# 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, 2012

OR

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

# Prudential Financial, Inc. 

## (Exact Name of Registrant as Specified in its Charter)

New Jersey
(State or Other Jurisdiction of
Incorporation or Organization)

22-3703799
(I.R.S. Employer

Identification Number)

## 751 Broad Street

## Newark, New Jersey 07102

(973) 802-6000
(Address and Telephone Number of Registrant s Principal Executive Offices)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of the Regulation S-T ( $\$ 232.405$ of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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.

Large accelerated filer x $\quad$ 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 October 31, 2012, 462 million shares of the registrant s Common Stock (par value $\$ 0.01$ ) were outstanding. In addition, 2 million shares of the registrant s Class B Stock, for which there is no established public trading market, were outstanding.

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## Forward-Looking Statements

Certain of the statements included in this Quarterly Report on Form 10-Q, including but not limited to those in Management s Discussion and Analysis of Financial Condition and Results of Operations, constitute forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. Words such as expects, believes, anticipates, includes, plans, assumes, estimates, projects, should, will, shall or variations of such words are generally part of forward-looking statements. Forward-looking statements are made based on management $s$ current expectations and beliefs concerning future developments and their potential effects upon Prudential Financial, Inc. and its subsidiaries. There can be no assurance that future developments affecting Prudential Financial, Inc. and its subsidiaries will be those anticipated by management. These forward-looking statements are not a guarantee of future performance and involve risks and uncertainties, and there are certain important factors that could cause actual results to differ, possibly materially, from expectations or estimates reflected in such forward-looking statements, including, among others: (1) general economic, market and political conditions, including the performance and fluctuations of fixed income, equity, real estate and other financial markets; (2) the availability and cost of additional debt or equity capital or external financing for our operations; (3) interest rate fluctuations or prolonged periods of low interest rates; (4) the degree to which we choose not to hedge risks, or the potential ineffectiveness or insufficiency of hedging or risk management strategies we do implement, with regard to variable annuity or other product guarantees; (5) any inability to access our credit facilities; (6) reestimates of our reserves for future policy benefits and claims; (7) differences between actual experience regarding mortality, morbidity, persistency, surrender experience, interest rates or market returns and the assumptions we use in pricing our products, establishing liabilities and reserves or for other purposes; (8) changes in our assumptions related to deferred policy acquisition costs, value of business acquired or goodwill; (9) changes in assumptions for retirement expense; (10) changes in our financial strength or credit ratings; (11) statutory reserve requirements associated with term and universal life insurance policies under Regulation XXX and Guideline AXXX; (12) investment losses, defaults and counterparty non-performance; (13) competition in our product lines and for personnel; (14) difficulties in marketing and distributing products through current or future distribution channels; (15) changes in tax law; (16) economic, political, currency and other risks relating to our international operations; (17) fluctuations in foreign currency exchange rates and foreign securities markets; (18) regulatory or legislative changes, including the Dodd-Frank Wall Street Reform and Consumer Protection Act; (19) inability to protect our intellectual property rights or claims of infringement of the intellectual property rights of others; (20) adverse determinations in litigation or regulatory matters and our exposure to contingent liabilities, including in connection with our divestiture or winding down of businesses; (21) domestic or international military actions, natural or man-made disasters including terrorist activities or pandemic disease, or other events resulting in catastrophic loss of life; (22) ineffectiveness of risk management policies and procedures in identifying, monitoring and managing risks; (23) effects of acquisitions, divestitures and restructurings, including possible difficulties in integrating and realizing the projected results of acquisitions, including risks associated with the acquisition of certain insurance operations in Japan; (24) interruption in telecommunication, information technology or other operational systems or failure to maintain the security, confidentiality or privacy of sensitive data on such systems; (25) changes in statutory or U.S. GAAP accounting principles, practices or policies; (26) Prudential Financial, Inc. s primary reliance, as a holding company, on dividends or distributions from its subsidiaries to meet debt payment obligations and the ability of the subsidiaries to pay such dividends or distributions in light of our ratings objectives and/or applicable regulatory restrictions; and (27) risks due to the lack of legal separation between our Financial Services Businesses and our Closed Block Business. Prudential Financial, Inc. does not intend, and is under no obligation, to update any particular forward-looking statement included in this document. See Risk Factors included in the Annual Report on Form 10-K for the year ended December 31, 2011 for discussion of certain risks relating to our businesses and investment in our securities.

