|------------------------------|----------|
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | | |
| Operating results: | | | | |
| Revenues | \$ 629 | \$ 585 | \$ 1,260 | \$ 1,144 |
| Benefits and expenses | 488 | 489 | 1,018 | 915 |
| Adjusted operating income | 141 | 96 | 242 | 229 |
| Realized investment gains (losses), net, and related adjustments(1) | 4 | (33) | (8) | (48) |
| Income from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ 145 | \$ 63 | \$ 234 | \$ 181 |

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

Adjusted Operating Income

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

2007 to 2006 Three Month Comparison. Adjusted operating income increased \$45 million, from \$96 million in the second quarter of 2006 to \$141 million in the second quarter of 2007. The increase in adjusted operating income primarily reflects more favorable mortality experience, net of reinsurance, compared to the second quarter of the prior year as well as a net reduction in amortization of deferred policy acquisition costs net of related amortization of unearned revenue reserves reflecting more favorable separate account fund performance and policy persistency in the second quarter of 2007 as compared to the second quarter of 2006.

2007 to 2006 Six Month Comparison. Adjusted operating income increased \$13 million, from \$229 million in the first six months of 2006 to \$242 million in the first six months of 2007. The increase in adjusted operating

Table of Contents

income primarily reflects a net reduction in amortization of deferred policy acquisition costs net of related amortization of unearned revenue reserves reflecting more favorable separate account fund performance and policy persistency in the first six months of 2007 as compared to the first six months of 2006, as well as higher fees resulting from higher asset balances reflecting market value changes. Mortality experience, net of reinsurance, was slightly less favorable compared to the first six months of 2006.

Revenues

2007 to 2006 Three Month Comparison. Revenues, as shown in the table above under Operating Results, increased by \$44 million, from \$585 million in the second quarter of 2006 to \$629 million in the second quarter of 2007. Premiums increased \$23 million, primarily due to increased premiums on term life insurance reflecting continued growth of our in force block of term insurance. Net investment income increased \$25 million, reflecting higher asset balances primarily from financing of regulatory reserves discussed below and higher yields in the second quarter of 2007. Policy charges and fee income decreased \$6 million, reflecting the decrease in amortization of unearned revenue reserves discussed above.

2007 to 2006 Six Month Comparison. Revenues increased by \$116 million, from \$1.144 billion in the first six months of 2006 to \$1.260 billion in the first six months of 2007. Premiums increased \$49 million, primarily due to increased premiums on term life insurance reflecting continued growth of our in force block of term insurance. Net investment income increased \$54 million, reflecting higher asset balances primarily from financing of regulatory reserves discussed below and higher yields in the in the first six months of 2007. Asset management fees and other income increased \$13 million, primarily due to higher asset based fees due to higher asset balances reflecting market value changes.

Benefits and Expenses

2007 to 2006 Three Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, were essentially unchanged, from \$489 million in the second quarter of 2006 to \$488 million in the second quarter of 2007. Amortization of deferred policy acquisition costs decreased \$27 million, reflecting favorable separate account fund performance and policy persistency in the second quarter of 2007 as compared to the second quarter of 2006. Offsetting this item was an increase in interest expense of \$19 million, primarily reflecting interest on borrowings related to the financing of regulatory reserves required to be held for certain term and universal life insurance policies, in addition to an increase in reserves on term life insurance associated with growth in our in force block of term insurance.

2007 to 2006 Six Month Comparison. Benefits and expenses increased \$103 million, from \$915 million in the first six months of 2006 to \$1.018 billion in the first six months of 2007. Policyholders' benefits, including interest credited to policyholders' account balances, increased \$88 million, due to less favorable mortality experience, net of reinsurance compared to the first six months of 2006 and increases in reserves on term life insurance associated with growth in our in force block of term insurance. Interest expense increased \$40 million, primarily reflecting interest on borrowings related to the financing of regulatory reserves required to be held for certain term and universal life insurance policies. Partially offsetting these items was a decrease in amortization of deferred policy acquisition costs of \$23 million, reflecting favorable separate account fund performance and policy persistency compared to the first six months of 2006.

Sales Results

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

The following table sets forth individual life insurance business sales, as measured by scheduled premiums from new sales on an annualized basis and first year excess premiums and deposits on a cash-received basis, for the periods indicated. Sales of the individual life insurance business do not correspond to revenues under U.S. GAAP. They are, however, a relevant measure of business activity. In managing our individual life insurance

Table of Contents

business, we analyze new sales on this basis because it measures the current sales performance of the business, while revenues primarily reflect the renewal persistency and aging of in force policies written in prior years and net investment income as well as current sales.

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|------------------|------------------|------------------|
| | 2007 | June 30, 2006 | 2007 | June 30, 2006 |
| (in millions) | | | | |
| Life insurance sales(1): | | | | |
| Excluding corporate-owned life insurance: | | | | |
| Variable life | \$ 19 | \$ 24 | \$ 67 | \$ 45 |
| Universal life | 45 | 43 | 89 | 83 |
| Term life | 54 | 34 | 103 | 65 |
| Total excluding corporate-owned life insurance | 118 | 101 | 259 | 193 |
| Corporate-owned life insurance | 3 | 4 | 8 | 5 |
| Total | \$ 121 | \$ 105 | \$ 267 | \$ 198 |

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|------------------|------------------|------------------|
| | 2007 | June 30, 2006 | 2007 | June 30, 2006 |
| (in millions) | | | | |
| Life insurance sales by distribution channel, excluding corporate-owned life insurance(1): | | | | |
| Prudential Agents | \$ 42 | \$ 45 | \$ 84 | \$ 90 |
| Third party | 76 | 56 | 175 | 103 |
| Total | \$ 118 | \$ 101 | \$ 259 | \$ 193 |

(1) Scheduled premiums from new sales on an annualized basis and first year excess premiums and deposits on a cash-received basis.

2007 to 2006 Three Month Comparison. Sales of new life insurance, excluding corporate-owned life insurance, measured as described above, increased \$17 million, from \$101 million in the second quarter of 2006 to \$118 million in the second quarter of 2007, primarily due to increased sales of term life products of \$20 million.

The increase in sales of life insurance, excluding corporate-owned life insurance, was driven by a \$20 million increase in sales from the third party distribution channel reflecting increased term and universal life sales. The increase was partially offset by decreased sales by Prudential Agents of \$3 million, reflecting a decline in the number of agents from 2,844 at June 30, 2006 to 2,512 at June 30, 2007.

2007 to 2006 Six Month Comparison. Sales of new life insurance, excluding corporate-owned life insurance, measured as described above, increased \$66 million, from \$193 million in the first six months of 2006 to \$259 million in the first six months of 2007. Sales of variable life products increased \$22 million, which included the benefit of several large case sales in 2007. Sales of term and universal life products increased \$44 million.

The increase in sales of life insurance, excluding corporate-owned life insurance, was driven by a \$72 million increase in sales from the third party distribution channel across all product lines. The increase was partially offset by decreased sales by Prudential Agents of \$6 million, reflecting a decline in the number of agents from 2,844 at June 30, 2006 to 2,512 at June 30, 2007.

Policy Surrender Experience

The following table sets forth the individual life insurance business policy surrender experience for variable and universal life insurance, measured by cash value of surrenders, for the periods indicated. These amounts do not

Table of Contents

correspond to expenses under U.S. GAAP. In managing this business, we analyze the cash value of surrenders because it is a measure of the degree to which policyholders are maintaining their in force business with us, a driver of future profitability. Generally, our term life insurance products do not provide for cash surrender values.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|--------|------------------------------|--------|
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | | |
| Cash value of surrenders | \$ 175 | \$ 212 | \$ 342 | \$ 403 |
| Cash value of surrenders as a percentage of mean future benefit reserves, policyholders' account balances, and separate account balances | 3.1% | 4.1% | 3.0% | 3.9% |

2007 to 2006 Three Month Comparison. The total cash value of surrenders decreased \$37 million, from \$212 million in the second quarter of 2006 to \$175 million in the second quarter of 2007, as the prior year quarter included the surrender of a large corporate-owned life insurance case. Cash value of surrenders as a percentage of mean future policy benefit reserves, policyholders' account balances and separate account balances decreased from 4.1% in the second quarter of 2006 to 3.1% in the second quarter of 2007, reflecting the surrender of the large corporate-owned life insurance case in the second quarter of 2006.

2007 to 2006 Six Month Comparison. The total cash value of surrenders decreased \$61 million, from \$403 million in the first six months of 2006 to \$342 million in the first six months of 2007, as the first six months of 2006 included a greater volume of surrenders of variable corporate-owned life insurance. Cash value of surrenders as a percentage of mean future policy benefit reserves, policyholders' account balances and separate account balances decreased from 3.9% in the first six months of 2006 to 3.0% in the first six months of 2007, reflecting the decrease in surrenders of variable corporate-owned life insurance from the prior year.

Individual Annuities**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, | |
|---|--------------------------------|--------|------------------------------|--------|
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | | |
| Operating results: | | | | |
| Revenues | \$ 632 | \$ 469 | \$ 1,236 | \$ 922 |
| Benefits and expenses | 452 | 347 | 890 | 682 |
| Adjusted operating income | 180 | 122 | 346 | 240 |
| Realized investment gains (losses), net, and related adjustments(1) | 1 | (44) | (7) | (51) |
| Related charges(1)(2) | (1) | 14 | (1) | 15 |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

| | | | | |
|--|--------|-------|--------|--------|
| Income from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ 180 | \$ 92 | \$ 338 | \$ 204 |
|--|--------|-------|--------|--------|

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

Table of Contents

On June 1, 2006, we acquired the variable annuity business of The Allstate Corporation, or Allstate, through a reinsurance transaction for \$635 million of total consideration, consisting primarily of a \$628 million ceding commission. Our initial investment in the business was approximately \$600 million, consisting of the total consideration, offset by the related tax benefits, plus an additional contribution of \$94 million to meet regulatory capital requirements. See Note 3 to the Unaudited Interim Consolidated Financial Statements for further discussion of this acquisition.

Adjusted Operating Income

2007 to 2006 Three Month Comparison. Adjusted operating income increased \$58 million, from \$122 million in the second quarter of 2006 to \$180 million in the second quarter of 2007. Results for the second quarter of 2007 included adjusted operating income of \$26 million from the variable annuity business acquired from Allstate, compared to \$8 million in the second quarter of 2006, which included the results only for the initial month of operations from the date of acquisition. The remainder of the increase came primarily from higher fee income driven by higher average asset balances from market appreciation and positive net asset flows in our variable annuity account values. An increase in amortization of deferred policy acquisition and other costs reflecting increased gross profits in the current period partially offset the increase in fee income. Also contributing to the increase in adjusted operating income for the current quarter was an \$11 million favorable variance in the mark-to-market of embedded derivatives and related hedge positions associated with our living benefit features, net of amortization of deferred policy acquisition and other costs, as fluctuations in value of the guarantees and associated hedging instruments resulted in a reduction in adjusted operating income in the second quarter of 2006 and increased adjusted operating income in the second quarter of 2007. Partially offsetting these increases was an increase in general and administrative expenses, net of capitalization, reflecting higher distribution and asset management costs associated with increased variable annuity sales and growth in variable annuity account values. The contribution of the acquired Allstate business to adjusted operating income for the second quarter of 2007 consists of revenues of \$102 million and benefits and expenses of \$76 million. Revenues from the acquired business consisted primarily of policy charges and fees of \$66 million, net investment income of \$17 million and asset management fees and other income of \$17 million. Benefits and expenses from this business consisted primarily of general and administrative expenses, net of capitalization of \$51 million and policyholders' benefits, including interest credited to policyholders' account balances, of \$23 million.

2007 to 2006 Six Month Comparison. Adjusted operating income increased \$106 million, from \$240 million in the first six months of 2006 to \$346 million in the first six months of 2007. Results for the first six months of 2007 included adjusted operating income of \$49 million from the variable annuity business acquired from Allstate, compared to \$8 million in the first six months of 2006, which included the results only for the initial month of operations from the date of acquisition. The remainder of the increase came primarily from higher fee income driven by higher average asset balances from market appreciation and positive net asset flows in our variable annuity account values. An increase in amortization of deferred policy acquisition and other costs reflecting increased gross profits in the current period partially offset the increase in fee income. Also contributing to the increase was a \$17 million favorable variance in the mark-to-market of embedded derivatives and related hedge positions associated with our living benefit features, net of amortization of deferred policy acquisition and other costs, as fluctuations in value of the guarantees and associated hedging instruments resulted in a reduction in adjusted operating income in the first six months of 2006 and increased adjusted operating income in the first six months of 2007. Partially offsetting these increases was an increase in general and administrative expenses, net of capitalization, reflecting higher distribution and asset management costs associated with increased variable annuity sales and growth in variable annuity account values, as well as growth of the business. The contribution of the acquired Allstate business to adjusted operating income for the first six months of 2007 consists of revenues of \$198 million and benefits and expenses of \$149 million. Revenues from the acquired business consisted primarily of policy charges and fees of \$129 million, net investment income of \$34 million and asset management fees and other income of \$32 million. Benefits and expenses from this business consisted primarily of general and administrative expenses, net of capitalization of \$100 million and policyholders' benefits, including interest credited to policyholders' account balances, of \$46 million.

Table of Contents*Revenues*

2007 to 2006 Three Month Comparison. Revenues, as shown in the table above under Operating Results, increased \$163 million, from \$469 million in the second quarter of 2006 to \$632 million in the second quarter of 2007, including increased revenues of \$74 million related to the variable annuity business acquired from Allstate. The remainder of the increase in revenues came primarily from a \$99 million increase in policy charges and fees and asset management fees and other income reflecting an increase in variable annuity account values driven by changes in average market value and positive net flows. Included in the increase in asset management fees and other income is a \$25 million favorable variance in the mark-to-market of embedded derivatives and related hedge positions associated with our living benefit features. Partially offsetting these items was a \$12 million decrease in net investment income, excluding the impact from the business acquired from Allstate, primarily from the shift in customer funds from fixed income investments to variable investments.

2007 to 2006 Six Month Comparison. Revenues, as shown in the table above under Operating Results, increased \$314 million, from \$922 million in the first six months of 2006 to \$1.236 billion in the first six months of 2007, including increased revenues of \$170 million related to the variable annuity business acquired from Allstate. The remainder of the increase in revenues came primarily from a \$159 million increase in policy charges and fees and asset management fees and other income reflecting an increase in variable annuity account values driven by changes in average market value and positive net flows. Included in the increase in asset management fees and other income is a \$34 million favorable variance in the mark-to-market of embedded derivatives and related hedge positions associated with our living benefit features. Partially offsetting these items was a decrease in net investment income, excluding the impact from the business acquired from Allstate, of \$22 million primarily from the shift in customer funds from fixed income investments to variable investments.

Benefits and Expenses

2007 to 2006 Three Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, increased \$105 million, from \$347 million in the second quarter of 2006 to \$452 million in the second quarter of 2007, including increased benefits and expenses of \$56 million related to the variable annuity business acquired from Allstate. The remainder of the increase came primarily from increases of \$22 million in amortization of deferred policy acquisition costs, and \$19 million in general and administrative expenses, net of capitalization. The increase in amortization of deferred policy acquisition costs reflects increased gross profits in the second quarter of 2007. The increase in general and administrative expenses, net of capitalization, reflects higher distribution and asset management costs associated with increased variable annuity sales and growth in variable annuity account values. Excluding the impact from the business acquired from Allstate, policyholders' benefits, including interest credited to policyholders' account balances, increased slightly, reflecting higher amortization of deferred sales inducements due to increased gross profits in the second quarter of 2007, partially offset by a decrease in interest credited to policyholders relating to the shift in customer funds from fixed income investments to variable investments discussed above.

2007 to 2006 Six Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, increased \$208 million, from \$682 million in the first six months of 2006 to \$890 million in the first six months of 2007, including increased benefits and expenses of \$129 million related to the variable annuity business acquired from Allstate. The remainder of the increase came primarily from increases of \$38 million in amortization of deferred policy acquisition costs, and \$37 million of general and administrative expenses, net of capitalization. The increase in amortization of deferred policy acquisition and other costs reflects increased gross profits in the first six months of 2007. The increase in general and administrative expenses, net of capitalization, reflects higher distribution and asset management costs associated with increased variable annuity sales and growth in variable annuity account values, as well as growth of the business. Excluding the impact from the business acquired from Allstate, policyholders' benefits, including interest credited to policyholders' account balances, decreased slightly, reflecting lower interest credited to policyholders relating to the shift in customer funds from fixed income investments to variable investments discussed above, partially offset by higher amortization of deferred sales inducements due to increased gross profits in the first six months of 2007.

Table of Contents*Account Values*

The following table sets forth changes in account values for the individual annuity business, for the periods indicated. For our individual annuity business, assets are reported at account value, and net sales (redemptions) are gross sales minus redemptions or surrenders and withdrawals, as applicable.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|-----------|------------------------------|-----------|
| | 2007 | 2006 | 2007 | 2006 |
| (in millions) | | | | |
| Variable Annuities(1): | | | | |
| Beginning total account value | \$ 75,591 | \$ 53,181 | \$ 74,555 | \$ 50,778 |
| Sales | 3,033 | 2,500 | 5,812 | 4,629 |
| Surrenders and withdrawals | (2,515) | (1,757) | (4,825) | (3,342) |
| Net sales | 518 | 743 | 987 | 1,287 |
| Benefit payments | (299) | (225) | (605) | (410) |
| Net flows | 219 | 518 | 382 | 877 |
| Change in market value, interest credited and other activity | 3,478 | (1,000) | 4,646 | 1,228 |
| Policy charges | (320) | (204) | (615) | (388) |
| Acquisition | | 16,312 | | 16,312 |
| Ending total account value(2) | \$ 78,968 | \$ 68,807 | \$ 78,968 | \$ 68,807 |
| Fixed Annuities: | | | | |
| Beginning total account value | \$ 3,679 | \$ 3,941 | \$ 3,748 | \$ 3,991 |
| Sales | 20 | 32 | 41 | 60 |
| Surrenders and withdrawals | (74) | (92) | (155) | (161) |
| Net redemptions | (54) | (60) | (114) | (101) |
| Benefit payments | (45) | (42) | (88) | (85) |
| Net flows | (99) | (102) | (202) | (186) |
| Interest credited and other activity | 29 | 33 | 64 | 68 |
| Policy charges | (1) | (1) | (2) | (2) |
| Ending total account value | \$ 3,608 | \$ 3,871 | \$ 3,608 | \$ 3,871 |

- (1) Variable annuities include only those sold as retail investment products. Investments through defined contribution plan products are included with such products within the Retirement segment.
- (2) As of June 30, 2007, variable annuity account values are invested in equity funds (\$42 billion or 53%), balanced funds (\$17 billion or 22%), bond funds (\$8 billion or 10%), and other (\$12 billion or 15%).

2007 to 2006 Three Month Comparison. Total account values for fixed and variable annuities amounted to \$82.6 billion as of June 30, 2007, an increase of \$3.3 billion from March 31, 2007. The increase came primarily from increases in the market value of customers' variable annuities and positive variable annuity net flows. Total account values as of June 30, 2007 increased \$9.9 billion from June 30, 2006, primarily reflecting increases in the market value of customers' variable annuities and positive variable annuity net flows. Individual variable annuity gross sales increased by \$533 million, from \$2.5 billion in the second quarter of 2006 to \$3.0 billion in the second quarter of 2007, reflecting increased sales of \$356 million related to the business acquired from Allstate, increased sales from our optional living benefit product features, and growth of

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

our distribution relationships. Individual variable annuity surrenders and withdrawals increased by \$758 million, from \$1.8 billion in the second quarter of 2006 to \$2.5 billion in the second quarter of 2007, including increased surrenders and withdrawals of \$491 million related to the business acquired from Allstate, as well as the impact of higher average account values due to market appreciation.

Table of Contents

2007 to 2006 Six Month Comparison. Total account values for fixed and variable annuities amounted to \$82.6 billion as of June 30, 2007, an increase of \$4.3 billion from December 31, 2006. The increase came primarily from increases in the market value of customers' variable annuities and positive variable annuity net flows. Total account values as of June 30, 2007 increased \$9.9 billion from June 30, 2006, primarily reflecting increases in the market value of customers' variable annuities and positive variable annuity net flows. Individual variable annuity gross sales increased by \$1.2 billion, from \$4.6 billion in the first six months of 2006 to \$5.8 billion in the first six months of 2007, reflecting increased sales of \$804 million related to the business acquired from Allstate, increased sales from our optional living benefit product features, and growth of our distribution relationships. Individual variable annuity surrenders and withdrawals increased by \$1.5 billion, from \$3.3 billion in the first six months of 2006 to \$4.8 billion in the first six months of 2007, including increased surrenders and withdrawals of \$1.1 billion related to the business acquired from Allstate, as well as the impact of higher average account values due to market appreciation.

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, | |
|--|--------------------------------|----------|------------------------------|----------|
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | | |
| Operating results: | | | | |
| Revenues | \$ 1,211 | \$ 1,117 | \$ 2,416 | \$ 2,226 |
| Benefits and expenses | 1,142 | 1,088 | 2,296 | 2,150 |
| Adjusted operating income | 69 | 29 | 120 | 76 |
| Realized investment gains (losses), net, and related adjustments(1) | (2) | (18) | 12 | (10) |
| Related charges(2) | | | | (1) |
| Income from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ 67 | \$ 11 | \$ 132 | \$ 65 |

- (1) Revenues exclude Realized investment gains (losses), net, and related adjustments. See Realized Investment Gains and General Account Investments Realized Investment Gains.
- (2) Benefits and expenses exclude related charges which represent the unfavorable (favorable) impact of Realized investment gains (losses), net, on interest credited to policyholders' account balances.

Adjusted Operating Income

2007 to 2006 Three Month Comparison. Adjusted operating income increased \$40 million, from \$29 million in the second quarter of 2006 to \$69 million in the second quarter of 2007, primarily reflecting more favorable claims experience in our group life business and, to a lesser extent, more favorable claims experience in our group disability business. Partially offsetting the benefit of these items were increased commission expenses and higher administrative operating expenses primarily reflecting growth in the disability business.

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

2007 to 2006 Six Month Comparison. Adjusted operating income increased \$44 million, from \$76 million in the first six months of 2006 to \$120 million in the first six months of 2007, primarily reflecting more favorable claims experience in our group life business. Also contributing to the increase in adjusted operating income, to a lesser extent, was more favorable claims experience, as well as growth, in our group disability business and a greater contribution from investment results due to growth in invested assets. Partially offsetting these increases were higher administrative operating expenses primarily reflecting growth in the business.

Table of Contents*Revenues*

2007 to 2006 Three Month Comparison. Revenues, as shown in the table above under Operating Results, increased by \$94 million, from \$1.117 billion in the second quarter of 2006 to \$1.211 billion in the second quarter of 2007. Group life premiums increased by \$35 million from \$693 million in the second quarter of 2006 to \$728 million in the second quarter of 2007, primarily reflecting increased premiums on our experience-rated group life business resulting from the increase in policyholder benefits on these contracts as discussed below. Group disability premiums, which include long-term care products, increased by \$17 million from \$193 million in the second quarter of 2006 to \$210 million in the second quarter of 2007, primarily reflecting growth in business in force resulting from new sales and continued strong persistency. Policy charges and fee income also increased by \$24 million primarily reflecting growth of business in force. In addition, net investment income increased \$13 million primarily reflecting a larger base of invested assets due to business growth.

2007 to 2006 Six Month Comparison. Revenues increased by \$190 million, from \$2.226 billion in the first six months of 2006 to \$2.416 billion in the first six months of 2007. Group life premiums increased by \$72 million from \$1.375 billion in the first six months of 2006 to \$1.447 billion in the first six months of 2007, reflecting increased premiums on experience-rated group life business resulting from the increase in policyholder benefits on these contracts as discussed below. Group life persistency remained strong, but deteriorated slightly from 96% in the first six months of 2006 to 95% in the first six months of 2007. Group disability premiums, which include long-term care products, increased by \$39 million from \$378 million in the first six months of 2006 to \$417 million in the first six months of 2007, primarily reflecting growth in business in force resulting from new sales and continued strong persistency, which deteriorated slightly from 92% in the first six months of 2006 to 91% in the first six months of 2007. Policy charges and fee income also increased by \$43 million primarily reflecting growth of business in force. In addition, net investment income increased \$29 million primarily reflecting a larger base of invested assets due to business growth.

Benefits and Expenses

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|-------|------------------------------|-------|
| | 2007 | 2006 | 2007 | 2006 |
| Benefits ratio(1): | | | | |
| Group life | 91.1% | 95.4% | 91.3% | 93.7% |
| Group disability | 84.7 | 89.4 | 87.8 | 88.4 |
| Administrative operating expense ratio(2): | | | | |
| Group life | 9.3 | 7.9 | 9.5 | 8.5 |
| Group disability | 20.0 | 21.7 | 21.0 | 21.6 |

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

2007 to 2006 Three Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, increased by \$54 million, from \$1.088 billion in the second quarter of 2006 to \$1.142 billion in the second quarter of 2007. The increase was primarily driven by an increase of \$26 million in policyholders' benefits, including the change in policy reserves, reflecting greater benefits on experience-rated group life business which, as discussed above, results in increased premiums. Partially offsetting this increase in policyholder benefits was the benefit from more favorable claims experience on the non-experience-rated group life business. In addition, interest credited to policyholder account balances increased \$10 million primarily due to an increase in policyholder account balances as a result of growth in the business. Also contributing to the

Table of Contents

increase in benefits and expenses were increased commission expenses and higher administrative operating expenses primarily reflecting growth in the disability business.

The group life benefits ratio improved 4.3 percentage points from the second quarter of 2006 to the second quarter of 2007, reflecting more favorable mortality experience in our group life business. The group disability benefits ratio improved 4.7 percentage points from the second quarter of 2006 to the second quarter of 2007, due to more favorable claims experience in our group disability business. The group life administrative operating expense ratio deteriorated from the second quarter of 2006 to the second quarter of 2007, due to lower gross premiums on experience-rated group life business. The group disability administrative operating expense ratio improved from the second quarter of 2006 to the second quarter of 2007, as the increase in the level of premiums outpaced the related increase in administrative operating expenses.

2007 to 2006 Six Month Comparison. Benefits and expenses increased by \$146 million, from \$2.150 billion in the first six months of 2006 to \$2.296 billion in the first six months of 2007. The increase was primarily driven by an increase of \$101 million in policyholders' benefits, including the change in policy reserves, reflecting greater benefits on experience-rated group life business which, as discussed above, results in increased premiums, and the growth of business in force. Partially offsetting the increases in policyholder benefits was the benefit from more favorable claims experience on the non-experience-rated group life business. In addition, interest credited to policyholder account balances increased \$20 million primarily due to an increase in policyholder account balances as a result of growth in the business. Also contributing to the increase in benefits and expenses were higher administrative operating expenses primarily reflecting growth in the business.

The group life benefits ratio improved 2.4 percentage points from the first six months of 2006 to the first six months of 2007, reflecting more favorable mortality experience in our group life business. The group disability benefits ratio improved 0.6 percentage points from the first six months of 2006 to the first six months of 2007, due to more favorable claims experience in our group disability business. The group life administrative operating expense ratio deteriorated from the first six months of 2006 to the first six months of 2007, due to lower gross premiums on experience-rated group life business. The group disability administrative operating expense ratio improved from the first six months of 2006 to the first six months of 2007, as the increase in the level of premiums outpaced the related increase in administrative operating expenses.

Sales Results

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

| | Three Months Ended | | Six Months Ended | |
|------------------------------------|--------------------|------------------|------------------|------------------|
| | June 30, 2007 | June 30, 2006 | June 30, 2007 | June 30, 2006 |
| | (in millions) | | | |
| New annualized premiums(1): | | | | |
| Group life | \$ 26 | \$ 25 | \$ 129 | \$ 231 |
| Group disability(2) | 26 | 18 | 118 | 92 |
| Total | \$ 52 | \$ 43 | \$ 247 | \$ 323 |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

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

Table of Contents

2007 to 2006 Three Month Comparison. Total new annualized premiums increased \$9 million, or 21%, from \$43 million in the second quarter of 2006 to \$52 million in the second quarter of 2007. This increase is attributable to higher group disability sales during the second quarter of 2007, which were driven by the assumption of existing liabilities from a third party, as well as growth in long-term care sales. Sales in our group life business were relatively stable.

2007 to 2006 Six Month Comparison. Total new annualized premiums decreased \$76 million, or 24%, from \$323 million in the first six months of 2006 to \$247 million in the first six months of 2007. This decrease is primarily driven by the benefit in the first quarter of 2006 of several large case sales in the group life business. Partially offsetting this decrease were higher large case and middle-market sales in the group disability business during the first six months of 2007.

