PRUDENTIAL FINANCIAL INC
Form 10-Q
October 30, 2008
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2008

OR

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

For the Transition Period from to

Commission File Number 001-16707

Prudential Financial, Inc.

(Exact Name of Registrant as Specified in its Charter)

New Jersey	**22-3703799**
(State or Other Jurisdiction of	**(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 x No ¨

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

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

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

As of September 30, 2008, 422 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

Table of Contents

FORWARD-LOOKING STATEMENTS

Certain of the statements included in this Quarterly Report on Form 10-Q, including but not limited to those in Management s Discussion and Analysis of Financial Condition and Results of Operations, constitute forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. Words such as expects, believes, anticipates, includes, plans, assumes, estimates, projects, should, will, shall or variations of such words are generally part of forward-looking statements. Forward-looking statements are made based on management s current expectations and beliefs concerning future developments and their potential effects upon Prudential Financial, Inc. and its subsidiaries. There can be no assurance that future developments affecting Prudential Financial, Inc. and its subsidiaries will be those anticipated by management. These forward-looking statements are not a guarantee of future performance and involve risks and uncertainties, and there are certain important factors that could cause actual results to differ, possibly materially, from expectations or estimates reflected in such forward-looking statements, including, among others: (1) general economic, market and political conditions, including the performance and fluctuations of fixed income, equity, real estate and other financial markets, particularly in light of the stress experienced by the global financial markets that began in the second half of 2007 and substantially increased in the third quarter of 2008; (2) the availability and cost of external financing for our operations, which has been affected by the stress experienced by the global financial markets; (3) interest rate fluctuations; (4) reestimates of our reserves for future policy benefits and claims; (5) differences between actual experience regarding mortality, morbidity, persistency, surrender experience, interest rates or market returns and the assumptions we use in pricing our products, establishing liabilities and reserves or for other purposes; (6) changes in our assumptions related to deferred policy acquisition costs, valuation of business acquired or goodwill; (7) changes in our claims-paying or credit ratings; (8) investment losses and defaults; (9) competition in our product lines and for personnel; (10) changes in tax law; (11) economic, political, currency and other risks relating to our international operations; (12) fluctuations in foreign currency exchange rates and foreign securities markets; 13) regulatory or legislative changes, including government actions in response to the stress experienced by the global financial markets; (14) changes in our claims paying or financial strength ratings; (15) adverse determinations in litigation or regulatory matters and our exposure to contingent liabilities, including in connection with our divestiture or winding down of businesses; (16) 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; (17) ineffectiveness of risk management policies and procedures in identifying, monitoring and managing risks; (18) effects of acquisitions, divestitures and restructurings, including possible difficulties in integrating and realizing the projected results of acquisitions; (19) changes in statutory or U.S. GAAP accounting principles, practices or policies; (20) changes in assumptions for retirement expense; (21) Prudential Financial, Inc. s primary reliance, as a holding company, on dividends or distributions from its subsidiaries to meet debt payment obligations and the ability of the subsidiaries to pay such dividends or distributions in light of our ratings objectives and/or applicable regulatory restrictions; and (22) 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 this Quarterly Report on Form 10-Q 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

September 30, 2008 and December 31, 2007 (in millions, except share amounts)

	September 30, 2008	December 31, 2007
ASSETS		
Fixed maturities:		
Available for sale, at fair value (amortized cost: 2008 $161,674; 2007 $160,137)	$ 155,604	$ 162,162
Held to maturity, at amortized cost (fair value: 2008 $3,410; 2007 $3,543)	3,481	3,548
Trading account assets supporting insurance liabilities, at fair value	14,392	14,473
Other trading account assets, at fair value	3,368	3,613
Equity securities, available for sale, at fair value (cost: 2008 $7,847; 2007 $7,895)	7,389	8,580
Commercial loans (includes $574 measured at fair value at September 30, 2008)	32,736	30,047
Policy loans	9,211	9,337
Securities purchased under agreements to resell	171	129
Other long-term investments	6,671	6,431
Short-term investments	7,884	5,237
Total investments	240,907	243,557
Cash and cash equivalents	11,361	11,060
Accrued investment income	2,271	2,174
Reinsurance recoverables	1,838	2,119
Deferred policy acquisition costs	14,067	12,339
Other assets	24,806	18,982
Separate account assets	165,148	195,583
TOTAL ASSETS	$ 460,398	$ 485,814
LIABILITIES AND STOCKHOLDERS EQUITY		
LIABILITIES		
Future policy benefits	$ 113,612	$ 111,468
Policyholders account balances	96,332	84,154
Policyholders dividends	2,000	3,661
Reinsurance payables	1,228	1,552
Securities sold under agreements to repurchase	8,426	11,441
Cash collateral for loaned securities	3,480	6,312
Income taxes	1,350	3,553
Short-term debt	14,539	15,657
Long-term debt	17,870	14,101

Other liabilities	17,714	14,875
Separate account liabilities	165,148	195,583
Total liabilities	441,699	462,357
COMMITMENTS AND CONTINGENT LIABILITIES (See Note 12)		
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; 604,902,338 and 604,901,479 shares issued as of September 30, 2008 and December 31, 2007, respectively)	6	6
Class B Stock ($.01 par value; 10,000,000 shares authorized; 2,000,000 shares issued and outstanding as of September 30, 2008 and December 31, 2007, respectively)		
Additional paid-in capital	21,845	20,856
Common Stock held in treasury, at cost (183,209,388 and 157,534,628 shares as of September 30, 2008 and December 31, 2007, respectively)	(11,640)	(9,693)
Accumulated other comprehensive income (loss)	(3,828)	447
Retained earnings	12,316	11,841
Total stockholders equity	18,699	23,457
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 460,398	$ 485,814

See Notes to Unaudited Interim Consolidated Financial Statements

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Unaudited Interim Consolidated Statements of Operations

Three and Nine Months Ended September 30, 2008 and 2007 (in millions, except per share amounts)

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
REVENUES				
Premiums	$ 3,618	$ 3,472	$ 11,503	$ 10,660
Policy charges and fee income	711	729	2,360	2,299
Net investment income	2,931	3,033	8,984	8,955
Realized investment gains (losses), net	(273)	(84)	(2,083)	453
Asset management fees and other income	49	1,243	1,545	3,226
Total revenues	7,036	8,393	22,309	25,593
BENEFITS AND EXPENSES				
Policyholders benefits	3,954	3,543	12,000	10,961
Interest credited to policyholders account balances	496	820	1,878	2,388
Dividends to policyholders	779	765	1,496	2,081
General and administrative expenses	1,992	2,145	6,431	6,473
Total benefits and expenses	7,221	7,273	21,805	21,903
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES	(185)	1,120	504	3,690
Income tax expense (benefit)	(143)	316	(48)	1,063
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES	(42)	804	552	2,627
Equity in earnings of operating joint ventures, net of taxes	(129)	67	(62)	200
INCOME (LOSS) FROM CONTINUING OPERATIONS	(171)	871	490	2,827
Income (loss) from discontinued operations, net of taxes	5	(4)	3	6
NET INCOME (LOSS)	$ (166)	$ 867	$ 493	$ 2,833
EARNINGS PER SHARE (See Note 6)				
Financial Services Businesses				
Basic:				
Income (loss) from continuing operations per share of Common Stock	$ (0.24)	$ 1.92	$ 1.33	$ 5.96
Income (loss) from discontinued operations, net of taxes	0.01	(0.01)	0.01	0.01
Net income (loss) per share of Common Stock	$ (0.23)	$ 1.91	$ 1.34	$ 5.97
Diluted:				
Income (loss) from continuing operations per share of Common Stock	$ (0.24)	$ 1.89	$ 1.32	$ 5.85
Income (loss) from discontinued operations, net of taxes	0.01	(0.01)		0.01

Net income (loss) per share of Common Stock	$ (0.23)	$ 1.88	$ 1.32	$ 5.86
Closed Block Business				
Basic and Diluted:				
Income (loss) from continuing operations per share of Class B Stock	$ (34.00)	$ (3.00)	$ (43.50)	$ 34.50
Income from discontinued operations, net of taxes				1.00
Net income (loss) per share of Class B Stock	$ (34.00)	$ (3.00)	$ (43.50)	$ 35.50

See Notes to Unaudited Interim Consolidated Financial Statements

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Unaudited Interim Consolidated Statement of Stockholders Equity

Nine Months Ended September 30, 2008 (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, 2007	$ 6	$	$ 20,856	$ 11,841	$ (9,693)	$ 447	$ 23,457
Common Stock acquired					(2,125)		(2,125)
Stock-based compensation programs			12	(21)	178		169
Impact on Company s investment in Wachovia Securities due to addition of A.G. Edwards business, net of tax			977				977
Cumulative effect of changes in accounting principles, net of taxes				3			3
Comprehensive income:							
Net income				493			493
Other comprehensive loss, net of taxes						(4,275)	(4,275)
Total comprehensive income (loss)							(3,782)
Balance, September 30, 2008	$ 6	$	$ 21,845	$ 12,316	$ (11,640)	$ (3,828)	$ 18,699

See Notes to Unaudited Interim Consolidated Financial Statements

3

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Unaudited Interim Consolidated Statements of Cash Flows

Nine Months Ended September 30, 2008 and 2007 (in millions)

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 493	$ 2,833
Adjustments to reconcile net income to net cash provided by operating activities:		
Realized investment (gains) losses, net	2,083	(453)
Policy charges and fee income	(709)	(664)
Interest credited to policyholders account balances	1,878	2,388
Depreciation and amortization	327	159
Change in:		
Deferred policy acquisition costs	(840)	(955)
Future policy benefits and other insurance liabilities	3,056	1,942
Trading account assets supporting insurance liabilities and other trading account assets	29	(1,572)
Income taxes	(827)	(82)
Other, net	825	505
Cash flows from operating activities	6,315	4,101
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from the sale/maturity/prepayment of:		
Fixed maturities, available for sale	63,060	68,107
Fixed maturities, held to maturity	192	203
Trading account assets supporting insurance liabilities and other trading account assets	17,323	
Equity securities, available for sale	3,043	4,091
Commercial loans	2,035	3,805
Policy loans	1,542	951
Other long-term investments	1,000	863
Short-term investments	26,194	12,729
Payments for the purchase/origination of:		
Fixed maturities, available for sale	(66,084)	(69,999)
Fixed maturities, held to maturity	(37)	(165)
Trading account assets supporting insurance liabilities and other trading account assets	(18,766)	
Equity securities, available for sale	(3,450)	(4,271)
Commercial loans	(4,656)	(6,014)
Policy loans	(1,160)	(957)
Other long-term investments	(2,203)	(1,351)
Short-term investments	(29,202)	(11,650)
Other, net	(43)	152
Cash flows used in investing activities	(11,212)	(3,506)
CASH FLOWS FROM FINANCING ACTIVITIES		
Policyholders account deposits	27,292	15,358
Policyholders account withdrawals	(17,042)	(15,324)
Net change in securities sold under agreements to repurchase and cash collateral for loaned securities	(5,686)	1,431
Cash dividends paid on Common Stock	(86)	(83)
Net change in financing arrangements (maturities 90 days or less)	(47)	918
Common Stock acquired	(2,110)	(2,250)
Common Stock reissued for exercise of stock options	93	175
Proceeds from the issuance of debt (maturities longer than 90 days)	7,353	3,803
Repayments of debt (maturities longer than 90 days)	(4,342)	(3,728)
Excess tax benefits from share-based payment arrangements	21	88
Other, net	(235)	360

Cash flows from financing activities	5,211	748
Effect of foreign exchange rate changes on cash balances	(13)	(27)
NET INCREASE IN CASH AND CASH EQUIVALENTS	301	1,316
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	11,060	8,589
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 11,361	$ 9,905
NON-CASH TRANSACTIONS DURING THE PERIOD		
Impact on Company s investment in Wachovia Securities due to addition of A.G. Edwards business, net of tax	$ 977	$
Treasury Stock shares issued for convertible debt redemption	$	$ 135
Treasury Stock shares issued for stock-based compensation programs	$ 88	$ 96

See Notes to Unaudited Interim Consolidated Financial Statements

4

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 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 for the year ended December 31, 2007 included in the Company s Current Report on Form 8-K dated May 16, 2008.

Use of Estimates

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

The most significant estimates include those used in determining deferred policy acquisition costs, 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 and nine months ended September 30, 2008 would have been increased by $0.2 million and $1 million, respectively, with no reportable impact to the earnings per share of Common Stock, on both a basic and diluted basis. Net income of the Financial Services Businesses for the three months ended September 30, 2007 would have been increased by $3 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 nine months ended September 30, 2007 would have been increased by $7 million, or $0.02 per share of Common Stock, on both a basic and diluted basis.

Income Taxes

The Company determines its interim tax provision using the annual effective tax rate methodology as required by Accounting Principles Board Opinion No. 28 and Financial Accounting Standards Board (FASB) Interpretation No. 18. The Company has utilized a discrete effective tax rate method to calculate taxes for the third quarter and first nine months of 2008. The Company believes that, at this time, the use of this discrete method is more appropriate than the full year effective tax rate method applied in prior quarters. As a result of the extreme volatility in the U.S. markets and its impact on the Company s ability to forecast pre-tax earnings, the 2008 effective tax rate estimate is unreliable.

The Company s liability for income taxes includes the liability for unrecognized tax benefits, interest and penalties which relate to tax years still subject to review by the Internal Revenue Service (IRS) or other taxing jurisdictions. Audit periods remain open for review until the statute of limitations has passed. Generally, for tax years which produce net operating losses, capital losses or tax credit carryforwards (tax attributes), the statute of limitations does not close, to the extent of these tax attributes, until the expiration of the statute of limitations

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

for the tax year in which they are fully utilized. The completion of review or the expiration of the statute of limitations for a given audit period could result in an adjustment to the liability for income taxes. The statute of limitations for the 2002 and 2003 tax years is set to expire in 2009. It is reasonably possible that the total net amount of unrecognized tax benefits will increase anywhere from $0 to $70 million within the next 12 months due to the expiration of the statute of limitations as well as cash receipts on settlement of the IRS examination. Taxable years 2004 through 2007 are still open for IRS examination.

The dividends received deduction, or DRD, reduces the amount of dividend income subject to U.S. tax and in recent years is the primary component of the difference between our effective tax rate and the federal statutory tax rate of 35%. The DRD for the current period was estimated using information from 2007 and current year results, and was adjusted to take into account the current year s equity market performance. The actual current year DRD can vary from the estimate based on factors such as, but not limited to, changes in the amount of dividends received that are eligible for the DRD, changes in the amount of distributions received from mutual fund investments, changes in the account balances of variable life and annuity contracts, and our taxable income before the DRD.

In December 2006, the IRS completed all fieldwork with regards to its examination of the consolidated federal income tax returns for tax years 2002 and 2003. The final report was initially submitted to the Joint Committee on Taxation for their review in April 2007. The final report was resubmitted in March 2008 and again in April 2008. The Joint Committee returned the report to the IRS for additional review of the industry issue regarding the methodology for calculating the DRD related to variable life insurance and annuity contracts. The IRS completed its review of the issue and proposed an adjustment with respect to the calculation of the DRD. In order to expedite a pending income tax refund related to the 2002 and 2003 years, the Company has agreed to such adjustment. Nevertheless, the Company believes that its return position is technically correct. Therefore, the Company intends to file a protective refund claim to recover the taxes associated with the agreed upon adjustment and to pursue such other actions as appropriate. The report, with the adjustment, was submitted to the Joint Committee on Taxation in October 2008. These activities had no impact on our 2007 or 2008 results.

Accounting Pronouncements Adopted

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. The Company adopted this guidance effective January 1, 2008.

Upon the adoption of SFAS No. 159, the Company elected the fair value option for certain investments held within the commercial mortgage operations of the Asset Management segment. Specifically, the fair value option was elected for funded commercial loans held for sale originated beginning January 1, 2008. In addition, the Company elected the fair value option for fixed rate commercial loans held for investment that were held at December 31, 2007 and for such loans originated beginning January 1, 2008. The Company elected the fair value option for the loan programs mentioned above primarily to eliminate the need for hedge accounting under SFAS No. 133, while still achieving an offset in earnings from the associated interest rate derivative hedges.

Due to volatility in the credit markets, the Company experienced unexpected volatility in the fair value of the aforementioned fixed rate commercial loans held for investment that was not substantially offset by the associated interest rate derivative hedges during the quarter ended March 31, 2008. Therefore, the Company decided to no longer elect the fair value option on loans held for investment that were originated after March 31, 2008, and has applied hedge accounting under SFAS No. 133. See Note 10 for more information on SFAS No. 159.