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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, 2012 and December 31, 2011 (in millions, except share amounts)

|  | $\begin{gathered} \text { September 30, } \\ 2012 \end{gathered}$ |  | $\begin{gathered} \text { December 31, } \\ 2011 \end{gathered}$ |  |
| :---: | :---: | :---: | :---: | :---: |
| ASSETS |  |  |  |  |
| Fixed maturities, available for sale, at fair value (amortized cost: 2012-\$250,475; 2011-\$240,424)(1) | \$ | 273,381 | \$ | 254,648 |
| Fixed maturities, held-to-maturity, at amortized cost (fair value: 2012-\$5,019; 2011-\$5,354)(1) |  | 4,720 |  | 5,107 |
| Trading account assets supporting insurance liabilities, at fair value(1) |  | 20,132 |  | 19,481 |
| Other trading account assets, at fair value(1) |  | 5,874 |  | 5,545 |
| Equity securities, available-for-sale, at fair value (cost: 2012-\$6,671; 2011-\$6,922) |  | 7,992 |  | 7,535 |
| Commercial mortgage and other loans (includes $\$ 248$ and $\$ 603$ measured at fair value under the fair value option at September 30, 2012 and December 31, 2011, respectively)(1) |  | 36,822 |  | 35,431 |
| Policy loans |  | 11,701 |  | 11,559 |
| Other long-term investments (includes $\$ 462$ and $\$ 366$ measured at fair value under the fair value option at September 30, 2012 and December 31, 2011, respectively)(1) |  | 8,155 |  | 7,820 |
| Short-term investments |  | 9,295 |  | 9,121 |
| Total investments |  | 378,072 |  | 356,247 |
| Cash and cash equivalents(1) |  | 13,906 |  | 14,251 |
| Accrued investment income(1) |  | 2,870 |  | 2,793 |
| Deferred policy acquisition costs |  | 13,666 |  | 12,517 |
| Other assets(1) |  | 15,674 |  | 16,056 |
| Separate account assets |  | 247,510 |  | 218,380 |
| TOTAL ASSETS | \$ | 671,698 | \$ | 620,244 |
| LIABILITIES AND EQUITY |  |  |  |  |
| LIABILITIES |  |  |  |  |
| Future policy benefits | \$ | 183,162 | \$ | 170,671 |
| Policyholders account balances |  | 135,669 |  | 134,558 |
| Policyholders dividends |  | 7,562 |  | 5,797 |
| Securities sold under agreements to repurchase |  | 8,033 |  | 6,218 |
| Cash collateral for loaned securities |  | 3,376 |  | 2,973 |
| Income taxes |  | 8,896 |  | 6,558 |
| Short-term debt |  | 3,013 |  | 2,336 |
| Long-term debt |  | 23,845 |  | 24,622 |

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| 2012 and December 31, 2011, respectively)(1) <br> 艮 |  | 11,266 |  | 13,290 |
| :---: | :---: | :---: | :---: | :---: |
| Separate account liabilities |  | 247,510 |  | 218,380 |
| Total liabilities |  | 632,332 |  | 585,403 |
| COMMITMENTS AND CONTINGENT LIABILITIES (See Note 15) |  |  |  |  |
| EQUITY |  |  |  |  |
| Preferred Stock (\$.01 par value; 10,000,000 shares authorized; none issued) |  | 0 |  | 0 |
| Common Stock ( $\$ .01$ par value; $1,500,000,000$ shares authorized; $660,111,299$ and $660,111,264$ shares issued at September 30, 2012 and December 31, 2011, respectively) |  | 6 |  | 6 |
| Class B Stock ( $\$ .01$ par value; $10,000,000$ shares authorized; $2,000,000$ shares issued and outstanding at September 30, 2012 and December 31, 2011, respectively) |  | 0 |  | 0 |
| Additional paid-in capital |  | 24,348 |  | 24,293 |
| Common Stock held in treasury, at cost (198,088,571 and 192,072,613 shares at September 30, 2012 and December 31, 2011, respectively) |  | $(12,225)$ |  | $(11,920)$ |
| Accumulated other comprehensive income |  | 9,650 |  | 5,418 |
| Retained earnings |  | 16,896 |  | 16,456 |
| Total Prudential Financial, Inc. equity |  | 38,675 |  | 34,253 |
| Noncontrolling interests |  | 691 |  | 588 |
| Total equity |  | 39,366 |  | 34,841 |
| TOTAL LIABILITIES AND EQUITY | \$ | 671,698 | \$ | 620,244 |

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

See Notes to Unaudited Interim Consolidated Financial Statements

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## PRUDENTIAL FINANCIAL, INC.