Investment Division*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, | |
|--|--------------------------------|--------|------------------------------|--------|
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | | |
| Operating results: | | | | |
| Revenues | \$ 617 | \$ 469 | \$ 1,174 | \$ 971 |
| Expenses | 427 | 332 | 800 | 665 |
| Adjusted operating income | 190 | 137 | 374 | 306 |
| Realized investment gains, net, and related adjustments(1) | (4) | | (2) | |
| Income from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ 186 | \$ 137 | \$ 372 | \$ 306 |

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

Adjusted Operating Income

2007 to 2006 Three Month Comparison. Adjusted operating income increased \$53 million, from \$137 million in the second quarter of 2006 to \$190 million in the second quarter of 2007. Results for the second quarter of 2007 benefited from increased asset management fees of \$34

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

million, primarily from the management of institutional and retail customer assets as a result of increased asset values due to market appreciation and net asset flows. Adjusted operating income for the current quarter also benefited from increased performance based incentive and transaction fees mainly related to our real estate investment management activities and from a greater contribution from the segment's commercial mortgage operations, primarily due to changes in value of hedging instruments. Higher expenses, primarily reflecting performance-based compensation, partially offset the foregoing increases. Results of the segment's proprietary investing business, which were essentially unchanged in the second quarter of 2007 compared to the second quarter of 2006, included income of \$11 million from changes in market value in a fixed income fund in the current period. Adjusted operating income for the second quarter of 2006 included income of \$23 million from proprietary investing and performance based incentive fees from a single investment.

2007 to 2006 Six Month Comparison. Adjusted operating income increased \$68 million, from \$306 million in the first six months of 2006 to \$374 million in the first six months of 2007. Results for the first six months of

Table of Contents

2007 benefited from increased asset management fees of \$62 million, primarily from institutional and retail customer assets as a result of increased asset values due to market appreciation and net asset flows. The segment's results for the first six months of 2007 also benefited from an increase in performance based incentive and transaction fees, primarily related to our real estate investment management activities, and increased income from our commercial mortgage operations, primarily due to changes in value of hedging instruments. Higher expenses, including performance-related compensation costs, partially offset the foregoing increases. Results of the segment's proprietary investing business, which were essentially unchanged in the first six months of 2007 compared to the first six months of 2006, included income of \$31 million from changes in market value in a fixed income fund in the current year period. Adjusted operating income for the first six months of 2006 included income of \$23 million from a single investment, as discussed above.

Revenues

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, asset management fees by source and assets under management for the periods indicated. In managing our business we analyze assets under management, which do not correspond to U.S. GAAP assets, because a principal source of our revenues are fees based on assets under management. The presentation of revenues below has been revised from the presentation in prior period reports to reflect revenues by type.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|---------------|------------------------------|---------------|
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | | |
| Revenues by type: | | | | |
| Asset management fees | \$ 271 | \$ 237 | \$ 533 | \$ 471 |
| Incentive, transaction, principal investing and capital markets revenues | 186 | 111 | 329 | 255 |
| Service, distribution and other revenues(1) | 160 | 121 | 312 | 245 |
| Total revenues | \$ 617 | \$ 469 | \$ 1,174 | \$ 971 |

- (1) Includes revenues under a contractual arrangement with Wachovia Securities, related to managed account services, which was originally scheduled to expire on July 1, 2006. This contract was amended effective July 1, 2005 to provide essentially a fixed fee for managed account services and is now scheduled to expire on July 1, 2008. Also includes payments from Wachovia Corporation 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 Wachovia Corporation. The agreement extends for ten years after termination of the joint venture. The revenue from Wachovia Corporation under this agreement was \$12 million and \$12 million in the three months ended June 30, 2007 and 2006, respectively, and \$25 million and \$26 million in the six months ended June 30, 2007 and 2006, respectively.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|---------------|------------------------------|---------------|
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | | |
| Asset management fees by source: | | | | |
| Institutional customers | \$ 123 | \$ 102 | \$ 240 | \$ 200 |
| Retail customers(1) | 87 | 76 | 171 | 152 |
| General account | 61 | 59 | 122 | 119 |
| Total revenues | \$ 271 | \$ 237 | \$ 533 | \$ 471 |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

- (1) Consists of individual mutual funds and both variable annuities and variable life insurance asset management revenues from our separate accounts. This also includes funds invested in proprietary mutual

Table of Contents

funds through our defined contribution plan products. Revenues from fixed annuities and the fixed rate options of both variable annuities and variable life insurance are included in the general account.

| | June 30, 2007 | June 30, 2006 |
|--|------------------|------------------|
| | (in billions) | |
| Assets Under Management (at fair market value): | | |
| Institutional customers(1) | \$ 166.2 | \$ 138.5 |
| Retail customers(2) | 87.1 | 75.1 |
| General account | 167.0 | 159.7 |
| Total | \$ 420.3 | \$ 373.3 |

(1) Consists of third party institutional assets and group insurance contracts.

(2) Consists of individual mutual funds and both variable annuities and variable life insurance assets in our separate accounts. This also includes funds invested in proprietary mutual funds through our defined contribution plan products. Fixed annuities and the fixed rate options of both variable annuities and variable life insurance are included in the general account.

2007 to 2006 Three Month Comparison. Revenues, as shown in the table above under Operating Results, increased \$148 million, from \$469 million in the second quarter of 2006 to \$617 million in the second quarter of 2007. Asset management fees increased \$34 million, primarily from the management of institutional and retail customer assets as a result of increased asset values due to market appreciation and net asset flows. Revenues from incentive, transaction, principal investing and capital markets revenues increased \$75 million, primarily reflecting increased income from real estate related investments and our commercial mortgage operations. Revenues in the prior year quarter benefited \$30 million from an individual transaction, as discussed above. Certain of our incentive fees are subject to positive or negative future adjustment based on cumulative fund performance in relation to specified benchmarks. Service, distribution and other revenues increased \$39 million primarily due to increased revenues in certain real estate funds, which is fully offset by higher expenses related to minority interest in these funds.

2007 to 2006 Six Month Comparison. Revenues, as shown in the table above under Operating Results, increased \$203 million, from \$971 million in the first six months of 2006 to \$1,174 million in the first six months of 2007. Asset management fees increased \$62 million, primarily from the management of institutional and retail customer assets as a result of increased asset values due to market appreciation and net asset flows. Revenues from incentive, transaction, principal investing and capital markets revenues increased \$74 million primarily reflecting greater transaction and incentive based fees from real estate related investments and increased revenues from the segment's proprietary investing business. Revenues in the prior year quarter benefited \$30 million from an individual transaction, as discussed above. Service, distribution and other revenues increased \$67 million primarily due to increased revenues in certain real estate funds, which is fully offset by higher expenses related to minority interest in these funds.

Expenses

2007 to 2006 Three Month Comparison. Expenses, as shown in the table above under Operating Results, increased \$95 million, from \$332 million in the second quarter of 2006 to \$427 million in the second quarter of 2007. The increase in expenses is due to higher performance based compensation costs resulting from favorable performance in the second quarter of 2007, as well as increased expenses associated with certain real estate funds, as discussed above.

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

2007 to 2006 Six Month Comparison. Expenses, as shown in the table above under Operating Results, increased \$135 million, from \$665 million in the first six months of 2006 to \$800 million in the first six months of 2007. The increase in expenses is due to higher performance based compensation costs resulting from

Table of Contents

favorable performance in the first six months of 2007, as well as increased expenses associated with certain real estate funds, as discussed above.

Financial Advisory***Operating Results***

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|---------|------------------------------|----------|
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | | |
| Operating results: | | | | |
| Revenues | \$ 94 | \$ 68 | \$ 205 | \$ 144 |
| Expenses | 22 | 38 | 36 | 221 |
| Adjusted operating income | 72 | 30 | 169 | (77) |
| Equity in earnings of operating joint ventures(1) | (93) | (60) | (204) | (129) |
| Income from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ (21) | \$ (30) | \$ (35) | \$ (206) |

- (1) Equity in earnings of operating joint ventures are included in adjusted operating income but excluded from income from continuing operations before income taxes and equity in earnings of operating joint ventures as they are reflected on a U.S. GAAP basis on an after-tax basis as a separate line in our Unaudited Interim Consolidated Statements of Operations.

On July 1, 2003, we combined our retail securities brokerage and clearing operations with those of Wachovia Corporation, or Wachovia, and formed Wachovia Securities Financial Holdings, LLC, or Wachovia Securities, a joint venture headquartered in Richmond, Virginia. We currently have a 38% ownership interest in the joint venture, while Wachovia owns the remaining 62%. As part of the transaction we retained certain assets and liabilities related to the contributed businesses, including liabilities for certain litigation and regulatory matters. We account for our 38% ownership of the joint venture under the equity method of accounting.

On May 31, 2007, Wachovia announced an agreement under which Wachovia proposes to acquire, among other things, the retail securities brokerage business of A.G. Edwards, Inc., which would be combined with the retail securities brokerage business of Wachovia Securities. As discussed in Note 10 to the Unaudited Interim Consolidated Financial Statements, we have elected the "lookback" option under the terms of the agreements relating to the joint venture in connection with the combination of the A.G. Edwards business with Wachovia Securities. The "lookback" option permits us to delay for two years following the combination of the A.G. Edwards business with Wachovia Securities our decision to make or not to make an additional capital contribution to the joint venture or other payments to avoid or limit dilution of our ownership interest in the joint venture. During this "lookback" period, our share in the earnings of the joint venture, as well as our share of the one-time costs associated with the combination, will be based on our diluted ownership level. Any capital contribution or other payment at the end of the "lookback" period to restore all or part of our ownership interest in the joint venture would be based on the appraised value of the existing joint venture and the A.G. Edwards business as of the date of the combination. In such event, we would also need to make a true-up payment of one-time costs to reflect the incremental increase in our ownership interest in the joint venture. Alternatively, we may at the end of the "lookback" period put our joint venture interests to Wachovia based on the appraised value of the joint venture, excluding the A.G. Edwards

business, as of the date of the combination.

We also retain our separate right to put our joint venture interests to Wachovia at any time after July 1, 2008 based on the appraised value of the joint venture, including the A.G. Edwards business, determined

Table of Contents

pursuant to appraisal procedures carried out following a decision by the Company to exercise this put . However, if in connection with the lookback option we elect at the end of the lookback period to make an additional capital contribution or other payment to avoid or limit dilution, we may not exercise this put option prior to the first anniversary of the end of the lookback period.

On June 6, 2007, we announced our decision to exit the equity sales, trading and research operations of the Prudential Equity Group, or PEG, the results of which were historically included in the Financial Advisory segment. As discussed in Note 3 to the Unaudited Interim Consolidated Financial Statements, PEG's operations were substantially wound down by June 30, 2007 and the results of PEG are excluded from the results of the Financial Advisory segment and reflected in discontinued operations for all periods presented.

2007 to 2006 Three Month Comparison. Adjusted operating income increased \$42 million, from \$30 million in the second quarter of 2006 to \$72 million in the second quarter of 2007. The segment's results for the second quarter of 2007 include our share of earnings from Wachovia Securities, on a pre-tax basis, of \$93 million, compared to \$60 million in the second quarter of 2006 reflecting increased commission and fee income of the joint venture. The segment's results also include expenses of \$21 million in the second quarter of 2007 related to obligations and costs we retained in connection with the contributed businesses, primarily for litigation and regulatory matters, compared to \$30 million in the second quarter of 2006.

2007 to 2006 Six Month Comparison. Adjusted operating income improved \$246 million, from a loss of \$77 million in the first six months of 2006 to income of \$169 million in the first six months of 2007. The segment's results for the first six months of 2007 include our share of earnings from Wachovia Securities, on a pre-tax basis, of \$204 million, compared to \$129 million in the first six months of 2006, reflecting increased commissions, including a greater contribution from equity syndication activity, and fee income, of the joint venture. The segment's results also include expenses of \$35 million in the first six months of 2007 related to obligations and costs we retained in connection with the contributed businesses, primarily for litigation and regulatory matters, compared to \$206 million in the first six months of 2006. Expenses in the first six months of 2006 reflected an increase in our reserve for settlement costs related to market timing issues involving the former Prudential Securities operations, with respect to which a settlement was reached in August 2006.

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, | |
|---|--------------------------------|----------|------------------------------|----------|
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | | |
| Operating results: | | | | |
| Revenues | \$ 1,150 | \$ 1,049 | \$ 2,313 | \$ 2,103 |
| Benefits and expenses | 1,012 | 907 | 2,027 | 1,824 |
| Adjusted operating income | 138 | 142 | 286 | 279 |
| Realized investment gains (losses), net, and related adjustments(1) | (51) | (79) | (58) | (84) |
| Related charges(2) | (3) | | (4) | |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

| | | | | |
|--|-------|-------|--------|--------|
| Investment gains (losses) on trading account assets supporting insurance liabilities, net(3) | (140) | (95) | (82) | (240) |
| Change in experience-rated contractholder liabilities due to asset value changes(4) | 104 | 74 | 64 | 171 |
| Income from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ 48 | \$ 42 | \$ 206 | \$ 126 |

Table of Contents

- (1) Revenues exclude Realized investment gains (losses), net, and related adjustments. See Realized Investment Gains and General Account Investments Realized Investment Gains.
- (2) Benefits and expenses exclude related charges which represent the unfavorable (favorable) impact of Realized investment gains (losses), net, on change in reserves and the amortization of deferred policy acquisition costs.
- (3) Revenues exclude net investment gains and losses on trading account assets supporting insurance liabilities. See Trading account assets supporting insurance liabilities.
- (4) Benefits and expenses exclude changes in contractholder liabilities due to asset value changes in the pool of investments supporting these experience-rated contracts. See Trading account assets supporting insurance liabilities.

Adjusted Operating Income

2007 to 2006 Three Month Comparison. Adjusted operating income for the Retirement segment decreased \$4 million, from \$142 million in the second quarter of 2006 to \$138 million in the second quarter of 2007, reflecting relatively unchanged results from both our full service and institutional investment products businesses. In our full service business, increased fees due to higher full service retirement account values were offset by an increase in general and administrative expenses driven by expenses incurred to expand our product and service capabilities. In our institutional investment products business, improved investment results from a larger base of invested assets were offset by a decrease in the level of mortgage prepayment income and a lower benefit in the current period from reserve refinements reflecting updates of client census data on a group annuity block of business.

2007 to 2006 Six Month Comparison. Adjusted operating income for the Retirement segment increased \$7 million, from \$279 million in the first six months of 2006 to \$286 million in the first six months of 2007, reflecting higher adjusted operating income in our full service business. This business benefited from increased fees due to higher full service retirement account values and the lack of transition expenses in the first six months of 2007, as the first six months of 2006 included \$6 million of transition expenses related to the completion of the integration of the retirement business acquired from CIGNA. Partially offsetting these items within the full service business was an increase in general and administrative expenses driven by expenses incurred to expand our product and service capabilities, and lower investment results primarily due to higher crediting rates on general account liabilities, partially offset by higher portfolio yields. The adjusted operating income from our institutional investment products business was relatively flat as a greater contribution from investment results primarily due to a larger base of invested assets and higher portfolio yields essentially offset a benefit to prior year period results from reserve refinements reflecting updates of client census data on a group annuity block of business and a decrease in the level of mortgage prepayment income. Contributing to the higher portfolio yields is the benefit from the sale of lower yielding bonds and reinvestment of proceeds at higher available interest rates. The realized investment losses generated from these sales are excluded from adjusted operating income. For a discussion of realized investment gains and losses, including those related to changes in interest rates, see Realized Investment Gains and Losses and General Account Investments Realized Investment Gains.

Revenues

2007 to 2006 Three Month Comparison. Revenues, as shown in the table above under Operating Results, increased \$101 million, from \$1.049 billion in the second quarter of 2006 to \$1.150 billion in the second quarter of 2007. Net investment income increased \$52 million, primarily due to a larger base of invested assets due to sales of guaranteed investment products in the institutional and retail markets, partially offset by decreases in the level of mortgage prepayment income. In addition, asset management fees and other income increased \$7 million, reflecting growth in fees due to higher full service retirement account values primarily resulting from market appreciation. Premiums increased \$41 million, driven by higher structured settlement sales, and resulted in a corresponding increase in policyholders' benefits, including the change in policy reserves, as discussed below.

Table of Contents

2007 to 2006 Six Month Comparison. Revenues, as shown in the table above under Operating Results, increased \$210 million, from \$2.103 billion in the first six months of 2006 to \$2.313 billion in the first six months of 2007. Net investment income increased \$148 million, primarily due to a larger base of invested assets due to sales of guaranteed investment products in the institutional and retail markets and higher portfolio yields, partially offset by decreases from mortgage prepayment income. Also contributing to the increase in net investment income is \$24 million relating to the change in the reinsurance arrangement with respect to the guaranteed cost business acquired from CIGNA. Due to this change, the results of this business, which were previously presented on a net basis in Asset management fees and other income are, beginning on April 1, 2006, presented on a gross basis in our results of operations. In addition, asset management fees and other income increased \$20 million reflecting growth in fees due to higher full service retirement account values primarily resulting from market appreciation. Premiums increased \$45 million, driven by higher structured settlement sales, and resulted in a corresponding increase in policyholders' benefits, including the change in policy reserves, as discussed below.

Benefits and Expenses

2007 to 2006 Three Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, increased \$105 million, from \$907 million in the second quarter of 2006 to \$1.012 billion in the second quarter of 2007. Interest credited to policyholders' account balances increased \$56 million, primarily reflecting higher interest credited on the greater base of guaranteed investment products sold in the institutional and retail markets. Policyholders' benefits, including the change in policy reserves, increased \$41 million and reflects the increase in premiums on higher structured settlement sales discussed above, and a lower benefit in the current period from reserve refinements reflecting updates of client census data on a group annuity block of business. In addition, general and administrative expenses, net of capitalization increased \$14 million primarily reflecting increased expenses incurred to expand our full service product and service capabilities.

2007 to 2006 Six Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, increased \$203 million, from \$1.824 billion in the first six months of 2006 to \$2.027 billion in the first six months of 2007. Interest credited to policyholders' account balances increased \$119 million, primarily reflecting higher interest credited on the greater base of guaranteed investment products sold in the institutional and retail markets and higher crediting rates on general account liabilities. Policyholders' benefits, including the change in policy reserves, increased \$74 million and primarily reflects the increase in premiums on higher structured settlement sales discussed above, as well as reserve refinements from updates of client census data on a group annuity block of business and less favorable retirement and mortality experience. Also contributing to the increase in policyholders' benefits is a \$21 million increase due to the change in the reinsurance arrangement with respect to the guaranteed cost business acquired from CIGNA discussed above. In addition, general and administrative expenses, net of capitalization increased \$10 million primarily reflecting increased expenses incurred to expand our full service product and service capabilities.

Table of Contents*Sales Results and Account Values*

The following table shows the changes in the account values and net additions (withdrawals) of Retirement segment products for the periods indicated. Net additions (withdrawals) are deposits and sales or additions, as applicable, minus withdrawals and benefits. These concepts do not correspond to revenues under U.S. GAAP, but are used as a relevant measure of business activity.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|-----------|------------------------------|------------|
| | 2007 | 2006 | 2007 | 2006 |
| (in millions) | | | | |
| Full Service(1): | | | | |
| Beginning total account value | \$ 99,558 | \$ 91,854 | \$ 97,430 | \$ 88,385 |
| Deposits and sales | 3,212 | 4,138 | 7,215 | 9,519 |
| Withdrawals and benefits | (3,203) | (3,412) | (6,636) | (8,883) |
| Change in market value, interest credited and interest income(2) | 4,466 | (1,043) | 6,024 | 2,516 |
| Ending total account value | \$ 104,033 | \$ 91,537 | \$ 104,033 | \$ 91,537 |
| Net additions (withdrawals) | \$ 9 | \$ 726 | \$ 579 | \$ 636 |
| Institutional Investment Products(3): | | | | |
| Beginning total account value | \$ 50,661 | \$ 47,215 | \$ 50,269 | \$ 48,080 |
| Additions | 1,597 | 1,088 | 3,130 | 2,624 |
| Withdrawals and benefits | (1,399) | (1,429) | (3,142) | (3,881) |
| Change in market value, interest credited and interest income | 325 | 423 | 932 | 605 |
| Other(4) | (258) | (384) | (263) | (515) |
| Ending total account value | \$ 50,926 | \$ 46,913 | \$ 50,926 | \$ 46,913 |
| Net additions (withdrawals) | \$ 198 | \$ (341) | \$ (12) | \$ (1,257) |

- (1) Ending total account value for the full service business includes assets of Prudential's retirement plan of \$5.8 billion and \$5.4 billion as of June 30, 2007 and 2006, respectively.
- (2) Change in market value, interest credited and interest income includes \$511 million for the three and six month ended June 30, 2007 representing a transfer from Institutional Investment Products to Full Service as a result of one client's change in contract form.
- (3) Ending total account value for the institutional investment products business includes assets of Prudential's retirement plan of \$4.8 billion and \$4.7 billion as of June 30, 2007 and 2006, respectively.
- (4) Other includes \$(511) million for the three and six months ended June 30, 2007 representing a transfer from Institutional Investment Products to Full Service as a result of one client's change in contract form. Remaining amounts for all periods presented primarily represents changes in asset balances for externally managed accounts.

2007 to 2006 Three Month Comparison. Account values in our full service business amounted to \$104.0 billion as of June 30, 2007, an increase of \$4.5 billion from March 31, 2007. The increase in account values was driven primarily by an increase in the market value of customer funds and interest on general account business. Account values in our full service business as of June 30, 2007 increased \$12.5 billion from June 30, 2006, primarily reflecting an increase in the market value of customer funds and interest on general account business. Net additions (withdrawals) decreased \$717 million, from net additions of \$726 million in the second quarter of 2006 to net additions of \$9 million in the second quarter of 2007. This decrease reflects lower gross sales, as the second quarter of 2006 included two large client sales totaling \$1.1 billion, partially offset by lower withdrawals and benefits.

Table of Contents

Account values in our institutional investment products business amounted to \$50.9 billion as of June 30, 2007, an increase of \$265 million from March 31, 2007, primarily reflecting interest on general account business as well as net additions. Account values in our institutional investment products business as of June 30, 2007 increased \$4.0 billion from June 30, 2006, primarily reflecting interest on general account business, an increase in the market value of customer funds and net additions. Net additions (withdrawals) improved \$539 million from net withdrawals of \$341 million in the second quarter of 2006 to net additions of \$198 million in the second quarter of 2007. This improvement primarily reflects higher additions driven by sales of guaranteed investment products in the institutional and retail markets.

2007 to 2006 Six Month Comparison. Account values in our full service business amounted to \$104.0 billion as of June 30, 2007, an increase of \$6.6 billion from December 31, 2006. The increase in account values was driven primarily by an increase in the market value of customer funds and interest on general account business, as well as net additions of \$579 million. Account values in our full service business as of June 30, 2007 increased \$12.5 billion from June 30, 2006, primarily reflecting an increase in the market value of customer funds and interest on general account business. Net additions (withdrawals) decreased \$57 million, from net additions of \$636 million in the first six months of 2006 to net additions of \$579 million in the first six months of 2007, reflecting lower gross sales, partially offset by lower withdrawals and benefits. The first six months of 2006 included three large client sales totaling \$2.7 billion, and three large plan terminations totaling \$2.2 billion primarily associated with merger and plan consolidation activity.

Account values in our institutional investment products business amounted to \$50.9 billion as of June 30, 2007, an increase of \$657 million from December 31, 2006, primarily reflecting interest on general account business and an increase in the market value of customer funds. Account values in our institutional investment products business as of June 30, 2007 increased \$4.0 billion from June 30, 2006, primarily reflecting interest on general account business, an increase in the market value of customer funds, and net additions. Net withdrawals improved \$1.2 billion from net withdrawals of \$1.3 billion in the first six months of 2006 to net withdrawals of \$12 million in the first six months of 2007. This improvement reflects the impact of a transfer in the first six months of 2006 of approximately \$1.8 billion from the Retirement segment to our Asset Management segment as well as higher additions driven by sales of guaranteed investment products in the institutional and retail markets. Partially offsetting these items is higher withdrawals in the first six months of 2007.

International Insurance and Investments Division

As a U.S.-based company with significant business operations outside the U.S., we seek to mitigate the risk that future unfavorable foreign currency exchange rate movements will reduce our U.S. dollar equivalent earnings. The operations of our International Insurance and International Investments segments are subject to currency fluctuations that can materially affect their U.S. dollar results from period to period even if results on a local currency basis are relatively constant. As discussed further below, we enter into forward currency derivative contracts, as well as 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.

The financial results of our International Insurance segment and International Investments segment, excluding the global commodities group, for all periods presented reflect the impact of an intercompany arrangement with Corporate and Other operations pursuant to which the segments non-U.S. dollar denominated earnings in all countries 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 exchange rate changes will reduce the segments U.S. dollar equivalent earnings. Pursuant to this program, Corporate and Other operations executes forward currency contracts with third parties to sell 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. This program is primarily associated with the International Insurance segment's businesses in Japan, Korea and Taiwan and the

Table of Contents

International Investments segment's businesses in Korea and Europe. The intercompany arrangement with Corporate and Other operations increased (decreased) revenues and adjusted operating income of each segment as follows for the periods indicated:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|------|------------------------------|-------|
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | | |
| Impact on revenues and adjusted operating income: | | | | |
| International Insurance | \$ 33 | \$ 3 | \$ 61 | \$ 15 |
| International Investments | (2) | (2) | (5) | (4) |
| Total International Insurance and Investments Division | \$ 31 | \$ 1 | \$ 56 | \$ 11 |

Results of Corporate and Other operations include any differences between the translation adjustments recorded by the segments and the gains or losses recorded from the forward currency contracts. The consolidated net impact of this program recorded within the Corporate and Other operations were losses of \$6 million and gains of \$7 million for the three months ended June 30, 2007 and 2006, respectively, and losses of \$10 million and gains of \$3 million for the six months ended June 30, 2007 and 2006, respectively.

In addition, our Japanese insurance operations hold dual currency investments in the form of fixed maturities and loans. The principal of these dual currency investments are yen-denominated while the related interest income is U.S. dollar denominated. These investments are the economic equivalent of exchanging what would otherwise be fixed streams of yen-denominated interest income for fixed streams of U.S. dollars. Our Japanese insurance operations also hold investments in yen-denominated investments that have been coupled with cross-currency coupon swap agreements, creating synthetic dual currency investments. The yen/U.S. dollar exchange rate is effectively fixed, as we are obligated in future periods to exchange fixed amounts of Japanese yen interest payments generated by the yen-denominated investments for U.S. dollars at the yen/U.S. dollar exchange rates specified by the cross-currency coupon swap agreements. The effect of these dual currency and synthetic dual currency investments is taken into account as part of our currency hedging program. As of June 30, 2007 and December 31, 2006, the principal of these investments were ¥545 billion, or \$4.9 billion, for both periods. For the three months ended June 30, 2007 and 2006, the weighted average yield generated by these investments was 2.4% and 3.9%, respectively. For the six months ended June 30, 2007 and 2006, the weighted average yield generated by these investments was 2.4% and 3.3%, respectively. For information regarding the weighted average exchange rate resulting from these investments see Dual Currency Investments, below.

Presented below is the fair value of these instruments as reflected on our balance sheet for the periods presented.

| | June 30, 2007 | December 31, 2006 |
|---|------------------|----------------------|
| | (in millions) | |
| Forward currency contracts | \$ 148 | \$ 105 |
| Cross-currency coupon swap agreements | 68 | 54 |
| Foreign exchange component of interest on dual currency investments | 30 | 11 |
| Total | \$ 246 | \$ 170 |

Our Japanese insurance operations also hold U.S. dollar denominated securities in their investment portfolio, which are discussed in further detail in Realized Investment Gains and General Account Investments General Account Investments.

Table of Contents**International Insurance**

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 foreign currency fluctuations. 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 Japanese yen at a rate of 102 yen per U.S. dollar; and Korean won at a rate of 1,030 won per U.S. dollar. New annualized premiums presented on a constant exchange rate basis in the Sales Results section below reflect translation based on these same uniform exchange rates.

Operating Results

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, | |
|--|--------------------------------|----------|------------------------------|----------|
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | | |
| Operating Results: | | | | |
| Revenues: | | | | |
| Life Planner operations | \$ 1,308 | \$ 1,197 | \$ 2,668 | \$ 2,414 |
| Gibraltar Life | 749 | 737 | 1,443 | 1,469 |
| | 2,057 | 1,934 | 4,111 | 3,883 |
| Benefits and expenses: | | | | |
| Life Planner operations | 1,055 | 975 | 2,145 | 1,964 |
| Gibraltar Life | 590 | 635 | 1,141 | 1,257 |
| | 1,645 | 1,610 | 3,286 | 3,221 |
| Adjusted operating income: | | | | |
| Life Planner operations | 253 | 222 | 523 | 450 |
| Gibraltar Life | 159 | 102 | 302 | 212 |
| | 412 | 324 | 825 | 662 |
| Realized investment gains (losses), net, and related adjustments(1) | 18 | (55) | 157 | (29) |
| Related charges(1)(2) | | 9 | (5) | 9 |
| Investment gains (losses) on trading account assets supporting insurance liabilities, net(3) | 32 | (56) | 54 | (25) |
| Change in experience-rated contractholder liabilities due to asset value changes(4) | (32) | 56 | (54) | 25 |
| Income from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ 430 | \$ 278 | \$ 977 | \$ 642 |

(1)

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Revenues exclude Realized investment gains (losses), net, and related charges and adjustments. The related charges represent the impact of Realized investment gains (losses), net, on the amortization of unearned revenue reserves. See Realized Investment Gains and General Account Investments Realized Investment Gains.