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

The Company does not have material commercial loans held for sale outside of the commercial mortgage operations. The fair value option has not been elected for the Company s other fixed rate commercial loans held for investment (primarily held by the general account), as the underlying business drivers and economics are different for these loans in that they are part of a diverse portfolio backing insurance liabilities.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. This statement defines fair value, establishes a framework for measuring fair value, 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 practices in determining fair value. The Company adopted this guidance effective January 1, 2008. See Note 10 for more information on SFAS No. 157.

In October 2008, the FASB issued FSP FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active. This FSP clarifies the application of SFAS No. 157 in a market that is not active and applies to financial assets within the scope of accounting pronouncements that require or permit fair value measurements in accordance with SFAS No. 157. The FSP is effective upon issuance, including prior periods for which financial statements have not been issued. Accordingly, the Company adopted this guidance effective September 30, 2008. The Company s adoption of this guidance did not have a material effect on the Company s consolidated financial position or results of operations.

In November 2007, the staff of the SEC issued Staff Accounting Bulletin (SAB) No. 109, Written Loan Commitments Recorded at Fair Value Through Earnings. SAB 109 revises and rescinds portions of SAB 105, Application of Accounting Principles to Loan Commitments. Specifically, SAB 109 states that the expected net future cash flows related to the associated servicing of the loan should be included in the measurement of all written loan commitments that are accounted for at fair value through earnings. SAB 109 is effective for all written loan commitments recorded at fair value that are entered into, or substantially modified, in fiscal quarters beginning after December 15, 2007. The Company adopted SAB 109 effective January 1, 2008 for its loan commitments that are recorded at fair value through earnings. The Company s adoption of this guidance did not have a material effect on the Company s consolidated financial position or results of operations.

In April 2007, the FASB issued FASB Staff Position (FSP) FIN 39-1, Amendment of FASB Interpretation No. 39. FSP FIN 39-1 modifies FIN No. 39, Offsetting of Amounts Related to Certain Contracts, and permits companies to offset cash collateral receivables or payables with net derivative positions under certain circumstances. This FSP is effective for fiscal years beginning after November 15, 2007 and is required to be applied retrospectively to financial statements for all periods presented. The Company s adoption of this guidance effective January 1, 2008 did not have a material effect on the Company s consolidated financial position or results of operations.

In January 2008, the FASB issued Statement No. 133 Implementation Issue No. E23, Hedging General: Issues Involving the Application of the Shortcut Method under Paragraph 68. Implementation Issue No. E23 amends Statement No. 133, paragraph 68 with respect to the conditions that must be met in order to apply the shortcut method for assessing hedge effectiveness. This implementation guidance was effective for hedging relationships designated on or after January 1, 2008. The Company s adoption of this guidance effective January 1, 2008 did not have a material effect on the Company s consolidated financial position or results of operations.

8

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

Recent Accounting Pronouncements

In September 2008, the FASB issued FSP FAS 133-1 and FIN 45-4, Disclosures about Credit Derivatives and Certain Guarantees an amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161. This FSP requires sellers of credit derivatives and certain guarantees to disclose (a) the nature of the credit derivative, the reason(s) for entering into the credit derivative, approximate term, performance triggers, and the current status of the performance risk; (b) the undiscounted maximum potential amount of future payments the seller could be required to make before considering any recoveries from recourse provisions or collateral; (c) the credit derivative s fair value; (d) the nature of any recourse provisions and any collateral assets held to ensure performance. This FSP also requires the above disclosures for hybrid instruments that contain embedded derivatives and amends paragraph 13 of FIN 45 to require disclosure of the current status of the guarantee s performance risk. In addition, this FSP clarifies that SFAS No. 161 shall be effective for financial statements issued for any annual or quarterly interim reporting period beginning after November 15, 2008. This FSP is effective for the Company s 2008 annual consolidated financial statements and the Company is currently assessing the impact on these statements.

In June 2008, the FASB Emerging Issues Task Force (EITF) reached consensus on the following issues contained in EITF Issue No. 07-5, Determining Whether an Instrument (or an Embedded Feature) is Indexed to an Entity s Own Stock: (1) how an entity should evaluate whether an instrument (or embedded feature) is indexed to the entity s own stock; (2) how the currency in which the strike price of an equity-linked financial instrument (or embedded equity-linked feature) is denominated affects the determination of whether the instrument is indexed to the entity s own stock; (3) how an issuer should account for equity-linked financial instruments issued to investors for purposes of establishing a market-based measure of the grant-date fair value of employee stock options. This guidance clarifies what instruments qualify as indexed to an entity s own stock and are thereby exempt from requirements of FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, and eligible for equity classification under EITF Issue No. 00-19, Accounting Recognition for Certain Transactions Involving Equity Instruments Granted to Other then Employees. This guidance is effective for fiscal years and interim periods beginning after December 15, 2008. Early application is not permitted. The Company is currently assessing the impact of EITF Issue No. 07-5 on the Company s consolidated financial statements.

In June 2008, the FASB issued FSP EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities. This FSP states that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share (EPS) pursuant to the two-class method described in paragraphs 60 and 61 of FASB Statement No. 128, Earnings per Share. This FSP is effective for fiscal years and interim periods beginning after December 15, 2008, and must be applied retrospectively to all EPS data presented. The Company is currently assessing the impact of FSP EITF 03-6-1 on the Company s calculation of EPS and the EPS data presented within the Company s consolidated financial statements.

In May 2008, the FASB issued FSP APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement). This FSP, which is effective for fiscal years and interim periods beginning after December 15, 2008 and must be applied retrospectively, addresses the accounting for certain convertible debt instruments including those that have been issued by the Company. It requires bifurcation of the instrument into a debt component that is initially recorded at fair value and an equity component. The difference between the fair value of the debt component and the initial proceeds from issuance of the instrument is recorded as a component of equity within additional paid-in capital. The liability component of the debt instrument is accreted to par using the effective yield method, with the accretion being reported as a

9

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

component of interest expense. Bond issuance costs are allocated to the debt and equity components in proportion to the debt proceeds. The Company will adopt this guidance effective January 1, 2009 and estimates the impact will be to reduce net income for the three and nine months ended September 30, 2008 by approximately $10 million and $29 million, or $0.02 and $0.07 per diluted share of Common Stock, respectively, and will reduce net income for the three and nine months ended September 30, 2007 by approximately $7 million and $35 million, or $0.02 and $0.07 per diluted share of Common Stock, respectively.

In April 2008, the FASB issued FSP FAS 142-3, Determination of the Useful Life of Intangible Assets. This FSP amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of recognized intangible assets under SFAS No. 142. The new guidance applies to (1) intangible assets that are acquired individually or with a group of other assets and (2) intangible assets acquired in both business combinations and asset acquisitions. This FSP is effective for fiscal years and interim periods beginning after December 15, 2008, with the guidance for determining the useful life of a recognized intangible asset being applied prospectively to intangible assets acquired after the effective date and the disclosure requirements being applied prospectively to all intangible assets recognized as of, and after, the effective date. The Company is currently assessing the impact of this FSP on the Company s consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133. This statement amends and expands the disclosure requirements for derivative instruments and hedging activities by requiring companies to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement No. 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. This statement is effective for fiscal years and interim periods beginning after November 15, 2008. The Company is currently assessing the impact of SFAS No. 161 on the notes to the consolidated financial statements.

In February 2008, the FASB issued FSP FAS 140-3, Accounting for Transfers of Financial Assets and Repurchase Financing Transactions. The FSP provides recognition and derecognition guidance for a repurchase financing transaction, which is a repurchase agreement that relates to a previously transferred financial asset between the same counterparties, that is entered into contemporaneously with or in contemplation of, the initial transfer. The FSP is effective for fiscal years beginning after November 15, 2008. The FSP is to be applied prospectively to new transactions entered into after the adoption date. The Company will adopt this guidance effective January 1, 2009. The Company is currently assessing the impact of this FSP on the Company s consolidated financial position and results of operations.

In February 2008, the FASB issued FSP FAS 157-2, Effective Date of FASB Statement No. 157. This FSP applies to nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). FSP FAS 157-2 delays the effective date of SFAS No. 157 for these items to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. The Company is currently assessing the impact of this FSP on the Company s consolidated financial position and results of operations.

In December 2007, the FASB issued SFAS No. 141R, Business Combinations. This statement, which addresses the accounting for business acquisitions, is effective for fiscal years beginning on or after December 15, 2008, with early adoption prohibited, and generally applies to business acquisitions completed after December 31, 2008. Among other things, the new standard requires that all acquisition-related costs be

10

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

expensed as incurred, and that all restructuring costs related to acquired operations be expensed as incurred. This new standard also addresses the current and subsequent accounting for assets and liabilities arising from contingencies acquired or assumed and, for acquisitions both prior and subsequent to December 31, 2008, requires the acquirer to recognize changes in the amount of its deferred tax benefits that are recognizable because of a business combination either in income from continuing operations in the period of the combination or directly in contributed capital, depending on the circumstances. The Company is currently assessing the impact of SFAS No. 141R on the Company s consolidated financial position and results of operations.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements. SFAS No. 160 will change the accounting for minority interests, which will be recharacterized as noncontrolling interests and classified by the parent company as a component of equity. This statement is effective for fiscal years beginning on or after December 15, 2008, with early adoption prohibited. Upon adoption, SFAS No. 160 requires retroactive adoption of the presentation and disclosure requirements for existing minority interests and prospective adoption for all other requirements. The Company is currently assessing the impact of SFAS No. 160 on the Company s 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 will adopt this guidance on December 31, 2008 and estimates the impact of changing from a September 30 measurement date to a December 31 measurement date will be a net after-tax increase to retained earnings of approximately $15 million.

3. ACQUISITIONS AND DISPOSITIONS

Acquisition of Hyundai Investment and Securities Co., Ltd.

In 2004, the Company acquired an 80 percent interest in Hyundai Investment and Securities Co., Ltd., a Korean asset management firm, from an agency of the Korean government, for $301 million in cash, including $210 million used to repay debt assumed. Subsequent to the acquisition, the company was renamed Prudential Investment & Securities Co., Ltd. On January 25, 2008, the Company acquired the remaining 20 percent for $90 million.

Additional Investment in UBI Pramerica

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

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

Discontinued Operations

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in millions)			
Equity sales, trading and research operations	$ 1	$ (1)	$ (1)	$ (104)
Real estate investments sold or held for sale	3		4	62
Canadian intermediate weekly premium and individual health operations		(1)		(1)
International securities operations		(2)	(2)	(1)
Healthcare operations	3		3	5
Income (loss) from discontinued operations before income taxes	7	(4)	4	(39)
Income tax expense (benefit)	2		1	(45)
Income (loss) from discontinued operations, net of taxes	$ 5	$ (4)	$ 3	$ 6

The nine months ended September 30, 2007 includes a $26 million tax benefit associated with a discontinued international business. Real estate investments sold or held for sale reflects the income from discontinued real estate investments.

The Company s Unaudited Interim Consolidated Statements of Financial Position include total assets and total liabilities related to discontinued businesses of $139 million and $20 million, respectively, as of September 30, 2008 and $242 million and $98 million, respectively, as of December 31, 2007. 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.

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

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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. At December 31, 2007, the Company recognized a policyholder dividend obligation of $732 million to Closed Block policyholders for the excess of actual cumulative earnings over the expected cumulative earnings. Additionally, net unrealized investment gains (losses) that arose subsequent to the establishment of the Closed Block were reflected as an adjustment to the policyholder dividend obligation of $1.047 billion as of December 31, 2007, with an offsetting amount reported in Accumulated other comprehensive income (loss). As of September 30, 2008, the excess of actual cumulative earnings over the expected cumulative earnings was $175 million. However, due to the accumulation of net unrealized investment losses that have arisen subsequent to the establishment of the Closed Block, the policyholder dividend obligation balance as of September 30, 2008 is zero. See the table below for changes in the components of the policyholder dividend obligation for the nine months ended September 30, 2008.

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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

	September 30, 2008	December 31, 2007
	(in millions)	
Closed Block Liabilities		
Future policy benefits	$ 51,552	$ 51,208
Policyholders dividends payable	1,284	1,212
Policyholder dividend obligation		1,779
Policyholders account balances	5,605	5,555
Other Closed Block liabilities	6,232	10,649
Total Closed Block Liabilities	64,673	70,403
Closed Block Assets		
Fixed maturities, available for sale, at fair value	37,384	45,459
Other trading account assets, at fair value	128	142
Equity securities, available for sale, at fair value	3,069	3,858
Commercial loans	7,939	7,353
Policy loans	5,389	5,395
Other long-term investments	1,461	1,311
Short-term investments	1,207	1,326
Total investments	56,577	64,844
Cash and cash equivalents	1,309	1,310
Accrued investment income	666	630
Other Closed Block assets	697	581
Total Closed Block Assets	59,249	67,365
Excess of reported Closed Block Liabilities over Closed Block Assets	5,424	3,038
Portion of above representing accumulated other comprehensive income:		
Net unrealized investment gains (losses)	(2,584)	1,006
Allocated to policyholder dividend obligation	175	(1,047)
Future earnings to be recognized from Closed Block Assets and Closed Block Liabilities	$ 3,015	$ 2,997

Information regarding the policyholder dividend obligation is as follows:

Nine Months Ended September 30,

	2008 (in millions)
Balance, January 1, 2008	$ 1,779
Impact from earnings allocable to policyholder dividend obligation	(557)
Change in net unrealized investment gains (losses)	(1,222)
Balance, September 30, 2008	$

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

Closed Block revenues and benefits and expenses for the three and nine months ended September 30, 2008 and 2007 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in millions)			
Revenues				
Premiums	$ 819	$ 797	$ 2,640	$ 2,580
Net investment income	784	891	2,425	2,616
Realized investment gains (losses), net	125	117	(319)	310
Other income	(8)	15	19	39
Total Closed Block revenues	1,720	1,820	4,765	5,545
Benefits and Expenses				
Policyholders benefits	940	910	3,005	2,933
Interest credited to policyholders account balances	35	34	105	105
Dividends to policyholders	745	726	1,402	1,985
General and administrative expenses	150	190	482	538
Total Closed Block benefits and expenses	1,870	1,860	4,994	5,561
Closed Block revenues, net of Closed Block benefits and expenses, before income taxes and discontinued operations	(150)	(40)	(229)	(16)
Income tax expense (benefit)	(150)	(32)	(211)	(27)
Closed Block revenues, net of Closed Block benefits and expenses and income taxes, before discontinued operations		(8)	(18)	11
Income from discontinued operations, net of taxes				2
Closed Block revenues, net of Closed Block benefits and expenses, income taxes and discontinued operations	$	$ (8)	$ (18)	$ 13

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:

	Issued	Common Stock Held In Treasury	Outstanding	Class B Stock Issued and Outstanding
		(in millions)		
Balance, December 31, 2007	604.9	157.5	447.4	2.0
Common Stock issued				
Common Stock acquired		28.6	(28.6)	
Stock-based compensation programs(1)		(2.9)	2.9	
Balance, September 30, 2008	604.9	183.2	421.7	2.0

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

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

Common Stock Held in Treasury

In November 2007, Prudential Financial s Board of Directors authorized the Company to repurchase at the discretion of management up to $3.5 billion of its outstanding Common Stock in calendar year 2008. 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) under the Securities Exchange Act of 1934, as amended (the Exchange Act). The 2008 stock repurchase program supersedes all previous repurchase programs. During the nine months ended September 30, 2008, the Company acquired 28.6 million shares of its Common Stock at a total cost of $2.125 billion. In light of recent market volatility and extraordinary events and developments affecting financial markets generally, including market conditions for issuance of certain capital instruments such as hybrid securities, the Company suspended all purchases of its Common Stock under the 2008 stock repurchase program effective October 10, 2008. From January 1, 2008 through October 9, 2008, the Company repurchased 29.3 million shares of its Common Stock at a total cost of $2.161 billion.

Comprehensive Income

The components of comprehensive income are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in millions)			
Net income (loss)	$ (166)	$ 867	$ 493	$ 2,833
Other comprehensive income (loss), net of taxes:				
Change in foreign currency translation adjustments	(353)	236	(92)	85
Change in net unrealized investments gains (losses)(1)	(2,041)	(415)	(4,205)	(955)
Change in pension and postretirement unrecognized net periodic benefit	11	3	22	27
Other comprehensive income (loss)(2)	(2,383)	(176)	(4,275)	(843)
Comprehensive income (loss)	$ (2,549)	$ 691	$ (3,782)	$ 1,990

(1) Includes cash flow hedges of $71 million and $(49) million for the three months ended September 30, 2008 and 2007, respectively, and $18 million and $(51) million for the nine months ended September 30, 2008 and 2007, respectively.
(2) Amounts are net of tax expense (benefit) of $(967) million and $(229) million for the three months September 30, 2008 and 2007, respectively and $(2,123) million and $(443) million for the nine months ended September 30, 2008 and 2007, respectively.