## Unaudited Interim Consolidated Statements of Operations

## Three and Nine Months Ended September 30, 2012 and 2011 (in millions, except per share amounts)

|  | Three Months Ended September 30, 20122011 |  |  | Nine Months Ended September 30, 2012 2011 |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| REVENUES |  |  |  |  |  |
| Premiums | \$ 9,027 | \$ | 6,084 | \$ 23,356 | \$ 17,864 |
| Policy charges and fee income | 1,224 |  | 958 | 3,335 | 2,911 |
| Net investment income | 3,433 |  | 3,333 | 10,111 | 9,778 |
| Asset management fees and other income | 905 |  | 2,028 | 3,167 | 3,846 |
| Realized investment gains (losses), net: |  |  |  |  |  |
| Other-than-temporary impairments on fixed maturity securities | (426) |  | (402) | $(1,345)$ | $(1,606)$ |
| Other-than-temporary impairments on fixed maturity securities transferred to Other |  |  |  |  |  |
| Comprehensive Income | 331 |  | 286 | 1,045 | 1,233 |
| Other realized investment gains (losses), net | $(1,350)$ |  | 2,644 | (766) | 3,319 |
| Total realized investment gains (losses), net | $(1,445)$ |  | 2,528 | $(1,066)$ | 2,946 |
| Total revenues | 13,144 |  | 14,931 | 38,903 | 37,345 |
| BENEFITS AND EXPENSES |  |  |  |  |  |
| Policyholders benefits | 9,576 |  | 6,208 | 23,446 | 17,676 |
| Interest credited to policyholders account balances | 1,057 |  | 1,463 | 3,270 | 3,477 |
| Dividends to policyholders | 517 |  | 679 | 1,563 | 1,961 |
| Amortization of deferred policy acquisition costs | 182 |  | 1,510 | 1,194 | 2,375 |
| General and administrative expenses | 2,779 |  | 2,665 | 8,264 | 7,738 |
| Total benefits and expenses | 14,111 |  | 12,525 | 37,737 | 33,227 |


| INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES | (967) | 2,406 | 1,166 | 4,118 |
| :---: | :---: | :---: | :---: | :---: |
| Income tax expense (benefit) | (331) | 860 | 572 | 1,312 |
| INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE EQUITY IN EARNINGS OF OPERATING JOINT VENTURES | (636) | 1,546 | 594 | 2,806 |
| Equity in earnings of operating joint ventures, net of taxes | 45 | 67 | 58 | 181 |
| INCOME (LOSS) FROM CONTINUING OPERATIONS | (591) | 1,613 | 652 | 2,987 |
| Income (loss) from discontinued operations, net of taxes | (2) | (9) | 12 | 21 |
| NET INCOME (LOSS) | (593) | 1,604 | 664 | 3,008 |
| Less: Income attributable to noncontrolling interests | 25 | 10 | 51 | 64 |

NET INCOME (LOSS) ATTRIBUTABLE TO PRUDENTIAL FINANCIAL, INC | $\$$ | $(618)$ | $\$ 1,594$ | $\$$ | 613 | $\$ 2,944$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |

EARNINGS PER SHARE (See Note 8)

## Financial Services Businesses

## Basic:

| Income (loss) from continuing operations attributable to Prudential Financial, Inc. per <br> share of Common Stock | $\$(1.41)$ | $\$$ | 3.24 | $\$$ | 1.19 | $\$$ | 5.88 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Income (loss) from discontinued operations, net of taxes |  | 0.00 |  | $(0.02)$ |  | 0.03 |  |

## Diluted:

| Income (loss) from continuing operations attributable to Prudential Financial, Inc. per <br> share of Common Stock <br> Income (loss) from discontinued operations, net of taxes | $\$$ | $(1.41)$ | $\$$ | 3.19 | $\$$ | 1.18 | $\$$ | 5.80 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |

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## PRUDENTIAL FINANCIAL, INC.

## Unaudited Interim Consolidated Statements of Comprehensive Income

Three and Nine Months Ended September 30, 2012 and 2011 (in millions)

|  | $\begin{aligned} & \text { Three Months Ended } \\ & \text { September 30, } \\ & 2012 \quad 2011 \end{aligned}$ |  |  | Nine Months Ended September 30, <br> 2012 <br> 2011 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| NET INCOME (LOSS) | \$ (593) | \$ | 1,604 | \$ 664 | \$ | 3,008 |
| Other comprehensive income, before tax: |  |  |  |  |  |  |
| Foreign currency translation adjustments: |  |  |  |  |  |  |
| Foreign currency translation adjustments for the period | 139 |  | 212 | 236 |  | 499 |
| Reclassification adjustment for amounts included in net income | 0 |  | (44) | 0 |  | (44) |
| Total | 139 |  | 168 | 236 |  | 455 |
| Net unrealized investment gains: |  |  |  |  |  |  |
| Unrealized investment gains for the period | 1,740 |  | 1,896 | 5,909 |  | 3,197 |
| Reclassification adjustment for (gains) losses included in net income | 19 |  | 49 | 168 |  | (122) |
| Total | 1,759 |  | 1,945 | 6,077 |  | 3,075 |
| Defined benefit pension and postretirement unrecognized net periodic benefit: |  |  |  |  |  |  |
| Impact of foreign currency changes and other | 5 |  | (5) | 18 |  | (11) |
| Amortization included in net income | 40 |  | 24 | 122 |  | 68 |
| Total | 45 |  | 19 | 140 |  | 57 |
| Other comprehensive income, before tax | 1,943 |  | 2,132 | 6,453 |  | 3,587 |
| Less: Income tax expense related to: |  |  |  |  |  |  |
| Foreign currency translation adjustments | 31 |  | 92 | 90 |  | 143 |
| Net unrealized investment gains | 557 |  | 679 | 2,077 |  | 1,052 |
| Defined benefit pension and postretirement unrecognized net periodic benefit | 16 |  | 8 | 42 |  | 23 |
| Total | 604 |  | 779 | 2,209 |  | 1,218 |
| Other comprehensive income, net of taxes | 1,339 |  | 1,353 | 4,244 |  | 2,369 |
| Comprehensive Income | 746 |  | 2,957 | 4,908 |  | 5,377 |
| Comprehensive income attributable to noncontrolling interests | (4) |  | (16) | (63) |  | (93) |
| Comprehensive income attributable to Prudential Financial, Inc. | \$ 742 | \$ | 2,941 | \$4,845 | \$ | 5,284 |