Table of Contents

- (2) Benefits and expenses exclude related charges that represent the element of Dividends to policyholders that is based on a portion of certain realized investment gains required to be paid to policyholders and the impact of Realized investment gains (losses), net, on the amortization of deferred policy acquisition costs.
- (3) Revenues exclude net investment gains and losses on trading account assets supporting insurance liabilities. See Trading Account Assets Supporting Insurance Liabilities.
- (4) Benefits and expenses exclude changes in contractholder liabilities due to asset value changes in the pool of investments supporting these experience-rated contracts. See Trading Account Assets Supporting Insurance Liabilities.

Adjusted Operating Income

2007 to 2006 Three Month Comparison. Adjusted operating income from Life Planner operations increased \$31 million, from \$222 million in the second quarter of 2006 to \$253 million in second quarter of 2007, including an \$8 million favorable impact of currency fluctuations. Excluding the impact of currency fluctuations, adjusted operating income of our Life Planner operations increased \$23 million, reflecting continued growth of our Japanese and Korean Life Planner operations and improved investment income margins. The improvement in investment income margins reflects the benefit of investment portfolio strategies, including lengthening the duration of our Japanese yen investment portfolio. The favorable impact of these items was partially offset by higher general and administrative expenses.

Gibraltar Life's adjusted operating income increased \$57 million, from \$102 million in the second quarter of 2006 to \$159 million in the second quarter of 2007. Results for the second quarter of 2007 benefited \$14 million from investment income associated with a single investment joint venture, reflecting the sale of real estate within the venture, while results for the second quarter of 2006 include a \$17 million charge for refinements in policy liabilities. Excluding the impact of these items and currency fluctuations, which had a favorable impact of \$1 million in comparison to the second quarter of 2006, adjusted operating income for Gibraltar Life increased \$25 million, primarily as a result of improved investment income margins. The improvement in investment income margins reflects the duration lengthening of our Japanese yen investment portfolio, increased utilization of U.S. dollar based investments, and continued growth of our U.S. dollar denominated annuity product.

2007 to 2006 Six Month Comparison. Adjusted operating income from Life Planner operations increased \$73 million, from \$450 million in the first six months of 2006 to \$523 million in first six months of 2007, including a \$17 million favorable impact of currency fluctuations. Excluding the impact of currency fluctuations, adjusted operating income of our Life Planner operations increased \$56 million, reflecting continued growth of our Japanese and Korean Life Planner operations and improved investment income margins. The improved investment income margins are primarily the result of duration lengthening in our Japanese yen investment portfolio and increased utilization of U.S. dollar based investments.

Gibraltar Life's adjusted operating income increased \$90 million, from \$212 million in the first six months of 2006 to \$302 million in the first six months of 2007. Results for the first six months of 2007 benefited \$14 million from investment income associated with a single investment joint venture, reflecting the sale of real estate within the venture, while results for the first six months of 2006 include a \$17 million charge for refinements in policy liabilities. Excluding the impact of these items and currency fluctuations, which had a favorable impact of \$2 million in comparison to the first six months of 2006, adjusted operating income for Gibraltar Life increased \$57 million primarily reflecting improved investment income margins. The improvement in investment income margins reflected the duration lengthening of our Japanese yen investment portfolio, increased utilization of U.S. dollar based investments, and continued growth of our U.S. dollar denominated annuity product.

Table of Contents*Revenues*

2007 to 2006 Three Month Comparison. Revenues, as shown in the table above under Operating Results, increased \$123 million, from \$1.934 billion in the second quarter of 2006 to \$2.057 billion in the second quarter of 2007, including a net unfavorable impact of \$47 million relating to currency fluctuations. Excluding the impact of currency fluctuations, revenues increased \$170 million, from \$2.089 billion in the second quarter of 2006 to \$2.259 billion in the second quarter of 2007.

Revenues from our Life Planner operations increased \$111 million, from \$1.197 billion in the second quarter of 2006 to \$1.308 billion in the second quarter of 2007, including a net unfavorable impact of currency fluctuations of \$22 million. Excluding the impact of currency fluctuations, revenues increased \$133 million from the second quarter of 2006 to the second quarter of 2007. This increase in revenues came primarily from increases in premiums and policy charges and fee income of \$92 million, from \$1.094 billion in the second quarter of 2006 to \$1.186 billion in the second quarter of 2007, and an increase in net investment income of \$33 million, from \$170 million in the second quarter of 2006 to \$203 million in the second quarter of 2007, due to asset growth and higher investment yields reflecting the benefit of investment portfolio strategies. Premiums and policy charges and fee income from our Japanese Life Planner operation increased \$74 million, from \$777 million in the second quarter of 2006 to \$851 million in the second quarter of 2007. Premiums and policy charges and fee income from our Korean operation increased \$9 million, from \$250 million in the second quarter of 2006 to \$259 million in the second quarter of 2007. The increase in premiums and policy charges and fee income in both operations was primarily the result of new sales and strong persistency.

Revenues from Gibraltar Life increased \$12 million, from \$737 million in the second quarter of 2006 to \$749 million in the second quarter of 2007, including an unfavorable impact from currency fluctuations of \$25 million. Excluding the impact of currency fluctuations, revenues for Gibraltar Life increased \$37 million, from \$818 million in the second quarter of 2006 to \$855 million in the second quarter of 2007. This increase reflects a \$42 million increase in net investment income, from \$196 million in the second quarter of 2006 to \$238 million in the second quarter of 2007, due to the same factors, discussed above, that benefited investment income margins, as well as \$14 million from investment income associated with a single investment joint venture, reflecting the sale of real estate within the venture. Partially offsetting the increase in net investment income is a decline in premiums of \$12 million, from \$604 million in the second quarter of 2006 to \$592 million in the second quarter of 2007. Premiums in the second quarter of 2006 benefited \$24 million from additional face amounts of insurance issued pursuant to a special dividend arrangement established as part of Gibraltar Life's reorganization for which the second quarter of 2007 includes no such benefit. Substantially all of these premiums recognized pursuant to the special dividend arrangement were offset by a corresponding charge to increase reserves for the affected policies. Excluding the impact of the special dividend arrangement, premiums increased \$12 million primarily reflecting an increase in sales of single premium contracts.

2007 to 2006 Six Month Comparison. Revenues increased \$228 million, from \$3.883 billion in the first six months of 2006 to \$4.111 billion in the first six months of 2007, including a net unfavorable impact of \$38 million relating to currency fluctuations. Excluding the impact of currency fluctuations, revenues increased \$266 million, from \$4,232 billion in the first six months of 2006 to \$4,498 billion in the first six months of 2007.

Revenues from our Life Planner operations increased \$254 million, from \$2.414 billion in the first six months of 2006 to \$2.668 billion in the first six months of 2007, including a net unfavorable impact of currency fluctuations of \$25 million. Excluding the impact of currency fluctuations, revenues increased \$279 million from the first six months of 2006 to the first six months of 2007. This increase in revenues came primarily from increases in premiums and policy charges and fee income of \$200 million, from \$2.237 billion in the first six months of 2006 to \$2.437 billion in the first six months of 2007, and an increase in net investment income of \$66 million, from \$340 million in the first six months of 2006 to \$406 million in the first six months of 2007, due to asset growth and higher investment yields reflecting duration lengthening of our Japanese yen investment portfolio and increased utilization of U.S. dollar based investments. Premiums and policy charges and fee income

Table of Contents

from our Japanese Life Planner operation increased \$155 million, from \$1.616 billion in the first six months of 2006 to \$1.771 billion in the first six months of 2007. Premiums and policy charges and fee income from our Korean operation increased \$28 million, from \$491 million in the first six months of 2006 to \$519 million in the first six months of 2007. The increase in premiums and policy charges and fee income in both operations was primarily the result of new sales and strong persistency.

Revenues from Gibraltar Life declined \$26 million, from \$1.469 billion in the first six months of 2006 to \$1.443 billion in the first six months of 2007, including a unfavorable impact from currency fluctuations of \$13 million. Excluding the impact of currency fluctuations, revenues for Gibraltar Life declined \$13 million, from \$1.651 billion in the first six months of 2006 to \$1.638 billion in the first six months of 2007. This decline reflects a decrease in premiums of \$94 million, from \$1.232 billion in the first six months of 2006 to \$1.138 billion in the first six months of 2007, as the first six months of 2006 benefited \$95 million from the special dividend arrangement as discussed above. Partially offsetting the decrease in premium is a \$69 million increase in net investment income, from \$387 million in the first six months of 2006 to \$456 million in the first six months of 2007, due to the same factors, discussed above, that benefited investment income margins, as well as \$14 million from investment income associated with a single investment joint venture, reflecting the sale of real estate within the venture.

Benefits and Expenses

2007 to 2006 Three Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, increased \$35 million, from \$1.610 billion in the second quarter of 2006 to \$1.645 billion in the second quarter of 2007, including a net favorable impact of \$56 million related to currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased \$91 million, from \$1.747 billion in the second quarter of 2006 to \$1.838 billion in the second quarter of 2007.

Benefits and expenses of our Life Planner operations increased \$80 million, from \$975 million in the second quarter of 2006 to \$1.055 billion in the second quarter of 2007, including the net favorable impact of \$30 million from currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased \$110 million, from \$1.039 billion in the second quarter of 2006 to \$1.149 billion in the second quarter of 2007. Benefits and expenses of our Japanese Life Planner operation increased \$62 million, from \$729 million in the second quarter of 2006 to \$791 million in the second quarter of 2007. Benefits and expenses from our Korean operation increased \$35 million, from \$214 million in the second quarter of 2006 to \$249 million in second quarter of 2007. The increase in benefits and expenses in both operations reflects an increase in changes in reserves, which was driven by new sales and strong persistency. Also contributing to the increase in benefits and expenses are higher general and administrative expenses.

Gibraltar Life's benefits and expenses declined \$45 million, from \$635 million in the second quarter of 2006 to \$590 million in the second quarter of 2007, including a \$26 million favorable impact of currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses declined \$19 million, from \$708 million in the second quarter of 2006 to \$689 million in the second quarter of 2007. This decline is primarily due to the effects of the special dividend arrangement discussed above and the \$17 million charge recognized in the second quarter of 2006 for refinements in policy liabilities. Partially offsetting the decline in benefits and expenses, was higher interest credited to policyholders account balances resulting from growth in our U.S. dollar denominated annuity product.

2007 to 2006 Six Month Comparison. Benefits and expenses increased \$65 million, from \$3.221 billion in the first six months of 2006 to \$3.286 billion in the first six months of 2007, including a net favorable impact of \$57 million related to currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased \$122 million, from \$3.544 billion in the first six months of 2006 to \$3.666 billion in the first six months of 2007.

Table of Contents

Benefits and expenses of our Life Planner operations increased \$181 million, from \$1.964 billion in the first six months of 2006 to \$2.145 billion in the first six months of 2007, including the net favorable impact of \$42 million from currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased \$223 million, from \$2.116 billion in the first six months of 2006 to \$2.339 billion in the first six months of 2007. Benefits and expenses of our Japanese Life Planner operation increased \$146 million, from \$1.492 billion in the first six months of 2006 to \$1.638 billion in the first six months of 2007. Benefits and expenses from our Korean operation increased \$52 million, from \$437 million in the first six months of 2006 to \$489 million in first six months of 2007. The increase in benefits and expenses in both operations reflects an increase in changes in reserves, which was driven by new sales and strong persistency.

Gibraltar Life's benefits and expenses declined \$116 million, from \$1.257 billion in the first six months of 2006 to \$1.141 billion in the first six months of 2007, including a \$15 million favorable impact of currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses declined \$101 million, from \$1.428 billion in the first six months of 2006 to \$1.327 billion in the first six months of 2007. This decline is primarily due to the effects of the special dividend arrangement discussed above and the \$17 million charge recognized in the first six months of 2006 for refinements in policy liabilities. Partially offsetting the decline in benefits and expenses, was higher interest credited to policyholders account balances resulting from growth in our U.S. dollar denominated annuity product.

Sales Results

In managing our international insurance business, we analyze revenues, as well as new annualized premiums, which do not correspond to revenues under U.S. GAAP. New annualized premiums measure the current sales performance of the segment, while revenues primarily reflect the renewal persistency of policies written in prior years and net investment income, in addition to current sales. New annualized premiums include 10% of first year premiums or deposits from single pay products. New annualized premiums on an actual and constant exchange rate basis are as follows for the periods indicated.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|------------------------------------|--------------------------------|---------------|------------------------------|---------------|
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | | |
| New annualized premiums: | | | | |
| On an actual exchange rate basis: | | | | |
| Life Planner operations | \$ 178 | \$ 185 | \$ 401 | \$ 401 |
| Gibraltar Life | 96 | 115 | 172 | 188 |
| Total | \$ 274 | \$ 300 | \$ 573 | \$ 589 |
| On a constant exchange rate basis: | | | | |
| Life Planner operations | \$ 186 | \$ 192 | \$ 421 | \$ 420 |
| Gibraltar Life | 105 | 121 | 189 | 201 |
| Total | \$ 291 | \$ 313 | \$ 610 | \$ 621 |

2007 to 2006 Three Month Comparison. On a constant exchange rate basis, new annualized premiums decreased \$22 million, from \$313 million in the second quarter of 2006 to \$291 million in the second quarter of 2007. On the same basis, new annualized premiums from our Japanese Life Planner operation decreased \$2 million, reflecting lower sales of term life products as a result of change in tax law, partially offset by higher sales of U.S. dollar denominated products. Sales in all other countries, also on a constant exchange rate basis, declined \$4 million reflecting a decrease in sales of retirement income products in Korea, partially offset by higher sales in Taiwan.

Table of Contents

New annualized premiums, on a constant exchange rate basis, from our Gibraltar Life operation decreased \$16 million from the second quarter of 2006 to the second quarter of 2007, primarily due to lower sales of our U.S. dollar denominated single premium fixed annuity in both the Life Advisor and bank channels, which was partially offset by higher sales of other products.

2007 to 2006 Six Month Comparison. On a constant exchange rate basis, new annualized premiums decreased \$11 million, from \$621 million in the first six months of 2006 to \$610 million in the first six months of 2007. On the same basis, new annualized premiums from our Japanese Life Planner operation increased \$14 million reflecting increased sales of U.S. dollar denominated products, partially offset by sales declines in other products, particularly those that are interest rate sensitive. There was an increase in sales of our U.S. dollar denominated retirement income product in anticipation of a rate increase relative to the product's annuitization benefits. Sales in all other countries, also on a constant exchange rate basis, declined \$13 million as sales of retirement income products in Korea decreased due to a premium rate increase that occurred in April 2007.

New annualized premiums, on a constant exchange rate basis, from our Gibraltar Life operation decreased \$12 million from the first six months of 2006 to the first six months of 2007, primarily due to lower sales of our U.S. dollar denominated single premium fixed annuity, which was partially offset by higher sales of other products.

Investment Margins and Other Profitability Factors

Many of our insurance products sold in international markets provide for the buildup of cash values for the policyholder at mandated guaranteed interest rates. Japanese authorities regulate interest rates guaranteed in our Japanese insurance contracts. The regulated guaranteed interest rates do not necessarily match the actual returns on the underlying investments. The spread between the actual investment returns and these guaranteed rates of return to the policyholder is an element of the profit or loss that we will experience on these products. With regulatory approval, guaranteed rates may be changed on new business. While these actions enhance our ability to set rates commensurate with available investment returns, the major sources of profitability on our products sold in Japan, other than those sold by Gibraltar Life, are margins on mortality, morbidity and expense charges rather than investment spreads.

We base premiums and cash values in most countries in which we operate on mandated mortality and morbidity tables. Our mortality and morbidity experience in the International Insurance segment on an overall basis in the first six months of 2007 and the first six months of 2006 was well within our pricing assumptions and below the guaranteed levels reflected in the premiums we charge.

Dual Currency Investments

The table below presents as of June 30, 2007, the yen-denominated earnings subject to our dual currency and synthetic dual currency investments and the related weighted average exchange rates resulting from these investments.

| Year | (1) Interest component of dual currency investments | Cross-currency coupon swap element of synthetic dual | Yen-denominated earnings subject to these investments | Weighted average exchange rate per U.S. Dollar |
|------|--|--|--|--|
|------|--|--|--|--|

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

| | | | currency investments (in billions) | | | | (Yen per \$) |
|-------------------|---|------|--|------|---|-------|--------------|
| Remainder of 2007 | ¥ | 1.8 | ¥ | 3.7 | ¥ | 5.5 | 91.5 |
| 2008 | | 3.5 | | 6.5 | | 10.0 | 90.3 |
| 2009 | | 3.4 | | 5.8 | | 9.2 | 89.1 |
| 2010 | | 3.2 | | 4.9 | | 8.1 | 87.2 |
| 2011-2034 | | 39.1 | | 60.2 | | 99.3 | 79.8 |
| Total | ¥ | 51.0 | ¥ | 81.1 | ¥ | 132.1 | 82.0 |

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

Table of Contents

The table above does not reflect the currency hedging program discussed above. Our Japanese insurance operations also hold U.S. dollar denominated securities in their investment portfolio, which are discussed in further detail in Realized Investment Gains and General Account Investments General Account Investments.

International Investments**Operating Results**

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

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|---------------|------------------|---------------|
| | 2007 | June 30, 2006 | 2007 | June 30, 2006 |
| | (in millions) | | | |
| Operating results: | | | | |
| Revenues | \$ 169 | \$ 146 | \$ 346 | \$ 296 |
| Expenses | 126 | 112 | 241 | 218 |
| Adjusted operating income | 43 | 34 | 105 | 78 |
| Realized investment gains (losses), net, and related adjustments(1) | 1 | | 1 | 1 |
| Related charges(2) | (3) | | (3) | |
| Equity in earnings of operating joint ventures(3) | (7) | (7) | (16) | (16) |
| Income from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ 34 | \$ 27 | \$ 87 | \$ 63 |

- (1) Revenues exclude Realized investment gains (losses), net, and related adjustments. See Realized Investment Gains and General Account Investments Realized Investment Gains.
- (2) Benefits and expenses exclude related charges which represent the unfavorable (favorable) impact of Realized investment gains (losses), net, on minority interest.
- (3) Equity in earnings of operating joint ventures are included in adjusted operating income but excluded from income from continuing operations before income taxes and equity in earnings of operating joint ventures as they are reflected on a U.S. GAAP basis on an after-tax basis as a separate line in our Unaudited Interim Consolidated Statements of Operations.

In 2004, we acquired an 80 percent interest in Hyundai Investment and Securities Co., Ltd., a Korean asset management firm, from an agency of the Korean government. We subsequently renamed the company Prudential Investment & Securities Co., Ltd, or PISC. On February 28, 2007, we notified the Korean government of our intention to purchase the remaining 20 percent under the terms of the original acquisition agreement.

On July 12, 2007, we sold our 50% interest in our operating joint ventures Oppenheim Pramerica Fonds Trust GmbH and Oppenheim Pramerica Asset Management S.a.r.l., which we account for under the equity method, to our partner Oppenheim S.C.A. for \$121 million. These businesses establish, package and distribute mutual fund products to German and other European retail investors. We estimate we will record a pre-tax gain on sale of \$38 million, which will be reflected in the adjusted operating income of our International Investments segment in the third quarter of 2007. These businesses contributed \$3 million and \$2 million of adjusted operating income to the results of the International Investments segment for the six months ended June 30, 2007 and 2006, respectively.

Adjusted Operating Income

2007 to 2006 Three Month Comparison. Adjusted operating income increased \$9 million, from \$34 million in the second quarter of 2006 to \$43 million in the second quarter of 2007. The increase was driven by more

Table of Contents

favorable results from the segment's asset management businesses, primarily due to higher distribution and brokerage income in its Korean operations. In addition, results for the second quarter of 2007 include income of \$6 million from market value changes on securities relating to exchange memberships, which was essentially offset by a decrease in sales and trading results from our global commodities group. Reflected in adjusted operating income is \$4 million and \$5 million in the second quarter of 2007 and 2006, respectively, of fee revenue from the Korean government under an agreement entered into in connection with the acquisition in 2004 of PISC, related to the provision of asset management and brokerage services, which agreement extends until February 27, 2009.

2007 to 2006 Six Month Comparison. Adjusted operating income increased \$27 million, from \$78 million in the first six months of 2006 to \$105 million in the first six months of 2007. The increase was driven by more favorable results from the segment's asset management businesses, principally in its Korean operations, and income from an equity-related investment. The increase in the earnings of our Korean asset management operation came primarily from fees associated with unusually strong sales of mutual funds invested in overseas markets that carry a front end load. Results for the first six months of 2007 and 2006 include income from market value changes on securities relating to exchange memberships of \$17 million and \$15 million, respectively, and fee revenue from the Korean government under the agreement discussed above of \$9 million and \$11 million, respectively.

Revenues

2007 to 2006 Three Month Comparison. Revenues, as shown in the table above under Operating Results, increased \$23 million, from \$146 million in the second quarter of 2006 to \$169 million in the second quarter of 2007, primarily as a result of higher commission and fee revenue from our Korean asset management operations.

2007 to 2006 Six Month Comparison. Revenues increased \$50 million, from \$296 million in the first six months of 2006 to \$346 million in the first six months of 2007, primarily as a result of higher commission and fee revenue from our Korean asset management operations.

Expenses

2007 to 2006 Three Month Comparison. Expenses, as shown in the table above under Operating Results, increased \$14 million, from \$112 million in the second quarter of 2006 to \$126 million in the second quarter of 2007, primarily due to higher operating expenses corresponding with the higher level of revenues generated by our Korean asset management operations.

2007 to 2006 Six Month Comparison. Expenses increased \$23 million, from \$218 million in the first six months of 2006 to \$241 million in the first six months of 2007, primarily due to higher operating expenses corresponding with the higher level of revenues generated by our Korean asset management operations.

Corporate and Other

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Corporate and Other includes corporate operations, after allocations to our business segments, and our real estate and relocation services business.

Corporate operations consist primarily of: (1) corporate-level income and expenses, after allocations to any of our business segments, including income and expense from our qualified pension and other employee benefit plans and investment returns on capital that is not deployed in any of our segments; (2) returns from investments that we do not allocate to any of our business segments, including debt-financed investment portfolios, as well as the impact of transactions with other segments; and (3) businesses that we have placed in wind-down status but have not divested.

Table of Contents

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|---------|------------------------------|-------|
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | | |
| Operating Results: | | | | |
| Corporate Operations(1) | \$ (26) | \$ 11 | \$ (14) | \$ 17 |
| Real Estate and Relocation Services | 18 | 29 | 15 | 39 |
| Adjusted operating income | (8) | 40 | 1 | 56 |
| Realized investment gains (losses), net, and related adjustments(2) | 72 | (105) | 90 | (63) |
| Investment gains on trading account assets supporting insurance liabilities(1)(3) | | | 2 | |
| Divested businesses(4) | (5) | (10) | 14 | 48 |
| Income from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ 59 | \$ (75) | \$ 107 | \$ 41 |

(1) Includes consolidating adjustments.

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

(3) Revenues exclude net investment gains and losses on trading account assets supporting insurance liabilities. See Trading Account Assets Supporting Insurance Liabilities.

(4) See Divested Businesses.

2007 to 2006 Three Month Comparison. Adjusted operating income decreased \$48 million, from income of \$40 million in the second quarter of 2006 to a loss of \$8 million in the second quarter of 2007. Adjusted operating income from corporate operations decreased \$37 million, from income of \$11 million in the second quarter of 2006 to a loss of \$26 million in the second quarter of 2007. The decrease came from higher employee benefit expenses in the second quarter of 2007, primarily reflecting the impact of market value adjustments on certain liabilities relating to deferred compensation arrangements, as well as a decrease in income from intercompany foreign exchange hedging arrangements. Corporate operations investment income, net of interest expense and interest credited to policyholders' account balances was essentially unchanged as the impact of deployment of our excess capital in our businesses and for share repurchases, increased borrowings and less favorable income from equity method investments was largely offset by income from the investment of proceeds from our December 2006 convertible debt issuance of \$2 billion principal amount. Investment income, net of interest expense, includes approximately \$7 million in the second quarter of 2007 and \$13 million in the second quarter of 2006 related to investment of proceeds of a \$2 billion issue of convertible debt securities in November 2005 that the company called for redemption in May 2007. Corporate operations includes income from our qualified pension plan of \$91 million in the second quarter of 2007, an increase of \$5 million from \$86 million in the second quarter of 2006. The increase reflects changes in the market value of our plan assets.

Adjusted operating income of our real estate and relocation services business decreased \$11 million, from \$29 million in the second quarter of 2006 to \$18 million in the second quarter of 2007. The decline was driven by lower transaction volume associated with less favorable residential real estate market conditions in the current quarter.

2007 to 2006 Six Month Comparison. Adjusted operating income decreased \$55 million, from \$56 million in the first six months of 2006 to \$1 million in the first six months of 2007. Adjusted operating income from corporate operations decreased \$31 million, from income of \$17 million in the first six months of 2006 to a loss of \$14 million in the first six months of 2007. The decrease came primarily from higher employee benefit expenses in the first six months of 2007, including the impact of market value adjustments on certain liabilities relating to deferred compensation arrangements. In addition, corporate operations investment income, net of interest expense and interest credited to policyholders' account balances decreased, primarily reflecting the

Table of Contents

impact of deployment of our excess capital in our businesses and for share repurchases, increased borrowings and less favorable income from equity method investments. These items were partially offset by income from the investment of proceeds from our December 2006 convertible debt issuance of \$2 billion principal amount. Investment income, net of interest expense, includes approximately \$20 million in the first six months of 2007 and \$26 million in the first six months of 2006 related to investment of proceeds of a \$2 billion issue of convertible debt securities in November 2005 that the company called for redemption in May 2007. Corporate operations includes income from our qualified pension plan of \$182 million in the first six months of 2007, an increase of \$10 million from \$172 million in the first six months of 2006. The increase reflects changes in the market value of our plan assets.

Adjusted operating income of our real estate and relocation services business decreased \$24 million, from \$39 million in the first six months of 2006 to \$15 million in the first six months of 2007. The decline was driven by lower transaction volume associated with less favorable residential real estate market conditions in the current period.

Results of Operations of Closed Block Business

We established the Closed Block Business effective as of the date of demutualization. The Closed Block Business includes our in force traditional domestic participating life insurance and annuity products and assets that are used for the payment of benefits and policyholder dividends on these policies, as well as other assets and equity and related liabilities that support these policies. We no longer offer these traditional domestic participating policies. See [Overview Closed Block Business](#) for additional details.

At the end of each year, the Board of Directors of Prudential Insurance determines the dividends payable on participating policies for the following year based on the experience of the Closed Block, including investment income, net realized and unrealized investment gains, mortality experience and other factors. Although Closed Block experience for dividend action decisions is based upon statutory results, at the time the Closed Block was established, we developed, as required by U.S. GAAP, an actuarial calculation of the timing of the maximum future earnings from the policies included in the Closed Block. If actual cumulative earnings in any given period are greater than the cumulative earnings we expected, we will 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 policyholder dividend obligations 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, 2007, the Company recognized a policyholder dividend obligation to Closed Block policyholders for the excess of actual cumulative earnings over the expected cumulative earnings of \$550 million. Actual cumulative earnings, as required by U.S. GAAP, reflect the recognition of realized investment gains in the current period, as well as changes in assets and related liabilities that support the policies. Additionally, net unrealized investment gains have arisen subsequent to the establishment of the Closed Block due to the impact of lower interest rates on the market value of fixed maturities available for sale. These net unrealized investment gains have been reflected as a policyholder dividend obligation of \$1.116 billion, as of June 30, 2007, to be paid to Closed Block policyholders, unless otherwise offset by future experience, with an offsetting amount reported in accumulated other comprehensive income.

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

Table of Contents

accordance with U.S. GAAP. The following table sets forth the Closed Block Business U.S. GAAP results for the periods indicated.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|----------|------------------------------|----------|
| | 2007 | 2006 | 2007 | 2006 |
| (in millions) | | | | |
| U.S. GAAP results: | | | | |
| Revenues | \$ 1,893 | \$ 1,849 | \$ 3,884 | \$ 3,700 |
| Benefits and expenses | 1,878 | 1,811 | 3,732 | 3,578 |
| Income from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ 15 | \$ 38 | \$ 152 | \$ 122 |

Income from Continuing Operations Before Income Taxes and Equity in Earnings of Operating Joint Ventures

2007 to 2006 Three Month Comparison. Income from continuing operations before income taxes and equity in earnings of operating joint ventures decreased \$23 million, from \$38 million in the second quarter of 2006 to \$15 million in the second quarter of 2007. Second quarter 2007 results reflect an increase of \$40 million in net investment income, primarily related to higher income on joint venture, limited partnerships and private equity fund investments accounted for under the equity method, and an improvement of \$20 million in net realized investment gains, from losses of \$28 million in the second quarter of 2006 to losses of \$8 million in the second quarter of 2007. For a discussion of Closed Block Business realized investment gains (losses), net, see Realized Investment Gains and General Account Investments Realized Investment Gains. The increase in net investment income and net realized investment gains was more than offset by an increase in dividends to policyholders of \$73 million, which is comprised primarily of an increase in the policyholder dividend obligation expense of \$69 million.