The balance of and changes in each component of Accumulated other comprehensive income (loss) for the nine months ended September 30, 2008 are as follows (net of taxes):

	Accumulated Other Comprehensive Income (Loss)			
	Foreign Currency Translation Adjustments	Net Unrealized Investment Gains (Losses)(1)	Pension and Postretirement Unrecognized Net Periodic Benefit (Cost)	Total Accumulated Other Comprehensive Income (Loss)
	(in millions)			
Balance, December 31, 2007	$ 312	$ 400	$ (265)	$ 447
Change in component during period	(92)	(4,205)	22	(4,275)
Balance, September 30, 2008	$ 220	$ (3,805)	$ (243)	$ (3,828)

(1) Includes cash flow hedges of $(155) million and $(173) million as of September 30, 2008 and December 31, 2007, respectively.

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 September 30,					
	2008			2007		
	Income	Weighted Average Shares(1)	Per Share Amount	Income	Weighted Average Shares	Per Share Amount
	(in millions, except per share amounts)					
Basic earnings per share						
Income (loss) from continuing operations attributable to the Financial Services Businesses	$ (113)			$ 864		
Direct equity adjustment	10			13		
Income (loss) from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment	$ (103)	423.8	$ (0.24)	$ 877	457.0	$ 1.92
Effect of dilutive securities and compensation programs(1)						

Stock options					5.0	
Deferred and long-term compensation programs					2.9	
Convertible senior notes						
Diluted earnings per share(1)						
Income (loss) from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment	$ (103)	423.8	$ (0.24)	$ 877	464.9	$ 1.89

(1) For the three months ended September 30, 2008, weighted average shares for basic earnings per share is also used for calculating diluted earnings per share because dilutive shares and dilutive earnings per share are not applicable when a loss from continuing operations is reported. As a result of the loss from continuing operations available to holders of Common Stock after direct equity adjustment for the three months ended September 30, 2008, all potential stock options and compensation programs were considered antidilutive.

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

	Nine Months Ended September 30,					
	2008			2007		
	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	$ 541			$ 2,716		
Direct equity adjustment	36			42		
Income from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment	$ 577	432.6	$ 1.33	$ 2,758	463.0	$ 5.96
Effect of dilutive securities and compensation programs						
Stock options		3.6			5.5	
Deferred and long-term compensation programs		2.4			2.8	
Convertible senior notes					0.3	
Diluted earnings per share						
Income from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment	$ 577	438.6	$ 1.32	$ 2,758	471.6	$ 5.85

For the three months ended September 30, 2008, 17.9 million options and 4.2 million shares related to deferred and long-term compensation programs, weighted for the portion of the period they were outstanding, are considered antidilutive as a result of the loss from continuing operations available to holders of Common Stock after direct equity adjustment. For the three months ended September 30, 2007, 2.3 million options, weighted for the portion of the period they were outstanding, with a weighted average exercise price of $91.65 per share, 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 nine months ended September 30, 2008 and 2007, 6.0 million and 1.7 million options, respectively, weighted for the portion of the period they were outstanding, with a weighted average exercise price of $80.57 and $91.58 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.

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 $2.0 billion November 2005 issuance was called for redemption in May 2007, as discussed in Note 7 below. These notes were dilutive to earnings per share for the nine months ended September 30, 2007 by 0.3 million shares, weighted 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 $2.0 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 the initial conversion price of $104.21. The $3.0 billion December 2007 issuance will be dilutive to earnings per share if the average market price of the Common Stock for a particular period is above the initial conversion price of $132.39.

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

Class B Stock

Income (loss) from continuing operations per share of Class B Stock was $(34.00) and $(3.00) for the three months ended September 30, 2008 and 2007, respectively, and $(43.50) and $34.50 for the nine months ended September 30, 2008 and 2007, 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 September 30, 2008 and 2007 amounted to $(68) million and $(6) million, respectively. The direct equity adjustment resulted in a decrease in the income (loss) from continuing operations attributable to the Closed Block Business applicable to holders of Class B Stock for earnings per share purposes of $10 million and $13 million for the three months ended September 30, 2008 and 2007, 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 nine months ended September 30, 2008 and 2007 amounted to $(87) million and $69 million, respectively. The direct equity adjustment resulted in a decrease in the income (loss) from continuing operations attributable to the Closed Block Business applicable to holders of Class B Stock for earnings per share purposes of $36 million and $42 million for the nine months ended September 30, 2008 and 2007, respectively. For the three and nine months ended September 30, 2008 and 2007, the weighted average number of shares of Class B Stock used in the calculation of earnings per share amounted to 2.0 million. There are no potentially dilutive shares associated with the Class B Stock.

7. DEBT

Junior Subordinated Notes

In June 2008, Prudential Financial issued $600 million of 8.875% fixed-to-floating rate junior subordinated notes to institutional investors. Also in June 2008, Prudential Financial issued $800 million of junior subordinated notes to retail investors with a fixed interest rate of 9.0% paid quarterly. On July 11, 2008, Prudential Financial issued an additional $120 million of retail junior subordinated notes following the underwriters exercise of their over-allotment option. Both issuances are considered hybrid capital securities, which receive enhanced equity treatment from the rating agencies. Both series of notes have a scheduled maturity of June 15, 2038 and a final maturity of June 15, 2068. Prudential Financial is required to use commercially reasonable efforts, subject to market disruption events, to raise sufficient proceeds from the issuance of specified qualifying capital securities, which include hybrid capital securities, to repay the principal of the notes at their scheduled maturity. For the institutional notes, interest is payable semi-annually at a fixed rate of 8.875% until June 15, 2018, from which date interest is payable quarterly at a floating rate of 3-month LIBOR plus 5.00%. Prudential Financial may redeem the institutional notes, subject to the terms of the replacement capital covenant, or RCC, as discussed below, in whole or in part, on or after June 15, 2018 at their principal amount plus accrued and unpaid interest or prior to June 15, 2018 at a make-whole price. Prudential Financial may redeem the retail notes, subject to the terms of the RCC as discussed below, on or after June 15, 2013, in whole or in part, at their principal amount plus accrued and unpaid interest or prior to June 15, 2013, in whole, at a make-whole price. Both series of notes may also be redeemed in whole upon the occurrence of certain defined events. Prudential Financial has the right to defer interest payments on either or both series of notes for a period up to ten years, during which time interest will be compounded. If Prudential Financial were to exercise its right to defer interest it will be required, commencing on the earlier of (i) the first interest payment date on which current interest is paid after the deferral period or (ii) the fifth anniversary of the deferral period, to issue specified alternative payment securities, which include but are not limited to Common Stock, to satisfy its obligation with respect to the deferred interest. In connection with the issuance of both series of notes, Prudential Financial entered into a RCC for the benefit of holders of debt that is senior to the junior subordinated notes. Under the RCC, Prudential Financial agreed that it will not repay, redeem, defease, or purchase the notes prior to June 15, 2048, unless it has

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

received proceeds from the issuance of specified replacement capital securities, which include but are not limited to hybrid capital securities as well as Common Stock. The RCC will terminate upon the occurrence of certain events, including acceleration due to an event of default. Interest expense on the notes was $35 million and $37 million for the three and nine months ended September 30, 2008, respectively.

Convertible Senior Notes

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 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.

Federal Home Loan Bank of New York

In June 2008, Prudential Insurance became a member of the Federal Home Loan Bank of New York (FHLBNY), which provides Prudential Insurance access to collateralized borrowings and other FHLBNY products. Prudential Insurance s membership in FHLBNY requires the ownership of member stock and any borrowings from FHLBNY will require the purchase of FHLBNY activity based stock in an amount equal to 4.5% of the borrowings. Under guidance of the New Jersey Department of Banking and Insurance, the total amount of securities that can be pledged as collateral by Prudential Insurance to FHLBNY is limited to 5% of the prior year s admitted assets of Prudential Insurance exclusive of separate account assets, which equates to $7.7 billion based on admitted assets as of December 31, 2007. Based on this permitted amount, the eligible securities available at Prudential Insurance, and net of the 4.5% activity based stock Prudential Insurance would be obligated to purchase from FHLBNY based on maximum borrowings, the estimated total borrowing capacity with the FHLBNY is $6.7 billion, as of September 30, 2008. As of September 30, 2008, outstanding borrowings with FHLBNY amounted to $100 million and are collateralized by $131 million of securities. Subsequent to September 30, 2008, Prudential Insurance borrowed an additional $1.0 billion from the FHLBNY.

8. 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.

20

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 September 30,			
	Pension Benefits		Other Postretirement Benefits	
	2008	2007	2008	2007
	(in millions)			
Components of net periodic (benefit) cost				
Service cost	$ 38	$ 42	$ 3	$ 3
Interest cost	116	108	31	34
Expected return on plan assets	(180)	(192)	(40)	(23)
Amortization of prior service cost	11	7	(3)	(1)
Amortization of actuarial (gain) loss, net	3	7		4
Special termination benefits		1		
Net periodic (benefit) cost	$ (12)	$ (27)	$ (9)	$ 17

	Nine Months Ended September 30,			
	Pension Benefits		Other Postretirement Benefits	
	2008	2007	2008	2007
	(in millions)			
Components of net periodic (benefit) cost				
Service cost	$ 115	$ 126	$ 9	$ 9
Interest cost	350	324	93	102
Expected return on plan assets	(540)	(576)	(120)	(69)
Amortization of prior service cost	33	21	(9)	(3)
Amortization of actuarial (gain) loss, net	11	21		11
Special termination benefits	2	3		
Net periodic (benefit) cost	$ (29)	$ (81)	$ (27)	$ 50

The Company made cash contributions during the nine months ended September 30, 2008 of $80 million to non-qualified pension plans and $15 million to postretirement plans. The Company anticipates that it will make cash contributions for the remainder of 2008 of approximately $70 million to non-qualified pension plans and approximately $5 million to postretirement plans. The Company does not anticipate making any contributions to the qualified pension plan in 2008. The Company also made a discretionary cash contribution in July of 2008 of $95 million to an irrevocable trust, commonly referred to as a rabbi trust, which holds assets of the Company to be used to satisfy its obligations with respect to certain non-qualified retirement plans.

9. 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

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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.

In 2008, the Company classified its commercial mortgage securitization operations as a divested business, reflecting its decision to exit this business. As a result of this decision, these operations, which involved the origination and purchase of commercial mortgage loans that we in turn would aggregate and sell into commercial mortgage-backed securitization transactions, together with related hedging activities, previously reported within the Asset Management segment, have been classified within divested businesses and are reflected in the Company s Corporate and Other operations. Accordingly, these results are excluded from adjusted operating income, with prior period results being adjusted to reflect such reclassification. These operations had pre-tax losses of $6 million and $129 million for the three and nine months ended September 30, 2008, respectively, and pre-tax losses of $42 million and $10 million for the three and nine months ended September 30, 2007, respectively. The Company retained and continues the remainder of its commercial mortgage origination, servicing and other commercial mortgage related activities, which remain a part of the Asset Management segment.

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;
- 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.

Effective with the first quarter of 2008, the Company amended its definition of adjusted operating income as it relates to certain externally managed investments in the European market held within the general account portfolio. These investments are medium term notes that are collateralized by investment portfolios primarily

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

consisting of investment grade European fixed income securities, including corporate bonds and asset-backed securities, and derivatives, as well as varying degrees of leverage. The notes have a stated coupon and provide a return based on the performance of the underlying portfolios and the level of leverage. The Company invests in these notes to earn a coupon through maturity, consistent with its investment purpose for other debt securities. The notes are accounted for under U.S. GAAP as available for sale fixed maturity securities with bifurcated embedded derivatives (total return swaps). Changes in the value of the fixed maturity securities are reported in Stockholders Equity under the heading Accumulated Other Comprehensive Income and changes in the market value of the embedded total return swaps are included in current period earnings in Realized investment gains (losses), net. Historically, adjusted operating income included cumulative losses and recoveries of such losses on the embedded derivatives in the period they occurred, while cumulative net gains on the embedded derivatives were deferred and amortized into adjusted operating income over the remaining life of the notes.

Adjusted operating income under the amended definition excludes any amounts related to changes in the market value of the embedded derivatives. Adjusted operating income for all periods presented has been revised to conform with the amended definition. The Company views adjusted operating income under the amended definition as a more meaningful presentation of its results for purposes of analyzing the operating performance of, and allocating resources to, its business segments, as the amended definition presents the results of these investments on a basis generally consistent with similar investments held directly within the general account portfolio. The Company believes the mark to market losses discussed below, resulting primarily from unprecedented credit spread widening, are not representative of the fundamental value of the underlying investments over the long term. Adjusted operating income continues to include the coupon on these notes, which reflects the market based interest rate and spread of securities comparable to the underlying securities that existed at the time the Company entered into the investments. The accounting for these investments under U.S. GAAP has not changed.

For the three months ended September 30, 2008 and 2007, the Company recorded losses of $132 million and $103 million, respectively, and for the nine months ended September 30, 2008 and 2007, recorded losses of $318 million and $92 million, respectively, within Realized investment gains (losses), net related to the change in value on the embedded derivatives associated with these investments, which are excluded from adjusted operating income under the amended definition. Adjusted operating income under the former definition included losses of $72 million and $69 million, respectively, for the three and nine months ended September 30, 2007.

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 from sales of securities. 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 are associated with: 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 the Company sells; and minority interest in consolidated operating subsidiaries. The related charges associated with policyholder dividends include a percentage of the net increase in the fair value of specified assets included in Gibraltar Life s reorganization plan that is required to be paid as a special dividend to

Gibraltar Life policyholders. Deferred

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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 represents 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 the Company s annuity products contain a market value adjustment feature that requires us to pay to the contract holder or entitles us to receive from the contract holder, 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 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 (a net gain of $12 million and $19 million for the three months ended September 30, 2008 and 2007, respectively, and a net gain of $16 million and $65 million for the nine months ended September 30, 2008 and 2007, respectively). As of September 30, 2008 and December 31, 2007, the fair value of open contracts used for this purpose was a net asset of $127 million and a net asset of $12 million, respectively.

The Company uses interest rate and currency swaps and other derivatives to manage interest and currency exchange rate exposures arising from mismatches between assets and liabilities, including duration mismatches. For 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,

24

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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 net gains of $14 million and $19 million for the three months ended September 30, 2008 and 2007, respectively, and net gains of $43 million and $62 million for the nine months ended September 30, 2008 and 2007, 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 net losses of $101 million and net gains of $16 million for the three months ended September 30, 2008 and 2007, respectively, and net losses of $146 million and net gains of $44 million for the nine months ended September 30, 2008 and 2007, respectively, related to these products and any associated derivative portfolio.

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

The Company conducts certain activities for which Realized investment gains (losses), net are a principal source of earnings for its businesses and therefore included in adjusted operating income, particularly within the Company s Asset Management segment. For example, Asset Management s 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, including related derivative results, are a principal activity for this business and included in adjusted operating income. In addition, the Realized investment gains (losses), net associated with loans originated by the Company s commercial mortgage operations, including related derivative results and retained mortgage servicing rights, are a principal activity for this business and included in adjusted operating income. Net realized investment gains of $64 million and losses of $47 million for the three months ended September 30, 2008 and 2007, respectively, and losses of $19 million and gains of $11 million for the nine months ended September 30, 2008 and 2007, respectively, related to these and other businesses were included in adjusted operating income as an adjustment to Realized investment gains (losses), net.

The Company has certain investments supporting insurance liabilities in its general account portfolio that are classified as trading. These trading investments are carried at fair value and included in Other trading account assets, at fair value on the Company s statements of financial position. Realized and unrealized gains and losses for these investments are recorded in Asset management fees and other income, and interest and dividend income for these investments is recorded in Net investment income. Consistent with the exclusion of realized investment gains and losses with respect to other investments supporting insurance liabilities managed on a consistent basis, the net gains or losses on these investments, which is 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 net losses of $77 million and $59 million for the three and nine months ended September 30, 2008, respectively. There was no adjustment for the three and nine months ended September 30, 2007.

The Company has certain assets and liabilities for which, under GAAP, the change in value due to changes in foreign currency exchange rates during the period is recorded in Asset management fees and other income.

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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 $31 million and net gain of $26 million for the three months ended September 30, 2008 and 2007, respectively, and net gains of $16 million and $51 million for the nine months ended September 30, 2008 and 2007, respectively.

As a result of the Chapter 11 bankruptcy petition filed by Lehman Brothers Holdings Inc. (Lehman Brothers) on September 15, 2008, the Company experienced losses during the third quarter of 2008 related to the unsecured portion of its counterparty exposure on derivative transactions it had entered into with Lehman Brothers and its affiliates. The Company has replaced these derivative positions with various other counterparties. These losses are recorded within Asset management fees and other income within the Company s Corporate and Other operations, under the broker-dealer accounting model followed by our affiliated derivative subsidiary that executed these transactions, and are excluded from adjusted operating income consistent with the adjusted operating income treatment of similar credit-related losses that are recorded within Realized investment gains (losses), net. For the three and nine months ended September 30, 2008, $75 million of these losses were recorded in Asset management fees and other income and are excluded from adjusted operating income as a related adjustment to Realized investment gains (losses), net. There was no adjustment for the three and nine months ended September 30, 2007. Any subsequent recoveries of these losses will also be excluded from adjusted operating income.