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## PRUDENTIAL FINANCIAL, INC.

## Unaudited Interim Consolidated Statements of Equity(1)

## Nine Months Ended September 30, 2012 and 2011 (in millions)

|  |  Additional <br> Common <br> Stock Paid-in <br> Capital |  | Prudential Financial, Inc. Equity |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | Retained Earnings | Common <br> Stock <br> Held In <br> Treasury | Accumulated Other Comprehensive Income (Loss) |  | Total <br> Prudential <br> Financial, Inc. Noncontrolling Equity Interests |  |  |  | $\begin{gathered} \text { Total } \\ \text { Equity } \\ \$ 34,841 \end{gathered}$ |
| Balance December 31, 2011 | \$ 6 | \$ 24,293 | \$ 16,456 | \$ (11,920) | \$ | 5,418 | \$ | 34,253 | \$ | 588 |  |
| Common Stock acquired |  |  |  | (650) |  |  |  | (650) |  | 0 | (650) |
| Contributions from noncontrolling interests |  |  |  |  |  |  |  |  |  | 2 | 2 |
| Distributions to noncontrolling interests |  |  |  |  |  |  |  |  |  | (78) | (78) |
| Consolidations/deconsolidations of noncontrolling interests |  | 0 |  |  |  |  |  | 0 |  | 116 | 116 |
| Stock-based compensation programs |  | 55 | (173) | 345 |  |  |  | 227 |  |  | 227 |
| Comprehensive income: |  |  |  |  |  |  |  |  |  |  |  |
| Net income |  |  | 613 |  |  |  |  | 613 |  | 51 | 664 |
| Other comprehensive income, net of tax |  |  |  |  |  | 4,232 |  | 4,232 |  | 12 | 4,244 |
| Total comprehensive income |  |  |  |  |  |  |  | 4,845 |  | 63 | 4,908 |
| Balance, September 30, 2012 | \$ 6 | \$ 24,348 | \$ 16,896 | \$ $(12,225)$ | \$ | 9,650 | \$ | 38,675 | \$ | 691 | \$ 39,366 |


|  | Prudential Financial, Inc. Equity |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Prudentia |  |  |  | Common <br> Stock <br> Held In <br> Treasury | Accumulated <br> Other <br> Comprehensive Income (Loss) |  | Total Prudential Financial, Inc. Equity |  | Noncontrolling Interests |  | Total Equity |
| Balance, December 31, 2010 | \$ 6 | \$ | 24,223 | \$ 16,381 | \$ $(11,173)$ | \$ | 2,978 | \$ | 32,415 | \$ | 513 | \$ 32,928 |
| Common Stock acquired |  |  |  |  | (750) |  |  |  | (750) |  |  | (750) |
| Cumulative effect of adoption of accounting principle |  |  |  | $(2,701)$ |  |  | (179) |  | $(2,880)$ |  |  | $(2,880)$ |
| Contributions from noncontrolling interests |  |  |  |  |  |  |  |  | 0 |  | 10 | 10 |
| Distributions to noncontrolling interests |  |  |  |  |  |  |  |  | 0 |  | (15) | (15) |
| Consolidations/deconsolidations of noncontrolling interests |  |  |  |  |  |  |  |  | 0 |  | 54 | 54 |
| Stock-based compensation programs |  |  | 34 | (29) | 185 |  |  |  | 190 |  |  | 190 |
| Comprehensive income: |  |  |  |  |  |  |  |  |  |  |  |  |
| Net income |  |  |  | 2,944 |  |  |  |  | 2,944 |  | 64 | 3,008 |
| Other comprehensive income, net of tax |  |  |  |  |  |  | 2,340 |  | 2,340 |  | 29 | 2,369 |
| Total comprehensive income |  |  |  |  |  |  |  |  | 5,284 |  | 93 | 5,377 |
| Balance, September 30, 2011 | \$ 6 | \$ | 24,257 | \$ 16,595 | \$ $(11,738)$ | \$ | 5,139 | \$ | 34,259 | \$ | 655 | \$ 34,914 |

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See Notes to Unaudited Interim Consolidated Financial Statements

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## PRUDENTIAL FINANCIAL, INC.