2007 to 2006 Six Month Comparison. Income from continuing operations before income taxes and equity in earnings of operating joint ventures increased \$30 million, from \$122 million in the first six months of 2006 to \$152 million in the first six months of 2007. Results for the first six months of 2007 reflect realized investment gains of \$199 million as compared to \$32 million in the first six months of 2006, an increase of \$167 million. For a discussion of Closed Block Business realized investment gains (losses), net, see Realized Investment Gains and General Account Investments Realized Investment Gains. The increase in net realized investment gains was partially offset by an increase in dividends to policyholders of \$153 million, which is comprised primarily of an increase in the policyholder dividend obligation expense of \$142 million.

Revenues

2007 to 2006 Three Month Comparison. Revenues, as shown in the table above under Operating Results, increased \$44 million, from \$1.849 billion in the second quarter of 2006 to \$1.893 billion in the second quarter of 2007, principally driven by the \$40 million increase in net investment income mainly related to higher income on joint venture, limited partnerships and private equity fund investments accounted for under the equity method.

2007 to 2006 Six Month Comparison. Revenues, as shown in the table above under Operating Results, increased \$184 million, from \$3.700 billion in the first six months of 2006 to \$3.884 billion in the first six months of 2007, principally driven by the \$167 million increase in net realized investment gains.

Benefits and Expenses

2007 to 2006 Three Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, increased \$67 million, from \$1.811 billion in the second quarter of 2006 to \$1.878 billion

Table of Contents

in the second quarter of 2007, as dividends to policyholders increased \$73 million reflecting an increase in the policyholder dividend obligation expense of \$69 million.

2007 to 2006 Six Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, increased \$154 million, from \$3.578 billion in the first six months of 2006 to \$3.732 billion in the first six months of 2007, as dividends to policyholders increased \$153 million reflecting an increase in the policyholder dividend obligation expense of \$142 million.

Income Taxes

Our income tax provision amounted to \$324 million in the second quarter of 2007 compared to \$165 million in the second quarter of 2006, representing 28% of income from continuing operations before income taxes and equity in earnings of operating joint ventures in both periods, as the benefit from an increase in the dividends received deduction was offset by the growth in pre-tax income.

Our income tax provision amounted to \$747 million in the first six months of 2007 compared to \$442 million in the first six months of 2006, representing 29% of income from continuing operations before income taxes and equity in earnings of operating joint ventures in both periods, as the benefit from an increase in the dividends received deduction was offset by the growth in pre-tax income.

We employ various tax strategies, including strategies to minimize the amount of taxes resulting from realized capital gains.

We adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 on January 1, 2007. For additional information regarding the adoption of this guidance, see Note 2 of 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. A summary of the results of discontinued operations by business is as follows for the periods indicated:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|-------|------------------------------|-------|
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | | |
| Equity sales, trading, and research operations | \$ (105) | \$ 10 | \$ (103) | \$ 16 |
| Real estate investments sold or held for sale | 44 | | 62 | |
| Philippine insurance operations | | (15) | | (15) |
| Canadian intermediate weekly premium and individual health operations | | (2) | | (6) |
| Other | 4 | (5) | 6 | (9) |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

| | | | | |
|--|---------|---------|-------|---------|
| Income (loss) from discontinued operations before income taxes | (57) | (12) | (35) | (14) |
| Income tax benefit | (28) | (2) | (45) | (2) |
| Income (loss) from discontinued operations, net of taxes | \$ (29) | \$ (10) | \$ 10 | \$ (12) |

The six months ended June 30, 2007 includes a \$28 million tax benefit associated with a discontinued international business.

Table of Contents

Results for our equity sales, trading and research operations known as Prudential Equity Group, previously included in the Financial Advisory segment, have been classified as discontinued operations for all periods presented, as a result of our decision to exit these operations. Included within the table above for the three and six months ended June 30, 2007 is a \$106 million pre-tax loss in connection with this decision, primarily related to employee severance costs. We estimate approximately \$10 million in additional costs will be incurred during 2007 in connection with this decision.

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

For additional information regarding discontinued operations, see Note 3 of the Unaudited Interim Consolidated Financial Statements.

Realized Investment Gains and General Account Investments

Realized Investment Gains

Realized investment gains and losses are generated from numerous sources, including the sale of fixed maturity securities, equity securities, investments in joint ventures and limited partnerships and other types of investments, as well as adjustments to the cost basis of investments for other than temporary impairments. Realized investment gains and losses are also generated from prepayment premiums received on private fixed maturity securities, recoveries of principal on previously impaired securities, provisions for losses on commercial loans, fair value changes on commercial mortgage operations loans, gains on commercial loans in connection with securitization transactions, fair value changes on embedded derivatives and derivatives that do not qualify for hedge accounting treatment, except those derivatives used in our capacity as a broker or dealer.

We perform impairment reviews on an ongoing basis to determine when a decline in value is other than temporary. In evaluating whether a decline in value is other than temporary, we consider several factors including, but not limited to, the following: the extent (generally if greater than 20%) and duration (generally if greater than six months) of the decline in value; the reasons for the decline (credit event, currency or interest-rate related); our ability and intent to hold our investment for a period of time to allow for a recovery of value; and the financial condition of and near-term prospects of the issuer. When we determine that there is an other than temporary impairment, we write down the value of the security to its fair value, with a corresponding charge recorded in Realized investment gains (losses), net. The causes of the impairments discussed below were specific to each individual issuer and did not directly result in impairments to other securities within the same industry or geographic region.

For a further discussion of our policies regarding other than temporary declines in investment value and the related methodology for recording fixed maturity impairments, see General Account Investments Fixed Maturity Securities Impairments of Fixed Maturity Securities below. For a further discussion of our policies regarding other than temporary declines in investment value and the related methodology for recording equity impairments, see General Account Investments Equity Securities Impairments of Equity Securities below.

The level of impairments generally reflects economic conditions and is expected to increase when economic conditions worsen and to decrease when economic conditions improve. We may realize additional credit and interest rate related losses through sales of investments pursuant to our credit risk and portfolio management objectives. Impairments, interest rate related losses and credit losses are excluded from adjusted operating income.

We require most issuers of private fixed maturity securities to pay us make-whole yield maintenance payments when they prepay the securities. Prepayments are driven by factors specific to the activities of our borrowers as well as the interest rate environment.

Table of Contents

We use interest and currency swaps and other derivatives to manage interest and currency exchange rate exposures arising from mismatches between assets and liabilities, including duration mismatches. We use derivative contracts to mitigate the risk that unfavorable changes in currency exchange rates will reduce U.S. dollar equivalent earnings generated by certain of our non-U.S. businesses. We also use equity-based derivatives to hedge the equity risks embedded in some in our annuity products. Derivative contracts also include forward purchases and sales of to-be-announced mortgage-backed securities primarily related to our mortgage dollar roll program. Many of these derivative contracts do not qualify for hedge accounting, and, consequently, we recognize the changes in fair value of such contracts from period to period in current earnings, although we do not necessarily account for the related assets or liabilities the same way. Accordingly, realized investment gains and losses from our derivative activities can contribute significantly to fluctuations in net income.

Adjusted operating income excludes Realized investment gains (losses), net, (other than those representing profit or loss of certain of our businesses which primarily originate investments for sale or syndication to unrelated investors, and those associated with terminating hedges of foreign currency earnings, current period yield adjustments, or product derivatives and the effect of any related economic hedging program) and related charges and adjustments.

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 three and six months ended June 30, 2007 and 2006, respectively, and gross realized investment gains and losses on fixed maturity securities by segment for the three and six months ended June 30, 2007 and 2006, respectively. For a discussion of our general account investment portfolio and related results, including overall income yield and investment income, as well as our policies regarding other than temporary declines in investment value and the related methodology for recording impairment charges, see General Account Investments below. For additional details regarding adjusted operating income, which is our measure of performance for the segments of our Financial Services Businesses, see Note 8 to the Unaudited Interim Consolidated Financial Statements.

Table of Contents

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|----------|------------------------------|----------|
| | 2007 | 2006 | 2007 | 2006 |
| (in millions) | | | | |
| Realized investment gains (losses), net: | | | | |
| Financial Services Businesses | \$ 125 | \$ (290) | \$ 338 | \$ (175) |
| Closed Block Business | (8) | (28) | 199 | 32 |
| Consolidated realized investment gains (losses), net | \$ 117 | \$ (318) | \$ 537 | \$ (143) |
| Financial Services Businesses: | | | | |
| Realized investment gains (losses), net | | | | |
| Fixed maturity investments | \$ 13 | \$ (253) | \$ 40 | \$ (310) |
| Equity securities | 74 | 50 | 206 | 109 |
| Derivative instruments | 37 | (118) | 36 | (57) |
| Other | 1 | 31 | 56 | 83 |
| Total | 125 | (290) | 338 | (175) |
| Related adjustments(1) | (86) | (44) | (153) | (109) |
| Realized investment gains (losses), net, and related adjustments | \$ 39 | \$ (334) | \$ 185 | \$ (284) |
| Related charges(2) | \$ (7) | \$ 23 | \$ (13) | \$ 23 |
| Closed Block Business: | | | | |
| Realized investment gains (losses), net | | | | |
| Fixed maturity investments | \$ (8) | \$ (40) | \$ 88 | \$ (32) |
| Equity securities | 124 | 58 | 238 | 128 |
| Derivative instruments | (131) | (59) | (128) | (120) |
| Other | 7 | 13 | 1 | 56 |
| Total | \$ (8) | \$ (28) | \$ 199 | \$ 32 |
| Realized investment gains (losses) by segment Fixed Maturity Securities | | | | |
| Financial Services Businesses: | | | | |
| Gross realized investment gains: | | | | |
| Individual Life | \$ 1 | \$ 1 | \$ 4 | \$ 8 |
| Individual Annuities | 8 | 4 | 13 | 8 |
| Group Insurance | 4 | 8 | 18 | 18 |
| Asset Management | | | | 2 |
| Financial Advisory | | | | |
| Retirement | 27 | 7 | 39 | 31 |
| International Insurance | 22 | 34 | 49 | 55 |
| International Investments | | | | |
| Corporate and Other Operations | 2 | 1 | 4 | 2 |
| Total | 64 | 55 | 127 | 124 |
| Gross realized investment losses: | | | | |
| Individual Life | (3) | (35) | (7) | (57) |
| Individual Annuities | (14) | (55) | (25) | (86) |
| Group Insurance | (1) | (20) | (2) | (28) |
| Asset Management | | | | (1) |
| Financial Advisory | | | | |
| Retirement | (11) | (84) | (29) | (128) |
| International Insurance | (10) | (56) | (11) | (71) |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

| | | | | |
|---|-------------|--------------|-------------|--------------|
| International Investments | (1) | | (1) | |
| Corporate and Other Operations | (11) | (58) | (12) | (63) |
| Total | (51) | (308) | (87) | (434) |
| Realized investment gains (losses), net Financial Services Businesses | \$ 13 | \$ (253) | \$ 40 | \$ (310) |
| Closed Block Business: | | | | |
| Gross realized investment gains | \$ 73 | \$ 52 | \$ 224 | \$ 117 |
| Gross realized investment losses | (81) | (92) | (136) | (149) |
| Realized investment gains (losses), net Closed Block Business | \$ (8) | \$ (40) | \$ 88 | \$ (32) |

Table of Contents

- (1) Related adjustments include that portion of realized investment gains (losses), net that are included in adjusted operating income, including those related to our Asset Management segment's commercial mortgage operations and proprietary investing business, as well as gains and losses pertaining to certain derivatives contracts, as described more fully in Note 8 to the Unaudited Interim Consolidated Financial Statements.
- (2) Reflects charges that are related to realized investment gains (losses), net and excluded from adjusted operating income, as described more fully in Note 8 to the Unaudited Interim Consolidated Financial Statements.

2007 to 2006 Three Month Comparison*Financial Services Businesses*

The Financial Services Businesses' net realized investment gains in the second quarter of 2007 were \$125 million, compared to net realized investment losses of \$290 million in the second quarter of 2006. Net realized gains on fixed maturity securities were \$13 million in the second quarter of 2007 and reflect net gains on sales and maturities of fixed maturity securities of \$23 million, including \$38 million of gross losses, and private bond prepayment premiums of \$3 million, partially offset by impairments of \$11 million and credit-related losses of \$2 million. Net realized losses on fixed maturity securities were \$253 million in the second quarter of 2006 and reflect net losses on sales and maturities of fixed maturity securities of \$240 million, including gross losses of \$291 million, mainly in the Retirement segment and Corporate & Other operations which were primarily interest-rate related. Fixed maturity net realized losses also included fixed maturity impairments of \$13 million and credit-related losses of \$4 million in the second quarter of 2006, partially offset by private bond prepayment premiums of \$4 million. Interest-rate related losses on fixed maturities primarily reflect sales of lower yielding bonds in a higher rate environment in order to meet various cash flow needs, manage portfolio duration and reflect our strategy for maximizing portfolio yield while minimizing the amount of taxes on realized capital gains. Interest-rate related losses, which are excluded from adjusted operating income, where the proceeds from the sale of the securities are reinvested will generally result in higher net investment income to be included in adjusted operating income in future periods. See *General Account Investments Investment Results* for a discussion of current period yields of the Financial Services Businesses. Net realized gains on equity securities were \$74 million in the second quarter of 2007, compared to net realized gains on equity securities of \$50 million in the second quarter of 2006. Net realized gains on equity securities in both periods were primarily due to sales of Japanese equities in our Gibraltar Life and Life Planner operations from portfolio restructuring and equity sales in our Korean insurance operations. Net gains on sales of equity securities were \$78 million and \$50 million in the second quarter of 2007 and 2006, respectively, and were partially offset by impairments of \$4 million in the second quarter of 2007. Net realized gains on derivatives were \$37 million in the second quarter of 2007, compared to net derivative losses of \$118 million in the second quarter of 2006. The net derivative gains in the second quarter of 2007 were primarily the result of net gains of \$74 million from foreign currency forward contracts used to hedge the future income of non-U.S. businesses, driven by the strengthening of the U.S. dollar against the Japanese Yen. Also contributing to net derivative gains was \$51 million of net derivative activity associated with our commercial mortgage operations. These gains were partially offset by losses on interest rate derivatives used to manage the duration of the U.S. investment and liability portfolio as interest rates rose during the quarter. The derivative losses in the second quarter of 2006 were primarily the result of net losses of \$55 million from foreign currency forward contracts used to hedge the future income of non-U.S. businesses, driven by the weakening of the U.S. dollar. Net derivative losses in the second quarter of 2006 also include \$53 million on currency swaps used in conjunction with fixed maturity investments and net losses of \$25 million on Japanese Yen interest rate derivatives used to manage the duration of the Japanese fixed maturity investment portfolio as Yen interest rates rose. Net realized investment gains on other investments were \$31 million in the second quarter of 2006, primarily related to gains from real estate related investments.

During the second quarter of 2007, we recorded total other than temporary impairments of \$15 million attributable to the Financial Services Businesses, compared to total other than temporary impairments of

Table of Contents

\$19 million attributable to the Financial Services Businesses in the second quarter of 2006. The impairments in the second quarter of 2007 consisted of \$11 million relating to fixed maturities, and \$4 million relating to equity securities. The impairments in the second quarter of 2006 consisted of \$13 million relating to fixed maturities and \$6 million relating to other invested assets which include real estate investments and investments in joint ventures and partnerships.

The impairments recorded on fixed maturities in the second quarter of 2007 consist of \$9 million on public securities and \$2 million on private securities, compared with fixed maturity impairments of \$11 million on public securities and \$2 million on private securities in the second quarter of 2006. Impairments in the second quarter of 2007 were concentrated in the finance and manufacturing sectors and were primarily driven by interest rates. Impairments in the second quarter of 2006 were concentrated in the manufacturing sector and were primarily driven by downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers.

Closed Block Business

For the Closed Block Business, net realized investment losses in the second quarter of 2007 were \$8 million, compared to net realized investment losses of \$28 million in the second quarter of 2006. Net realized losses on fixed maturity securities were \$8 million in the second quarter of 2007 and \$40 million in the second quarter of 2006, and reflect net losses on sales and maturities of fixed maturity securities of \$7 million and \$36 million, respectively, including \$74 million and \$73 million of gross losses, respectively. Fixed maturity net realized losses also included fixed maturity impairments of \$2 million and credit-related losses of \$5 million in the second quarter of 2007 and fixed maturity impairments of \$15 million and credit-related losses of \$4 million in the second quarter of 2006. Partially offsetting these losses were private bond prepayment premiums of \$6 million and \$15 million, in the second quarter of 2007 and 2006, respectively. Net realized gains on equity securities were \$124 million in the second quarter of 2007, compared to net realized gains of \$58 million in the second quarter of 2006, as a result of sales pursuant to our active management strategy. Net losses on derivatives were \$131 million in the second quarter of 2007, compared to net losses of \$59 million in the second quarter of 2006. Derivative losses in the second quarter of 2007 were primarily the result of net losses of \$57 million on forward contracts of to-be-announced securities primarily related to our dollar roll program, and losses of \$53 million on interest derivatives used to manage the duration of the fixed maturity investment portfolio. Derivative losses in the second quarter of 2006 were primarily the result of net losses of \$28 million on interest rate derivatives used to manage the duration of the fixed maturity investment portfolio along with derivative losses of \$25 million on currency derivatives used to hedge foreign fixed maturity investments. Net realized investment gains on other investments were \$7 million in the second quarter of 2007 primarily related to the sale of a private partnership investment, compared to \$13 million in the second quarter of 2006 primarily due to the sale of an investment in a real estate operating company.

During the second quarter of 2007, we recorded total other than temporary impairments of \$3 million attributable to the Closed Block Business, compared to total other than temporary impairments of \$20 million attributable to the Closed Block Business in the second quarter of 2006. The impairments in the second quarter of 2007 consisted of \$2 million relating to fixed maturities and \$1 million relating to other invested assets which include real estate investments and investments in joint ventures and partnerships. The impairments in the second quarter of 2006 consisted of \$15 million relating to fixed maturities and \$5 million relating to equity securities.

The impairments recorded on fixed maturities in the second quarter of 2007 consist of \$1 million on public securities, and \$1 million on private securities, compared with \$3 million on public securities and \$12 million on private securities in the second quarter of 2006. Impairments in the second quarter of 2007 were concentrated in the finance and manufacturing sectors and were primarily driven by interest rates. Impairments in the second quarter of 2006 were concentrated in the services and manufacturing sectors and were primarily driven by downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers. Included in private fixed maturity impairments for 2006 were impairments relating to an amusement ride manufacturer.

Table of Contents***2007 to 2006 Six Month Comparison****Financial Services Businesses*

The Financial Services Businesses' net realized investment gains in the first six months of 2007 were \$338 million, compared to net realized investment losses of \$175 million in the first six months of 2006. Net realized gains on fixed maturity securities were \$40 million in the first six months of 2007 and reflect net gains on sales and maturities of fixed maturity securities of \$62 million, including \$61 million of gross losses, and private bond prepayment premiums of \$4 million, partially offset by impairments of \$22 million and credit-related losses of \$4 million. Net realized losses on fixed maturity securities were \$310 million in the first six months of 2006 and reflect net losses on sales and maturities of fixed maturity securities of \$306 million, including gross losses of \$410 million, mainly in the Retirement and Individual Annuities segments which were primarily interest-rate related. Fixed maturity net realized losses also included fixed maturity impairments of \$16 million and credit-related losses of \$8 million in the first six months of 2006, partially offset by private bond prepayment premiums of \$20 million. Interest-rate related losses on fixed maturities primarily reflect sales of lower yielding bonds in a higher rate environment in order to meet various cash flow needs, manage portfolio duration and reflect our strategy for maximizing portfolio yield while minimizing the amount of taxes on realized capital gains. Interest-rate related losses, which are excluded from adjusted operating income, where the proceeds from the sale of the securities are reinvested will generally result in higher net investment income to be included in adjusted operating income in future periods. See *General Account Investments Investment Results* for a discussion of current period yields of the Financial Services Businesses. Net realized gains on equity securities were \$206 million in the first six months of 2007, compared to net realized gains on equity securities of \$109 million in the first six months of 2006. Net realized gains on equity securities for both periods were primarily due to sales of Japanese equities in our Gibraltar Life and Life Planner operations from portfolio restructuring and equity sales in our Korean insurance operations. Net gains on sales of equity securities were \$225 million and \$117 million in the first six months of 2007 and 2006, respectively, and were partially offset by impairments of \$19 million and \$8 million in the first six months of 2007 and 2006, respectively. Net realized gains on derivatives were \$36 million in the first six months of 2007, compared to net derivative losses of \$57 million in the first six months of 2006. The derivative gains in the first six months of 2007 were primarily the result of net gains of \$88 million from foreign currency forward contracts used to hedge the future income of non-U.S. businesses, driven by the strengthening of the U.S. dollar against the Japanese Yen. Also contributing to net derivative gains was \$55 million of net derivative activity associated with our commercial mortgage operations. These gains were partially offset by losses on interest rate derivatives used to manage the duration of the U.S. investment and liability portfolio as interest rates rose during the period. The derivative losses in the first six months of 2006 were primarily the result of net losses of \$68 million from foreign currency forward contracts used to hedge the future income of non-U.S. businesses, driven by the weakening of the U.S. dollar and net losses of \$42 million on Japanese Yen interest rate derivatives used to manage the duration of the Japanese fixed maturity investment portfolio as Yen interest rates rose. These losses were partially offset by net gains of \$49 million from US treasury futures positions used to manage the duration of the US dollar fixed maturity investment portfolio as interest rates rose. Net realized investment gains on other investments were \$56 million in the first six months of 2007, primarily related to gains from real estate related investments, the sale of a private partnership investment, commercial loans, and loan securitizations. Net realized investment gains on other investments were \$83 million in the first six months of 2006, primarily related to gains from real estate related investments.

During the first six months of 2007, we recorded total other than temporary impairments of \$42 million attributable to the Financial Services Businesses, compared to total other than temporary impairments of \$30 million attributable to the Financial Services Businesses in the first six months of 2006. The impairments in the first six months of 2007 consisted of \$22 million relating to fixed maturities, and \$19 million relating to equity securities, and \$1 million relating to other invested assets which include real estate investments and investments in joint ventures and partnerships. The impairments in the first six months of 2006 consisted of \$16 million relating to fixed maturities, \$8 million relating to equity securities, and \$6 million relating to other invested assets which include real estate investments and investments in joint ventures and partnerships.

Table of Contents

The impairments recorded on fixed maturities in the first six months of 2007 consist of \$19 million on public securities and \$3 million on private securities, compared with fixed maturity impairments of \$14 million on public securities and \$2 million on private securities in the first six months of 2006. Impairments in the first six months of 2007 were concentrated in the finance and manufacturing sectors and were primarily driven by interest rates. Impairments in the second quarter of 2006 were concentrated in the manufacturing sector and were primarily driven by downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers.

Closed Block Business

For the Closed Block Business, net realized investment gains in the first six months of 2007 were \$199 million, compared to net realized investment gains of \$32 million in the first six months of 2006. Net realized gains on fixed maturity securities were \$88 million in the first six months of 2007 and reflect net gains on sales and maturities of fixed maturity securities of \$96 million, including \$121 million of gross losses, and private bond prepayment premiums of \$7 million, partially offset by impairments of \$9 million and credit-related losses of \$6 million. Net realized losses on fixed maturity securities were \$32 million in the first six months of 2006 and reflect net losses on sales and maturities of fixed maturity securities of \$35 million, including gross losses of \$122 million. Fixed maturity net realized losses also included fixed maturity impairments of \$19 million and credit-related losses of \$8 million in the first six months of 2006, offset by private bond prepayment premiums of \$30 million. Net realized gains on equity securities were \$238 million in the first six months of 2007, compared to net realized gains of \$128 million in the first six months of 2006, as a result of sales pursuant to our active management strategy. Net losses on derivatives were \$128 million in the first six months of 2007, compared to net losses of \$120 million in the first six months of 2006. Derivative losses in the first six months of 2007 were primarily the result of net losses of \$55 million on interest derivatives used to manage the duration of the fixed maturity investment portfolio along with losses \$48 million on forward contracts of to-be-announced securities primarily related to our dollar roll program. Derivative losses in the first six months of 2006 were primarily the result of net losses of \$54 million on interest rate derivatives used to manage the duration of the fixed maturity investment portfolio and net losses of \$38 million related to currency derivatives used to hedge foreign fixed maturity investments. Net realized investment gains on other investments were \$56 million in the first six months of 2006 primarily due to the sale of an investment in a real estate operating company.

During the first six months of 2007, we recorded total other than temporary impairments of \$13 million attributable to the Closed Block Business, compared to total other than temporary impairments of \$36 million attributable to the Closed Block Business in the first six months of 2006. The impairments in the first six months of 2007 consisted of \$9 million relating to fixed maturities, \$1 million relating to equity securities, and \$3 million relating to other invested assets which include commercial loans, real estate investments and investments in joint ventures and partnerships. The impairments in the first six months of 2006 consisted of \$19 million relating to fixed maturities, \$16 million relating to equity securities, and \$1 million relating to other invested assets which include commercial loans, real estate investments and investments in joint ventures and partnerships.

The impairments recorded on fixed maturities in the first six months of 2007 consist of \$3 million on public securities and \$6 million on private securities, compared with \$5 million on public securities and \$14 million on private securities in the first six months of 2006. Impairments in both the first six months of 2007 and the first six months of 2006 were concentrated in the services and manufacturing sectors and were primarily driven by interest rates, downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers. Included in private fixed maturity impairments for 2006 were impairments relating to an amusement ride manufacturer.

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 loans, equity securities and other invested assets. 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

Table of Contents

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.

Our total general account investments were \$225.9 billion and \$229.7 billion as of June 30, 2007 and December 31, 2006, respectively, which are segregated between the Financial Services Businesses and the Closed Block Business. Total general account investments attributable to the Financial Services Businesses were \$157.6 billion and \$159.6 billion as of June 30, 2007 and December 31, 2006, respectively, while total general account investments attributable to the Closed Block Business were \$68.3 billion and \$70.1 billion as of June 30, 2007 and December 31, 2006, respectively. The following table sets forth the composition of the investments of our general account as of the dates indicated. The average duration of our general account investment portfolio attributable to the domestic Financial Services Businesses as of June 30, 2007 is between 4 and 5 years.

| | Financial Services Businesses | June 30, 2007 | | % of Total |
|--|-------------------------------------|-----------------------------|-------------------|---------------|
| | | Closed Block Business | Total | |
| (\$ in millions) | | | | |
| Fixed Maturities: | | | | |
| Public, available for sale, at fair value | \$ 89,557 | \$ 36,438 | \$ 125,995 | 56.8% |
| Public, held to maturity, at amortized cost | 2,842 | | 2,842 | 1.8 |
| Private, available for sale, at fair value | 18,594 | 11,786 | 30,380 | 11.8 |
| Private, held to maturity, at amortized cost | 528 | | 528 | 0.3 |
| Trading account assets supporting insurance liabilities, at fair value | 14,069 | | 14,069 | 8.9 |
| Other trading account assets, at fair value | 137 | 13 | 150 | 0.1 |
| Equity securities, available for sale, at fair value | 4,581 | 4,097 | 8,678 | 2.9 |
| Commercial loans, at book value | 17,585 | 7,227 | 24,812 | 11.2 |
| Policy loans, at outstanding balance | 3,642 | 5,400 | 9,042 | 2.3 |
| Other long-term investments(1) | 2,674 | 914 | 3,588 | 1.7 |
| Short-term investments | 3,427 | 2,376 | 5,803 | 2.2 |
| Total general account investments | 157,636 | 68,251 | 225,887 | 100.0% |
| Invested assets of other entities and operations(2) | 9,699 | | 9,699 | |
| Total investments | \$ 167,335 | \$ 68,251 | \$ 235,586 | |

| | Financial Services Businesses | December 31, 2006 | | % of Total |
|--|-------------------------------------|-----------------------------|------------|---------------|
| | | Closed Block Business | Total | |
| (\$ in millions) | | | | |
| Fixed Maturities: | | | | |
| Public, available for sale, at fair value | \$ 92,802 | \$ 38,752 | \$ 131,554 | 57.3% |
| Public, held to maturity, at amortized cost | 3,025 | | 3,025 | 1.3 |
| Private, available for sale, at fair value | 18,336 | 12,021 | 30,357 | 13.2 |
| Private, held to maturity, at amortized cost | 443 | | 443 | 0.2 |
| Trading account assets supporting insurance liabilities, at fair value | 14,262 | | 14,262 | 6.2 |
| Other trading account assets, at fair value | 109 | | 109 | 0.1 |
| Equity securities, available for sale, at fair value | 4,314 | 3,772 | 8,086 | 3.5 |
| Commercial loans, at book value | 17,275 | 7,318 | 24,593 | 10.7 |
| Policy loans, at outstanding balance | 3,472 | 5,415 | 8,887 | 3.9 |
| Other long-term investments(1) | 2,791 | 965 | 3,756 | 1.6 |
| Short-term investments | 2,752 | 1,851 | 4,603 | 2.0 |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

| | | | | |
|---|------------|-----------|------------|--------|
| Total general account investments | 159,581 | 70,094 | 229,675 | 100.0% |
| Invested assets of other entities and operations(2) | 5,742 | | 5,742 | |
| Total investments | \$ 165,323 | \$ 70,094 | \$ 235,417 | |

Table of Contents

- (1) Other long-term investments consist of real estate and non-real estate related investments in joint ventures (other than our investment in operating joint ventures, which includes our investment in Wachovia Securities) and partnerships, investment real estate held through direct ownership and other miscellaneous investments.
- (2) Includes invested assets of securities brokerage, securities trading, banking operations, real estate and relocation services, and asset management operations. Excludes assets of our asset management operations managed for third parties and those assets classified as separate account assets on our balance sheet.