Investment gains and losses on trading account assets supporting insurance liabilities and changes in experience-rated contract holder liabilities due to asset value changes. Certain products included in the Retirement and International Insurance segments are experience-rated in that investment results associated with these products will ultimately accrue to contract holders. The investments supporting these experience-rated products, excluding commercial loans, are classified as trading and are carried at fair value. These trading investments are reflected on the statements of financial position as Trading account assets supporting insurance liabilities, at fair value. Realized and unrealized gains and losses for these investments are reported in Asset management fees and other income. Interest and dividend income for these investments is reported in Net investment income. Commercial 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. In addition, 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 contract holder liabilities due to asset value changes in the pool of investments (including commercial 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 contract holders.

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.

26

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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.

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 September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in millions)			
Adjusted Operating Income before income taxes for Financial Services Businesses by Segment:				
Individual Life	$ 238	$ 251	$ 437	$ 493
Individual Annuities	(307)	205	(38)	551
Group Insurance	101	100	271	220
Total Insurance Division	32	556	670	1,264
Asset Management	(8)	161	301	503
Financial Advisory	(217)	85	(150)	254
Retirement	133	65	398	351
Total Investment Division	(92)	311	549	1,108
International Insurance	460	423	1,326	1,245
International Investments	37	114	89	219
Total International Insurance and Investments Division	497	537	1,415	1,464
Corporate Operations	(17)	(33)	(31)	(47)
Real Estate and Relocation Services	(4)	21	(30)	36
Total Corporate and Other	(21)	(12)	(61)	(11)
Adjusted Operating Income before income taxes for Financial Services Businesses	416	1,392	2,573	3,825
Reconciling items:				
Realized investment gains (losses), net, and related adjustments	(564)	(178)	(1,756)	10
Charges related to realized investment gains (losses), net	17	(2)	45	(15)
Investment gains (losses) on trading account assets supporting insurance liabilities, net	(534)	36	(919)	10
Change in experience-rated contractholder liabilities due to asset value changes	388	(6)	682	4
Divested businesses	(3)	(27)	(128)	19
Equity in earnings of operating joint ventures	208	(103)	108	(323)

Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures for Financial Services Businesses	(72)	1,112	605	3,530
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures for Closed Block Business	(113)	8	(101)	160
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures	$ (185)	$ 1,120	$ 504	$ 3,690

27

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 September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in millions)			
Financial Services Businesses:				
Individual Life	$ 682	$ 672	$ 2,038	$ 1,932
Individual Annuities	528	633	1,723	1,869
Group Insurance	1,232	1,203	3,707	3,619
Total Insurance Division	2,442	2,508	7,468	7,420
Asset Management	345	558	1,457	1,693
Financial Advisory	(214)	98	(127)	303
Retirement	1,118	1,195	3,592	3,508
Total Investment Division	1,249	1,851	4,922	5,504
International Insurance	2,226	2,040	6,880	6,148
International Investments	157	251	487	597
Total International Insurance and Investments Division	2,383	2,291	7,367	6,745
Corporate Operations	4	32	82	190
Real Estate and Relocation Services	68	89	177	229
Total Corporate and Other	72	121	259	419
Total	6,146	6,771	20,016	20,088
Reconciling items:				
Realized investment gains (losses), net, and related adjustments	(564)	(178)	(1,756)	10
Charges related to realized investment gains (losses), net	2	2	18	5
Investment gains (losses) on trading account assets supporting insurance liabilities, net	(534)	36	(919)	10
Divested businesses		(21)	(103)	33
Equity in earnings of operating joint ventures	208	(103)	108	(323)

Total Financial Services Businesses	5,258	6,507	17,364	19,823
Closed Block Business	1,778	1,886	4,945	5,770
Total per Unaudited Interim Consolidated Financial Statements	$ 7,036	$ 8,393	$ 22,309	$ 25,593

The Asset Management segment revenues include intersegment revenues of $84 million and $92 million for the three months ended September 30, 2008 and 2007, respectively, and $264 million and $274 million for the nine months ended September 30, 2008 and 2007, 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:

	September 30, 2008	December 31, 2007
	(in millions)	
Individual Life	$ 34,160	$ 36,124
Individual Annuities	69,725	76,685
Group Insurance	32,189	32,913
Total Insurance Division	136,074	145,722
Asset Management	41,258	40,592
Financial Advisory	2,791	1,294
Retirement	120,945	132,614
Total Investment Division	164,994	174,500
International Insurance	67,604	65,387
International Investments	10,550	7,711
Total International Insurance and Investments Division	78,154	73,098
Corporate Operations	13,199	17,430
Real Estate and Relocation Services	1,142	1,281
Total Corporate and Other	14,341	18,711
Total Financial Services Businesses	393,563	412,031
Closed Block Business	66,835	73,783
Total per Unaudited Interim Consolidated Financial Statements	$ 460,398	$ 485,814

10. FAIR VALUE

Transition Impact As discussed in Note 2, the Company adopted SFAS No. 157 and SFAS No. 159 effective January 1, 2008. As a result of adopting SFAS No. 157, the Company eliminated the deferral of gains at inception of certain derivatives contracts whose fair value was not evidenced by market-observable data. The elimination of the deferral of these gains resulted in a net after-tax increase to retained earnings of $3 million.

Also as discussed in Note 2, in conjunction with the adoption of SFAS No. 159, the Company elected the fair value option for fixed rate commercial loans held for investment that were held at December 31, 2007. This election resulted in $399 million of commercial loans being reported at fair value, with no material impact on the Company s consolidated financial position. In addition, SFAS No. 159 requires entities to classify cash receipts and cash payments related to items measured at fair value according to their nature and purpose on the Statement of Cash Flows. As a result, cash flows related to trading account assets supporting insurance liabilities and certain other assets are classified as investing rather than operating as of the adoption date of this guidance.

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

Fair Value Measurement Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS No. 157 establishes a framework for measuring fair value that includes a hierarchy used to classify the inputs used in measuring fair value. The hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three levels. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement. The levels of the fair value hierarchy are as follows:

Level 1 Fair value is based on unadjusted quoted prices in active markets that are accessible to the Company for identical assets or liabilities. These generally provide the most reliable evidence and are used to measure fair value whenever available. Active markets are defined as having the following for the measured asset/liability: i) many transactions, ii) current prices, iii) price quotes not varying substantially among market makers, iv) narrow bid/ask spreads and v) most information publicly available. The Company s Level 1 assets and liabilities primarily include certain cash equivalents and short term investments, equity securities and derivative contracts that are traded in an active exchange market. Prices are obtained from readily available sources for market transactions involving identical assets or liabilities.

Level 2 Fair value is based on significant inputs, other than Level 1 inputs, that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability through corroboration with observable market data. Level 2 inputs include quoted market prices in active markets for similar assets and liabilities, quoted market prices in markets that are not active for identical or similar assets or liabilities and other market observable inputs. The Company s Level 2 assets and liabilities include: fixed maturities (corporate public and private bonds, most government securities, certain asset-backed and mortgage-backed securities, etc.), certain equity securities and commercial loans, short-term investments and certain cash equivalents (primarily commercial paper), and certain over-the-counter derivatives. Valuations are generally obtained from third party pricing services for identical or comparable assets or liabilities, non-binding broker quotes (when pricing service information is not available) or through the use of valuation methodologies using observable market inputs. Prices from pricing services are validated through comparison to internal pricing information and economic indicators as well as backtesting to trade data or other data to confirm that the pricing service s significant inputs are observable. Broker quotes are non-binding, are reviewed for reasonableness, based on the Company s understanding of the market, and are generally considered Level 3. Under certain conditions, the Company may conclude the prices received from independent third party pricing services or brokers are not reasonable or reflective of market activity. In those instances, the Company may choose to over-ride the third-party pricing information or quotes received and apply internally developed values to the related assets or liabilities. In such cases, the valuations are generally classified as Level 3. As of September 30, 2008 such over-rides on a net basis resulted in lower pricing levels being used and in aggregate were not materially different from the prices received from the independent pricing services.

Level 3 Fair value is based on at least one or more significant unobservable inputs for the asset or liability. These inputs reflect the Company s assumptions about the assumptions market participants would use in pricing the asset or liability. The Company s Level 3 assets and liabilities primarily include: certain private fixed maturities and equity securities, certain manually priced public equity securities and fixed maturities, including certain asset-backed securities and securities where the Company chose to over-ride pricing information received from third parties, certain highly structured over-the-counter derivative contracts, certain commercial loans, certain consolidated real estate funds for which the Company is the general partner, and embedded derivatives resulting from certain products with guaranteed benefits. Prices are determined using valuation methodologies such as option pricing models, discounted cash flow models and other similar techniques. Prices may also be based upon non-binding quotes from brokers or other market-makers that are reviewed for reasonableness, based on the Company s understanding of the market.

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis, as of September 30, 2008.

	As of September 30, 2008				
	Level 1	Level 2	Level 3 (in millions)	Netting(2)	Total
Fixed maturities, available for sale	$ 5	$ 153,399	$ 2,200	$	$ 155,604
Trading account assets supporting insurance liabilities	1,093	13,169	130		14,392
Other trading account assets	519	4,315	802	(2,268)	3,368
Equity securities, available for sale	4,905	2,234	250		7,389
Commercial loans		511	63		574
Other long-term investments	550	30	991		1,571
Short term investments	3,752	2,711			6,463
Cash and cash equivalents	1,241	7,455			8,696
Other assets	52	3,596			3,648
Sub-total excluding separate account assets	12,117	187,420	4,436	(2,268)	201,705
Separate account assets(1)	73,963	68,310	22,875		165,148
Total assets	$ 86,080	$ 255,730	$ 27,311	$ (2,268)	$ 366,853
Future policy benefits			785		785
Long-term debt			280		280
Other liabilities	65	2,383	158	(2,079)	527
Total liabilities	$ 65	$ 2,383	$ 1,223	$ (2,079)	$ 1,592

(1) Separate account assets represent segregated funds that are invested for certain customers. Investment risks associated with market value changes are borne by the customers, except to the extent of minimum guarantees made by the Company with respect to certain accounts. Separate account assets classified as Level 3 consist primarily of real estate and real estate investment funds. Separate account liabilities are not included in the above table as they are reported at contract value and not fair value in the Company s Unaudited Interim Consolidated Statement of Financial Position.

(2) Netting amounts represent cash collateral and the impact of offsetting asset and liability positions held with the same counterparty as permitted by FASB Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts and FSP FIN 39-1, Amendment of FASB Interpretation No. 39.*

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

The following tables provide a summary of the changes in fair value of Level 3 assets and liabilities for the three and nine months ended September 30, 2008, as well as the portion of gains or losses included in income for the three and nine months ended September 30, 2008 attributable to unrealized gains or losses related to those assets and liabilities still held at September 30, 2008.

	Three Months Ended September 30, 2008				
	Fixed Maturities, Available For Sale	Trading Account Assets Supporting Insurance Liabilities	Other Trading Account Assets (in millions)	Equity Securities, Available for Sale	Commercial Loans
Fair value, beginning of period	$ 1,859	$ 157	$ 640	$ 138	$ 70
Total gains or (losses) (realized/unrealized):					
Included in earnings:					
Realized investment gains (losses), net	(39)		74	(1)	(7)
Asset management fees and other income		(20)	(7)		
Included in other comprehensive income (loss)	(88)			1	
Net investment income	3		1		
Purchases, sales, issuances, and settlements	308	(9)	111	1	
Foreign currency translation			(2)	(1)	
Transfers into (out of) Level 3(1)	157	2	(15)	112	
Fair value, end of period	$ 2,200	$ 130	$ 802	$ 250	$ 63
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held by the Company at the end of the period(2):					
Included in earnings:					
Realized investment gains (losses), net	$ (41)	$	$ 74	$ (1)	$ (7)
Asset management fees and other income	$	$ (20)	$ (8)	$	$
Included in other comprehensive income (loss)	$ (87)	$	$	$ (2)	$

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

	Three Months Ended September 30, 2008				
	Other Long-term Investments	Separate Account Assets(3)	Future Policy Benefits	Long-Term Debt	Other Liabilities
			(in millions)		
Fair value, beginning of period	$ 928	$ 24,559	$ (327)	$ (211)	$ (88)
Total gains or (losses) (realized/unrealized):					
Included in earnings:					
Realized investment gains (losses), net			(435)		(73)
Asset management fees and other income	18			(6)	
Interest credited to policyholders account balances		194			
Included in other comprehensive income					
Net investment income					
Purchases, sales, issuances, and settlements	54	209	(23)	(63)	3
Foreign currency translation	(9)				
Transfers into (out of) Level 3(1)		(2,087)			
Fair value, end of period	$ 991	$ 22,875	$ (785)	$ (280)	$ (158)
Unrealized gains (losses) for the period relating to those Level 3 assets and liabilities that were still held by the Company at the end of the period(2):					
Included in earnings:					
Realized investment gains (losses), net	$	$	$ (444)	$	$ (74)
Asset management fees and other income	$ 17	$	$	$ (5)	$
Interest credited to policyholders account balances	$	$ (85)	$	$	$

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

Transfers The amount of Separate Account Assets transferred out of Level 3 in the third quarter totaled $2,087 million. This was primarily a result of the utilization of vendor pricing information that the Company was able to validate in the third quarter that was unavailable in the second quarter.

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

	Nine Months Ended September 30, 2008				
	Fixed Maturities, Available For Sale	Trading Account Assets Supporting Insurance Liabilities	Other Trading Account Assets	Equity Securities, Available for Sale	Commercial Loans
			(in millions)		
Fair value, beginning of period	$ 2,890	$ 291	$ 497	$ 190	$
Total gains or (losses) (realized/unrealized):					
Included in earnings:					
Realized investment gains (losses), net	(268)		106	(3)	(12)
Asset management fees and other income		(19)	(11)		
Included in other comprehensive income (loss)	(217)			(20)	
Net investment income	7	(1)	1		
Purchases, sales, issuances, and settlements	(56)	(25)	226	21	(6)
Foreign currency translation			(2)	(1)	
Transfers into (out of) Level 3(1)	(156)	(116)	(15)	63	81
Fair value, end of period	$ 2,200	$ 130	$ 802	$ 250	$ 63
Unrealized gains (losses) for the period relating to those Level 3 assets that were still held by the Company at the end of the period(2):					
Included in earnings:					
Realized investment gains (losses), net	$ (282)	$	$ 106	$ (4)	$ (12)
Asset management fees and other income	$	$ (31)	$ (11)	$	$
Included in other comprehensive income (loss)	$ (213)	$	$	$ (20)	$

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

	Nine Months Ended September 30, 2008				
	Other Long-term Investments	Separate Account Assets(3)	Future Policy Benefits (in millions)	Long-Term Debt	Other Liabilities
Fair value, beginning of period	$ 824	$ 21,815	$ (168)	$ (152)	$ (77)
Total gains or (losses) (realized/unrealized):					
Included in earnings:					
Realized investment gains (losses), net			(553)		(84)
Asset management fees and other income	108			(5)	
Interest credited to policyholders account balances		123			
Included in other comprehensive income					
Net investment income	3				
Purchases, sales, issuances, and settlements	65	1,327	(64)	(123)	3
Foreign currency translation	(9)				
Transfers into (out of) Level 3(1)		(390)			
Fair value, end of period	$ 991	$ 22,875	$ (785)	$ (280)	$ (158)
Unrealized gains (losses) for the period relating to those Level 3 assets and liabilities that were still held by the Company at the end of the period(2):					
Included in earnings:					
Realized investment gains (losses), net	$	$	$ (562)	$	$ (84)
Asset management fees and other income	$ 75	$	$	$ (5)	$
Interest credited to policyholders account balances	$	$ (320)	$	$	$

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

Nonrecurring Fair Value Measurements Certain assets and liabilities are measured at fair value on a nonrecurring basis. As of September 30, 2008, the Company has written down certain commercial loans that are carried at the lower of cost or market, to their fair value of $162 million. This resulted in charges of $8 million and $43 million for the three and nine months ended September 30, 2008, respectively. The fair value measurements were classified as Level 3 in the valuation hierarchy. The inputs utilized for these valuations are pricing indicators from the whole loan market, which the Company considers its principal market for these loans. In addition, during the three months ended September 30, 2008, the Company sold certain commercial loans that were carried at the lower of cost or market for $38 million. These loans had been previously written down from $46 million to $32 million during the year.