## Unaudited Interim Consolidated Statements of Cash Flows

Nine Months Ended September 30, 2012 and 2011 (in millions)

|  | 2012 | 2011 |
| :---: | :---: | :---: |
| CASH FLOWS FROM OPERATING ACTIVITIES |  |  |
| Net income | \$ 664 | 3,008 |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |  |
| Realized investment (gains) losses, net | 1,066 | $(2,946)$ |
| Policy charges and fee income | $(1,080)$ | (826) |
| Interest credited to policyholders account balances | 3,269 | 3,477 |
| Depreciation and amortization | 230 | 202 |
| Gains on trading account assets supporting insurance liabilities, net | (503) | (179) |
| Change in: |  |  |
| Deferred policy acquisition costs | $(1,438)$ | 75 |
| Future policy benefits and other insurance liabilities | 11,336 | 4,787 |
| Other trading account assets | 4 | 340 |
| Income taxes | 879 | 359 |
| Other, net | $(2,678)$ | 2,524 |
| Cash flows from operating activities | 11,749 | 10,821 |
| CASH FLOWS FROM INVESTING ACTIVITIES |  |  |
| Proceeds from the sale/maturity/prepayment of: |  |  |
| Fixed maturities, available-for-sale | 28,302 | 31,857 |
| Fixed maturities, held-to-maturity | 377 | 336 |
| Trading account assets supporting insurance liabilities and other trading account assets | 10,230 | 18,883 |
| Equity securities, available-for-sale | 3,245 | 2,823 |
| Commercial mortgage and other loans | 3,528 | 3,138 |
| Policy loans | 1,698 | 1,521 |
| Other long-term investments | 1,105 | 1,556 |
| Short-term investments | 20,985 | 16,799 |
| Payments for the purchase/origination of: |  |  |
| Fixed maturities, available-for-sale | $(38,848)$ | $(38,963)$ |
| Fixed maturities, held-to-maturity | (18) | (38) |
| Trading account assets supporting insurance liabilities and other trading account assets | $(10,190)$ | $(20,317)$ |
| Equity securities, available-for-sale | $(2,897)$ | $(2,335)$ |
| Commercial mortgage and other loans | $(5,348)$ | $(4,598)$ |
| Policy loans | $(1,527)$ | $(1,334)$ |
| Other long-term investments | $(1,316)$ | $(1,252)$ |
| Short-term investments | $(20,905)$ | $(16,858)$ |
| Acquisition of subsidiaries, net of cash acquired. | 0 | $(2,321)$ |
| Other, net | 167 | 119 |
| Cash flows used in investing activities | $(11,412)$ | $(10,984)$ |

CASH FLOWS FROM FINANCING ACTIVITIES

| Policyholders account deposits | 17,095 | 18,632 |
| :---: | :---: | :---: |
| Policyholders account withdrawals | $(17,935)$ | $(17,047)$ |
| Net change in securities sold under agreements to repurchase and cash collateral for loaned securities | 2,222 | 1,356 |
| Cash dividends paid on Common Stock | (53) | (51) |
| Net change in financing arrangements (maturities 90 days or less) | (74) | 207 |
| Common Stock acquired | (650) | (695) |
| Common Stock reissued for exercise of stock options | 117 | 89 |
| Proceeds from the issuance of debt (maturities longer than 90 days) | 2,396 | 1,229 |
| Repayments of debt (maturities longer than 90 days) | $(2,384)$ | (891) |


| Excess tax benefits from share-based payment arrangements | 53 | 13 |
| :---: | :---: | :---: |
| Change in bank deposits | $(1,730)$ | (114) |
| Other, net | 274 | (135) |
| Cash flows from (used in) financing activities | (669) | 2,593 |
| Effect of foreign exchange rate changes on cash balances | (13) | 181 |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (345) | 2,611 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR | 14,251 | 12,915 |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | \$ 13,906 | \$ 15,526 |
| NON-CASH TRANSACTIONS DURING THE PERIOD |  |  |
| Treasury Stock shares issued for stock-based compensation programs | \$ 209 | \$ 73 |

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# PRUDENTIAL FINANCIAL, INC. 

Notes to Unaudited Interim Consolidated Financial Statements

## 1. BUSINESS AND BASIS OF PRESENTATION

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

## Basis of Presentation

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

In the opinion of management, all adjustments necessary for a fair statement of the financial position and results of operations have been made. All such adjustments are of a normal, recurring nature, except for the adjustments described below under Out of Period Adjustments. Interim results are not necessarily indicative of the results that may be expected for the full year. These financial statements should be read in conjunction with the Company s Audited Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2011.