The decrease in general account investments attributable to the Financial Services Businesses in 2007 was primarily due to the liquidation of the investment grade fixed income investment portfolio purchased using the proceeds of the convertible senior notes issued in 2005. These notes were called for redemption during the second quarter of 2007, as discussed in Note 6 to the Unaudited Interim Consolidated Financial Statements. Also contributing to the decrease was net operating and capital outflows, changes in foreign exchange rates, and declines in market value attributable to higher interest rates, partially offset by portfolio growth as a result of reinvestment of net investment income. The decrease in general account investments attributable to the Closed Block Business in 2007 was primarily due to a decline of investments financed by borrowings.

We have substantial insurance operations in Japan, with 29% and 30% of our Financial Services Businesses' general account investments relating to our Japanese insurance operations as of June 30, 2007 and December 31, 2006, 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, 2007 | December 31, 2006 |
|--|------------------|----------------------|
| | (in millions) | |
| Fixed Maturities: | | |
| Public, available for sale, at fair value | \$ 31,246 | \$ 32,242 |
| Public, held to maturity, at amortized cost | 2,842 | 3,025 |
| Private, available for sale, at fair value | 3,170 | 3,139 |
| Private, held to maturity, at amortized cost | 528 | 443 |
| Trading account assets supporting insurance liabilities, at fair value | 1,146 | 1,106 |
| Other trading account assets, at fair value | 28 | 28 |
| Equity securities, available for sale, at fair value | 2,526 | 2,372 |
| Commercial loans, at book value | 2,758 | 2,782 |
| Policy loans, at outstanding balance | 1,003 | 1,016 |
| Other long-term investments(1) | 744 | 970 |
| Short-term investments | 339 | 374 |
| Total Japanese general account investments(2) | \$ 46,330 | \$ 47,497 |

- (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.
- (2) Excludes assets classified as separate accounts assets on our balance sheet.

Our Japanese insurance operations use the yen as their functional currency, as it is the currency in which they conduct the majority of their operations. 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. dollars. As of June 30, 2007, our Japanese insurance operations had \$9.1 billion of investments denominated in U.S. dollars, including \$1.1 billion that were hedged to yen through third party derivative contracts and \$3.4 billion that support liabilities denominated in U.S. dollars. As of December 31, 2006, our Japanese insurance operations had \$9.3 billion of investments denominated in U.S. dollars, including \$1.2 billion that were hedged to yen through third party derivative contracts and \$3.1 billion that support liabilities denominated in U.S. dollars.

Table of Contents**Investment Results**

The following tables set forth the income yield and investment income, excluding realized investment gains (losses), for each major investment category of our general account for the periods indicated.

| | Three Months Ended June 30, 2007 | | | | | |
|---|--|----------|-----------------|--------|-----------------|----------|
| | Closed Block | | | | | |
| | Financial Services Businesses | | Business | | Combined | |
| | Yield(1) | Amount | Yield(1) | Amount | Yield(1) | Amount |
| | (\$ in millions) | | | | | |
| Fixed maturities | 5.05% | \$ 1,423 | 6.52% | \$ 759 | 5.47% | \$ 2,182 |
| Trading account assets supporting insurance liabilities | 4.98 | 175 | 4.98 | 175 | 4.98 | 175 |
| Equity securities | 4.56 | 44 | 3.66 | 29 | 4.15 | 73 |
| Commercial loans | 6.03 | 261 | 6.72 | 120 | 6.24 | 381 |
| Policy loans | 5.10 | 46 | 6.19 | 83 | 5.75 | 129 |
| Short-term investments and cash equivalents | 4.41 | 87 | 3.24 | 42 | 4.36 | 129 |
| Other investments | 6.65 | 46 | 22.09 | 49 | 10.39 | 95 |
| Gross investment income before investment expenses | 5.15 | 2,082 | 6.56 | 1,082 | 5.55 | 3,164 |
| Investment expenses | (0.15) | (135) | (0.22) | (136) | (0.17) | (271) |
| Investment income after investment expenses | 5.00% | 1,947 | 6.34% | 946 | 5.38% | 2,893 |
| Investment results of other entities and operations(2) | | 131 | | | | 131 |
| Total investment income | | \$ 2,078 | | \$ 946 | | \$ 3,024 |

| | Three Months Ended June 30, 2006 | | | | | |
|---|--|----------|----------------------------------|--------|-----------------|----------|
| | Financial Services Businesses | | Closed Block Business | | Combined | |
| | Yield(1) | Amount | Yield(1) | Amount | Yield(1) | Amount |
| | (\$ in millions) | | | | | |
| Fixed maturities | 4.84% | \$ 1,322 | 6.41% | \$ 748 | 5.30% | \$ 2,070 |
| Trading account assets supporting insurance liabilities | 4.67 | 164 | 4.67 | 164 | 4.67 | 164 |
| Equity securities | 4.00 | 36 | 3.21 | 23 | 3.64 | 59 |
| Commercial loans | 6.26 | 251 | 7.33 | 131 | 6.59 | 382 |
| Policy loans | 4.80 | 38 | 6.19 | 83 | 5.68 | 121 |
| Short-term investments and cash equivalents | 5.40 | 79 | 12.06 | 46 | 6.41 | 125 |
| Other investments | 4.83 | 35 | 2.35 | 5 | 4.25 | 40 |
| Gross investment income before investment expenses | 4.98 | 1,925 | 6.34 | 1,036 | 5.37 | 2,961 |
| Investment expenses | (0.15) | (126) | (0.22) | (130) | (0.17) | (256) |
| Investment income after investment expenses | 4.83% | 1,799 | 6.12% | 906 | 5.20% | 2,705 |
| Investment results of other entities and operations(2) | | 78 | | | | 78 |
| Total investment income | | \$ 1,877 | | \$ 906 | | \$ 2,783 |

-
- (1) Yields are annualized, for interim periods, and based on quarterly average carrying values except for fixed maturities, equity securities and securities lending activity. Yields for fixed maturities are based on

Table of Contents

amortized cost. Yields for equity securities are based on cost. Yields for securities lending activity are calculated net of corresponding liabilities and rebate expenses. Yields exclude investment income on assets other than those included in invested assets of the Financial Services Businesses. Prior periods yields are presented on a basis consistent with the current period presentation.

- (2) Includes investment income of securities brokerage, securities trading, banking operations, real estate and relocation services, and asset management operations.

The net investment income yield on our general account investments after investment expenses, excluding realized investment gains (losses), was 5.38% and 5.20% for the three months ended June 30, 2007 and 2006, respectively. The net investment income yield attributable to the Financial Services Businesses was 5.00% for the three months ended June 30, 2007, compared to 4.83% for the three months ended June 30, 2006. See below for a discussion of the change in the Financial Services Businesses' yields.

The net investment income yield attributable to the Closed Block Business was 6.34% for the three months ended June 30, 2007, compared to 6.12% for the three months ended June 30, 2006. The increase was primarily due to higher income from investments in joint ventures and limited partnerships, driven by net appreciation of underlying assets.

| | Six Months Ended June 30, 2007 | | | | | |
|---|----------------------------------|----------|--------------------------|----------|----------|----------|
| | Financial Services Businesses | | Closed Block Business | | Combined | |
| | Yield(1) | Amount | Yield(1) | Amount | Yield(1) | Amount |
| | (\$ in millions) | | | | | |
| Fixed maturities | 5.05% | \$ 2,837 | 6.49% | \$ 1,515 | 5.46% | \$ 4,352 |
| Trading account assets supporting insurance liabilities | 4.94 | 346 | | | 4.94 | 346 |
| Equity securities | 4.63 | 89 | 3.18 | 50 | 3.98 | 139 |
| Commercial loans | 6.05 | 517 | 7.08 | 252 | 6.35 | 769 |
| Policy loans | 5.08 | 89 | 6.17 | 164 | 5.74 | 253 |
| Short-term investments and cash equivalents | 4.89 | 183 | 5.46 | 82 | 5.02 | 265 |
| Other investments | 6.66 | 92 | 20.39 | 90 | 9.97 | 182 |
| Gross investment income before investment expenses | 5.16 | 4,153 | 6.56 | 2,153 | 5.56 | 6,306 |
| Investment expenses | (0.15) | (274) | (0.22) | (274) | (0.17) | (548) |
| Investment income after investment expenses | 5.01% | 3,879 | 6.34% | 1,879 | 5.39% | 5,758 |
| Investment results of other entities and operations(2) | | 256 | | | | 256 |
| Total investment income | | \$ 4,135 | | \$ 1,879 | | \$ 6,014 |

Table of Contents

| | Six Months Ended June 30, 2006 | | | | | |
|---|----------------------------------|----------|--------------------------|----------|----------|----------|
| | Financial Services Businesses | | Closed Block Business | | Combined | |
| | Yield(1) | Amount | Yield(1) | Amount | Yield(1) | Amount |
| | (\$ in millions) | | | | | |
| Fixed maturities | 4.82% | \$ 2,572 | 6.47% | \$ 1,475 | 5.30% | \$ 4,047 |
| Trading account assets supporting insurance liabilities | 4.59 | 318 | | | 4.59 | 318 |
| Equity securities | 4.77 | 83 | 3.09 | 44 | 4.02 | 127 |
| Commercial loans | 6.14 | 485 | 7.76 | 275 | 6.64 | 760 |
| Policy loans | 4.86 | 75 | 6.19 | 165 | 5.70 | 240 |
| Short-term investments and cash equivalents | 4.95 | 150 | 9.76 | 92 | 5.70 | 242 |
| Other investments | 7.19 | 98 | 9.60 | 42 | 7.82 | 140 |
| Gross investment income before investment expenses | 4.99 | 3,781 | 6.52 | 2,093 | 5.43 | 5,874 |
| Investment expenses | (0.15) | (239) | (0.24) | (255) | (0.18) | (494) |
| Investment income after investment expenses | 4.84% | 3,542 | 6.28% | 1,838 | 5.25% | 5,380 |
| Investment results of other entities and operations(2) | | 149 | | | | 149 |
| Total investment income | | \$ 3,691 | | \$ 1,838 | | \$ 5,529 |

- (1) Yields are annualized, for interim periods, and 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 securities lending activity are calculated net of corresponding liabilities and rebate expenses. Yields exclude investment income on assets other than those included in invested assets of the Financial Services Businesses. Prior periods yields are presented on a basis consistent with the current period presentation.
- (2) Includes investment income of securities brokerage, securities trading, banking operations, real estate and relocation services, and asset management operations.

The net investment income yield on our general account investments after investment expenses, excluding realized investment gains (losses), was 5.39% and 5.25% for the six months ended June 30, 2007 and 2006, respectively. The net investment income yield attributable to the Financial Services Businesses was 5.01% for the six months ended June 30, 2007, compared to 4.84% for the six months ended June 30, 2006. See below for a discussion of the change in the Financial Services Businesses yields.

The net investment income yield attributable to the Closed Block Business was 6.34% for the six months ended June 30, 2007, compared to 6.28% for the six months ended June 30, 2006. The increase was primarily due to higher income from investments in joint ventures and limited partnerships, driven by net appreciation of underlying assets.

Table of Contents

The following tables set forth the income yield and investment income, excluding realized investment gains (losses), for each major investment category of the Financial Services Business general account, excluding the Japanese operations portion of the general account which is presented separately below, for the periods indicated.

| | Three Months Ended June 30, 2007 | | Three Months Ended June 30, 2006 | |
|---|-------------------------------------|----------|-------------------------------------|----------|
| | Yield(1) | Amount | Yield(1) | Amount |
| | (\$ in millions) | | | |
| Fixed maturities | 6.31% | \$ 1,161 | 6.21% | \$ 1,086 |
| Trading account assets supporting insurance liabilities | 5.32 | 172 | 4.98 | 162 |
| Equity securities | 7.19 | 33 | 5.57 | 24 |
| Commercial loans | 6.32 | 230 | 6.73 | 229 |
| Policy loans | 5.61 | 36 | 5.46 | 30 |
| Short-term investments and cash equivalents | 4.55 | 82 | 5.60 | 74 |
| Other investments | 2.07 | 10 | 1.59 | 8 |
| Gross investment income before investment expenses | 6.04 | 1,724 | 5.99 | 1,613 |
| Investment expenses | (0.14) | (111) | (0.13) | (103) |
| Investment income after investment expenses | 5.90% | 1,613 | 5.86% | 1,510 |
| Investment results of other entities and operations(2) | | 131 | | 78 |
| Total investment income | | \$ 1,744 | | \$ 1,588 |

- (1) Yields are annualized, for interim periods, and 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 securities lending activity are calculated net of corresponding liabilities and rebate expenses. Yields exclude investment income on assets other than those included in invested assets of the Financial Services Businesses. Prior periods yields are presented on a basis consistent with the current period presentation.
- (2) Includes investment income of securities brokerage, securities trading, banking operations, real estate and relocation services, and asset management operations.

The net investment income yield attributable to the non-Japanese operations portion of the Financial Services Businesses portfolio was 5.90% for the three months ended June 30, 2007, compared to 5.86% for the three months ended June 30, 2006. The increase was primarily due to an increase in fixed maturity yields as a result of interest rates increases, including the benefit of reinvestment of proceeds from sales of fixed maturities at higher available interest rates as discussed above under Realized Investment Gains.

| | Six Months Ended June 30, 2007 | | Six Months Ended June 30, 2006 | |
|---|-----------------------------------|----------|-----------------------------------|----------|
| | Yield(1) | Amount | Yield(1) | Amount |
| | (\$ in millions) | | | |
| Fixed maturities | 6.35% | \$ 2,322 | 6.17% | \$ 2,112 |
| Trading account assets supporting insurance liabilities | 5.23 | 337 | 4.89 | 313 |
| Equity securities | 7.06 | 65 | 7.16 | 61 |
| Commercial loans | 6.35 | 456 | 6.61 | 445 |
| Policy loans | 5.60 | 70 | 5.49 | 58 |
| Short-term investments and cash equivalents | 5.19 | 173 | 5.21 | 143 |
| Other investments | 3.29 | 31 | 4.55 | 41 |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

| | | | | |
|--|--------|----------|--------|----------|
| Gross investment income before investment expenses | 6.10 | 3,454 | 6.00 | 3,173 |
| Investment expenses | (0.14) | (226) | (0.14) | (194) |
| Investment income after investment expenses | 5.96% | 3,228 | 5.86% | 2,979 |
| Investment results of other entities and operations(2) | | 256 | | 149 |
| Total investment income | | \$ 3,484 | | \$ 3,128 |

Table of Contents

- (1) Yields are annualized, for interim periods, and 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 securities lending activity are calculated net of corresponding liabilities and rebate expenses. Yields exclude investment income on assets other than those included in invested assets of the Financial Services Businesses. Prior periods yields are presented on a basis consistent with the current period presentation.
- (2) Includes investment income of securities brokerage, securities trading, banking operations, real estate and relocation services, and asset management operations.

The net investment income yield attributable to the non-Japanese operations portion of the Financial Services Businesses portfolio was 5.96% for the six months ended June 30, 2007, compared to 5.86% for the six months ended June 30, 2006. The increase was primarily due to an increase in fixed maturity yields as a result of interest rates increases, including higher rates on floating rate investments and the benefit of reinvestment of proceeds from sales of fixed maturities at higher available interest rates as discussed above under Realized Investment Gains.

The following tables set forth the income yield and investment income, excluding realized investment gains (losses), for each major investment category of our Japanese operations general account for the periods indicated.

| | Three Months Ended June 30, 2007 | | Three Months Ended June 30, 2006 | |
|---|-------------------------------------|--------|-------------------------------------|--------|
| | Yield(1) | Amount | Yield(1) | Amount |
| | (\$ in millions) | | | |
| Fixed maturities | 2.75% | \$ 262 | 2.47% | \$ 236 |
| Trading account assets supporting insurance liabilities | 1.13 | 3 | 0.94 | 2 |
| Equity securities | 2.15 | 11 | 2.53 | 12 |
| Commercial loans | 4.50 | 31 | 3.60 | 22 |
| Policy loans | 3.79 | 10 | 3.37 | 8 |
| Short-term investments and cash equivalents | 3.37 | 5 | 3.93 | 5 |
| Other investments | 17.32 | 36 | 11.54 | 27 |
| Gross investment income before investment expenses | 3.08 | 358 | 2.71 | 312 |
| Investment expenses | (0.18) | (24) | (0.17) | (23) |
| Total investment income | 2.90% | \$ 334 | 2.54% | \$ 289 |

- (1) Yields are annualized, for interim periods, and 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 securities lending activity are calculated net of corresponding liabilities and rebate expenses. Yields exclude investment income on assets other than those included in invested assets of the Financial Services Businesses. Prior periods yields are presented on a basis consistent with the current period presentation.

The net investment income yield attributable to the Japanese insurance operations portfolios was 2.90% for the three months ended June 30, 2007, compared to 2.54% for the three months ended June 30, 2006. The increase in yield on the Japanese insurance portfolio is primarily attributable to an increase in unhedged U.S. dollar investments and the lengthening of the duration of the investment portfolio. Also contributing to the increase were more favorable results from joint venture investments within other investments. The U.S. 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 Japanese fixed maturities. The average value of U.S. dollar denominated fixed maturities that are not hedged to yen through third party derivative contracts for the

Table of Contents

three months ended June 30, 2007 and 2006 was approximately \$7.0 billion and \$6.1 billion, respectively, based on amortized cost.

| | Six Months Ended June 30, 2007 | | Six Months Ended June 30, 2006 | |
|---|-----------------------------------|----------------------------|-----------------------------------|--------|
| | Yield(1) | Amount (\$ in millions) | Yield(1) | Amount |
| Fixed maturities | 2.69% | \$ 515 | 2.46% | \$ 460 |
| Trading account assets supporting insurance liabilities | 1.61 | 9 | 0.95 | 5 |
| Equity securities | 2.42 | 24 | 2.48 | 22 |
| Commercial loans | 4.43 | 61 | 3.43 | 40 |
| Policy loans | 3.78 | 19 | 3.50 | 17 |
| Short-term investments and cash equivalents | 2.91 | 10 | 3.08 | 7 |
| Other investments | 14.11 | 61 | 12.41 | 57 |
| Gross investment income before investment expenses | 3.00 | 699 | 2.71 | 608 |
| Investment expenses | (0.18) | (48) | (0.18) | (45) |
| Total investment income | 2.82% | \$ 651 | 2.53% | \$ 563 |

- (1) Yields are annualized, for interim periods, and 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 securities lending activity are calculated net of corresponding liabilities and rebate expenses. Yields exclude investment income on assets other than those included in invested assets of the Financial Services Businesses. Prior periods yields are presented on a basis consistent with the current period presentation.

The net investment income yield attributable to the Japanese insurance operations portfolios was 2.82% for the six months ended June 30, 2007, compared to 2.53% for the six months ended June 30, 2006. The increase in yield on the Japanese insurance portfolio is primarily attributable to an increase in unhedged U.S. dollar investments and the lengthening of the duration of the investment portfolio. Also contributing to the increase were more favorable results from joint venture investments within other investments. The U.S. 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 Japanese fixed maturities. The average value 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, 2007 and 2006 was approximately \$7.0 billion and \$6.0 billion, respectively, based on amortized cost.

Fixed Maturity Securities

Our fixed maturity securities portfolio consists of publicly traded and privately placed debt securities across an array of industry categories. The fixed maturity securities relating to our international insurance operations are primarily comprised of foreign government 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.

Table of Contents

| Industry(1) | June 30, 2007 | | | Fair value (in millions) | December 31, 2006 | | | Fair Value |
|----------------------------|-------------------|---------------------------|----------------------------|-----------------------------|-------------------|---------------------------|----------------------------|-------------------|
| | Amortized Cost | Gross Unrealized Gains(2) | Gross Unrealized Losses(2) | | Amortized Cost | Gross Unrealized Gains(2) | Gross Unrealized Losses(2) | |
| Corporate Securities: | | | | | | | | |
| Finance | \$ 18,603 | \$ 225 | \$ 246 | \$ 18,582 | \$ 19,189 | \$ 324 | \$ 102 | \$ 19,411 |
| Manufacturing | 14,145 | 468 | 204 | 14,409 | 14,133 | 577 | 139 | 14,571 |
| Utilities | 9,660 | 384 | 134 | 9,910 | 9,313 | 454 | 74 | 9,693 |
| Services | 7,724 | 261 | 119 | 7,866 | 7,398 | 297 | 71 | 7,624 |
| Energy | 3,617 | 157 | 65 | 3,709 | 3,550 | 189 | 45 | 3,694 |
| Retail and Wholesale | 2,560 | 67 | 33 | 2,594 | 2,605 | 78 | 20 | 2,663 |
| Transportation | 2,578 | 103 | 38 | 2,643 | 2,483 | 128 | 20 | 2,591 |
| Other | 552 | 16 | 13 | 555 | 563 | 11 | 15 | 559 |
| Total Corporate Securities | 59,439 | 1,681 | 852 | 60,268 | 59,234 | 2,058 | 486 | 60,806 |
| Foreign Government | 25,107 | 463 | 201 | 25,369 | 25,164 | 685 | 70 | 25,779 |
| Asset-Backed Securities | 14,599 | 128 | 66 | 14,661 | 16,196 | 156 | 29 | 16,323 |
| Mortgage Backed | 7,981 | 44 | 125 | 7,900 | 8,523 | 77 | 53 | 8,547 |
| U.S. Government | 3,018 | 249 | 26 | 3,241 | 2,812 | 324 | 14 | 3,122 |
| Total | \$ 110,144 | \$ 2,565 | \$ 1,270 | \$ 111,439 | \$ 111,929 | \$ 3,300 | \$ 652 | \$ 114,577 |

- (1) Investment data has been classified based on Lehman industry categorizations for domestic public holdings and similar classifications by industry for all other holdings.
- (2) Includes \$6 million of gross unrealized gains and \$88 million of gross unrealized losses as of June 30, 2007, compared to \$24 million of gross unrealized gains and \$53 million of gross unrealized losses as of December 31, 2006 on securities classified as held to maturity, which are not reflected in other comprehensive income.

As a percentage of amortized cost, fixed maturity investments attributable to the Financial Services Businesses as of June 30, 2007, consist primarily of 23% foreign government sector, 17% finance sector, 13% asset-backed securities sector and 13% manufacturing sector compared to 22% foreign government sector, 17% finance sector, 14% asset-backed securities sector and 13% manufacturing sector as of December 31, 2006. As of June 30, 2007, 98% of the mortgage-backed securities in the Financial Services Businesses were publicly traded agency pass-through securities related to residential mortgage loans, which are supported by implicit or explicit government guarantees and have credit ratings of AA or AAA. Collateralized mortgage obligations represented the remaining 2% of mortgage-backed securities (and less than 1% of total fixed maturities in the Financial Services Businesses). As of June 30, 2007, included within asset-backed securities attributable to the Financial Services Business is approximately \$8.5 billion of securities collateralized by sub-prime mortgages including approximately 70% with AAA credit ratings, 20% with AA credit ratings, 9% with A credit ratings, and the remainder with BBB credit ratings. Approximately half of the \$8.5 billion in securities collateralized by sub-prime mortgages are AAA rated senior securities with expected lives of one year or less. For a further discussion of credit quality, see below under Fixed Maturity Securities Credit Quality.

The gross unrealized losses related to our fixed maturity portfolio attributable to the Financial Services Businesses were \$1.3 billion as of June 30, 2007, compared to \$0.7 billion as of December 31, 2006. The gross unrealized losses as of June 30, 2007 were concentrated primarily in the finance, manufacturing, and foreign government sectors. The gross unrealized losses as of December 31, 2006 were concentrated primarily in the finance, manufacturing, and utilities sectors.

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.

| Industry(1) | June 30, 2007 | | | Fair value (in millions) | December 31, 2006 | | | Fair Value |
|-----------------------------------|------------------|------------------------|-------------------------|-----------------------------|-------------------|------------------------|-------------------------|------------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | |
| Corporate Securities: | | | | | | | | |
| Manufacturing | \$ 8,154 | \$ 249 | \$ 117 | \$ 8,286 | \$ 8,358 | \$ 349 | \$ 80 | \$ 8,627 |
| Finance | 9,358 | 63 | 159 | 9,262 | 8,930 | 135 | 46 | 9,019 |
| Utilities | 5,459 | 257 | 111 | 5,605 | 5,753 | 323 | 66 | 6,010 |
| Services | 4,459 | 157 | 65 | 4,551 | 4,765 | 219 | 41 | 4,943 |
| Energy | 1,889 | 74 | 31 | 1,932 | 2,104 | 120 | 14 | 2,210 |
| Retail and Wholesale | 1,612 | 52 | 22 | 1,642 | 1,691 | 71 | 11 | 1,751 |
| Transportation | 1,080 | 51 | 23 | 1,108 | 1,061 | 66 | 12 | 1,115 |
| Other | | | | | | | | |
| Total Corporate Securities | 32,011 | 903 | 528 | 32,386 | 32,662 | 1,283 | 270 | 33,675 |
| Asset-Backed Securities | 8,309 | 17 | 28 | 8,298 | 8,171 | 23 | 15 | 8,179 |
| U.S. Government | 3,828 | 148 | 88 | 3,888 | 4,376 | 242 | 38 | 4,580 |
| Mortgage Backed | 3,235 | 8 | 75 | 3,168 | 3,362 | 14 | 35 | 3,341 |
| Foreign Government | 445 | 43 | 4 | 484 | 895 | 105 | 2 | 998 |
| Total | \$ 47,828 | \$ 1,119 | \$ 723 | \$ 48,224 | \$ 49,466 | \$ 1,667 | \$ 360 | \$ 50,773 |

(1) Investment data has been classified based on Lehman industry categorizations for domestic public holdings and similar classifications by industry for all other holdings.

As a percentage of amortized cost, fixed maturity investments attributable to the Closed Block Business as of June 30, 2007 consist primarily of 20% finance sector, 17% asset-backed securities sector, 17% manufacturing sector, 11% utilities sector, and 9% services sector compared to 18% finance sector, 17% manufacturing sector, 17% asset-backed securities sector, 12% utilities sector, and 10% services sector as of December 31, 2006. As of June 30, 2007, 82% of the mortgage-backed securities in the Closed Block Business were publicly traded agency pass-through securities related to residential mortgage loans, which are supported by implicit or explicit government guarantees and have credit ratings of AA or AAA. Collateralized mortgage obligations represented the remaining 18% of mortgage-backed securities (and 1% of total fixed maturities in the Closed Block Business), and have credit ratings of A or better. As of June 30, 2007, included within asset-backed securities attributable to the Closed Block Business is approximately \$6.8 billion of securities collateralized by sub-prime mortgages including approximately 81% with AAA credit ratings, 17% with AA credit ratings, 2% with A credit ratings, and less than 1% with BBB credit ratings. More than half of the \$6.8 billion of securities collateralized by sub-prime mortgages are AAA rated senior securities with expected lives of one year or less. For a further discussion of credit quality, see below under Fixed Maturity Securities Credit Quality.

The gross unrealized losses related to our fixed maturity portfolio attributable to the Closed Block Business were \$0.7 billion as of June 30, 2007 compared to \$0.4 billion as of December 31, 2006. The gross unrealized losses as of June 30, 2007 and December 31, 2006 were concentrated primarily in the finance, manufacturing, and utilities.

Table of Contents*Fixed Maturity Securities Credit Quality*

The Securities Valuation Office, or SVO, of the National Association of Insurance Commissioners, or NAIC, evaluates the investments of insurers for regulatory reporting purposes and assigns fixed maturity securities to one of six categories called NAIC Designations. NAIC designations of 1 or 2 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 are referred to as below investment grade, which include securities rated Ba1 or lower by Moody's and BB+ or lower by Standard & Poor's. 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 non-U.S. dollar denominated investments of our Japanese insurance companies are based on ratings assigned by Moody's, Standard & Poor's, or rating equivalents based on ratings assigned by Japanese credit ratings agencies.

The amortized cost of our public and private below investment grade fixed maturities attributable to the Financial Services Businesses totaled \$7.2 billion, or 6%, of the total fixed maturities as of June 30, 2007 and \$7.1 billion, or 6%, of the total fixed maturities as of December 31, 2006. Below investment grade fixed maturities represented 7% and 11% of the gross unrealized losses attributable to the Financial Services Businesses as of June 30, 2007 and December 31, 2006, respectively.