In addition, as of September 30, 2008, certain equity and cost method investments had been written down to fair value, resulting in impairments of $19 million and $32 million for the three and nine months ended September 30, 2008. The fair value of the investments associated with $13 million and $26 million of these impairments for the three and nine months ended September 30, 2008, respectively, were based on inputs classified as Level 3 in the valuation hierarchy. The inputs utilized were primarily discounted estimated future

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

cash flows and valuations provided by the general partners taken into consideration with deal and management fee expenses. The fair value of the investments associated with measurements for $6 million of these impairments for the three and nine months ended September 30, 2008 were based on inputs classified as Level 2. The fair value measurement was based on the negotiated sale price.

Fair Value Option As discussed above, SFAS No. 159 provides a fair value option election that allows the Company to irrevocably elect fair value as the measurement attribute for certain financial assets and liabilities. The following table presents information regarding changes in fair values recorded in earnings, including gains or losses on sales, for commercial loans where the fair value option has been elected.

	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2008
	Reported in Realized Investment Gains (Losses), net (in millions)	
Assets:		
Commercial Loans:		
Changes in instrument-specific credit risk	$ (17)	$ (38)
Other changes in fair value	$ 2	$ 1

Changes in fair value due to instrument-specific credit risk are estimated based on changes in credit spreads and quality ratings for the period reported.

None of the loans where the fair value option has been selected are more than 90 days past due or in non-accrual status. Interest income on commercial loans is included in net investment income. For the three and nine months ended September 30, 2008, the Company recorded $15 million and $37 million, respectively of interest income on these loans. Interest income on these loans is recorded based on the effective interest rates as determined at the closing of the loan.

The fair values and aggregate contractual principal amounts of commercial loans, for which the fair value option has been elected, were $574 million and $607 million, respectively, as of September 30, 2008.

11. INVESTMENT IN WACHOVIA SECURITIES

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 currently headquartered in St. Louis, Missouri. As of December 31, 2007, the Company had a 38% ownership interest in the joint venture with Wachovia owning the remaining 62%. The transaction included certain assets and liabilities of the Company s securities brokerage operations; however, the Company retained certain assets and liabilities related to the contributed businesses, including liabilities for certain litigation and regulatory matters. The Company and Wachovia have each agreed to indemnify the other for certain losses, including losses resulting from litigation and regulatory matters relating to certain events arising from the operations of their respective contributed businesses prior to March 31, 2004.

On October 1, 2007, Wachovia completed the acquisition of A.G. Edwards, Inc. (A.G. Edwards) for $6.8 billion and on January 1, 2008 combined the retail securities brokerage business of A.G. Edwards with Wachovia Securities.

The A.G. Edwards transaction entitled the Company to elect a lookback option under the terms of the agreements relating to the joint venture. The lookback option, which the Company has elected, permits the

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

Company to delay for a period of two years ending on January 1, 2010, the decision on whether or not to make 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 the A.G. Edwards business with Wachovia Securities is based on the Company s diluted ownership level, which is in the process of being determined. Any payments at the end of the lookback period to restore all or part of the Company s ownership interest in the joint venture will be based on the appraised or agreed value of the joint venture excluding the A.G. Edwards business as well as the A.G. Edwards business. In such event, the Company may also need to make a true-up payment of one-time costs incurred during the lookback period associated with the combination to reflect the incremental increase in its ownership interest in the joint venture. Alternatively, at the end of the lookback period, the Company may put its joint venture interests to Wachovia based on the appraised value of the joint venture, excluding the A.G. Edwards business, as of January 1, 2008, the date of the combination of the A.G. Edwards business with Wachovia Securities.

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 as if it were a public company and including a control premium such as would apply in the case of a sale of 100% of its common equity. However, if in connection with the lookback option the Company elects at the end of the lookback period to make payments 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. The agreement between Prudential Financial and Wachovia also gives the Company put rights, and Wachovia call rights, in certain other specified circumstances, at prices determined in accordance with the agreement.

The Company and Wachovia have had negotiations concerning possible modifications to the terms of the existing agreements relating to the joint venture. Based upon the existing agreements and our estimates of the values of the A.G. Edwards business and the joint venture excluding the A.G. Edwards business, the Company adjusted the carrying value of its ownership interest in the joint venture effective as of January 1, 2008 to reflect the addition of that business and the dilution of its 38% ownership level and to record the value of the above described rights under the lookback option. As a result, effective January 1, 2008, the Company recognized an increase to Additional paid-in capital of $977 million, net of tax. The Company s recorded share of pre-tax losses from the joint venture of $129 million for the nine months ended September 30, 2008 reflects its estimated diluted ownership level based upon the existing agreements and its estimates of the values of the A.G. Edwards business and the joint venture excluding the A.G. Edwards business. As noted above, the Company and Wachovia have had negotiations concerning possible modifications to the terms of the existing agreements relating to the joint venture. Such modifications, if agreed to, as well as the establishment of definitive agreed or appraised values for the A.G. Edwards business and the joint venture excluding the A.G. Edwards business, will result in an adjustment to the credit to equity and a true-up to the earnings from the joint venture for any difference between the diluted ownership percentage used to record earnings for the nine months ended September 30, 2008 and the finally determined diluted ownership percentage. The Company does not anticipate any such adjustment to have a material effect on its reported results of operations.

On October 3, 2008, Wachovia and Wells Fargo & Company (Wells Fargo) announced that they had entered into an Agreement and Plan of Merger, pursuant to which Wells Fargo will acquire all of Wachovia Corporation and all its businesses and obligations. Wachovia has notified the Company that Wells Fargo s brokerage business will be contributed to the joint venture in accordance with the terms of the existing joint venture agreements.

Earnings of the joint venture included in the results of the Financial Advisory segment are subject to certain risks pertaining to the joint venture operations, including customer claims, litigation and regulatory investigations affecting Wachovia Securities businesses. Such customer claims, litigation and regulatory matters include

37

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

matters typical for retail securities brokerage and clearing operations and matters unique to the joint venture operations. In recent months, following the failure in early 2008 of the auctions which set the rates for most auction rate securities, Wachovia Securities has become the subject of customer complaints, legal actions, including a putative class action, and investigations by securities regulators and agencies relating to Wachovia Securities role in the underwriting, sale and auction of auction rate securities. On August 15, 2008, Wachovia announced that it had reached an agreement in principle for a global settlement of investigations concerning the underwriting, sale and subsequent auction of certain auction rate securities by subsidiaries of Wachovia Securities and had recorded an increase to legal reserves. The Company s recorded share of pre-tax earnings from the joint venture for the nine months ended September 30, 2008 includes $235 million, which is the Company s share of this charge.

12. CONTINGENT LIABILITIES AND LITIGATION AND REGULATORY MATTERS

Contingent Liabilities

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

Litigation and Regulatory Matters

The Company is subject to legal and regulatory actions in the ordinary course of its businesses. Pending legal and regulatory actions include proceedings relating to aspects of the Company s businesses and operations that are specific to it and proceedings that are typical of the businesses in which it operates, including in both cases businesses that have 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. The outcome of a litigation or regulatory matter, and the amount or range of potential loss at any particular time, is often inherently uncertain.

Insurance and Annuities

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 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

38

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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 June 2007, Prudential Financial and Prudential Insurance moved to dismiss the complaint. In November 2007, the court granted the motion, in part, and dismissed the commercial bribery and conspiracy to commit malpractice claims and denied the motion with respect to other claims. In December 2007, the Prudential defendants answered the complaints and asserted counterclaims against each plaintiff for breach of contract and cross-claims against Leeds Morelli & Brown for breach of contract and the covenant of good faith and fair dealing, fraudulent inducement, indemnification and contribution. In January 2008, plaintiffs filed a demand pursuant to New Jersey law stating that they were seeking damages in the amount of $6.5 billion.

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 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. In addition, in April 2008, Prudential Insurance reached a settlement of proceedings regarding these matters with the District Attorneys of San Diego, Los Angeles and Alameda counties. Pursuant to this settlement, Prudential Insurance paid $350,000 in penalties and costs. 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*. In August and September 2007, the court dismissed the anti-trust and RICO claims. In January 2008, the court dismissed the ERISA claims with prejudice. In February 2008, the court dismissed the state law claims without prejudice. Plaintiffs appealed to the Third Circuit Court of Appeals. The above settlements 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. In August 2008, the Company reached a resolution of the investigations by the SEC into these matters. In connection with such resolution, the SEC, on August 6, 2008, filed a complaint in the United States District Court for the District of New Jersey, alleging, among other things, that the Company improperly accounted for the reinsurance contracts, resulting in overstatements of the Company s consolidated results for the years 2000, 2001 and 2002 in certain of the Company s reports filed with the SEC under the Exchange Act, in violation of the financial reporting, books-and-records and internal control provisions of the

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

Exchange Act and related rules and regulations of the SEC thereunder. In connection with the settlement, the Company has consented to entry of a final judgment enjoining it from future violations of specified provisions of the Exchange Act and related rules and regulations of the SEC thereunder. The settlement, in which the Company neither admits nor denies the allegations in the complaint, resolves the SEC s investigations into these matters without the imposition of any monetary fine or penalty. The settlement documents include allegations that may result in litigation, adverse publicity and other potentially adverse impacts to the Company s businesses.

The Company s subsidiary, Prudential Annuities Life Assurance Corporation (formerly known as American Skandia Life Assurance Corporation), is in the final stages of its 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 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 and remanded the case to the district court for further proceedings. 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 district court denied class certification. In September 2007, the Second Circuit Court of Appeals reversed the district court s decision denying class certification and remanded the case to the district court for further proceedings. 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. In June 2008, the *CHS Electronics* and *Gillet* matters were settled by all defendants. Prudential Securities share of the settlement amount was not material.

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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 New York Attorney Generals Office. 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 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, but remained a defendant in other actions in the consolidated proceeding. In June 2008, the Company was dismissed with prejudice from the remaining actions consolidated in *In re: Mutual Fund Investment Litigation*, other than *Saunders v. Putnam American Government Income Fund, et al*. In July 2006, in *Saunders*, the United States District Court for the District of Maryland had 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. In July 2008, the Company moved for summary judgment and plaintiffs moved for class certification in *Saunders*.

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

Commencing in 2003, the Company received formal requests for information from the SEC and NYAG relating to market timing in variable annuities by certain Prudential Annuities entities. In connection with these investigations, with the approval of Skandia Insurance Company Ltd. (publ) (Skandia), an offer was made by Prudential Annuities 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 a Prudential Annuities entity would be subject to the indemnification provisions of the acquisition agreement pursuant to which the Company purchased the Prudential Annuities entities in May 2003 from Skandia. If achieved, settlement of the matters relating to Prudential Annuities 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 October 2007, Prudential Retirement Insurance and Annuity Co. (PRIAC) filed an action in the United States District Court for the Southern District of New York, *Prudential Retirement Insurance & Annuity Co. v. State Street Global Advisors,* in PRIAC s fiduciary capacity and on behalf of certain defined benefit and defined contribution plan clients of PRIAC, against an unaffiliated asset manager, State Street Global Advisors (SSgA) and SSgA s affiliate, State Street Bank and Trust Company (State Street). This action seeks, among other relief, restitution of certain losses attributable to certain investment funds sold by SSgA as to which PRIAC believes SSgA employed investment strategies and practices that were misrepresented by SSgA and failed to exercise the standard of care of a prudent investment manager. PRIAC also intends to vigorously pursue any other available remedies against SSgA and State Street in respect of this matter. Given the unusual circumstances surrounding the management of these SSgA funds and in order to protect the interests of the affected plans and their participants while PRIAC pursues these remedies, PRIAC implemented a process under which affected plan clients that authorized PRIAC to proceed on their behalf have received payments from funds provided by PRIAC for the losses referred to above. The Company s consolidated financial statements, and the results of the Retirement segment included in the Company s Investment Division, for the year ended December 31, 2007 include a pre-tax charge of $82 million, reflecting these payments to plan clients and certain related costs. In September 2008, the court denied State Street defendants motion to dismiss the claims for damages and other relief under Section 502(a)(2) of ERISA but dismissed the claim for equitable relief under Section 502(a)(3) of ERISA. In October 2008, defendants answered the complaint and asserted counterclaims for contribution and indemnification, defamation and violations of Massachusetts unfair and deceptive trade practices law.

In September and October 2005, five purported class action lawsuits were filed against the Company, Prudential Securities 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

42

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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 December 2006, these 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 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. The complaint seeks back overtime pay and statutory damages, recovery of improper deductions, interest and attorneys fees. In December 2007, plaintiffs moved to certify the class. In March 2008, the court granted plaintiffs motion to conditionally certify a nationwide class. In March 2008, a purported nationwide class action lawsuit was filed in the United States District Court for the Southern District of California, *Wang v. Prudential Financial, Inc. and Prudential Insurance*, on behalf of agents who sold the Company s financial products. The complaint alleges claims that the Company failed to pay overtime and provide other benefits in violation of state and federal law and seeks compensatory and punitive damages in unspecified amounts. In September 2008, the *Wang* matter was transferred to the United States District Court for the District of New Jersey and consolidated with the *Bouder* lawsuit.

Summary

The Company s litigation and regulatory matters are subject to many uncertainties, and given their complexity and scope, the outcomes 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. In light of the unpredictability of the Company s litigation and regulatory matters, it is also possible that in certain cases an ultimate unfavorable resolution of one or more pending litigation or regulatory matters could have a material adverse effect on the Company s financial position. Management believes, however, that, based on information currently known to it, the ultimate outcome of all pending litigation and regulatory matters, after consideration of applicable reserves and rights to indemnification, is not likely to have a material adverse effect on the Company s financial position.

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Unaudited Interim Supplemental Combining Statements of Financial Position

September 30, 2008 and December 31, 2007 (in millions)

	September 30, 2008			December 31, 2007		
	Financial Services Businesses	Closed Block Business	Consolidated	Financial Services Businesses	Closed Block Business	Consolidated
ASSETS						
Fixed maturities:						
Available for sale, at fair value	$ 114,626	$ 40,978	$ 155,604	$ 112,748	$ 49,414	$ 162,162
Held to maturity, at amortized cost	3,481		3,481	3,548		3,548
Trading account assets supporting insurance liabilities, at fair value	14,392		14,392	14,473		14,473
Other trading account assets, at fair value	3,240	128	3,368	3,471	142	3,613
Equity securities, available for sale, at fair value	4,258	3,131	7,389	4,640	3,940	8,580
Commercial loans	24,173	8,563	32,736	22,093	7,954	30,047
Policy loans	3,822	5,389	9,211	3,942	5,395	9,337
Securities purchased under agreements to resell	171		171	129		129
Other long-term investments	5,255	1,416	6,671	5,163	1,268	6,431
Short-term investments	6,621	1,263	7,884	3,852	1,385	5,237
Total investments	180,039	60,868	240,907	174,059	69,498	243,557
Cash and cash equivalents	9,907	1,454	11,361	9,624	1,436	11,060
Accrued investment income	1,551	720	2,271	1,496	678	2,174
Reinsurance recoverables	1,838		1,838	2,119		2,119
Deferred policy acquisition costs	12,472	1,595	14,067	11,396	943	12,339
Other assets	22,608	2,198	24,806	17,754	1,228	18,982
Separate account assets	165,148		165,148	195,583		195,583
TOTAL ASSETS	$ 393,563	$ 66,835	$ 460,398	$ 412,031	$ 73,783	$ 485,814
LIABILITIES AND ATTRIBUTED EQUITY						
LIABILITIES						
Future policy benefits	$ 62,080	$ 51,532	$ 113,612	$ 60,259	$ 51,209	$ 111,468
Policyholders account balances	90,727	5,605	96,332	78,599	5,555	84,154
Policyholders dividends	716	1,284	2,000	670	2,991	3,661
Reinsurance payables	1,228		1,228	1,552		1,552
Securities sold under agreements to repurchase	4,209	4,217	8,426	5,281	6,160	11,441
Cash collateral for loaned securities	2,231	1,249	3,480	3,041	3,271	6,312
Income taxes	1,300	50	1,350	3,402	151	3,553
Short-term debt	13,788	751	14,539	14,514	1,143	15,657
Long-term debt	16,120	1,750	17,870	12,351	1,750	14,101
Other liabilities	17,265	449	17,714	14,609	266	14,875
Separate account liabilities	165,148		165,148	195,583		195,583
Total liabilities	374,812	66,887	441,699	389,861	72,496	462,357

COMMITMENTS AND CONTINGENT LIABILITIES

ATTRIBUTED EQUITY						
Accumulated other comprehensive income (loss)	(2,563)	(1,265)	(3,828)	459	(12)	447
Other attributed equity	21,314	1,213	22,527	21,711	1,299	23,010
Total attributed equity	18,751	(52)	18,699	22,170	1,287	23,457
TOTAL LIABILITIES AND ATTRIBUTED EQUITY	$ 393,563	$ 66,835	$ 460,398	$ 412,031	$ 73,783	$ 485,814

See Notes to Unaudited Interim Supplemental Combining Financial Information

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Unaudited Interim Supplemental Combining Statements of Operations

Three Months Ended September 30, 2008 and 2007 (in millions)

	Three Months Ended September 30, 2008			2007		
	Financial Services Businesses	Closed Block Business	Consolidated	Financial Services Businesses	Closed Block Business	Consolidated
REVENUES						
Premiums	$ 2,799	$ 819	$ 3,618	$ 2,675	$ 797	$ 3,472
Policy charges and fee income	711		711	729		729
Net investment income	2,083	848	2,931	2,073	960	3,033
Realized investment gains (losses), net	(392)	119	(273)	(197)	113	(84)
Asset management fees and other income	57	(8)	49	1,227	16	1,243
Total revenues	5,258	1,778	7,036	6,507	1,886	8,393
BENEFITS AND EXPENSES						
Policyholders benefits	3,014	940	3,954	2,633	910	3,543
Interest credited to policyholders account balances	461	35	496	786	34	820
Dividends to policyholders	34	745	779	38	727	765
General and administrative expenses	1,821	171	1,992	1,938	207	2,145
Total benefits and expenses	5,330	1,891	7,221	5,395	1,878	7,273
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES	(72)	(113)	(185)	1,112	8	1,120
Income tax expense (benefit)	(88)	(55)	(143)	315	1	316
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES	16	(58)	(42)	797	7	804
Equity in earnings of operating joint ventures, net of taxes	(129)		(129)	67		67
INCOME (LOSS) FROM CONTINUING OPERATIONS	(113)	(58)	(171)	864	7	871
Income (loss) from discontinued operations, net of taxes	5		5	(4)		(4)
NET INCOME (LOSS)	$ (108)	$ (58)	$ (166)	$ 860	$ 7	$ 867

See Notes to Unaudited Interim Supplemental Combining Financial Information

Table of Contents

PRUDENTIAL FINANCIAL, INC.