The Company s Gibraltar Life Insurance Company, Ltd. ( Gibraltar Life ) consolidated operations, including the previously-acquired AIG Star Life Insurance Co., Ltd., AIG Edison Life Insurance Company, AIG Financial Assurance Japan K.K., and AIG Edison Service Co., Ltd. use a November 30 fiscal year end for purposes of inclusion in the Company s Consolidated Financial Statements. Therefore, the Unaudited Interim Consolidated Financial Statements as of September 30, 2012, include the assets and liabilities of Gibraltar Life as of August 31, 2012 and the results of operations for Gibraltar Life for the three and nine months ended August 31, 2012.

## 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.

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Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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

## Reclassifications

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

## Out of Period Adjustments

In the second quarter of 2012, the Company recorded two out of period adjustments resulting in a decrease of $\$ 122$ million to Income from continuing operations before income taxes and equity in earnings of operating joint ventures for the nine months ended September 30, 2012.

The first adjustment related to a decline in the value of a real estate-related investment. Based on a review of the underlying collateral and a related guarantee, the Company determined that impairments of $\$ 75$ million should be recognized, of which $\$ 61$ million should have been recorded in prior years. The second adjustment consisted of an increase of $\$ 61$ million in reserves for estimated payments arising from use of new Social Security Master Death File matching criteria to identify deceased policy and contract holders. During the initial calculation of the reserve in the third quarter of 2011, the Company excluded certain life policies in extended term status from the analysis used to identify potential claims.

The adjustments resulted in a decrease in adjusted operating income, the Company s measure of segment performance, of $\$ 106$ million for the nine months ended September 30, 2012, including a reduction of $\$ 61$ million to the Asset Management segment and a reduction of $\$ 45$ million to the Corporate and Other operations of the Financial Services Businesses. In addition, the adjustments resulted in a reduction of $\$ 16$ million to the Closed Block Business. The adjustments are not material to any previously reported quarterly or annual financial statements.

In addition to the two out of period adjustments discussed above, in the first quarter of 2011, the Company recorded an out of period adjustment that decreased Income from continuing operations before income taxes and equity in earnings of operating joint ventures by $\$ 95$ million. This adjustment had no impact on adjusted operating income, the Company s measure of segment performance, and was not material to any previously reported quarterly or annual financial statements. For additional information regarding this out of period adjustment, see Note 1 to the Company s Consolidated Financial Statements included in its 2011 Annual Report on Form 10-K.

For further information on the presentation of segment results and a definition of adjusted operating income, see Note 11.

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

## 2. SIGNIFICANT ACCOUNTING POLICIES AND PRONOUNCEMENTS

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

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

Fixed maturities are comprised of bonds, notes and redeemable preferred stock. Fixed maturities classified as available-for-sale are carried at fair value. See Note 13 for additional information regarding the determination of fair value. Fixed maturities for which the Company has asserted the positive intent and ability to hold to maturity are carried at amortized cost and classified as held-to-maturity. The amortized cost of fixed maturities is adjusted for amortization of premiums and accretion of discounts to maturity. Interest income, as well as the related amortization of premium and accretion of discount, is included in Net investment income under the effective yield method. For mortgage-backed and asset-backed securities, the effective yield is based on estimated cash flows, including interest rate and prepayment assumptions based on data from widely accepted third-party data sources or internal estimates. In addition to interest rate and prepayment assumptions, cash flow estimates also vary based on other assumptions regarding the underlying collateral, including default rates and changes in value. These assumptions can significantly impact income recognition and the amount of other-than-temporary impairments recognized in earnings and other comprehensive income. For high credit quality mortgage-backed and asset-backed securities (those rated AA or above), cash flows are updated quarterly, and the amortized cost and effective yield of the security are adjusted as necessary to reflect historical prepayment experience and changes in estimated future prepayments. The adjustments to amortized cost are recorded as a charge or credit to net investment income in accordance with the retrospective method. For mortgage-backed and asset-backed securities rated below AA or those for which an other than temporary impairment has been recorded, the effective yield is adjusted prospectively for any changes in estimated cash flows. See the discussion below on realized investment gains and losses for a description of the accounting for impairments. Unrealized gains and losses on fixed maturities classified as available-for-sale, net of tax, and the effect on deferred policy acquisition costs, value of business acquired, unearned revenue reserves, deferred sales inducements, future policy benefits and policyholders dividends that would result from the realization of unrealized gains and losses, are included in Accumulated other comprehensive income (loss).

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

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

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Company s former global commodities group, in Income from discontinued operations, net of taxes.

Equity securities available-for-sale are comprised of common stock, mutual fund shares, non-redeemable preferred stock, and certain perpetual preferred stock, and are carried at fair value. The associated unrealized

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

gains and losses, net of tax, and the effect on deferred policy acquisition costs, value of business acquired, unearned revenue reserves, deferred sales inducements, future policy benefits and policyholders dividends that would result from the realization of unrealized gains and losses, are included in Accumulated other comprehensive income (loss). The cost of equity securities is written down to fair value when a decline in value is considered to be other-than-temporary. See the discussion below on realized investment gains and losses for a description of the accounting for impairments. Dividends from these investments are recognized in Net investment income when earned.