The amortized cost of our public and private below investment grade fixed maturities attributable to the Closed Block Business totaled \$5.6 billion, or 12%, of the total fixed maturities as of June 30, 2007 and \$6.2 billion, or 13%, of the total fixed maturities as of December 31, 2006. Below investment grade fixed maturities represented 9% of the gross unrealized losses attributable to the Closed Block Business as of June 30, 2007, compared to 16% of gross unrealized losses as of December 31, 2006.

Public Fixed Maturities Credit Quality

The following table sets forth our public fixed maturity portfolios by NAIC rating attributable to the Financial Services Businesses as of the dates indicated.

| (1) (2) NAIC Designation | Rating Agency Equivalent | June 30, 2007 | | | December 31, 2006 | | | | |
|--------------------------------|---------------------------|-------------------|---------------------------------|----------------------------------|--------------------------------|-------------------|---------------------------------|----------------------------------|---------------|
| | | Amortized Cost | Gross Unrealized Gains(3) | Gross Unrealized Losses(3) | Fair Value (in millions) | Amortized Cost | Gross Unrealized Gains(3) | Gross Unrealized Losses(3) | Fair Value |
| 1 | Aaa, Aa, A | \$ 73,373 | \$ 1,207 | \$ 773 | \$ 73,807 | \$ 75,796 | \$ 1,787 | \$ 322 | \$ 77,261 |
| 2 | Baa | 13,671 | 497 | 217 | 13,951 | 13,328 | 580 | 137 | 13,771 |
| | Subtotal Investment Grade | 87,044 | 1,704 | 990 | 87,758 | 89,124 | 2,367 | 459 | 91,032 |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

| | | | | | | | | | |
|---|---------------------------------|-----------|----------|----------|-----------|-----------|----------|--------|-----------|
| 3 | Ba | 2,579 | 97 | 44 | 2,632 | 2,692 | 109 | 22 | 2,779 |
| 4 | B | 1,691 | 75 | 28 | 1,738 | 1,746 | 93 | 23 | 1,816 |
| 5 | C and lower | 146 | 9 | 4 | 151 | 115 | 8 | 2 | 121 |
| 6 | In or near default | 35 | 10 | | 45 | 48 | 7 | 1 | 54 |
| | Subtotal Below Investment Grade | 4,451 | 191 | 76 | 4,566 | 4,601 | 217 | 48 | 4,770 |
| | Total Public Fixed Maturities | \$ 91,495 | \$ 1,895 | \$ 1,066 | \$ 92,324 | \$ 93,725 | \$ 2,584 | \$ 507 | \$ 95,802 |

Table of Contents

- (1) Reflects equivalent ratings for investments of the international insurance operations that are not rated by U.S. insurance regulatory authorities.
- (2) Includes, as of June 30, 2007 and December 31, 2006, respectively, 22 securities with amortized cost of \$126 million (fair value, \$126 million) and 10 securities with amortized cost of \$50 million (fair value, \$51 million) that have been categorized based on expected NAIC designations pending receipt of SVO ratings.
- (3) Includes \$4 million of gross unrealized gains and \$80 million gross unrealized losses as of June 30, 2007, compared to \$22 million of gross unrealized gains and \$47 million of gross unrealized losses as of December 31, 2006 on securities classified as held to maturity that are not reflected in other comprehensive income.

The following table sets forth our public fixed maturity portfolios by NAIC rating attributable to the Closed Block Business as of the dates indicated.

| (1) NAIC Designation | Rating Agency Equivalent | June 30, 2007 | | | December 31, 2006 | | | | |
|-------------------------------|---------------------------------|-------------------|------------------------------|-------------------------------|--------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| | | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value (in millions) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| 1 | Aaa, Aa, A | \$ 26,652 | \$ 310 | \$ 414 | \$ 26,548 | \$ 27,181 | \$ 582 | \$ 161 | \$ 27,602 |
| 2 | Baa | 6,146 | 155 | 129 | 6,172 | 6,332 | 264 | 69 | 6,527 |
| | Subtotal Investment Grade | 32,798 | 465 | 543 | 32,720 | 33,513 | 846 | 230 | 34,129 |
| 3 | Ba | 1,992 | 51 | 35 | 2,008 | 2,367 | 103 | 17 | 2,453 |
| 4 | B | 1,561 | 35 | 20 | 1,576 | 2,003 | 63 | 20 | 2,046 |
| 5 | C and lower | 107 | 6 | 1 | 112 | 105 | 3 | 3 | 105 |
| 6 | In or near default | 17 | 6 | 1 | 22 | 17 | 3 | 1 | 19 |
| | Subtotal Below Investment Grade | 3,677 | 98 | 57 | 3,718 | 4,492 | 172 | 41 | 4,623 |
| Total Public Fixed Maturities | | \$ 36,475 | \$ 563 | \$ 600 | \$ 36,438 | \$ 38,005 | \$ 1,018 | \$ 271 | \$ 38,752 |

- (1) Includes, as of June 30, 2007 and December 31, 2006, respectively, 17 securities with amortized cost of \$47 million (fair value, \$50 million) and 6 securities with amortized cost of \$19 million (fair value, \$19 million) that have been categorized based on expected NAIC designations pending receipt of SVO ratings.

Private Fixed Maturities Credit Quality

The following table sets forth our private fixed maturity portfolios by NAIC rating attributable to the Financial Services Businesses as of the dates indicated.

| (1) (2) NAIC Designation | Rating Agency Equivalent | June 30, 2007 | | | December 31, 2006 | | | | |
|--------------------------------|---------------------------|-------------------|---------------------------------|----------------------------------|--------------------------------|-------------------|---------------------------------|----------------------------------|---------------|
| | | Amortized Cost | Gross Unrealized Gains(3) | Gross Unrealized Losses(3) | Fair Value (in millions) | Amortized Cost | Gross Unrealized Gains(3) | Gross Unrealized Losses(3) | Fair Value |
| 1 | Aaa, Aa, A | \$ 6,027 | \$ 228 | \$ 81 | \$ 6,174 | \$ 6,214 | \$ 248 | \$ 49 | \$ 6,413 |
| 2 | Baa | 9,915 | 339 | 107 | 10,147 | 9,463 | 377 | 73 | 9,767 |
| | Subtotal Investment Grade | 15,942 | 567 | 188 | 16,321 | 15,677 | 625 | 122 | 16,180 |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

| | | | | | | | | | |
|---|---------------------------------|-----------|--------|--------|-----------|-----------|--------|--------|-----------|
| 3 | Ba | 1,378 | 52 | 9 | 1,421 | 1,422 | 50 | 11 | 1,461 |
| 4 | B | 769 | 15 | 5 | 779 | 645 | 12 | 7 | 650 |
| 5 | C and lower | 432 | 18 | 2 | 448 | 321 | 18 | 4 | 335 |
| 6 | In or near default | 128 | 18 | | 146 | 139 | 11 | 1 | 149 |
| | Subtotal Below Investment Grade | 2,707 | 103 | 16 | 2,794 | 2,527 | 91 | 23 | 2,595 |
| | Total Private Fixed Maturities | \$ 18,649 | \$ 670 | \$ 204 | \$ 19,115 | \$ 18,204 | \$ 716 | \$ 145 | \$ 18,775 |

Table of Contents

- (1) Reflects equivalent ratings for investments of the international insurance operations that are not rated by U.S. insurance regulatory authorities.
- (2) Includes, as of June 30, 2007 and December 31, 2006, respectively, 215 securities with amortized cost of \$4,010 million (fair value, \$4,002 million) and 221 securities with amortized cost of \$3,465 million (fair value, \$3,537 million) that have been categorized based on expected NAIC designations pending receipt of SVO ratings.
- (3) Includes \$2 million of gross unrealized gains and \$8 million of gross unrealized losses as of June 30, 2007, compared to \$2 million of gross unrealized gains and \$6 million of gross unrealized losses as of December 31, 2006 on securities classified as held to maturity that are not reflected in other comprehensive income.

The following table sets forth our private fixed maturity portfolios by NAIC rating attributable to the Closed Block Business as of the dates indicated.

| (1) NAIC Designation | Rating Agency Equivalent | June 30, 2007 | | | December 31, 2006 | | | Fair Value (in millions) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|--------------------------------|---------------------------------|-------------------|------------------------------|-------------------------------|-------------------|------------------------------|-------------------------------|--------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| | | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | | | | | |
| 1 | Aaa, Aa, A | \$ 2,889 | \$ 156 | \$ 49 | \$ 2,996 | \$ 3,098 | \$ 180 | \$ 26 | \$ 3,252 | | | |
| 2 | Baa | 6,552 | 283 | 63 | 6,772 | 6,620 | 355 | 47 | 6,928 | | | |
| | Subtotal Investment Grade | 9,441 | 439 | 112 | 9,768 | 9,718 | 535 | 73 | 10,180 | | | |
| 3 | Ba | 1,097 | 72 | 5 | 1,164 | 1,173 | 75 | 7 | 1,241 | | | |
| 4 | B | 499 | 23 | 5 | 517 | 413 | 18 | 7 | 424 | | | |
| 5 | C and lower | 290 | 15 | 1 | 304 | 131 | 14 | 2 | 143 | | | |
| 6 | In or near default | 26 | 7 | | 33 | 26 | 7 | | 33 | | | |
| | Subtotal Below Investment Grade | 1,912 | 117 | 11 | 2,018 | 1,743 | 114 | 16 | 1,841 | | | |
| Total Private Fixed Maturities | | \$ 11,353 | \$ 556 | \$ 123 | \$ 11,786 | \$ 11,461 | \$ 649 | \$ 89 | \$ 12,021 | | | |

- (1) Includes, as of June 30, 2007 and December 31, 2006, respectively, 103 securities with amortized cost of \$1,332 million (fair value, \$1,337 million) and 119 securities with amortized cost of \$1,386 million (fair value, \$1,421 million) that have been categorized based on expected NAIC designations pending receipt of SVO ratings.

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 sell credit protection on an identified name, or a basket of names in a first to default structure, and in return receive a quarterly premium. With single name credit default derivatives, this premium or credit spread generally corresponds to the difference between the yield on the referenced name's public fixed maturity cash instruments and swap rates, at the time the agreement is executed. With first-to-default baskets, because of the additional credit risk inherent in a basket of named credits, the premium generally corresponds to a high proportion of the sum of the credit spreads of the names in the basket. If there is an event of default by the referenced name or one of the referenced names in a basket, as defined by the agreement, then we are obligated to pay the counterparty the referenced amount of the contract and receive in return the referenced defaulted security or similar security. Subsequent defaults on the remaining names within such instruments require no further payment to counterparties.

Table of Contents

The majority of referenced names in the 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 generally have maturities of five years or less. As of June 30, 2007 and December 31, 2006, we had \$1.6 billion in outstanding notional amounts of credit derivative contracts where we have sold credit protection. The Financial Services Businesses had \$1.2 billion of outstanding notional amounts as of June 30, 2007 and December 31, 2006. The Closed Block Business had \$388 million and \$378 million of outstanding notional amounts, as of June 30, 2007 and December 31, 2006, respectively. 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 was \$3 million for the three months ended June 30, 2007 and 2006, respectively, and \$6 million for the six months ended June 30, 2007 and 2006, and is included in adjusted operating income as an adjustment to Realized investment gains (losses), net over the life of the derivative.

The following table sets forth our exposure where we have sold credit protection through credit derivatives in the Financial Services Businesses by NAIC rating of the underlying credits as of the dates indicated.

| (1) NAIC Designation | Rating Agency Equivalent | June 30, 2007 | | December 31, 2006 | |
|----------------------------|---------------------------------|---------------|---------------|-------------------|------------|
| | | Notional | Fair Value | Notional | Fair Value |
| | | | (in millions) | | |
| 1 | Aaa, Aa, A | \$ 717 | \$ 7 | \$ 952 | \$ 12 |
| 2 | Baa | 377 | (2) | 162 | 2 |
| | Subtotal Investment Grade | 1,094 | 5 | 1,114 | 14 |
| 3 | Ba | 40 | (1) | 20 | |
| 4 | B | 38 | (1) | 38 | |
| 5 | C and lower | | | | |
| 6 | In or near default | | | | |
| | Subtotal Below Investment Grade | 78 | (2) | 58 | |
| Total | | \$ 1,172 | \$ 3 | \$ 1,172 | \$ 14 |

(1) First-to-default credit swap baskets, which may include credits of varying qualities, are grouped above based on the lowest credit in the basket. However, such basket swaps may entail greater credit risk than the rating level of the lowest credit.

The following table sets forth our exposure where we have sold credit protection through credit derivatives in the Closed Block Business portfolios by NAIC rating of the underlying credits as of the dates indicated.

| (1) NAIC Designation | Rating Agency Equivalent | June 30, 2007 | | December 31, 2006 | |
|----------------------------|---------------------------|---------------|---------------|-------------------|------------|
| | | Notional | Fair Value | Notional | Fair Value |
| | | | (in millions) | | |
| 1 | Aaa, Aa, A | \$ 363 | \$ 2 | \$ 363 | \$ 4 |
| 2 | Baa | 20 | | 10 | |
| | Subtotal Investment Grade | 383 | 2 | 373 | 4 |
| 3 | Ba | 5 | | 5 | |
| 4 | B | | | | |
| 5 | C and lower | | | | |
| 6 | In or near default | | | | |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

| | | | | |
|---------------------------------|--------|------|--------|------|
| Subtotal Below Investment Grade | 5 | | 5 | |
| Total | \$ 388 | \$ 2 | \$ 378 | \$ 4 |

Table of Contents

- (1) First-to-default credit swap baskets, which may include credits of varying qualities, are grouped above based on the lowest credit in the basket. However, such basket swaps may entail greater credit risk than the rating level of the lowest credit.

In addition to selling credit protection, in limited instances we have purchased credit protection using credit derivatives in order to hedge specific credit exposures in our investment portfolio. The premium paid for the credit derivatives we purchase was not material for the three months ended June 30, 2007 and 2006, or the six month ended June 30, 2007 and 2006.

Unrealized Losses from Fixed Maturity Securities

The following table sets forth the amortized cost and gross unrealized losses of fixed maturity securities attributable to the Financial Services Businesses where the estimated fair value had declined and remained below amortized cost by 20% or more for the following timeframes:

| | June 30, 2007 | | December 31, 2006 | |
|--|----------------|-------------------------|-------------------|-------------------------|
| | Amortized Cost | Gross Unrealized Losses | Amortized Cost | Gross Unrealized Losses |
| | (in millions) | | | |
| Less than six months | \$ 24 | \$ 5 | \$ 17 | \$ 4 |
| Six months or greater but less than nine months | | | | |
| Nine months or greater but less than twelve months | | | | |
| Twelve months and greater | | | | |
| Total | \$ 24 | \$ 5 | \$ 17 | \$ 4 |

The gross unrealized losses as of June 30, 2007 were primarily concentrated in the public utilities and finance sectors and as of December 31, 2006 were primarily concentrated in the manufacturing sector.

The following table sets forth the amortized cost and gross unrealized losses of fixed maturity securities attributable to the Closed Block Business where the estimated fair value had declined and remained below amortized cost by 20% or more for the following timeframes:

| | June 30, 2007 | | December 31, 2006 | |
|--|----------------|-------------------------|-------------------|-------------------------|
| | Amortized Cost | Gross Unrealized Losses | Amortized Cost | Gross Unrealized Losses |
| | (in millions) | | | |
| Less than six months | \$ 13 | \$ 3 | \$ 9 | \$ 3 |
| Six months or greater but less than nine months | | | | |
| Nine months or greater but less than twelve months | | | | |
| Twelve months and greater | | | | |
| Total | \$ 13 | \$ 3 | \$ 9 | \$ 3 |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

The gross unrealized losses were primarily concentrated in the manufacturing sector as of June 30, 2007 while the gross unrealized losses were primarily concentrated in the services sector as of December 31, 2006.

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

Table of Contents

identify potential credit deterioration whether due to ratings downgrades, unexpected price variances, and/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.

Fixed maturity securities classified as held to maturity are those securities where we have the intent and ability to hold the securities until maturity. These securities are reflected at amortized cost in our consolidated statements of financial position. Other fixed maturity securities are considered available for sale, and, as a result, we record unrealized gains and losses to the extent that amortized cost is different from estimated fair value. All held to maturity securities and all available for sale securities with unrealized losses are subject to our review to identify other-than-temporary impairments in value. In evaluating whether a decline in value is other-than-temporary, we consider several factors including, but not limited to, the following:

the extent (generally if greater than 20%) and the duration (generally if greater than six months) of the decline;

the reasons for the decline in value (credit event, currency or interest rate related);

our ability and intent to hold our investment for a period of time to allow for a recovery of value; and

the financial condition of and near-term prospects of the issuer.

When we determine that there is an other-than-temporary impairment, we record a writedown to estimated fair value, which reduces the cost basis. 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. Accordingly, the discount (or reduced premium) based on the new cost basis is accreted into net investment income over the remaining life of the security based upon the amount and timing of expected future cash flows and is included in adjusted operating income. Estimated fair values for fixed maturities, other than private placement securities, are based on quoted market prices or prices obtained from independent pricing services. For these private fixed maturities, fair value is determined typically by using a discounted cash flow model, which relies upon the average of spread surveys collected from private market intermediaries who are active in both primary and secondary transactions and takes into account, among other factors, the credit quality of the issuer and the reduced liquidity associated with private placements. The estimated fair value of certain non-performing private placement fixed maturities is based on management's estimates. Impairments on fixed maturity securities are included in Realized investment gains (losses), net and are excluded from adjusted operating income.

Impairments of fixed maturity securities attributable to the Financial Services Businesses were \$11 million and \$13 million for the three months ended June 30, 2007 and 2006, respectively and \$22 million and \$16 million for the six months ended June 30, 2007 and 2006, respectively. Impairments of fixed maturity securities attributable to the Closed Block Business were \$2 million and \$15 million for the three months ended June 30, 2007 and 2006, respectively and \$9 million and \$19 million for the six months ended June 30, 2007 and 2006, respectively. For a further discussion of impairments, see Realized Investment Gains above.

Trading account assets supporting insurance liabilities

Certain products included in the retirement business we acquired from CIGNA, as well as certain products included in the International Insurance segment, are experience-rated, meaning that the investment results associated with these products will ultimately accrue to contractholders. The investments supporting these

Table of Contents

experience-rated products, excluding commercial loans, are classified as trading. These trading investments 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. Investment income for these investments is reported in Net investment income. The following table sets forth the composition of this portfolio as of the dates indicated.

| | June 30, 2007 | | December 31, 2006 | |
|---|----------------|------------|-------------------|------------|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| | (in millions) | | | |
| Short-term Investments and Cash Equivalents | \$ 260 | \$ 260 | \$ 299 | \$ 299 |
| Fixed Maturities: | | | | |
| U.S. Government | 199 | 200 | 173 | 175 |
| Foreign Government | 351 | 350 | 316 | 319 |
| Corporate Securities | 10,026 | 9,808 | 10,089 | 9,904 |
| Asset-Backed Securities | 614 | 606 | 609 | 603 |
| Mortgage Backed | 1,809 | 1,749 | 1,933 | 1,905 |
| Total Fixed Maturities | 12,999 | 12,713 | 13,120 | 12,906 |
| Equity Securities | 1,042 | 1,096 | 833 | 1,057 |
| Total trading account assets supporting insurance liabilities | \$ 14,301 | \$ 14,069 | \$ 14,252 | \$ 14,262 |

As of June 30, 2007, as a percentage of amortized cost, 74% of the portfolio was comprised of publicly traded securities, compared to 76% of the portfolio as of December 31, 2006. As of June 30, 2007, 95% of the fixed maturity portfolio was classified as investment grade compared to 97% as of December 31, 2006. As of June 30, 2007, 81% of the mortgage-backed securities were publicly traded agency pass-through securities related to residential mortgage loans, which are supported by implicit or explicit government guarantees and have credit ratings of AA or AAA. Collateralized mortgage obligations represented the remaining 19% of mortgage-backed securities, which virtually all have credit ratings of A or better. As of June 30, 2007, included within asset-backed securities is approximately \$0.3 billion of securities collateralized by sub-prime mortgages, including approximately 73% with AAA credit ratings, 22% with AA credit ratings, 3% with A credit ratings, and the remainder with BBB credit ratings. For a discussion of changes in the fair value of our trading account assets supporting insurance liabilities see Trading Account Assets Supporting Insurance Liabilities, below.

Table of Contents

The following table sets forth our public fixed maturities included in our trading account assets supporting insurance liabilities portfolio by NAIC rating as of the dates indicated.

| (1) (2) | NAIC Designation | Rating Agency Equivalent | June 30, 2007 | | | | December 31, 2006 | | | |
|---------|--|--------------------------|----------------|---------------------------|----------------------------|---------------|-------------------|---------------------------|----------------------------|------------|
| | | | Amortized Cost | Gross Unrealized Gains(3) | Gross Unrealized Losses(3) | Fair Value | Amortized Cost | Gross Unrealized Gains(3) | Gross Unrealized Losses(3) | Fair Value |
| | | | | | | (in millions) | | | | |
| 1 | Aaa, Aa, A | | \$ 7,422 | \$ 11 | \$ 157 | \$ 7,276 | \$ 7,772 | \$ 25 | \$ 117 | \$ 7,680 |
| 2 | Baa | | 1,683 | 1 | 46 | 1,638 | 1,800 | 3 | 42 | 1,761 |
| | Subtotal Investment Grade | | 9,105 | 12 | 203 | 8,914 | 9,572 | 28 | 159 | 9,441 |
| 3 | Ba | | 152 | | 10 | 142 | 79 | | 7 | 72 |
| 4 | B | | 39 | | 1 | 38 | 1 | | | 1 |
| 5 | C and lower | | 1 | | | 1 | 1 | | | 1 |
| 6 | In or near default | | 4 | | 3 | 1 | | | | |
| | Subtotal Below Investment Grade | | 196 | | 14 | 182 | 81 | | 7 | 74 |
| | Total Public Trading Account Assets Supporting Insurance Liabilities | | \$ 9,301 | \$ 12 | \$ 217 | \$ 9,096 | \$ 9,653 | \$ 28 | \$ 166 | \$ 9,515 |

(1) See Fixed Maturity Securities Credit Quality above for a discussion on NAIC designations.

(2) Reflects equivalent ratings for investments of the international insurance operations that are not rated by U.S. insurance regulatory authorities.

(3) Amounts are reported in Asset management fees and other income.

Table of Contents

The following table sets forth our private fixed maturities included in our trading account assets supporting insurance liabilities portfolio by NAIC rating as of the dates indicated.

| (1) | (2) | NAIC Designation | Rating Agency Equivalent | June 30, 2007 | | | December 31, 2006 | | | Fair Value | |
|---|-----|---------------------------------|--------------------------|-------------------|---------------------------------|----------------------------------|-------------------|---------------------------------|----------------------------------|---------------|----------|
| | | | | Amortized Cost | Gross Unrealized Gains(3) | Gross Unrealized Losses(3) | Amortized Cost | Gross Unrealized Gains(3) | Gross Unrealized Losses(3) | | |
| | | | | | | | | | | | |
| | | | | | | | | | | (in millions) | |
| 1 | | Aaa, Aa, A | | \$ 966 | \$ 3 | \$ 32 | \$ 937 | \$ 861 | \$ 3 | \$ 27 | \$ 837 |
| 2 | | Baa | | 2,274 | 12 | 66 | 2,220 | 2,242 | 13 | 62 | 2,193 |
| | | Subtotal Investment Grade | | 3,240 | 15 | 98 | 3,157 | 3,103 | 16 | 89 | 3,030 |
| 3 | | Ba | | 292 | 3 | 8 | 287 | 266 | 3 | 8 | 261 |
| 4 | | B | | 152 | 1 | 1 | 152 | 12 | | | 12 |
| 5 | | C and lower | | 7 | | | 7 | 79 | | 2 | 77 |
| 6 | | In or near default | | 7 | 7 | | 14 | 7 | 4 | | 11 |
| | | Subtotal Below Investment Grade | | 458 | 11 | 9 | 460 | 364 | 7 | 10 | 361 |
| Total Private Trading Account Assets Supporting Insurance Liabilities | | | | \$ 3,698 | \$ 26 | \$ 107 | \$ 3,617 | \$ 3,467 | \$ 23 | \$ 99 | \$ 3,391 |

- (1) See Fixed Maturity Securities Credit Quality above for a discussion on NAIC designations.
- (2) Reflects equivalent ratings for investments of the international insurance operations that are not rated by U.S. insurance regulatory authorities.
- (3) Amounts are reported in Asset management fees and other income.

Commercial Loans

As of both June 30, 2007 and December 31, 2006, we held approximately 11% of our general account investments in commercial loans. This percentage is net of a \$0.1 billion allowance for losses as of both June 30, 2007 and December 31, 2006.

Our 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 commercial loan portfolio by geographic region and property type as of the dates indicated.

Table of Contents

| | June 30, 2007 | | | | December 31, 2006 | | | |
|------------------------------------|----------------------------------|---------------|----------------------------|---------------|----------------------------------|---------------|----------------------------|---------------|
| | 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 |
| Commercial loans by region: | | | | | | | | |
| U.S. Regions: | | | | | | | | |
| Pacific | \$ 4,578 | 25.9% | \$ 2,487 | 34.2% | \$ 4,463 | 25.7% | \$ 2,629 | 35.8% |
| South Atlantic | 3,638 | 20.6 | 1,352 | 18.6 | 3,423 | 19.7 | 1,364 | 18.6 |
| Middle Atlantic | 2,365 | 13.4 | 1,597 | 22.0 | 2,514 | 14.5 | 1,527 | 20.8 |
| East North Central | 1,561 | 8.8 | 413 | 5.7 | 1,464 | 8.4 | 416 | 5.7 |
| Mountain | 912 | 5.1 | 408 | 5.6 | 868 | 5.0 | 452 | 6.1 |
| West South Central | 881 | 5.0 | 414 | 5.7 | 838 | 4.8 | 401 | 5.4 |
| New England | 685 | 3.9 | 289 | 4.0 | 627 | 3.6 | 244 | 3.3 |
| West North Central | 531 | 3.0 | 156 | 2.2 | 523 | 3.0 | 207 | 2.8 |
| East South Central | 421 | 2.4 | 100 | 1.4 | 416 | 2.4 | 113 | 1.5 |
| Subtotal U.S. | 15,572 | 88.1 | 7,216 | 99.4 | 15,136 | 87.1 | 7,353 | 100.0 |
| Asia | 1,468 | 8.3 | | | 1,576 | 9.1 | | |
| Other | 647 | 3.6 | 45 | 0.6 | 657 | 3.8 | | |
| Total Commercial Loans | \$ 17,687 | 100.0% | \$ 7,261 | 100.0% | \$ 17,369 | 100.0% | \$ 7,353 | 100.0% |

| | June 30, 2007 | | | | December 31, 2006 | | | |
|---|----------------------------------|---------------|----------------------------|---------------|----------------------------------|---------------|----------------------------|---------------|
| | 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 |
| Commercial loans by property type: | | | | | | | | |
| Industrial buildings | \$ 3,609 | 20.4% | \$ 1,698 | 23.4% | \$ 3,558 | 20.5% | \$ 1,826 | 24.8% |
| Office buildings | 3,192 | 18.1 | 1,347 | 18.6 | 3,151 | 18.2 | 1,398 | 19.0 |
| Apartment complexes | 3,163 | 17.9 | 1,504 | 20.7 | 3,055 | 17.6 | 1,498 | 20.4 |
| Other | 2,343 | 13.2 | 830 | 11.4 | 2,143 | 12.2 | 799 | 10.9 |
| Retail stores | 2,232 | 12.6 | 1,077 | 14.8 | 2,121 | 12.3 | 1,067 | 14.5 |
| Agricultural properties | 1,129 | 6.4 | 804 | 11.1 | 1,190 | 6.9 | 763 | 10.4 |
| Residential properties | 904 | 5.1 | 1 | | 997 | 5.7 | 2 | |
| Subtotal of collateralized loans | 16,572 | 93.7 | 7,261 | 100.0 | 16,215 | 93.4 | 7,353 | 100.0 |
| Uncollateralized loans | 1,115 | 6.3 | | | 1,154 | 6.6 | | |
| Total Commercial Loans | \$ 17,687 | 100.0% | \$ 7,261 | 100.0% | \$ 17,369 | 100.0% | \$ 7,353 | 100.0% |

Commercial Loan Quality

We establish valuation allowances for loans that are determined to be non-performing as a result of our loan review process. We define a non-performing loan as a loan for which it is probable that amounts due according to the contractual terms of the loan agreement will not be collected. Valuation allowances for a non-performing 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. We record subsequent adjustments

to our valuation allowances when appropriate.