Unaudited Interim Supplemental Combining Statements of Operations

Nine Months Ended September 30, 2008 and 2007 (in millions)

	Nine Months Ended September 30,					
	2008			2007		
	Financial Services Businesses	Closed Block Business	Consolidated	Financial Services Businesses	Closed Block Business	Consolidated
REVENUES						
Premiums	$ 8,863	$ 2,640	$ 11,503	$ 8,080	$ 2,580	$ 10,660
Policy charges and fee income	2,360		2,360	2,299		2,299
Net investment income	6,359	2,625	8,984	6,116	2,839	8,955
Realized investment gains (losses), net	(1,744)	(339)	(2,083)	141	312	453
Asset management fees and other income	1,526	19	1,545	3,187	39	3,226
Total revenues	17,364	4,945	22,309	19,823	5,770	25,593
BENEFITS AND EXPENSES						
Policyholders benefits	8,995	3,005	12,000	8,028	2,933	10,961
Interest credited to policyholders account balances	1,773	105	1,878	2,283	105	2,388
Dividends to policyholders	94	1,402	1,496	95	1,986	2,081
General and administrative expenses	5,897	534	6,431	5,887	586	6,473
Total benefits and expenses	16,759	5,046	21,805	16,293	5,610	21,903
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES	605	(101)	504	3,530	160	3,690
Income tax expense (benefit)	2	(50)	(48)	1,014	49	1,063
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES	603	(51)	552	2,516	111	2,627
Equity in earnings of operating joint ventures, net of taxes	(62)		(62)	200		200
INCOME (LOSS) FROM CONTINUING OPERATIONS	541	(51)	490	2,716	111	2,827
Income from discontinued operations, net of taxes	3		3	4	2	6
NET (LOSS) INCOME	$ 544	$ (51)	$ 493	$ 2,720	$ 113	$ 2,833

See Notes to Unaudited Interim Supplemental Combining Financial Information

46

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.

The Financial Services Businesses and Closed Block Business participate in separate internal short-term cash management facilities, pursuant to which they invest cash from securities lending and repurchase activities as well as certain trading and operating activities. The net funds invested in these facilities are generally held in investments that are short term, including mortgage- and asset-backed securities. As of September 30, 2008, the Financial Services Business and the Closed Block Business held $6.8 billion and $5.6 billion, respectively, in their short-term cash management facilities. Historically, a proportionate interest in each security held in a commingled portfolio was allocated to the Financial

Services Businesses and the Closed Block Business as of the balance sheet date, based upon their proportional cash contributions to a single facility. Participation in the commingled facility by the Financial Services Businesses and the Closed Block Business was dependent on cash flows arising from the activities noted above, which in turn, under the historical allocation methodology, could change the allocation of the facility s assets between the two Businesses. A proportionate share of any realized investment gain or loss was recorded by each Business based upon their respective ownership percentages in the commingled facility as of the date of the realized gain or loss. Beginning April 1, 2008, management

PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

implemented changes in order to permit each Business to hold discrete ownership of its investments in separate facilities without affecting or being affected by the level of participation of the other Business. With these changes, any realized investment gain or loss are recorded by the respective Business based upon their discrete ownership of investments in their facility. Beginning in the third quarter of 2007, pending the implementation of these changes, the commingled facility was managed so that the proportionate interests of the Financial Services Businesses and Closed Block Business in the entire facility were maintained at approximately the same proportions held as of June 30, 2007 (approximately 49% and 51%, respectively).

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.

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 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 September 30, 2008, compared with December 31, 2007, and its consolidated results of operations for the three and nine months ended September 30, 2008 and 2007. You should read the following analysis of our consolidated financial condition and results of operations in conjunction with the MD&A and the audited Consolidated Financial Statements for the year ended December 31, 2007 included in the Company s Current Report on Form 8-K dated May 16, 2008, as well as the Risk Factors section, 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 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 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.

The Closed Block Business is not a separate legal entity from the Financial Services Businesses; however, they are operated as separate entities and are separated for financial reporting purposes. The Financial Services Businesses are not obligated to pay dividends on Closed Block policies. Dividends on Closed Block policies reflect the experience of the Closed Block over time and are subject to adjustment by Prudential Insurance s Board of Directors. Further, our plan of demutualization provides that we are not required to pay dividends on policies within the Closed Block from assets that are not within the Closed Block and that the establishment of the Closed Block does not represent a guarantee that any certain level of dividends will be maintained.

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, 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 stress experienced by global financial markets that began in the second half of 2007 continued and substantially increased during the third quarter of 2008. The volatility and disruption in the global financial markets have reached unprecedented levels. The impact of these events and other items, include the following:

- For the three months ended September 30, 2008, our Financial Services Businesses had a net loss of $108 million and the Closed Block Business had a net loss of $58 million, as unfavorable financial market conditions had a substantial negative effect on reported results of our domestic businesses and market values in our investment portfolio.

- In light of recent market volatility and extraordinary events and developments affecting financial markets generally, including market conditions for issuance of certain capital instruments such as hybrid securities, we suspended all purchases of our Common Stock under our existing share repurchase program effective October 10, 2008.

Net unrealized gains (losses) on general account fixed maturity investments of the Financial Services Businesses were an unrealized loss of $3.522 billion as of September 30, 2008, compared to an unrealized gain of $1.332 billion as of December 31, 2007. Gross unrealized gains declined from $3.302

Table of Contents

billion as of December 31, 2007 to $2.328 billion as of September 30, 2008 and gross unrealized losses increased from $1.970 billion to $5.850 billion for the same periods. The increase in gross unrealized losses was primarily due to credit spread increases in the credit markets and liquidity concerns. Net unrealized gains (losses) on general account fixed maturity investments of the Closed Block Business were an unrealized loss of $2.585 billion as of September 30, 2008, compared to an unrealized gain of $682 million as of December 31, 2007.

As discussed within Liquidity and Capital Resources, as of September 30, 2008, we had significant cash, cash equivalents and short-term investments on our balance sheet, including $3.8 billion at Prudential Financial, the parent holding company; however, adverse capital market conditions have affected and may continue to affect the availability and cost of borrowed funds and could impact our ability to refinance existing borrowings.

As discussed within Liquidity and Capital Resources, as of September 30, 2008, we estimate that the total adjusted operating capital of our domestic life insurance subsidiaries met the Risk Based Capital levels required to meet their ratings objectives. However, subsequent to September 30, 2008 market conditions have negatively impacted the level of capital in our domestic life insurance subsidiaries and absent a recovery in markets we will need to take capital management actions to maintain capital consistent with these ratings objectives, which may include redeployment of financial resources from internal sources or, if markets continue to decline, require external sources of capital. Certain of these capital management activities may require regulatory approval.

During the quarter ended September 30, 2008, we continued to have positive net flows in our domestic annuity, retirement and asset management businesses, as well as sales growth in our Individual Life, Group Insurance and International Insurance segments.

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 nine months ended September 30, 2008 and 2007 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 September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
	(in millions)			
Adjusted operating income before income taxes for segments of the Financial Services Businesses:				
Individual Life	$ 238	$ 251	$ 437	$ 493
Individual Annuities	(307)	205	(38)	551
Group Insurance	101	100	271	220
Asset Management	(8)	161	301	503
Financial Advisory	(217)	85	(150)	254
Retirement	133	65	398	351
International Insurance	460	423	1,326	1,245
International Investments	37	114	89	219
Corporate and Other	(21)	(12)	(61)	(11)
Reconciling Items:				
Realized investment gains (losses), net, and related adjustments	(564)	(178)	(1,756)	10
Charges related to realized investment gains (losses), net	17	(2)	45	(15)
Investment gains (losses) on trading account assets supporting insurance liabilities, net	(534)	36	(919)	10
Change in experience-rated contractholder liabilities due to asset value changes	388	(6)	682	4
Divested businesses	(3)	(27)	(128)	19
Equity in earnings of operating joint ventures	208	(103)	108	(323)
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures for Financial Services Businesses	(72)	1,112	605	3,530
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures for Closed Block Business	(113)	8	(101)	160
Consolidated income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures	$ (185)	$ 1,120	$ 504	$ 3,690

Results for the three and nine months ended September 30, 2008 presented above reflect the following:

Individual Life segment results for the third quarter of 2008 and the first nine months of 2008 declined from the same periods in the prior year primarily due to a net increase in amortization of deferred policy acquisition costs, net of related amortization of unearned revenue reserves, due to unfavorable equity market performance, partially offset by improved mortality experience, net of reinsurance. Adjusted operating income in both the current year and prior year periods benefited from the annual reviews of the estimate of total gross profits used as a basis for amortizing deferred policy acquisition costs and unearned revenue reserves, which benefited the current year period $79 million and the prior year period $78 million.

Individual Annuities segment results for the third quarter and first nine months of 2008 declined in comparison to the corresponding prior year periods, reflecting the impact of our annual reviews of the reserve for the guaranteed minimum death and income benefit features of our variable annuity products and the estimate of total gross profits used as a basis for amortizing deferred policy acquisition and other costs. Results for the third quarter and first nine months of 2008 included $380 million of charges

Table of Contents

from the annual reviews, largely reflecting the impact of current market conditions, compared to $30 million of benefits in the third quarter and first nine months of 2007. Also contributing to the decline was an unfavorable variance in the mark-to-market of embedded derivatives and related hedge positions associated with our living benefit features.

Group Insurance segment results were relatively unchanged in the third quarter of 2008 as the benefit of growth and more favorable claims experience in our group disability business was mostly offset by lower investment yields. Group Insurance segment results for the first nine months of 2008 improved reflecting growth in our group disability business, as well as higher earnings in our group life business from more favorable claims experience and the benefit from a premium adjustment for updated data on a large case.

Asset Management segment results declined in both the third quarter and first nine months of 2008 largely attributable to unfavorable results from the segment s proprietary investing business primarily related to investment results in fixed income and equity investments, as well as a decrease in performance based incentive fees, primarily related to institutional real estate funds. These items were partially offset by higher asset management fees.

Financial Advisory segment results for the third quarter of 2008 and the first nine months of 2008 decreased in comparison to the corresponding prior year periods, as the current year periods include losses from our share of the retail brokerage joint venture with Wachovia. These results include a charge of $235 million related to our share of Wachovia s global settlement concerning the underwriting, sale and subsequent auction of certain auction rate securities. In addition, results in the third quarter and first nine months of 2008 include transition costs of $37 million and $130 million, respectively, associated with the January 1, 2008 combination of the A.G. Edwards business with Wachovia Securities. Our reported share of earnings and transition costs for the first nine months of 2008 are based on our estimate of our diluted ownership percentage subsequent to this combination.

Retirement segment results for the third quarter and first nine months of 2008 increased in comparison to the corresponding prior year periods. The third quarter and first nine months of 2007 include an $81 million charge for payments made to plan clients related to a legal action filed against an unaffiliated asset manager. Results for both periods include the impact of our annual reviews and other cumulative adjustments relating to the amortization of deferred policy acquisition costs and valuation of business acquired. Absent the impact of these items, results for the third quarter and first nine months of 2008 decreased in comparison to the corresponding prior year periods, primarily reflecting higher general and administrative expenses, driven by expenses incurred to expand our full service product and service capabilities, and a decrease in asset management fees, driven by a decrease in average full service fee-based retirement account values, primarily resulting from equity market depreciation.

The International Insurance segment is comprised of its Life Planner and Gibraltar Life operations. Results from the segment s Life Planner operations improved for both the third quarter and first nine months of 2008 primarily reflecting continued growth of our Japanese Life Planner operations and, to a lesser extent, improved investment income margins. Results from the segment s Gibraltar Life operation benefited in both the third quarter and first nine months of 2008 from improved investment income margins which benefited from various investment portfolio strategies, and the continued growth of our U.S. dollar denominated annuity product.

International Investments segment results declined in both the third quarter and first nine months of 2008 due to the benefit of certain one-time items recognized in the prior year, as well as lower earnings in the current year in the segment s Korean asset management operation.

Corporate and Other results for the third quarter of 2008 and the first nine months of 2008 declined from the same periods in the prior year primarily due to losses in our real estate and relocation services business.

Realized investment gains (losses), net, and related adjustments for the Financial Services Businesses in the third quarter and first nine months of 2008 amounted to $(564) million and $(1,756) million, respectively. Results for the third quarter and first nine months of 2008 relate primarily to other-than-temporary impairments of fixed maturity and equity securities of $(404) million and $(1,387) million, respectively.

Income (loss) from continuing operations before income taxes in the Closed Block Business decreased $121 million in the third quarter of 2008 compared to the third quarter of 2007, primarily reflecting a decrease in net investment income and an increase in dividends paid and accrued to policyholders, which was partially offset by the resulting decrease in the cumulative earnings policyholder dividend obligation expense. Income (loss) from continuing operations before income taxes in the Closed Block Business decreased $261 million for the first nine months of 2008 compared to the first nine months of 2007, reflecting a decrease in net realized investment gains and net investment income, partially offset by the resulting decrease in the cumulative earnings policyholder dividend obligation expense.

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, including the recognition of other-than-temporary impairments;
- 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.

For an updated discussion of the application of estimates and assumptions around the valuation of investments, see Valuation of Assets and Liabilities Fair Value of Assets and Liabilities. For an updated discussion of the application of estimates and assumptions around the recognition of other-than-temporary impairments, see Realized Investment Gains and Losses and General Account Investments General Account Investments Fixed Maturity Securities Other-than-Temporary Impairments of Fixed Maturity Securities and Realized Investment Gains and Losses and General Account Investments General Account Investments Equity Securities Other-than-Temporary Impairments of Equity Securities.

A discussion of each of the remaining critical accounting estimates may be found in our Current Report on Form 8-K dated May 16, 2008, under Management s Discussion and Analysis of Financial Condition and Results of Operations Accounting Policies and Pronouncements Application of Critical Accounting Estimates.

Table of Contents

Accounting Pronouncements Adopted

See Note 2 to the Unaudited Interim Consolidated Financial Statements for a discussion of recently adopted accounting pronouncements, including the adoption of SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities and SFAS No. 157, Fair Value Measurements.