Commercial mortgage and other loans consist of commercial mortgage loans, agricultural loans, loans backed by residential properties, as well as certain other collateralized and uncollateralized loans. Commercial mortgage loans are broken down by class which is based on property type (industrial properties, retail, office, multi-family/apartment, hospitality, and other). Loans backed by residential properties primarily include recourse loans held by the Company s international insurance businesses. Other collateralized loans primarily include senior loans made by the Company s international insurance businesses and loans made to the Company s former real estate franchisees. Uncollateralized loans primarily represent reverse dual currency loans and corporate loans held by the Company sinternational insurance businesses.

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

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

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

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

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The Company reviews the performance and credit quality of the commercial mortgage and other loan portfolio on an on-going basis. Loans are placed on watch list status based on a predefined set of criteria and are assigned one of three categories. Loans are placed on early warning status in cases where, based on the Company $s$ analysis of the loan s collateral, the financial situation of the borrower or tenants or other market

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

factors, it is believed a loss of principal or interest could occur. Loans are classified as closely monitored when it is determined that there is a collateral deficiency or other credit events that may lead to a potential loss of principal or interest. Loans not in good standing are those loans where the Company has concluded that there is a high probability of loss of principal, such as when the loan is delinquent or in the process of foreclosure. As described below, in determining the allowance for losses, the Company evaluates each loan on the watch list to determine if it is probable that amounts due will not be collected according to the contractual terms of the loan agreement.

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

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

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

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

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

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

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

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

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

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

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

Realized investment gains (losses) are computed using the specific identification method with the exception of some of Company s International Insurance businesses portfolios, where the average cost method is used. Realized investment gains and losses are generated from

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numerous sources, including the sale of fixed maturity securities, equity securities, investments in joint ventures and limited partnerships and other types of investments, as well as adjustments to the cost basis of investments for net other-than-temporary impairments recognized in earnings. Realized investment gains and losses are also generated from prepayment premiums received on private fixed maturity securities, allowance for losses on commercial mortgage and other loans, fair value

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changes on commercial mortgage loans carried at fair value, and fair value changes on embedded derivatives and free-standing derivatives that do not qualify for hedge accounting treatment, except those derivatives used in the Company s capacity as a broker or dealer.


#### Abstract

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


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

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

For debt securities, the split between the amount of an other-than-temporary impairment recognized in other comprehensive income and the net amount recognized in earnings is driven principally by assumptions regarding the amount and timing of projected cash flows. For mortgage-backed and asset-backed securities, cash flow estimates consider the payment terms of the underlying assets backing a particular security, including interest rate and prepayment assumptions, based on data from widely accepted third-party data sources or internal estimates. In addition to interest rate and prepayment assumptions, cash flow estimates also include other

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assumptions regarding the underlying collateral including default rates and recoveries, which vary based on the asset type and geographic location, as well as the vintage year of the security. For structured securities, the payment priority within the tranche structure is also considered. For all other debt securities, cash flow estimates are driven by assumptions regarding probability of default and estimates regarding timing and amount of recoveries associated with a default. The Company has developed these estimates using information based on its historical experience as well as using market observable data, such as industry analyst reports and forecasts, sector credit ratings and other data relevant to the collectability of a security, such as the general payment terms of the security and the security s position within the capital structure of the issuer.

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

## Derivative Financial Instruments

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

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

Derivatives were also used in a derivative broker-dealer capacity in the Company s former global commodities group to meet the needs of clients by structuring transactions that allow clients to manage their exposure to interest rates, foreign exchange rates, indices and prices of securities and commodities. The Company s global commodities group was sold on July 1, 2011. See Note 3 for further details. Realized and unrealized changes in fair value of derivatives used in these dealer-related operations are included in Income from discontinued operations, net of taxes in the periods in which the changes occur. Cash flows from such derivatives are reported in the operating activities section of the Unaudited Interim Consolidated Statements of Cash Flows.

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

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

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

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

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

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

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

If it is determined that a derivative no longer qualifies as an effective fair value or cash flow hedge or management removes the hedge designation, the derivative will continue to be carried on the balance sheet at its fair value, with changes in fair value recognized currently in Realized investment gains (losses), net. In this scenario, the hedged asset or liability under a fair value hedge will no longer be adjusted for changes in fair value and the existing basis adjustment is amortized to the income statement line associated with the asset or liability. The
component of Accumulated other comprehensive income (loss) related to discontinued cash flow hedges is reclassified to the income statement line associated with the hedged cash flows consistent with the earnings impact of the original hedged cash flows.

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

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## PRUDENTIAL FINANCIAL, INC.