Table of Contents

The following tables set forth the gross carrying value for commercial loans by loan classification as of the dates indicated:

| | June 30, 2007 | | December 31, 2006 | |
|--------------------------------|----------------------------------|--------------------------|----------------------------------|--------------------------|
| | Financial Services Businesses | Closed Block Business | Financial Services Businesses | Closed Block Business |
| | (in millions) | | | |
| Performing | \$ 17,633 | \$ 7,260 | \$ 17,309 | \$ 7,352 |
| Delinquent, not in foreclosure | 49 | | 53 | |
| Delinquent, in foreclosure | | | | |
| Restructured | 5 | 1 | 7 | 1 |
| Total Commercial Loans | \$ 17,687 | \$ 7,261 | \$ 17,369 | \$ 7,353 |

The following table sets forth the change in valuation allowances for our commercial loan portfolio as of the dates indicated:

| | June 30, 2007 | | December 31, 2006 | |
|---|----------------------------------|--------------------------|----------------------------------|--------------------------|
| | Financial Services Businesses | Closed Block Business | Financial Services Businesses | Closed Block Business |
| | (in millions) | | | |
| Allowance, beginning of period | \$ 94 | \$ 35 | \$ 93 | \$ 36 |
| (Release of)/addition to allowance for losses | 9 | (1) | 2 | (1) |
| Charge-offs, net of recoveries | | | (2) | |
| Change in foreign exchange | (1) | | 1 | |
| Allowance, end of period | \$ 102 | \$ 34 | \$ 94 | \$ 35 |

Equity Securities

The equity securities attributable to the Financial Services Businesses consist principally of investments in common and preferred stock of publicly traded companies. 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:

| | June 30, 2007 | | | | December 31, 2006 | | | |
|---------------------|-----------------|------------------------------|-------------------------------|-----------------|-------------------|------------------------------|-------------------------------|-----------------|
| | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| | (in millions) | | | | | | | |
| Public equity | \$ 3,701 | \$ 698 | \$ 45 | \$ 4,354 | \$ 3,659 | \$ 550 | \$ 47 | \$ 4,162 |
| Private equity | 220 | 8 | 1 | 227 | 152 | 5 | 5 | 152 |
| Total Equity | \$ 3,921 | \$ 706 | \$ 46 | \$ 4,581 | \$ 3,811 | \$ 555 | \$ 52 | \$ 4,314 |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Public equity securities include common stock mutual fund shares representing our interest in the underlying assets of certain of our separate account investments. These mutual funds invest primarily in high yield bond funds. The cost, gross unrealized gains, gross unrealized losses, and fair value of these shares as of June 30, 2007 was \$1,325 million, \$42 million, \$17 million, and \$1,350 million, respectively. The cost, gross unrealized gains, gross unrealized losses, and fair value of these shares as of December 31, 2006 was \$1,291 million, \$46 million, \$13 million, and \$1,324 million, respectively.

The equity securities attributable to the Closed Block Business consist principally of investments in common and preferred stock of publicly traded companies. The following table sets forth the composition of our

Table of Contents

equity securities portfolio attributable to the Closed Block Business and the associated gross unrealized gains and losses as of the dates indicated:

| | Cost | June 30, 2007 | | Fair Value (in millions) | Cost | December 31, 2006 | | Fair Value |
|---------------------|-----------------|------------------------|-------------------------|-----------------------------|-----------------|------------------------|-------------------------|-----------------|
| | | Gross Unrealized Gains | Gross Unrealized Losses | | | Gross Unrealized Gains | Gross Unrealized Losses | |
| Public equity | \$ 3,256 | \$ 885 | \$ 73 | \$ 4,068 | \$ 2,989 | \$ 843 | \$ 71 | \$ 3,761 |
| Private equity | 25 | 4 | | 29 | 10 | 1 | | 11 |
| Total Equity | \$ 3,281 | \$ 889 | \$ 73 | \$ 4,097 | \$ 2,999 | \$ 844 | \$ 71 | \$ 3,772 |

Unrealized Losses from Equity Securities

The following table sets forth the cost and gross unrealized losses of our equity securities attributable to the Financial Services Businesses where the estimated fair value had declined and remained below cost by 20% or more for the following timeframes:

| | June 30, 2007 | | December 31, 2006 | |
|--|---------------|--|-------------------|-------------------------|
| | Cost | Gross Unrealized Losses (in millions) | Cost | Gross Unrealized Losses |
| Less than six months | \$ 29 | \$ 8 | \$ 62 | \$ 19 |
| Six months or greater but less than nine months | | | | |
| Nine months or greater but less than twelve months | | | | |
| Twelve months and greater | | | | |
| Total | \$ 29 | \$ 8 | \$ 62 | \$ 19 |

The gross unrealized losses as of June 30, 2007 were primarily concentrated in the manufacturing, retail and wholesale, and other sectors compared to December 31, 2006 where the gross unrealized losses were primarily concentrated in the services, retail and wholesale and other sectors.

The following table sets forth the cost and gross unrealized losses of our equity securities attributable to the Closed Block Business where the estimated fair value had declined and remained below cost by 20% or more for the following timeframes:

| | June 30, 2007 | | December 31, 2006 | |
|----------------------|---------------|--|-------------------|-------------------------|
| | Cost | Gross Unrealized Losses (in millions) | Cost | Gross Unrealized Losses |
| Less than six months | \$ 32 | \$ 8 | \$ 16 | \$ 5 |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

| | | | |
|--|--------------|-------------|--------------|
| Six months or greater but less than nine months | 1 | | 1 |
| Nine months or greater but less than twelve months | | | |
| Twelve months and greater | | | |
| Total | \$ 32 | \$ 8 | \$ 17 |

The gross unrealized losses as of June 30, 2007 were primarily concentrated in the finance, services and energy sectors compared to December 31, 2006 where the gross unrealized losses were primarily concentrated in the utilities and transportation sectors.

Table of Contents*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. In evaluating whether a decline in value is other-than-temporary, we consider several factors including, but not limited to, the following:

the extent (generally if greater than 20%) and the duration (generally if greater than six months) of the decline;

the reasons for the decline in value (credit event, currency or market fluctuation);

our ability and intent to hold the investment for a period of time to allow for a recovery of value; and

the financial condition of and near-term prospects of the issuer.

When we determine that there is an other-than-temporary impairment, we record a writedown to estimated fair value, which reduces the cost basis. The new cost basis of an impaired security is not adjusted for subsequent increases in estimated fair value. Estimated fair values for publicly traded equity securities are based on quoted market prices or prices obtained from independent pricing services. Estimated fair values for privately traded equity securities are determined using valuation and discounted cash flow models that require a substantial level of judgment. Impairments on equity securities are included in Realized investment gains (losses), net and are excluded from adjusted operating income.

Impairments of equity securities attributable to the Financial Services Businesses were \$4 million and \$0 million for the three months ended June 30, 2007 and 2006, respectively and \$19 million and \$8 million for the six months ended June 30, 2007 and 2006, respectively. Impairments of equity securities attributable to the Closed Block Business were \$0 million and \$5 million for the three months ended June 30, 2007 and 2006, respectively and \$1 million and \$16 million for the six months ended June 30, 2007 and 2006, respectively. For a further discussion of impairments, see Realized Investment Gains above.

Other Long-Term Investments

Other long-term investments are comprised as follows:

| | June 30, 2007 | | December 31, 2006 | |
|--|-------------------------------------|-----------------------------|-------------------------------------|-----------------------------|
| | Financial Services Businesses | Closed Block Business | Financial Services Businesses | Closed Block Business |
| | (in millions) | | | |
| Joint ventures and limited partnerships: | | | | |
| Real estate related | \$ 311 | \$ 234 | \$ 293 | \$ 216 |
| Non real estate related | 500 | 853 | 372 | 785 |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

| | | | | |
|---|----------|--------|----------|--------|
| Real estate held through direct ownership | 873 | 4 | 992 | 13 |
| Other | 990 | (177) | 1,134 | (49) |
| Total other long-term investments | \$ 2,674 | \$ 914 | \$ 2,791 | \$ 965 |

Trading Account Assets Supporting Insurance Liabilities

Trading account assets supporting insurance liabilities, at fair value include assets that support certain products included in the retirement business we acquired from CIGNA, as well as certain products included in the International Insurance segment, which are experience-rated, meaning that the investment results associated with these products will ultimately accrue to contractholders. Realized and unrealized investment gains and losses for these investments are reported in Asset management fees and other income. Investment income for these investments is reported in Net investment income.

Table of Contents

Results for the three months ended June 30, 2007 and 2006 include the recognition of \$108 million and \$151 million of investment losses, respectively, and for the six months ended June 30, 2007 and 2006 include the recognition of \$26 million and \$265 million of investment losses, respectively, on Trading account assets supporting insurance liabilities, at fair value. These losses primarily represent interest-rate related mark-to-market adjustments on fixed maturity securities. Consistent with our treatment of Realized investment gains (losses), net, these losses, which will ultimately accrue to the contractholders, are excluded from adjusted operating income. In addition, results for the three months ended June 30, 2007 and 2006 include decreases of \$72 million and \$130 million, respectively, and for the six months ended June 30, 2007 and 2006 include decreases of \$10 million and \$196 million, respectively, in contract holder liabilities due to asset value changes in the pool of investments that support these experience-rated contracts. These liability changes are reflected in Interest credited to policyholders account balances and are also excluded from adjusted operating income. As prescribed by U.S. GAAP, changes in the fair value of mortgage loans, other than when associated with impairments, are not recognized in income in the current period, while the impact of these changes in mortgage loan value are reflected as a change in the liability to contractholders in the current period. Included in the amounts above related to the change in the liability to contractholders are decreases related to mortgage loans of \$12 million and \$13 million for the three months ended June 30, 2007 and 2006, respectively, and decreases related to mortgage loans of \$15 million and \$25 million for the six months ended June 30, 2007 and 2006, respectively.

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 the 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, | |
|--|--------------------------------|----------------|------------------------------|--------------|
| | 2007 | 2006 | 2007 | 2006 |
| | (in millions) | | | |
| Exchange shares previously held by Prudential Equity Group | \$ (6) | \$ (6) | \$ (6) | \$ 39 |
| Prudential Securities capital markets | 1 | (2) | 9 | (1) |
| Prudential Home Mortgage Company | | | 7 | |
| Property and casualty insurance | | (2) | 4 | 10 |
| Total divested businesses excluded from adjusted operating income | \$ (5) | \$ (10) | \$ 14 | \$ 48 |

Results for our equity sales, trading and research operations known as Prudential Equity Group, previously included in the Financial Advisory segment, have been classified as discontinued operations for all periods presented, as a result of our decision to exit these operations. In addition, income from securities relating to trading exchange memberships of Prudential Equity Group, previously reported within the Financial Advisory segment or Corporate and Other operations, has been classified within divested businesses and excluded from adjusted operating income for all periods presented. See Note 3 to the Unaudited Interim Consolidated Financial Statements for additional information concerning Prudential Equity Group.

Table of Contents**Liquidity and Capital Resources****Prudential Financial**

The principal sources of funds available to Prudential Financial, the parent holding company and registrant, to meet its obligations, including the payment of shareholder dividends, debt service, operating expenses, capital contributions and obligations to subsidiaries are dividends, returns of capital, interest income from its subsidiaries, and cash and short-term investments. These sources of funds are complemented by Prudential Financial's access to the capital markets and bank facilities. We believe that cash flows from these sources are sufficient to satisfy the current liquidity requirements of Prudential Financial, including reasonably foreseeable contingencies. As of June 30, 2007, Prudential Financial had cash and short-term investments of approximately \$1.301 billion, an increase of \$197 million, or 17.8%, from December 31, 2006. Prudential Financial's principal sources and uses of cash and short-term investments for the first six months of 2007 were as follows:

| | Six Months Ended June 30, 2007 (in millions) |
|--|---|
| Sources: | |
| Dividends and/or returns of capital from subsidiaries(1) | \$ 1,750 |
| Proceeds from the issuance of retail medium-term notes, net of repayments(2) | 486 |
| Proceeds from the issuance of long-term debt(3) | 772 |
| Proceeds from the issuance of short-term debt, net of repayments | 1,205 |
| Proceeds from stock-based compensation and exercise of stock options | 244 |
| Net receipts under intercompany loan agreements | 204 |
| Total sources | 4,661 |
| Uses: | |
| Capital contributions to subsidiaries(4) | 122 |
| Share repurchases(5) | 1,451 |
| Repayment of floating rate convertible senior notes(3) | 2,000 |
| Shareholder dividends | 80 |
| Purchase of funding agreements from Prudential Insurance, net of maturities(2) | 486 |
| Other, net | 325 |
| Total uses | 4,464 |
| Net increase in cash and short-term investments | \$ 197 |

-
- (1) Includes dividends and/or returns of capital of \$1.0 billion from Prudential Insurance, \$388 million from international insurance and investments subsidiaries, \$154 million from American Skandia, \$147 million from asset management subsidiaries, \$57 million from securities subsidiaries, and \$4 million from other businesses.
- (2) Proceeds from the issuance of retail medium-term notes are used primarily to purchase funding agreements from Prudential Insurance. See *Financing Activities* for a discussion of our retail note program.
- (3) See *Financing Activities*.
- (4) Includes capital contributions of \$66 million to domestic insurance subsidiaries and \$56 million to international insurance and investments subsidiaries.
- (5) See *Uses of Capital* *Share Repurchases*.

Sources of Capital

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Prudential Financial is a holding company whose principal asset is its investments in subsidiaries. Prudential Financial's capitalization and use of financial leverage are consistent with its ratings targets. Our long-term senior debt rating targets for Prudential Financial are A for Standard & Poor's Rating Services, or S&P, Moody's Investors Service, Inc., or Moody's, and Fitch Ratings Ltd., or Fitch, and A for A.M. Best Company,

Table of Contents

or A.M. Best. We seek to capitalize all of our subsidiaries and businesses in accordance with their ratings targets. Our financial strength rating targets for our domestic life insurance companies are AA/Aa/AA for S&P, Moody's and Fitch, respectively, and A+ for A.M. Best. For updates to our ratings since December 31, 2006 see Ratings. The primary components of capitalization for the Financial Services Businesses consist of the equity we attribute to the Financial Services Businesses (excluding accumulated other comprehensive income related to unrealized gains and losses on investments and pension and postretirement benefits) and outstanding capital debt of the Financial Services Businesses, as discussed below under Financing Activities. Based on these components, the capital position of the Financial Services Businesses as of June 30, 2007 was as follows:

| | June 30, 2007 (in millions) |
|--|--|
| Attributed equity (excluding unrealized gains and losses on investments and pension/postretirement benefits) | \$ 21,792 |
| Capital debt(1) | 4,382 |
| Total capital | \$ 26,174 |

(1) Our capital debt to total capital ratio was 16.7% as of June 30, 2007.

As shown in the table above, as of June 30, 2007, the Financial Services Businesses had approximately \$26.2 billion in capital, all of which was available to support the aggregate capital requirements of its three divisions and its Corporate and Other operations. Based on our assessments of these businesses and operations, we believe that this level of capital exceeds the amount required to support current business risks by over \$2.0 billion as of June 30, 2007. Although some of these resources are in our regulated subsidiaries, and their availability may be subject to prior regulatory notice, approval or non-disapproval, we believe these resources give us substantial financial flexibility.

We believe that migrating toward a capital structure comprised of 70% attributed equity, 20% capital debt and 10% hybrid equity securities is consistent with our ratings objectives for Prudential Financial, and would support the issuance of approximately \$5.0 billion of additional capital debt and hybrid equity securities. This capital structure assumes that the hybrid equity securities we issue achieve 75% equity credit, with the remaining 25% treated as capital debt, and that market conditions exist which make hybrid equity securities a cost effective source of capital.

The Risk Based Capital, or RBC, ratio is the primary measure by which we evaluate the capital adequacy of Prudential Insurance, which includes businesses in both the Financial Services Businesses and the Closed Block Business. We manage Prudential Insurance's RBC ratio to a level consistent with our ratings targets. RBC is determined by statutory formulas that consider risks related to the type and quality of the invested assets, insurance-related risks associated with Prudential Insurance's products, interest rate risks and general business risks. The RBC ratio calculations are intended to assist insurance regulators in measuring the adequacy of Prudential Insurance's statutory capitalization.

In April 2007, we transferred \$1 billion of assets within the qualified pension plan under Section 420 of the Internal Revenue Code from assets supporting pension benefits to assets supporting retiree medical benefits. The transfer resulted in a reduction to the prepaid benefit for the qualified pension plan and an offsetting decrease in the accrued benefit liability for the postretirement plan with no net effect on stockholders equity on the Company's consolidated financial position. The net effect of this transfer added approximately \$600 million to Prudential Insurance's statutory capital and increased Prudential Insurance's RBC ratio.

In the second quarter of 2007, Prudential Insurance declared an ordinary dividend of \$97 million and an additional extraordinary dividend of \$1.200 billion to Prudential Holdings, LLC. Of this, \$1.0 billion was paid to Prudential Holdings and in turn distributed to Prudential Financial. The remaining \$297 million will be paid to Prudential Holdings in September of 2007, of which a substantial portion will be paid to Prudential Financial. In

Table of Contents

June 2007, American Skandia Life Assurance Corporation paid an ordinary dividend of \$112 million to American Skandia, which American Skandia subsequently paid as a dividend to Prudential Financial.

Uses of Capital

Share Repurchases. In November 2006, Prudential Financial's Board of Directors authorized the Company to repurchase up to \$3.0 billion of its outstanding Common Stock in calendar year 2007. The timing and amount of any repurchases under this authorization will be determined by management based upon market conditions and other considerations, and the repurchases may be effected in the open market, through derivative, accelerated repurchase and other negotiated transactions and through prearranged trading plans complying with Rule 10b5-1(c) of the Exchange Act. The 2007 stock repurchase program supersedes all previous repurchase programs. During the first six months of 2007, we repurchased 16.0 million shares of our Common Stock at a total cost of \$1.5 billion.

Rabbi Trust. In July 2007, we established an irrevocable trust, commonly referred to as a rabbi trust, for the purpose of holding assets of the Company to be used to satisfy its obligations with respect to certain non-qualified retirement plans. Assets held in a rabbi trust are available to the general creditors of the Company in the event of insolvency or bankruptcy. We may from time to time at our discretion make contributions to the trust to fund accrued benefits payable to participants in one or more of the plans, and, in the case of a change in control of the Company, as defined in the trust agreement, we will be required to make contributions to the plans to fund the accrued benefits, vested and unvested, payable on a pretax basis to participants in the plans. We made a discretionary payment to the trust fund in July 2007 in the amount of \$95 million.

Demutualization Consideration. We remain obligated to disburse \$95 million of demutualization consideration to governmental authorities if we are unable to establish contact with eligible policyholders within time periods prescribed by state unclaimed property laws. These laws historically required remittance after periods ranging from three to seven years, but many states have enacted laws that reduce these holding periods to accelerate the reporting of unclaimed demutualization property.

Restrictions on Dividends and Returns of Capital from Subsidiaries

Our insurance and various other companies are subject to regulatory limitations on the payment of dividends and other transfers of funds to affiliates. With respect to Prudential Insurance, New Jersey insurance law provides that, except in the case of extraordinary dividends or distributions, all dividends or distributions paid by Prudential Insurance may be declared or paid only from unassigned surplus, as determined pursuant to statutory accounting principles, less unrealized investment gains and revaluation of assets. Prudential Insurance must also notify the New Jersey Department of Banking and Insurance of its intent to pay a dividend. If the dividend, together with other dividends or distributions made within the preceding twelve months, would exceed a specified statutory limit or would not be paid from earned surplus, Prudential Insurance must also obtain the prior non-disapproval of the Department. The current statutory limitation applicable to New Jersey life insurers generally is the greater of 10% of the prior calendar year's statutory surplus or the prior calendar year's statutory net gain from operations excluding realized investment gains and losses. In addition to these regulatory limitations, the terms of the IHC debt contain restrictions potentially limiting dividends by Prudential Insurance applicable to the Financial Services Businesses in the event the Closed Block Business is in financial distress and under certain other circumstances.

The laws regulating dividends of the other states and foreign jurisdictions where our other insurance companies are domiciled are similar, but not identical, to New Jersey's. Pursuant to Gibraltar Life's reorganization, in addition to regulatory restrictions, there are certain restrictions on Gibraltar Life's ability to pay dividends to Prudential Financial. We anticipate that it will be several years before these restrictions will allow

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Gibraltar Life to pay dividends. There are also regulatory restrictions on the payment of dividends by The Prudential Life Insurance Company, Ltd., or Prudential of Japan. In 2006, Prudential of Japan paid its first

Table of Contents

dividend to Prudential International Insurance Holdings, Ltd., which subsequently distributed the proceeds to Prudential Financial. The ability of our asset management subsidiaries, and the majority of our other operating subsidiaries, to pay dividends is largely unrestricted.

Alternative Sources of Liquidity

Prudential Financial, the parent holding company, maintains an intercompany liquidity account that is designed to maximize the use of cash by facilitating the lending and borrowing of funds between the parent holding company and its affiliates on a daily basis. Depending on the overall availability of cash, the parent holding company invests excess cash on a short-term basis or borrows funds in the capital markets. It also has access to bank facilities. See [Lines of Credit and Other Credit Facilities](#).

Liquidity of Subsidiaries

Domestic Insurance Subsidiaries

General Liquidity

Liquidity refers to a company's ability to generate sufficient cash flows to meet the needs of its operations. We manage the liquidity of our domestic insurance operations to ensure stable, reliable and cost-effective sources of cash flows to meet all of our obligations. Liquidity is provided by a variety of sources, as described more fully below, including portfolios of liquid assets. The investment portfolios of our domestic operations are integral to the overall liquidity of those operations. We segment our investment portfolios and employ an asset/liability management approach specific to the requirements 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. We use a projection process for cash flows from operations to ensure sufficient liquidity to meet projected cash outflows, including claims.

Liquidity is measured against internally developed benchmarks that take into account the characteristics of the asset portfolio. The results are affected substantially by the overall asset type and quality of our investments.

Cash Flow

The principal sources of liquidity for Prudential Insurance and our other domestic insurance subsidiaries are premiums and annuity considerations, investment and fee income and investment maturities and sales associated with our insurance and annuity operations. 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, and payments in connection with financing activities.

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

We believe that the cash flows from our insurance and annuity operations are adequate to satisfy the current liquidity requirements of these operations, including under reasonably foreseeable stress scenarios. The continued adequacy of this liquidity will depend upon factors such as future securities market conditions, changes in interest rate levels and policyholder perceptions of our financial strength, each of which could lead to reduced cash inflows or increased cash outflows.

Our domestic insurance operations' cash flows from investment activities result from repayments of principal, proceeds from maturities and sales of invested assets and investment income, net of amounts reinvested. The primary liquidity risks with respect to these cash flows are the risk of default by debtors, our counterparties' willingness to extend repurchase and/or securities lending arrangements and market volatility. We closely manage these risks through our credit risk management process and regular monitoring of our liquidity position.

Table of Contents

In managing the liquidity of our domestic insurance operations, we also consider the risk of policyholder and contract holder withdrawals of funds earlier than our assumptions in selecting assets to support these contractual obligations. We use surrender charges and other contract provisions to mitigate the extent, timing and profitability impact of withdrawals of funds by customers from annuity contracts and deposit liabilities. The following table sets forth withdrawal characteristics of our general account annuity reserves and deposit liabilities (based on statutory liability values) as of the dates indicated.

| | June 30, 2007 | | December 31, 2006 | |
|--|------------------|------------|-------------------|------------|
| | Amount | % of Total | Amount | % of Total |
| | (\$ in millions) | | | |
| Not subject to discretionary withdrawal provisions | \$ 32,579 | 44% | \$ 30,209 | 42% |
| Subject to discretionary withdrawal, with adjustment: | | | | |
| With market value adjustment | 20,291 | 28 | 20,540 | 28 |
| At market value | 1,190 | 2 | 1,169 | 2 |
| At contract value, less surrender charge of 5% or more | 1,735 | 2 | 1,953 | 3 |
| Subtotal | 55,795 | 76 | 53,871 | 75 |
| Subject to discretionary withdrawal at contract value with no surrender charge or surrender charge of less than 5% | 17,773 | 24 | 18,096 | 25 |
| Total annuity reserves and deposit liabilities | \$ 73,568 | 100% | \$ 71,967 | 100% |

Individual life insurance policies are less susceptible to withdrawal than our annuity reserves and deposit liabilities because policyholders may incur surrender charges and be subject to a new underwriting process in order to obtain a new insurance policy. Annuity benefits under group annuity contracts are generally not subject to early withdrawal.

Gross account withdrawals for our domestic insurance operations products amounted to approximately \$9.8 billion for both the first six months of 2007 and 2006. Because these withdrawals were consistent with our assumptions in asset/liability management, the associated cash outflows did not have a material adverse impact on our overall liquidity.

Liquid Assets

Liquid assets include cash, cash equivalents, short-term investments, fixed maturities that are not designated as held to maturity and public equity securities. As of June 30, 2007 and December 31, 2006, our domestic insurance operations had liquid assets of \$136.3 billion and \$140.9 billion, respectively. The portion of liquid assets comprised of cash and cash equivalents and short-term investments was \$8.0 billion and \$8.4 billion as of June 30, 2007 and December 31, 2006, respectively. As of June 30, 2007, \$111.0 billion, or 90%, of the fixed maturity investments that are not designated as held to maturity within our domestic insurance company general account portfolios were rated investment grade. The remaining \$12.6 billion, or 10%, of these fixed maturity investments were rated non-investment grade. We consider attributes of the various categories of liquid assets (for example, type of asset and credit quality) in calculating internal liquidity measures in order to evaluate the adequacy of our domestic insurance operations liquidity under a variety of stress scenarios. We believe that the liquidity profile of our assets is sufficient to satisfy current liquidity requirements, including under foreseeable stress scenarios.

Given the size and liquidity profile of our investment portfolios, we believe that claim experience varying from our projections does not constitute a significant liquidity risk. Our asset/liability management process takes into account the expected maturity of investments and

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

expected claim payments as well as the specific nature and risk profile of the liabilities. Historically, there has been no significant variation between the expected maturities of our investments and the payment of claims.

Table of Contents

Our domestic insurance companies' liquidity is managed through access to substantial investment portfolios as well as a variety of instruments available for funding and/or managing short-term cash flow mismatches, including from time to time those arising from claim levels in excess of projections. To the extent we need to pay claims in excess of projections, we may borrow temporarily or sell investments sooner than anticipated to pay these claims, which may result in realized investment gains or losses or increased borrowing costs affecting results of operations. For a further discussion of realized investment gains or losses, see *Realized Investment Gains and General Account Investments* *Realized Investment Gains*. We believe that borrowing temporarily or selling investments earlier than anticipated will not have a material impact on the liquidity of our domestic insurance companies. Payment of claims and sale of investments earlier than anticipated would have an impact on the reported level of cash flow from operating and investing activities, respectively, in our financial statements.

Prudential Funding, LLC

Prudential Funding, LLC, or Prudential Funding, a wholly owned subsidiary of Prudential Insurance, serves as an additional source of financing for Prudential Insurance and its subsidiaries, as well as for other subsidiaries of Prudential Financial. Prudential Funding operates under a support agreement with Prudential Insurance whereby Prudential Insurance has agreed to maintain Prudential Funding's positive tangible net worth at all times. Prudential Funding borrows funds primarily through the direct issuance of commercial paper. Prudential Funding's outstanding loans to other subsidiaries of Prudential Financial have declined over time as it transitions into a financing company primarily for Prudential Insurance and its remaining subsidiaries. While our other subsidiaries continue to borrow from Prudential Funding, they also borrow from Prudential Financial and directly from third parties. The impact of Prudential Funding on liquidity is considered in the internal liquidity measures of the domestic insurance operations.

As of June 30, 2007, Prudential Financial, Prudential Insurance and Prudential Funding had unsecured committed lines of credit totaling \$4.5 billion. There were no outstanding borrowings under these facilities as of June 30, 2007. For a further discussion of lines of credit, see *Lines of Credit and Other Credit Facilities*.

International Insurance Subsidiaries

In our international insurance operations, liquidity is provided through ongoing operations as well as portfolios of liquid assets. In managing the liquidity and the interest and credit risk profiles of our international insurance portfolios, we employ a discipline similar to the discipline employed for domestic insurance subsidiaries. We monitor liquidity through the use of internal liquidity measures, taking into account the liquidity of the asset portfolios.

As with our domestic operations, in managing the liquidity of these operations, we consider the risk of policyholder and contractholder withdrawals of funds earlier than our assumptions in selecting assets to support these contractual obligations. As of June 30, 2007 and December 31, 2006, our international insurance subsidiaries had total general account insurance related liabilities (other than dividends payable to policyholders) of \$48.9 billion and \$49.1 billion, respectively. Of those amounts, \$26.7 billion and \$27.8 billion, respectively, were associated with Gibraltar Life, our largest international insurance subsidiary. Concurrent with our acquisition of Gibraltar Life in April 2001, substantially all of its insurance liabilities were restructured under a plan of reorganization to include special surrender penalties on existing policies. These charges mitigate the extent, timing, and profitability impact of withdrawals of funds by customers and apply to \$19.6 billion and \$21.2 billion of Gibraltar Life's insurance related reserves as of June 30, 2007 and December 31, 2006, respectively.