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 September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
	(in millions)			
Financial Services Businesses by segment:				
Individual Life	$ 80	$ 217	$ 209	$ 451
Individual Annuities	(363)	179	(167)	517
Group Insurance	55	67	22	199
Total Insurance Division	(228)	463	64	1,167
Asset Management	(4)	170	307	510
Financial Advisory	(2)	(12)	(21)	(47)
Retirement	(249)	18	(514)	224
Total Investment Division	(255)	176	(228)	687
International Insurance	386	569	878	1,546
International Investments	29	106	69	193
Total International Insurance and Investments Division	415	675	947	1,739
Corporate and Other	(4)	(202)	(178)	(63)
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures for Financial Services Businesses	(72)	1,112	605	3,530
Income tax expense (benefit)	(88)	315	2	1,014
Income from continuing operations before equity in earnings of operating joint ventures for Financial Services Businesses	16	797	603	2,516
Equity in earnings of operating joint ventures, net of taxes	(129)	67	(62)	200
Income (loss) from continuing operations for Financial Services Businesses	(113)	864	541	2,716
Income (loss) from discontinued operations, net of taxes	5	(4)	3	4
Net income (loss) Financial Services Businesses	$ (108)	$ 860	$ 544	$ 2,720
Basic income (loss) from continuing operations per share Common Stock	$ (0.24)	$ 1.92	$ 1.33	$ 5.96
Diluted income (loss) from continuing operations per share Common Stock	$ (0.24)	$ 1.89	$ 1.32	$ 5.85
Basic net income (loss) per share Common Stock	$ (0.23)	$ 1.91	$ 1.32	$ 5.97
Diluted net income (loss) per share Common Stock	$ (0.23)	$ 1.88	$ 1.32	$ 5.86
Closed Block Business:				
Income (loss) from continuing operations before income taxes for Closed Block Business	$ (113)	$ 8	$ (101)	$ 160
Income tax expense (benefit)	(55)	1	(50)	49
Income (loss) from continuing operations for Closed Block Business	(58)	7	(51)	111

Income from discontinued operations, net of taxes				2
Net income (loss) Closed Block Business	$ (58)	$ 7	$ (51)	$ 113
Basic and diluted income (loss) from continuing operations per share Class B Stock	$ (34.00)	$ (3.00)	$ (43.50)	$ 34.50
Basic and diluted net income (loss) per share Class B Stock	$ (34.00)	$ (3.00)	$ (43.50)	$ 35.50
Consolidated:				
Net income (loss)	$ (166)	$ 867	$ 493	$ 2,833

Table of Contents

Results of Operations Financial Services Businesses

2008 to 2007 Three Month Comparison. Income (loss) from continuing operations attributable to the Financial Services Businesses decreased $977 million, from income of $864 million in the third quarter of 2007 to a loss of $113 million in the third quarter of 2008. The decrease reflects the impact of unfavorable market conditions on the results of our segments and investment portfolio. Results for the third quarter of 2008 include net investment losses within both our general account and proprietary investments. In addition, results for the third quarter of 2008 include reserve increases for the guaranteed minimum death and income benefit features of our variable annuity products and increased amortization of deferred policy acquisition and other costs reflecting an update of actuarial assumptions based on an annual review, including the impact of markets. Results for the third quarter of 2008 also include the company s share of results of the retail securities brokerage joint venture with Wachovia, including costs associated with a settlement relating to auction rate securities. On a diluted per share basis, income (loss) from continuing operations attributable to the Financial Services Businesses for the three months ended September 30, 2008 of $(0.24) per share of Common Stock decreased from $1.89 per share of Common Stock for the three months ended September 30, 2007. 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 Losses and General Account Investments Realized Investment Gains and Losses, below. For additional information regarding investment income, excluding realized investment gains (losses) see Realized Investment Gains and Losses and General Account Investments General Account Investments, below.

The direct equity adjustment increased income from continuing operations available to holders of the Common Stock for earnings per share purposes by $10 million for the three months ended September 30, 2008, compared to $13 million for the three months ended September 30, 2007. 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.

2008 to 2007 Nine Month Comparison. Income from continuing operations attributable to the Financial Services Businesses decreased $2.175 billion, from $2.716 billion for the first nine months of 2007 to $541 million for the first nine months of 2008. The decrease reflects the impact of unfavorable market conditions on the results of our segments and investment portfolio. Results for the first nine months of 2008 include net investment losses on our general account investments and lower proprietary investing results. In addition, results for the first nine months of 2008 include reserve increases for the guaranteed minimum death and income benefit features of our variable annuity products and increased amortization of deferred policy acquisition and other costs reflecting an update of actuarial assumptions based on an annual review, including the impact of markets. Results for the first nine months of 2008 also include the company s share of results of the retail securities brokerage joint venture with Wachovia, including costs associated with a settlement relating to auction rate securities. On a diluted per share basis, income from continuing operations attributable to the Financial Services Businesses for the nine months ended September 30, 2008 of $1.32 per share of Common Stock decreased from $5.85 per share of Common Stock for the nine months ended September 30, 2007. This decrease reflects the decline in earnings discussed above, partially offset by the benefit of a lower number of shares of Common Stock outstanding due to share repurchases.

Table of Contents

The direct equity adjustment increased income from continuing operations available to holders of the Common Stock for earnings per share purposes by $36 million for the nine months ended September 30, 2008, compared to $42 million for the nine months ended September 30, 2007.

Results of Operations Closed Block Business

2008 to 2007 Three Month Comparison. Income (loss) from continuing operations attributable to the Closed Block Business for the three months ended September 30, 2008, was a loss of $58 million, or $(34.00) per share of Class B Stock, compared to income of $7 million, or $(3.00) per share of Class B Stock, for the three months ended September 30, 2007. The direct equity adjustment decreased income from continuing operations available to the Class B Stock holders for earnings per share purposes by $10 million for the three months ended September 30, 2008, compared to $13 million for the three months ended September 30, 2007. For a discussion of the results of operations for the Closed Block Business, see Results of Operations of Closed Block Business, below.

2008 to 2007 Nine Month Comparison. Income (loss) from continuing operations attributable to the Closed Block Business for the nine months ended September 30, 2008, was a loss of $51 million, or $(43.50) per share of Class B Stock, compared to income of $111 million, or $34.50 per share of Class B Stock, for the nine months ended September 30, 2007. The direct equity adjustment decreased income from continuing operations available to the Class B Stock holders for earnings per share purposes by $42 million for the nine months ended September 30, 2008, compared to $36 million for the nine months ended September 30, 2007. For a discussion of the results of operations for the Closed Block Business, see Results of Operations of Closed Block Business, below.

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.

Effective with the first quarter of 2008, we amended our definition of adjusted operating income as it relates to certain externally managed investments in the European market held within the general account portfolio. These investments are medium term notes that are collateralized by investment portfolios primarily consisting of investment grade European fixed income securities, including corporate bonds and asset-backed securities, and derivatives, as well as varying degrees of leverage. The notes have a stated coupon and provide a return based on the performance of the underlying portfolios and the level of leverage. We invest in these notes to earn a coupon through maturity, consistent with our investment purpose for other debt securities. The notes are accounted for under U.S. GAAP as available for sale fixed maturity securities with bifurcated embedded derivatives (total return swaps). Changes in the value of the fixed maturity securities are reported in Stockholders Equity under the heading Accumulated Other Comprehensive Income and changes in the market value of the embedded total return swaps are included in current period earnings in Realized investment gains (losses), net. Historically, adjusted operating income included cumulative losses and recoveries of such losses on the embedded derivatives in the period they occurred, while cumulative net gains on the embedded derivatives were deferred and amortized into adjusted operating income over the remaining life of the notes.

Adjusted operating income under the amended definition excludes any amounts related to changes in the market value of the embedded derivatives. Adjusted operating income for all periods presented has been revised to conform with the amended definition. We view adjusted operating income under the amended definition as a more meaningful presentation of our results for purposes of analyzing the operating performance of, and allocating resources to, our business segments, as the amended definition presents the results of these investments on a basis generally consistent with similar investments held directly within the general account portfolio. We believe the mark to market losses discussed below, resulting primarily from unprecedented credit spread widening, are not representative of the fundamental value of the underlying investments over the long term. Adjusted operating income continues to include the coupon on these notes, which reflects the market based interest rate and spread of securities comparable to the underlying securities that existed at the time we entered into the investments. The accounting for these investments under U.S. GAAP has not changed.

For the three months ended September 30, 2008 and 2007, we recorded losses of $132 million and $103 million, respectively, and for the nine months ended September 30, 2008 and 2007, recorded losses of $318 million and $92 million, respectively, within Realized investment gains (losses), net related to the change in value on the embedded derivatives associated with these investments, which are excluded from adjusted operating income under the amended definition. Adjusted operating income under the former definition included losses of $72 million and $69 million, respectively, for the three and nine months ended September 30, 2007.

In 2008, we classified our commercial mortgage securitization operations as a divested business, reflecting our decision to exit this business. As a result of this decision, these operations, which involved the origination and purchase of commercial mortgage loans that we in turn would aggregate and sell into commercial mortgage-backed securitization transactions, together with related hedging activities, previously reported within the Asset Management segment, have been classified within divested businesses and are reflected in our Corporate and Other operations. Accordingly, these results are excluded from adjusted operating income, with prior period results being adjusted to reflect such reclassification. These operations had pre-tax losses of $6 million and $129 million for the three and nine months ended September 30, 2008, respectively, and pre-tax losses of $42 million and $10 million for the three and nine months ended September 30, 2007, respectively. We retained and continue the remainder of our commercial mortgage origination, servicing and other commercial mortgage related activities, which remain a part of the Asset Management segment.

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 from sales of securities. 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

Table of Contents

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

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 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 September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in millions)			
Operating results:				
Revenues	$ 682	$ 672	$ 2,038	$ 1,932
Benefits and expenses	444	421	1,601	1,439
Adjusted operating income	238	251	437	493
Realized investment gains (losses), net, and related adjustments(1)	(158)	(34)	(228)	(42)
Income from continuing operations before income taxes and equity in earnings of operating joint ventures	$ 80	$ 217	$ 209	$ 451

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

Adjusted Operating Income

2008 to 2007 Three Month Comparison. Adjusted operating income decreased $13 million, from $251 million in the third quarter of 2007 to $238 million in the third quarter of 2008. Adjusted operating income for the third quarter of 2008 includes a $79 million benefit from a net reduction in amortization of deferred policy acquisition costs and other costs due to an increased estimate of total gross profits used as a basis for amortizing

Table of Contents

deferred policy acquisition costs and unearned revenue reserves, based on an annual review, primarily reflecting improved future mortality expectations, compared to a similar benefit for $78 million from the annual review in the third quarter of 2007. Third quarter 2008 results also include a $53 million benefit from compensation received based on multi-year profitability of third-party products we distribute, while results for the year-ago quarter include a similar benefit amounting to $57 million. Absent the effect of these items, adjusted operating income for the third quarter of 2008 decreased $10 million from the year-ago quarter. On this basis, the decrease in adjusted operating income primarily reflects a net increase in amortization of deferred policy acquisition costs net of related amortization of unearned revenue reserves, primarily reflecting the impact of unfavorable equity markets on both separate account fund performance and variable product policy persistency. These items were partially offset by more favorable mortality experience, net of reinsurance, compared to the third quarter of the prior year. The net increase in the amortization of deferred policy acquisition costs net of related amortization of unearned revenue reserves reflects the impact of actual market performance on both actual profits and estimated future gross profits, used as the basis for amortizing deferred policy acquisition costs.

2008 to 2007 Nine Month Comparison. Adjusted operating income decreased $56 million, from $493 million in the first nine months of 2007 to $437 million in the first nine months of 2008. Adjusted operating income for the first nine months of 2008 includes a $79 million benefit from a net reduction in amortization of deferred policy acquisition costs and other costs while adjusted operating income for the first nine months of 2007 included a similar benefit for $78 million, based on an annual review, as discussed above. Results for the first nine months of 2008 also include a $53 million benefit from compensation received based on multi-year profitability of third-party products we distribute, while the first nine months of 2007 included a $57 million benefit for this item, as discussed above. Absent the effect of these items, adjusted operating income for the first nine months of 2008 decreased $53 million from the prior year period. On this basis, the decrease in adjusted operating income primarily reflects a net increase in amortization of deferred policy acquisition costs net of related amortization of unearned revenue reserves as well as lower asset based fees, primarily reflecting the impact of unfavorable equity markets on both separate account fund performance and variable product policy persistency. These decreases were partially offset by improved mortality experience, net of reinsurance, compared to the prior year.

Revenues

2008 to 2007 Three Month Comparison. Revenues, as shown in the table above under Operating Results, increased by $10 million, from $672 million in the third quarter of 2007 to $682 million in the third quarter of 2008. Premiums increased $18 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 $26 million, reflecting higher asset balances primarily from the financing of regulatory capital requirements associated with statutory reserves for certain term and universal life insurance policies and growth in universal life account balances due to increased policyholder deposits. Partially offsetting these increases was a decrease in policy charges and fee income of $17 million, including $36 million due to the effects of updates in both periods of our assumptions related to the amortization of unearned revenue reserves based on the annual reviews, as discussed above. Absent this item, policy charges and fee income increased $19 million primarily reflecting the increase in amortization of unearned revenue reserves, discussed above. Lower asset based fees due to lower separate account asset balances reflecting market value changes partially offset the foregoing items.

2008 to 2007 Nine Month Comparison. Revenues increased by $106 million, from $1.932 billion in the first nine months of 2007 to $2.038 billion in the first nine months of 2008. Premiums increased $62 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 $72 million, reflecting higher asset balances primarily from the financing of regulatory capital requirements associated with statutory reserves for certain term and universal life insurance policies and growth in universal life account balances due to increased policyholder deposits. Policy charges and fee income increased $5 million, including a $36 million decrease due to the effects of updates in both periods of our assumptions related to the amortization of unearned revenue reserves based on the annual reviews, as discussed above. Absent this item, policy charges and fee income increased $41 million primarily reflecting the increase in amortization of unearned revenue reserves, discussed above. These items were partially offset by lower asset based fees due to lower separate account asset balances reflecting market value changes.

Benefits and Expenses

2008 to 2007 Three Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, increased by $23 million, from $421 million in the third quarter of 2007 to $444 million in the third quarter of 2008. Absent the impacts of the annual reviews conducted in the third quarter of both periods, as discussed above, benefits and expenses increased $60 million, from $544 million in the third quarter of 2007 to $604 million in the third quarter of 2008. On this basis, amortization of deferred policy acquisition costs increased $45 million, primarily reflecting the impact of unfavorable equity markets on both separate account fund performance and variable product policy persistency. Also on this basis, policyholders benefits, including interest credited to policyholders account balances were essentially unchanged from the prior year quarter. An increase in policyholder reserves driven by growth in our in force block of term insurance, as well as an increase in interest credited to policyholders due to growth in universal life account balances due to increased policyholder deposits, were offset by more favorable mortality experience compared to the prior year resulting from lower death claims. Interest expense increased $10 million, primarily reflecting interest on increased borrowings related to the financing of regulatory capital requirements associated with statutory reserves for certain term and universal life insurance policies.

2008 to 2007 Nine Month Comparison. Benefits and expenses increased $162 million, from $1.439 billion in the first nine months of 2007 to $1.601 billion in the first nine months of 2008. Absent the impacts of the annual reviews conducted in the third quarter of both periods, as discussed above, benefits and expenses increased $199 million, from $1.562 billion in the first nine months of 2007 to $1.761 billion in the first nine months of 2008. On this basis, amortization of deferred policy acquisition costs increased $97 million, primarily reflecting the impact of unfavorable equity markets on both separate account fund performance and variable product policy persistency. Also on this basis, policyholders benefits, including interest credited to policyholders account balances, increased $50 million, reflecting higher policyholder reserves from growth in our in force block of term insurance and an increase in interest credited to policyholders due to growth in universal life account balances due to increased policyholder deposits. Interest expense increased $36 million, primarily reflecting interest on increased borrowings related to the financing of regulatory capital requirements associated with statutory reserves for certain term and universal life insurance policies.

Table of Contents

Sales Results

The following table sets forth individual life insurance 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. Individual life insurance sales do not correspond to revenues under U.S. GAAP. They are, however, a relevant measure of business activity. In managing our individual life insurance 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 September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in millions)			
Life insurance sales(1):				
Excluding corporate-owned life insurance:				
Variable life	$ 12	$ 19	$ 52	$ 86
Universal life	52	40	147	129
Term life	53	54	156	157
Total excluding corporate-owned life insurance	117	113	355	372
Corporate-owned life insurance		1	1	9
Total	$ 117	$ 114	$ 356	$ 381

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in millions)			
Life insurance sales by distribution channel, excluding corporate-owned life insurance(1):				
Prudential Agents	$ 35	$ 44	$ 113	$ 128
Third party	82	69	242	244
Total	$ 117	$ 113	$ 355	$ 372

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

2008 to 2007 Three Month Comparison. Sales of new life insurance, excluding corporate-owned life insurance, measured as described above, increased $4 million, from $113 million in the third quarter of 2007 to $117 million in the third quarter of 2008, primarily due to higher sales of universal life products from the third party distribution channel, as the current quarter includes a greater benefit from large case sales. The increase in universal life sales was partially offset by a decrease in sales of variable life and term life products by Prudential Agents. Sales by Prudential Agents were $9 million lower than the prior year quarter, reflecting a product shift towards annuity sales. The number of Prudential Agents decreased from 2,552 at September 30, 2007 to 2,482 at September 30, 2008.

2008 to 2007 Nine Month Comparison. Sales of new life insurance, excluding corporate-owned life insurance, measured as described above, decreased $17 million, from $372 million in the first nine months of 2007 to $355 million in the first nine months of 2008, primarily due to lower sales of variable life products from Prudential Agents and third party distribution channels, as the prior year period included a greater benefit from large case sales which have uneven sales patterns. The decrease in variable life sales was partially offset by higher sales of universal life products from the third party distribution channel. Sales by Prudential Agents were $15 million lower than the prior year period, reflecting a product shift towards annuity sales. The number of Prudential Agents decreased from 2,552 at September 30, 2007 to 2,482 at September 30, 2008.

Table of Contents

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 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 September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	($ in millions)			
Cash value of surrenders	$ 188	$ 223	$ 562	$ 565
Cash value of surrenders as a percentage of mean future benefit reserves, policyholders account balances, and separate account balances	3.5%	3.8%	3.4%	3.3%

2008 to 2007 Three Month Comparison. The total cash value of surrenders decreased $35 million, from $223 million in the third quarter of 2007 to $188 million in the third quarter of 2008, reflecting a greater volume of variable product surrenders in the third quarter of 2007. Cash value of surrenders as a percentage of mean future policy benefit reserves, policyholders account balances and separate account balances decreased from 3.8% in the third quarter of 2007 to 3.5% in the third quarter of 2008.

2008 to 2007 Nine Month Comparison. The total cash value of surrenders decreased $3 million, from $565 million in the first nine months of 2007 to $562 million in the first nine months of 2008, reflecting a lower volume of variable product surrenders in the first nine months of 2008 compared to the first nine months of 2007. Cash value of surrenders as a percentage of mean future policy benefit reserves, policyholders account balances and separate account balances was relatively unchanged, from 3.3% in the first nine months of 2007 to 3.4% in the first nine months of 2008.

Individual Annuities

Operating Results

The following table sets forth the Individual Annuities segment s operating results for the periods indicated.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in millions)			
Operating results:				
Revenues	$ 528	$ 633	$ 1,723	$ 1,869
Benefits and expenses	835	428	1,761	1,318

Adjusted operating income	(307)	205	(38)	551
Realized investment gains (losses), net, and related adjustments(1)	(75)	(33)	(180)	(40)
Related charges(1)(2)	19	7	51	6
Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures	$ (363)	$ 179	$ (167)	$ 517

(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 Losses and General Account Investments Realized Investment Gains and Losses.

(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.

Adjusted Operating Income

2008 to 2007 Three Month Comparison. Adjusted operating income decreased $512 million, from $205 million in the third quarter of 2007 to a loss of $307 million in the third quarter of 2008. Results for both periods include the impact of the annual reviews of the reserve for the guaranteed minimum death and income benefit features of our variable annuity products and our estimate of total gross profits used as a basis for amortizing deferred policy acquisition and other costs. Adjusted operating income for the third quarter of 2008 included $380 million of charges from these annual reviews, including $265 million relating to reserve increases for the guaranteed minimum death and income benefit features of our variable annuity products and $115 million relating to increased amortization of deferred policy acquisition and other costs. The charge relating to increased amortization of deferred policy acquisition and other costs primarily reflects the impact on gross profits of market value decreases in the underlying assets associated with our variable annuity products. The reserve increases for the guaranteed minimum death and income benefit features of our variable annuity products also reflects this impact, as well as increased cost of expected income and death benefit claims due to lower expected lapse rates for policies where the current policyholder account value is below the guaranteed minimum death benefit. Adjusted operating income for the third quarter of 2007 included $30 million of benefits from the annual reviews, reflecting market value increases in the underlying assets associated with our variable annuity products, and decreased cost of actual and expected death claims, partially offset by the impact of model refinements and higher expected lapse rates for the variable annuity business acquired from The Allstate Corporation (Allstate).

Absent the effect of the annual reviews discussed above, adjusted operating income for the third quarter of 2008 decreased $102 million from the third quarter of 2007. Contributing to this decrease is a $109 million unfavorable variance in the mark-to-market of embedded derivatives and related hedge positions associated with our living benefit features. The unfavorable variance reflects a charge of $94 million in the third quarter of 2008 compared to a benefit of $15 million in the third quarter of 2007, and was largely due to unfavorable basis risk, reflecting the underperformance of the underlying separate account funds relative to the performance we expected and utilized as a basis for developing our hedging strategy, driven by financial market conditions in the third quarter of 2008. The charge in the third quarter of 2008 includes a $66 million benefit for an update of the assumptions used in the valuation of the embedded derivatives, primarily relating to an update of implied volatility ratios to better match the actual equity indices referenced. Given the sensitivity of the fair value of both the embedded derivatives and related hedge positions to financial market conditions, the variance related to the mark-to-market of these items for a given period will be largely dependent on the financial market conditions at the end of the period. For additional information regarding the methodology used in determining the fair value of the embedded derivatives associated with our living benefit features, see Valuation of Assets and Liabilities Fair Value of Assets and Liabilities Valuation of Variable Annuity Optional Living Benefit Features.

Also contributing to the decrease in adjusted operating income in the third quarter of 2008 was a decrease in fee income, driven by lower average variable annuity asset balances invested in separate accounts. The declines in separate account assets were due to market depreciation and transfers of balances to our general account, partially offset by consistent positive net asset flows since the third quarter of 2007. The transfer of balances to our general account relates to an automatic rebalancing element in some of our living benefit features, which, as part of the overall product design, transferred approximately $5 billion of investments in the third quarter of 2008, out of the separate accounts and into our general account due to equity market declines. Higher average annuity account values invested in our general account resulting from these transfers also lead to improved investment results. Also serving as a partial offset to the decrease in adjusted operating income in the third quarter of 2008 was a decrease in the amortization of deferred policy acquisition costs and other costs, absent the effect of the annual reviews discussed above. The decrease primarily reflects the impact on gross profits of the unfavorable variance in the mark-to-market of embedded derivatives and related hedge positions associated with our living benefit features and the decrease in fee income, partially offset by the quarterly adjustments for current period experience.

The quarterly adjustments for current period experience referred to above reflects the cumulative impact of differences between actual gross profits for the period and the previously estimated expected gross profits for the period, as well as an update for current and future expected claims costs associated with the guaranteed minimum death and income benefit features of our variable annuity products. The third quarter of 2008 reflects charges of $38 million relating to these quarterly adjustments, due to less favorable than expected experience, while the third quarter of 2007 reflects benefits of $15 million due to better than expected experience. Total estimated gross profits, including actual experience and estimates for future periods, are used as the basis for amortizing deferred policy acquisition and other costs. In addition, total estimated revenues and guaranteed benefit claims, which are components of total gross profits, are used for establishing the reserves for the guaranteed minimum death and income benefit features of our variable annuity products. To the extent each period s actual experience differs from the previous estimate for that period, the assumed level of total gross profits may change, and a cumulative adjustment to previous periods costs, referred to as an adjustment for current period experience, may be required. The adjustment for deferred policy acquisition and other costs in the third quarter of 2008 resulted from less favorable than expected gross profits, due primarily to lower than expected fee income and the unfavorable variance in the mark-to-market of embedded derivatives and related hedge positions associated with our living benefit features. In addition to these drivers, the adjustment for the reserves for the guaranteed minimum death and income benefit features of our variable annuity products in the third quarter of 2008 also reflected higher actual contract guarantee claims costs in the third quarter of 2008, primarily driven by financial market conditions.

Further or continued deterioration of financial market conditions could result in additional market depreciation within our separate account assets and corresponding decreases in our fee income, which could lead to an impairment of some or all of the goodwill associated with our individual annuities business in future periods. As of September 30, 2008 the carrying value of this goodwill was $97 million. Further or continued market declines could also result in additional adjustments to the amortization of deferred policy acquisition and other costs, and the costs relating to the reserves for the guaranteed minimum death and income benefit features of our variable annuity products. In light of recent market conditions, adjustments to our estimate of total gross profits to reflect actual fund performance and any corresponding changes to the future rate of return assumptions will no longer be dependent on a comparison to a statistically generated range of estimated gross profits. Instead, for purposes of evaluating deferred policy acquisition and other costs and the reserves for the guaranteed minimum death and income benefit features of our variable annuity products, total estimated gross profits will be updated for these items each quarter. We will continue to derive future rate of return assumptions using a reversion to the mean approach, a common industry practice. Under this approach, we consider actual returns over a period of time and adjust future projected returns so that the assets grow at the expected rate of return for the entire period. If the projected future rate of return is greater than our maximum future rate of return assumption, as was the case for certain groups of contracts in our annual review in the third quarter of 2008, we use the maximum future rate of return. Given that the estimates of future gross profits for certain of our variable annuity contracts are already based upon our maximum future rate of return assumption, all else being equal, further market movements could have a greater impact on the amortization of deferred policy acquisition and other costs, and the costs relating to the reserves for the guaranteed minimum death and income benefit features of our variable annuity products, in comparison to prior periods.

2008 to 2007 Nine Month Comparison. Adjusted operating income decreased $589 million, from $551 million in the first nine months of 2007 to a loss of $38 million in the first nine months of 2008. Adjusted operating income for the first nine months of 2008 included $380 million of charges and the first nine months of 2007 included $30 million of benefits from the annual reviews discussed above. Absent the effect of these annual reviews, adjusted operating income for the first nine months of 2008 decreased $179 million from the first nine months of 2007. Contributing to this decrease is a $182 million unfavorable variance in the mark-to-market of embedded derivatives and related hedge positions associated with our living benefit features. The unfavorable variance reflects a charge of $140 million in the first nine months of 2008 compared to a benefit of $42 million in the first nine months of 2007, and was largely due to unfavorable basis risk, reflecting the underperformance of the underlying separate account funds relative to the performance we expected and utilized as a basis for developing our hedging strategy, driven by financial market conditions in the first nine months of 2008. The charge in the first nine months of 2008 includes a $66 million benefit for an update of the assumptions used in the valuation of the embedded derivatives, primarily relating to an update of implied volatility ratios to better match the actual equity indices referenced.

Also contributing to the decrease in adjusted operating income in the first nine months of 2008 is a decrease in fee income, driven by lower average variable annuity asset balances invested in separate accounts. The declines in separate account assets were due to market depreciation and transfers of balances to our general account, partially offset by consistent positive net asset flows since September 30, 2007. The transfer of balances to our general account relates to an automatic rebalancing element in some of our living benefit features, which, as part of the overall product design, transferred approximately $9 billion of investments in the first nine months of 2008 out of the separate accounts and into our general account due to equity market declines. Higher average annuity account values invested in our general account resulting from these transfers, also lead to improved investment results. Also serving as a partial offset to the decrease in adjusted operating income in the third quarter of 2008 was a decrease in the amortization of deferred policy acquisition costs and other costs, absent the effect of the annual reviews discussed above. The decrease primarily reflects the impact on gross profits of the unfavorable variance in the mark-to-market of embedded derivatives and related hedge positions associated with our living benefit features and the decrease in fee income, partially offset by the quarterly adjustments for current period experience.

The quarterly adjustments for current period experience referred to above reflects the cumulative impact of differences between actual gross profits for the period and the previously estimated expected gross profits for the period, as well as an update for current and future expected claims costs associated with the guaranteed minimum death and income benefit features of our variable annuity products. The first nine months of 2008 reflects charges of $47 million relating to these quarterly adjustments, due to less favorable than expected experience, while the first nine months of 2007 reflects benefits of $37 million due to better than expected experience. Less favorable than expected gross profits in the current period were primarily due to lower than expected fee income, the unfavorable variance in the mark-to-market of embedded derivatives and related hedge positions associated with our living benefit features, and higher actual contract guarantee claims costs in the first nine months of 2008, primarily driven by financial market conditions.

Revenues

2008 to 2007 Three Month Comparison. Revenues, as shown in the table above under Operating Results, decreased $105 million, from $633 million in the third quarter of 2007 to $528 million in the third quarter of 2008. Policy charges and fees and asset management fees and other income decreased $166 million, including a $109 million unfavorable variance in the mark-to-market of embedded derivatives and related hedge positions associated with our living benefit features, as discussed above. Also contributing to the decrease in policy charges and fees and asset management fees and other income is a decrease in fee income driven by lower average variable annuity asset balances invested in separate accounts due to market depreciation and transfers of balances to our general account, partially offset by consistent positive net asset flows since the third quarter of 2007. The transfer of balances to our general account relates to an automatic rebalancing element in some of our living benefit features, which, as part of the overall product design, transferred investments out of the separate accounts and into our general account due to equity market declines. Partially offsetting this decrease, net investment income increased $56 million reflecting higher average annuity account values invested in our general account, also resulting from these transfers.

2008 to 2007 Nine Month Comparison. Revenues, as shown in the table above under Operating Results, decreased $146 million, from $1.869 billion in the first nine months of 2007 to $1.723 billion in the first nine months of 2008. Policy charges and fees and asset management fees and other income decreased $235 million, including a $182 million unfavorable variance in the mark-to-market of embedded derivatives and related hedge positions associated with our living benefit features, as discussed above. Also contributing to the decrease in

Table of Contents

policy charges and fees and asset management fees and other income is a decrease in fee income driven by lower average variable annuity asset balances invested in separate accounts due to market depreciation and the transfer of balances to our general account relating to an automatic rebalancing element in some of our living benefit features, as discussed above. Partially offsetting this decrease, net investment income increased $92 million reflecting higher average annuity account values invested in our general account, also resulting from these transfers.

Benefits and Expenses

2008 to 2007 Three Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, increased $407 million, from $428 million in the third quarter of 2007 to $835 million in the third quarter of 2008. Absent the impact of the annual reviews discussed above, which account for $410 million of increases, benefits and expenses decreased $3 million reflecting a decrease in the amortization of deferred policy acquisition and other costs, partially offset by an increase in interest credited to policyholders account balances and policyholders benefits. The decrease in amortization of deferred policy acquisition and other costs on this basis primarily reflects the impact on gross profits of the unfavorable variance in the mark-to-market of embedded derivatives and related hedge positions associated with our living benefit features and the decrease in fee income, partially offset by the quarterly adjustment for current period experience discussed above. Also on this basis, interest credited to policyholders account balances increased $29 million reflecting higher average annuity account values invested in our general account resulting from transfers relating to an automatic rebalancing element in some of our living benefit features, as discussed above. Policyholders benefits, including changes in reserves, increased $24 million on this basis, primarily reflecting the impact of the quarterly adjustment for current period experience discussed above.

2008 to 2007 Nine Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, increased $443 million, from $1.318 billion in the first nine months of 2007 to $1.761 billion in the first nine months of 2008. Absent the impact of the annual reviews discussed above, which account for $410 million of the increase, benefits and expenses increased $33 million. On this basis, interest credited to policyholders account balances increased $61 million reflecting higher average annuity account values invested in our general account resulting from transfers relating to an automatic rebalancing element in some of our living benefit features, as discussed above. Also on this basis, policyholders benefits, including changes in reserves, increased $35 million primarily reflecting the impact of the quarterly adjustments for current period experience discussed above. Partially offsetting these increases was a decrease in the amortization of deferred policy acquisition and other costs, absent the effect of the annual reviews discussed above, primarily reflecting the impact on gross profits of the unfavorable variance in the mark-to-market of embedded derivatives and related hedge positions associated with of our living benefit features and the decrease in fee income, partially offset by the quarterly adjustments for current period experience discussed above.

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 September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
	(in millions)			
Variable Annuities(1):				
Beginning total account value	$ 74,707	$ 78,968	$ 80,330	$ 74,555
Sales	2,507	2,825	8,076	8,637
Surrenders and withdrawals	(1,988)	(2,328)	(6,346)	(7,153)
Net sales	519	497	1,730	1,484
Benefit payments	(259)	(265)	(815)	(870)
Net flows	260	232	915	614
Change in market value, interest credited and other activity	(6,712)	2,295	(12,367)	6,941
Policy charges	(287)	(322)	(910)	(937)
Ending total account value(2)	$ 67,968	$ 81,173	$ 67,968	$ 81,173
Fixed Annuities:				
Beginning total account value	$ 3,394	$ 3,608	$ 3,488	$ 3,748
Sales	33	16	74	57
Surrenders and withdrawals	(71)	(69)	(185)	(224)
Net redemptions	(38)	(53)	(111)	(167)
Benefit payments	(37)	(41)	(120)	(129)
Net flows	(75)	(94)	(231)	(296)
Interest credited and other activity	32	33	95	97
Policy charges	(2)	(1)	(3)	(3)
Ending total account value	$ 3,349	$ 3,546	$ 3,349	$ 3,546

(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 September 30, 2008, variable annuity account values are invested in equity funds ($24 billion or 36%), balanced funds ($16 billion or 23%), bond funds ($9 billion or 13%), and other ($19 billion or 28%). Variable annuity account values with living benefit features were $35.1 billion and $36.0 billion as of September 30, 2008 and 2007, respectively.

2008