The following table sets forth the schedule (for each fiscal year ending March 31) of special surrender charges on Gibraltar Life policies that are in force:

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

| | | | |
|-------------|-------------|-------------|-------------|
| 2006 | 2007 | 2008 | 2009 |
| 8% | 6% | 4% | 2% |

Table of Contents

Policies issued by Gibraltar Life post-acquisition are not subject to the above restructured policy surrender charge schedule. Policies issued post-acquisition are generally subject to discretionary withdrawal at contract value, less applicable surrender charges, which currently start at 5% or more.

A special dividend to certain Gibraltar Life policyholders was payable in 2005 and will again be payable in 2009. The special dividend is based on 70% of net realized investment gains, if any, over the value of certain real estate and loans, net of transaction costs and taxes, included in the Gibraltar Life reorganization plan. As of June 30, 2007, a liability of \$317 million related to the 2009 special dividend is included in Policyholders' dividends. The 2009 special dividend will take the form of either additional policy values or cash. Gibraltar Life's investment portfolio is structured to provide adequate liquidity for the special dividend.

Prudential of Japan had \$17.0 billion and \$16.8 billion of general account insurance related liabilities, other than dividends to policyholders, as of June 30, 2007 and December 31, 2006, respectively. Prudential of Japan did not have a material amount of general account annuity reserves or deposit liabilities subject to discretionary withdrawal as of June 30, 2007 or December 31, 2006. Additionally, we believe that the individual life insurance policies sold by Prudential of Japan do not have significant withdrawal risk because policyholders may incur surrender charges and must undergo a new underwriting process in order to obtain a new insurance policy.

As of June 30, 2007 and December 31, 2006, our international insurance subsidiaries had cash and short-term investments of approximately \$1.0 billion and \$1.1 billion, respectively, and fixed maturity investments, other than those designated as held to maturity, with fair values of \$36.6 billion and \$37.0 billion, respectively. As of June 30, 2007, \$35.6 billion, or 97%, of the fixed maturity investments that are not designated as held to maturity within our international insurance subsidiaries were rated investment grade. The remaining \$1.0 billion, or 3%, of these fixed maturity investments were rated non-investment grade. Of those amounts, \$19.7 billion of the investment grade fixed maturity investments and \$0.6 billion of the non-investment grade fixed maturity investments were associated with Gibraltar Life. We consider attributes of the various categories of liquid assets (for example, type of asset and credit quality) in calculating internal liquidity measures to evaluate the adequacy of our international insurance operations' liquidity under stress scenarios. We believe that ongoing operations and the liquidity profile of our international insurance assets provide sufficient liquidity under reasonably foreseeable stress scenarios.

Asset Management Subsidiaries

Our asset management businesses, which include real estate, public and private fixed income and public equity asset management, as well as commercial mortgage origination, servicing and securitization, proprietary investing and retail investment products, such as mutual funds and wrap-fee products, are largely unregulated from the standpoint of dividends and distributions. Our asset management subsidiaries through which we conduct these businesses generally do not have restrictions on the amount of distributions they can make, and they provide a stable source of significant cash flow to Prudential Financial.

The principal sources of liquidity for our asset management subsidiaries include asset management fees, revenues from proprietary investments and commercial mortgage operations, and available borrowing lines from internal sources including Prudential Funding and Prudential Financial, as well as from third parties. The principal uses of liquidity include the financing associated with our proprietary investments and commercial mortgage operations, general and administrative expenses, and distribution of dividends and returns of capital to Prudential Financial.

The primary liquidity risks for our asset management subsidiaries include the potential impacts of adverse market conditions and poor investment management performance on the profitability of the businesses. Our asset management subsidiaries continue to maintain sufficiently

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

liquid balance sheets. As of June 30, 2007 and December 31, 2006, our asset management subsidiaries had cash and cash equivalents and short-term investments of \$1,098 million and \$949 million, respectively. We believe the cash flows from our asset

Table of Contents

management businesses are adequate to satisfy the current liquidity requirements of their operations, as well as requirements that could arise under foreseeable stress scenarios, which are monitored through the use of internal measures.

Prudential Securities Group

As of June 30, 2007 and December 31, 2006, Prudential Securities Group's assets totaled \$7.9 billion and \$7.4 billion, respectively. Prudential Securities Group owns our 38% investment in Wachovia Securities as well as the retained wholly owned businesses. On May 31, 2007, Wachovia announced an agreement under which Wachovia proposes to acquire, among other things, the retail securities brokerage business of A.G. Edwards, Inc., which would be combined with the retail securities brokerage business of Wachovia Securities. See Note 10 to the Unaudited Interim Consolidated Financial Statements for additional information concerning this pending acquisition and its effect on our investment in Wachovia Securities. The wholly owned businesses remaining in Prudential Securities Group continue to maintain sufficiently liquid balance sheets, consisting mostly of cash and cash equivalents, segregated client assets, and short-term receivables from clients, broker-dealers, and exchanges. Distributions from our investment in Wachovia Securities to Prudential Securities Group totaled \$189 million and \$147 million for the six months ended June 30, 2007 and 2006, respectively.

On June 6, 2007, we announced our decision to exit the equity sales, trading, and research operations of the Prudential Equity Group, or PEG, the results of which were historically included in the Financial Advisory Segment. As discussed in Note 3 of the Unaudited Interim Consolidated Financial Statements, PEG's operations were substantially wound down by June 30, 2007 and are reflected in discontinued operations for all periods presented. PEG has sufficient capital and liquidity to cover the costs associated with the divestiture.

Financing Activities

As of June 30, 2007 and December 31, 2006, total short- and long-term debt of the Company on a consolidated basis was \$24.1 billion and \$24.0 billion, respectively, which includes \$12.1 billion and \$11.6 billion, respectively, related to the parent company, Prudential Financial.

Prudential Financial is authorized to borrow funds from various sources to meet its capital needs, as well as the capital needs of its subsidiaries. The following table sets forth the outstanding short- and long-term debt of Prudential Financial, other than debt to consolidated subsidiaries, as of the dates indicated:

| | June 30, 2007 | December 31, 2006 |
|--|------------------|----------------------|
| | (in millions) | |
| Borrowings: | | |
| General obligation short-term debt: | | |
| Commercial paper | \$ 1,491 | \$ 282 |
| Floating rate convertible senior notes | 2,000 | 4,000 |
| Current portion of long-term debt | 1,021 | 107 |
| General obligation long-term debt: | | |
| Senior debt | 5,382 | 5,421 |
| Retail medium-term notes | 2,178 | 1,777 |
| Total general obligations | \$ 12,072 | \$ 11,587 |

Prudential Financial's short-term debt included commercial paper borrowings of \$1,491 million and \$282 million as of June 30, 2007 and December 31, 2006, respectively. The weighted average interest rate on the commercial paper borrowings under this program was 5.30% and 4.70% for the six months ended June 30, 2007 and 2006, respectively.

Table of Contents

In March 2006, Prudential Financial filed an updated shelf registration statement with the SEC, superseding its previous shelf registration statement, that permits the issuance of public debt, equity and hybrid securities. The updated shelf registration statement was established under the SEC rules adopted in 2005 that allow for automatic effectiveness upon filing, pay-as-you-go fees and the ability to add securities by filing automatically effective amendments for companies qualifying as Well-Known Seasoned Issuers. As a result, this new shelf registration statement has no stated issuance capacity.

In March 2006, Prudential Financial filed a prospectus supplement for a new Medium-Term Notes, Series D program under the shelf registration statement, which superseded its Medium-Term Notes, Series C program. The Company is authorized to issue up to \$5 billion of notes under the Series D program. As of June 30, 2007, approximately \$2.1 billion remained available under the program. Prudential Financial issued \$100 million of 2-year medium term notes in January 2007 and \$100 million of 2-year medium term notes in February 2007. Prudential Financial also issued \$25 million of 1-year medium term notes, \$25 million of 2-year medium term notes, and \$25 million of 3-year medium term notes in April 2007. In addition, in June 2007, Prudential Financial issued \$250 million of 5-year medium term notes and \$250 million of 10-year medium term notes. The net proceeds from the sale of these notes were used for general corporate purposes, including a loan to a domestic insurance subsidiary used to finance certain regulatory reserves required to be held in connection with the intercompany reinsurance of certain term life policies. The weighted average interest rates on Prudential Financial's medium-term and senior notes, including the effect of interest rate hedging activity, were 5.41% and 5.45% for the first six months of 2007 and 2006, respectively, excluding the effect of debt issued to consolidated subsidiaries.

In March 2006, Prudential Financial filed a prospectus supplement under the shelf registration statement for its retail medium-term notes, including the InterNotes® program, which superseded the 2005 retail medium-term notes program. The Company is authorized to issue up to \$2.5 billion of notes under the new program. As of June 30, 2007, approximately \$1.3 billion remained available under the program. This retail medium-term notes program serves as a funding source for a spread product of our Retirement segment that is economically similar to funding agreement-backed medium-term notes issued to institutional investors, except that the retail notes are senior obligations of Prudential Financial and are purchased by retail investors. The weighted average interest rates on Prudential Financial's retail medium-term notes were 5.58% and 5.44% for the first six months of 2007 and 2006, respectively, excluding the effect of debt issued to consolidated subsidiaries.

In September 2006, Prudential Financial updated its European medium-term notes program under the shelf registration statement. The Company is authorized to issue up to \$1.5 billion of notes under the program. As of June 30, 2007, there was no debt outstanding under this program.

In January and April 2007, Prudential Financial filed prospectus supplements to register under the shelf registration statement resales of the floating rate convertible senior notes that were issued in a private placement in November 2005 (\$2.0 billion). On April 13, 2007, Prudential Financial announced its intention to call all such outstanding floating rate convertible senior notes for redemption on May 21, 2007. Prior to the redemption, substantially all holders elected to convert their senior notes as provided under their terms. The senior notes required net settlement in shares; therefore, upon conversion, the holders received cash equal to the par amount of the senior notes surrendered for conversion plus accrued interest and shares of Prudential Financial Common Stock for the portion of the settlement amount in excess of the par amount. The settlement amount in excess of the par amount was based upon the excess of the closing market price of Prudential Financial Common Stock for a 10-day period defined under the terms of the senior notes, or \$100.80 per share, over the initial conversion price of \$90 per share. Accordingly, at conversion we issued 2,367,887 shares of Common Stock from treasury. The conversion had no impact on our results of operations and resulted in a net increase to shareholders' equity of \$44 million, reflecting the tax benefit associated with the conversion of the senior notes. The payment of principal and accrued interest was funded primarily through the liquidation of the investment grade fixed income investment portfolio purchased with the proceeds of the convertible senior notes issued in 2005.

Table of Contents

In April and July 2007, Prudential Financial filed prospectus supplements to register under the shelf registration statement resales of the floating rate convertible senior notes that were issued in a private placement in December 2006 (\$2.0 billion). These convertible senior notes are convertible by the holders at any time after issuance into cash and shares of Prudential Financial's Common Stock. The conversion price, \$104.21 per share for the December 2006 issuance, is subject to adjustment upon certain corporate events. The conversion feature requires net settlement in shares; therefore, upon conversion, a holder would receive cash equal to the par amount of the convertible notes surrendered for conversion and shares of Prudential Financial Common Stock only for the portion of the settlement amount in excess of the par amount, if any. The interest rate on these convertible senior notes is a floating rate equal to 3-month LIBOR minus 2.4%, to be reset quarterly. See Note 12 to our Consolidated Financial Statements included in our 2006 Annual Report on Form 10-K for additional information concerning these convertible senior notes. Prudential Financial is obligated to file once per quarter a prospectus supplement to register resales of these convertible senior notes.

Current capital markets activities for the Company on a consolidated basis principally consist of unsecured short-term and long-term debt borrowings issued by Prudential Funding and Prudential Financial, unsecured third party bank borrowing, and asset-based or secured financing. The secured financing arrangements include transactions such as securities lending and repurchase agreements, which we generally use to finance liquid securities in our short-term spread portfolios, primarily within Prudential Insurance.

The following table sets forth total consolidated borrowings of the Company as of the dates indicated:

| | June 30, 2007 | December 31, 2006 |
|--|------------------|----------------------|
| | (in millions) | |
| Borrowings: | | |
| General obligation short-term debt(1) | \$ 12,661 | \$ 12,452 |
| General obligation long-term debt: | | |
| Senior debt | 8,232 | 8,545 |
| Surplus notes(2) | 1,044 | 1,043 |
| Total general obligation long-term debt | 9,276 | 9,588 |
| Total general obligations | 21,937 | 22,040 |
| Limited and non-recourse borrowing: | | |
| Limited and non-recourse short-term debt | 286 | 84 |
| Limited and non-recourse long-term debt(3) | 1,875 | 1,835 |
| Total limited and non-recourse borrowing | 2,161 | 1,919 |
| Total borrowings(4) | 24,098 | 23,959 |
| Total asset-based financing | 17,604 | 19,123 |
| Total borrowings and asset-based financings | \$ 41,702 | \$ 43,082 |

(1) As of June 30, 2007 and December 31, 2006, included \$250 million of fixed rate surplus notes maturing in July 2007.

(2) As of June 30, 2007 and December 31, 2006, included \$600 million of surplus notes issued by a subsidiary of Prudential Insurance to fund regulatory reserves.

(3)

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

As of June 30, 2007 and December 31, 2006, \$1.750 billion of limited and non-recourse debt outstanding was attributable to the Closed Block Business.

- (4) Does not include \$8.0 billion and \$6.5 billion of medium-term notes of consolidated trust entities secured by funding agreements purchased with the proceeds of such notes as of June 30, 2007 and December 31, 2006, respectively. These notes are included in Policyholders' account balances. For additional information see Funding Agreement Notes Issuance Program.

Table of Contents

Total general debt obligations decreased by \$103 million from December 31, 2006 to June 30, 2007, reflecting a \$312 million net decrease in long-term debt and a \$209 million net increase in short-term debt. The net decrease in long-term debt was primarily driven by reclassification of long-term debt to short-term debt, offset by issuance of medium-term notes and retail medium term notes during the six months ended June 30, 2007. The net increase in short-term debt was primarily due to the reclassification of long-term debt to short-term debt and higher outstanding commercial paper supporting our operating businesses at Prudential Financial, offset by the repayment of the floating rate convertible senior notes.

Prudential Funding's commercial paper and master note borrowings as of June 30, 2007 and December 31, 2006 were \$7.2 billion and \$7.3 billion, respectively. The weighted average interest rates on the commercial paper borrowings and master notes were 5.25% and 4.68% for the six months ended June 30, 2007 and 2006, respectively. During 2002, Prudential Financial issued a subordinated guarantee covering Prudential Funding's domestic commercial paper program.

The total principal amount of debt outstanding under Prudential Funding's domestic medium-term note programs was \$772 million, as of June 30, 2007 and December 31, 2006, of which \$600 million was reflected in the general obligation short-term debt as of June 30, 2007. The weighted average interest rates on Prudential Funding's long-term debt, including the effect of interest rate hedging activity, were 6.22%, and 5.59% for the six months ended June 30, 2007 and 2006, respectively.

Prudential Insurance had outstanding fixed rate surplus notes totaling \$694 million and \$693 million as of June 30, 2007 and December 31, 2006, respectively, of which \$250 million was reflected in the general obligation short-term debt. These debt securities, which are included as surplus of Prudential Insurance on a statutory accounting basis, are subordinated to other Prudential Insurance borrowings and to policyholder obligations and are subject to regulatory approvals for principal and interest payments.

During the fourth quarter of 2006, a subsidiary of Prudential Insurance entered into a Surplus Note Purchase Agreement with an unaffiliated financial institution that provides for the issuance of up to \$3 billion of ten-year floating rate surplus notes for the purpose of financing certain regulatory reserves required to be held in connection with the intercompany reinsurance of certain term life insurance policies. Surplus notes issued under this facility are subordinated to policyholder obligations and are subject to regulatory approvals for principal and interest payments. Concurrent with entering into the agreement, the subsidiary issued \$600 million of notes under this facility. See Note 12 to our Consolidated Financial Statements included in our 2006 Annual Report on Form 10-K for additional information.

Our total borrowings consist of capital debt, investment related debt, securities business related debt and debt related to specified other businesses. Capital debt is borrowing that is used or will be used to meet the capital requirements of Prudential Financial as well as borrowings invested in equity or debt securities of direct or indirect subsidiaries of Prudential Financial and subsidiary borrowings utilized for capital requirements. Investment related borrowings consist of debt issued to finance specific investment assets or portfolios of investment assets, including institutional spread lending investment portfolios, real estate and real estate related investments held in consolidated joint ventures, as well as institutional and insurance company portfolio cash flow timing differences. Securities business related debt consists of debt issued to finance primarily the liquidity of our broker-dealers and our capital markets and other securities business related operations. Debt related to specified other businesses consists of borrowings associated with our individual annuity business, real estate franchises and relocation services. Borrowings under which either the holder is entitled to collect only against the assets pledged to the debt as collateral, or has only very limited rights to collect against other assets, have been classified as limited and non-recourse debt. Consolidated borrowings as of June 30, 2007 and December 31, 2006 include \$1.750 billion of limited and non-recourse debt attributable to the Closed Block Business.

Table of Contents

The following table summarizes our borrowings, categorized by use of proceeds, as of the dates indicated:

| | June 30, 2007 | December 31, 2006 |
|---|------------------|----------------------|
| | (in millions) | |
| General obligations: | | |
| Capital debt | \$ 4,382 | \$ 4,377 |
| Investment related | 12,415 | 13,907 |
| Securities business related | 3,589 | 2,334 |
| Specified other businesses | 1,551 | 1,422 |
| Total general obligations | 21,937 | 22,040 |
| Limited and non-recourse debt | 2,161 | 1,919 |
| Total borrowings | \$ 24,098 | \$ 23,959 |
| Short-term debt | \$ 12,947 | \$ 12,536 |
| Long-term debt | 11,151 | 11,423 |
| Total borrowings | \$ 24,098 | \$ 23,959 |
| Borrowings of Financial Services Businesses | \$ 20,934 | \$ 20,471 |
| Borrowings of Closed Block Business | 3,164 | 3,488 |
| Total borrowings | \$ 24,098 | \$ 23,959 |

Funding Agreement Notes Issuance Program

In 2003, Prudential Insurance established a Funding Agreement Notes Issuance Program pursuant to which a Delaware statutory trust issues medium-term notes (which are included in our statements of financial position in Policyholders' account balances and not included in the foregoing table) secured by funding agreements issued to the trust by Prudential Insurance and included in our Retirement segment. The funding agreements provide cash flow sufficient for the debt service on the related medium-term notes. The medium-term notes are sold in transactions not requiring registration under the Securities Act of 1933, as amended. As of June 30, 2007 and December 31, 2006, the outstanding aggregate principal amount of such notes totaled approximately \$8.0 billion and \$6.5 billion, respectively, out of a total authorized amount of up to \$15 billion. The notes have fixed or floating interest rates and original maturities ranging from two to seven years.

Lines of Credit and Other Credit Facilities

As of June 30, 2007, Prudential Financial, Prudential Insurance and Prudential Funding had unsecured committed lines of credit totaling \$4.5 billion. In May 2007, Prudential Financial and certain of its subsidiaries entered into a new \$2.0 billion 5-year credit facility, which includes 22 financial institutions, replacing a \$1.5 billion facility that would have expired in September 2010. An additional \$2.5 billion is also available under a facility that expires in December 2011, which includes 22 financial institutions. Borrowings under the outstanding facilities will mature no later than the respective expiration dates of the facilities. We use these facilities primarily as back-up liquidity lines for our commercial paper programs, and there were no outstanding borrowings under any of these facilities as of June 30, 2007.

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

Our ability to borrow under these facilities is conditioned on the continued satisfaction of customary conditions, including maintenance at all times by Prudential Insurance of total adjusted capital of at least \$5.5 billion based on statutory accounting principles prescribed under New Jersey law. Prudential Insurance's total adjusted capital as of March 31, 2007 was \$10.0 billion and continues to be above the \$5.5 billion threshold. The ability of Prudential Financial to borrow under these facilities is also conditioned on its maintenance of consolidated net worth of at least \$12.5 billion, calculated in accordance with GAAP. Prudential Financial's net worth on a consolidated basis totaled \$22.9 billion as of both June 30, 2007 and December 31, 2006. We also use uncommitted lines of credit from banks and other financial institutions.

Table of Contents

Ratings

On May 3, 2007, S&P raised Prudential Insurance, PRUCO Life Insurance, PRUCO Life Insurance of New Jersey, American Skandia Life Assurance, Prudential Retirement Insurance and Annuity, Prudential Life Insurance Co., Ltd. (Prudential of Japan) and Gibraltar Insurance Co., Ltd. counterparty credit and financial strength ratings to AA from AA-. S&P also raised the counterparty credit rating on Prudential Financial to A+/A-1 from A/A-1, the counterparty credit rating on the capital and surplus notes of Prudential Insurance to A+ from A, the counterparty credit rating on Prudential Funding, LLC to AA from AA- and the long-term senior debt rating of PRICOA Global Funding to AA from AA-. S&P stated that the outlook on all these companies is stable.

There have been no updates during 2007 to the remainder of our ratings, which were disclosed in *Business Ratings* in our 2006 Annual Report on Form 10-K.

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 or equity or commodity prices. To varying degrees, the investment and trading activities supporting all of our products and services generate market risks. There have been no material changes in our market risk exposures from December 31, 2006, a description of which may be found in our Annual Report on Form 10-K for the year ended December 31, 2006, Item 7A, *Quantitative and Qualitative Disclosures About Market Risk*, filed with the Securities and Exchange Commission.

Item 4. *Controls and Procedures*

In order to ensure that the information we must disclose in our filings with the Securities and Exchange Commission is recorded, processed, summarized, and reported on a timely basis, the Company's management, including our Chief Executive Officer and Chief Financial Officer, 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, 2007. Based on such evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of June 30, 2007, 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, 2007, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. *Legal Proceedings*

We are subject to legal and regulatory actions in the ordinary course of our businesses, including class action lawsuits. Our pending legal and regulatory actions include proceedings specific to us and proceedings generally applicable to business practices in the industries in which we operate. We are also subject to litigation arising out of our general business activities, such as our investments, contracts, leases and labor and

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

employment relationships, including claims of discrimination and harassment. In some of our pending legal and regulatory actions, parties are seeking large and/or indeterminate amounts, including punitive or exemplary damages.

In May 2007, *Azar, et al. v. Prudential Insurance*, the class action pending in the District Court for Valencia County, New Mexico, settled. The settlement, which is subject to final approval by the court, provides that Prudential Insurance will pay the difference between the annualized modal premium and the annual premium and attorneys' fees.

In July 2007, the settlement, which involves Prudential and certain other defendants, in the adversary proceeding pending in the United States Bankruptcy Court for the Southern District of New York, *Enron Corp. v. J.P. Morgan Securities, Inc., et al.*, was submitted to court for approval. The agreement provides that the Prudential defendants will pay \$16.3 million.

Table of Contents

In May 2007, the Company moved to dismiss the complaint in *Lederman v. Prudential Financial, Inc., et. al.* The motion is pending.

Our litigation and regulatory matters are subject to many uncertainties, and given their complexity and scope, the outcomes cannot be predicted. It is possible that our 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. Management believes, however, that the ultimate outcome of all pending litigation and regulatory matters, after consideration of applicable reserves and rights to indemnification, should not have a material adverse effect on our financial position.

The foregoing discussion is limited to recent developments concerning our legal and regulatory proceedings. See Note 9 to the Unaudited Interim Consolidated Financial Statements included herein for additional discussion of our litigation and regulatory matters.

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, 2006. 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 our Annual Report on Form 10-K and this Quarterly Report on Form 10-Q.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) On May 21, 2007, in connection with the redemption of all of the Company's outstanding floating rate convertible senior notes due 2035, the Company issued in reliance upon the exemption from registration provided by Section 3(a)(9) of the Securities Act 2,367,887 shares of its Common Stock, of which 188,014 shares were not registered as of such date for resale under the Company's shelf registration statement on Form S-3. \$2 billion aggregate principal amount of senior notes had been issued in November 2005 to qualified institutional buyers in reliance on Section 4(2) of the Securities Act and Rule 144A under the Securities Act. Prior to the redemption, substantially all holders elected to convert their senior notes as provided for under their terms. The senior notes required net settlement in shares; therefore, upon conversion, the holders received cash equal to the par amount of the senior notes surrendered for conversion plus accrued interest and shares of the Company's Common Stock for the portion of the settlement amount in excess of the par amount. The settlement amount in excess of the par amount was based upon the excess of the closing market price of the Company's Common Stock for a 10-day period defined under the terms of the senior notes, or \$100.80 per share, over the initial conversion price of \$90 per share. The payment of principal and accrued interest was funded primarily through the liquidation of the investment grade fixed income investment portfolio purchased with the proceeds from the issuance of the senior notes. See Item 2 **Management's Discussion and Analysis of Financial Condition and Results of Operations** **Liquidity and Capital Resources** **Financing Activities** .

Table of Contents

(c) The following table provides information about purchases by the Company during the quarter ended June 30, 2007, of its Common Stock.

| Period | Total Number of Shares Purchased(1) (2) | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Program(1) | Approximate Dollar Value of Shares that May Yet be Purchased under the Program(1) |
|-----------------------|---|------------------------------|---|---|
| April 1, 2007 through | | | | |
| April 30, 2007 | 2,572,617 | \$ 92.98 | 2,557,000 | |
| May 1, 2007 through | | | | |
| May 31, 2007 | 2,534,632 | \$ 100.80 | 2,514,000 | |
| June 1, 2007 through | | | | |
| June 30, 2007 | 2,613,615 | \$ 99.47 | 2,611,500 | |
| Total | 7,720,864 | \$ 97.75 | 7,682,500 | \$ 1,500,345,088 |

- (1) In November 2006, Prudential Financial's Board of Directors authorized the Company to repurchase up to \$3.0 billion of its outstanding Common Stock in calendar year 2007.
- (2) Includes shares of Common Stock withheld from participants for income tax withholding purposes whose shares of restricted stock, restricted stock units, and performance shares vested during the period. Restricted stock, restricted stock units, and performance shares were 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.

Item 4. Submission of Matters to a Vote of Security Holders

At the Prudential Financial annual meeting of shareholders on May 8, 2007 the following voting occurred:

The shareholders elected twelve directors to serve a one-year term until the 2008 Annual Meeting of Shareholders, or in each case until their successors are elected and qualified. The voting results were as follows:

| Name of Director | Votes For | Withheld |
|---------------------|-------------|-----------|
| Frederic K. Becker | 292,143,604 | 4,454,831 |
| Gordon M. Bethune | 292,316,188 | 4,282,247 |
| Gaston Caperton | 292,492,799 | 4,105,636 |
| Gilbert F. Casellas | 292,343,923 | 4,244,512 |
| James G. Cullen | 292,187,267 | 4,411,168 |
| William H. Gray III | 291,415,382 | 5,184,053 |
| Jon F. Hanson | 292,195,905 | 4,402,530 |
| Constance J. Horner | 292,167,160 | 4,431,275 |
| Karl J. Krapek | 292,087,348 | 4,511,087 |
| Christine A. Poon | 292,575,991 | 4,022,444 |
| Arthur F. Ryan | 289,748,107 | 6,850,328 |
| James A. Unruh | 291,749,108 | 4,849,327 |

Edgar Filing: PRUDENTIAL FINANCIAL INC - Form 10-Q

The shareholders ratified the appointment of PricewaterhouseCoopers LLP as the Company's independent registered public accounting firm (independent auditor) for 2007. The voting results were as follows:

| Votes For | Votes Against | Abstentions |
|------------------|----------------------|--------------------|
| 291,355,076 | 992,653 | 3,250,706 |

Table of Contents

Item 6. Exhibits

- 3.1 Amended and Restated Certificate of Incorporation of Prudential Financial, Inc. Incorporated by reference to Exhibit 3.1 to Prudential Financial, Inc. s June 9, 2005 Current Report on Form 8-K.
- 3.2 Amended and Restated By-Laws of Prudential Financial, Inc. Incorporated by reference to Exhibit 3.2 to Prudential Financial, Inc. s June 9, 2005 Current Report on Form 8-K.
- 10.1 Prudential Financial, Inc. Nonqualified Retirement Plan Trust Agreement between Prudential Financial, Inc. and Wachovia Bank, N.A.*
- 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.

* 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, 6th Floor

Newark, NJ 07102

Table of Contents

SIGNATURES

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

PRUDENTIAL FINANCIAL, INC.

By: */s/* RICHARD J. CARBONE
Richard J. Carbone

Senior Vice President and Chief Financial Officer

(Authorized signatory and principal financial officer)

Date: August 2, 2007

Table of Contents

Exhibit Index

Exhibit Number and Description

| | |
|------|---|
| 3.1 | Amended and Restated Certificate of Incorporation of Prudential Financial, Inc. Incorporated by reference to Exhibit 3.1 to Prudential Financial, Inc. s June 9, 2005 Current Report on Form 8-K. |
| 3.2 | Amended and Restated By-Laws of Prudential Financial, Inc. Incorporated by reference to Exhibit 3.2 to Prudential Financial, Inc. s June 9, 2005 Current Report on Form 8-K. |
| 10.1 | Prudential Financial, Inc. Nonqualified Retirement Plan Trust Agreement between Prudential Financial, Inc. and Wachovia Bank, N.A.* |
| 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. |

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