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

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

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

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

## Adoption of New Accounting Pronouncements

Effective January 1, 2012, the Company adopted, retrospectively, updated guidance regarding the presentation of comprehensive income. The updated guidance eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders equity. Under the updated guidance, an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The updated guidance does not change the items that are reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The Company opted to present the total of comprehensive income, the components of net income, and the components of other comprehensive income in two separate but consecutive statements. The Unaudited Interim Consolidated Financial Statements included herein reflect the adoption of this updated guidance.

Effective January 1, 2012, the Company adopted, prospectively, updated guidance regarding the fair value measurements and disclosure requirements. The updated guidance clarifies existing guidance related to the application of fair value measurement methods and requires expanded disclosures. The expanded disclosures required by this guidance are included in Note 13. Adoption of this guidance did not have a material effect on the Company s consolidated financial position or results of operations.

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Effective January 1, 2012, the Company adopted, prospectively, updated guidance regarding the assessment of effective control for repurchase agreements. The Company s adoption of this guidance did not have a material effect on the Company s consolidated financial position, results of operations, and financial statement disclosures.

Effective January 1, 2012, the Company adopted, retrospectively, new authoritative guidance to address diversity in practice regarding the interpretation of which costs relating to the acquisition of new or renewal

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PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

insurance contracts qualify for deferral. Under the amended guidance, acquisition costs are to include only those costs that are directly related to the acquisition or renewal of insurance contracts by applying a model similar to the accounting for loan origination costs. An entity may defer incremental direct costs of contract acquisition with independent third parties or employees that are essential to the contract transaction, as well as the portion of employee compensation, including payroll fringe benefits and other costs directly related to underwriting, policy issuance and processing, medical inspection, and contract selling for successfully negotiated contracts. Prior period financial information presented in these financial statements has been adjusted to reflect the retrospective adoption of the amended guidance. The lower level of costs now qualifying for deferral will be only partially offset by a lower level of amortization of Deferred policy acquisition costs , and, as such, will initially result in lower earnings in future periods, primarily within the International Insurance and Individual Annuities segments. The impact to the International Insurance segment largely reflects lower deferrals of allocated costs of its proprietary distribution system, while the impact to the Individual Annuities segment mainly reflects lower deferrals of its wholesaler costs. While the adoption of this amended guidance changes the timing of when certain costs are reflected in the Company $s$ results of operations, it has no effect on the total acquisition costs to be recognized over time and has no impact on the Company s cash flows.

The following tables present amounts as previously reported in 2011, the effect on those amounts of the change due to the retrospective adoption of the amended guidance related to the deferral of acquisition costs as described above, and the adjusted amounts that are reflected in the Unaudited Interim Consolidated Financial Statements, included herein.

## Unaudited Interim Consolidated Statement of Financial Position:

|  | December 31, 2011 |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | As Previously Reported | Effect of Change (in millions) | As Currently Reported |  |
| Deferred policy acquisition costs | \$ 16,790 | \$ $(4,273)$ | \$ | 12,517 |
| Other assets | 16,060 | (4) |  | 16,056 |
| TOTAL ASSETS | 624,521 | $(4,277)$ |  | 620,244 |
| Future policy benefits | 170,459 | 212 |  | 170,671 |
| Policyholders account balances | 134,552 | 6 |  | 134,558 |
| Income taxes | 8,083 | $(1,525)$ |  | 6,558 |
| Total liabilities | 586,710 | $(1,307)$ |  | 585,403 |
| Accumulated other comprehensive income (loss) | 5,563 | (145) |  | 5,418 |
| Retained earnings | 19,281 | $(2,825)$ |  | 16,456 |
| Total Prudential Financial, Inc. equity | 37,223 | $(2,970)$ |  | 34,253 |
| Total equity | 37,811 | $(2,970)$ |  | 34,841 |
| TOTAL LIABILITIES AND EQUITY | \$ 624,521 | \$ $(4,277)$ | \$ | 620,244 |

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## PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

## Unaudited Interim Consolidated Statement of Operations:

|  | Three M <br> As Previously Reported |  |  | Sep |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | Effect of Change (in millions) |  | As Currently Reported |  |
| REVENUES |  |  |  |  |  |  |
| Premiums |  | 6,092 | \$ | (8) | \$ | 6,084 |
| Asset management fees and other income |  | 2,006 |  | 22 |  | 2,028 |
| Total revenues |  | 14,917 |  | 14 |  | 14,931 |
| BENEFITS AND EXPENSES |  |  |  |  |  |  |
| Amortization of deferred policy acquisition costs |  | 1,786 |  | (276) |  | 1,510 |
| General and administrative expenses |  | 2,447 |  | 218 |  | 2,665 |
| Total benefits and expenses |  | 12,583 |  | (58) |  | 12,525 |
| INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME |  |  |  |  |  |  |
| TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES |  | 2,334 |  | 72 |  | 2,406 |
| Income tax expense |  | 848 |  | 12 |  | 860 |
| INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE EQUITY IN |  |  |  |  |  |  |
| EARNINGS OF OPERATING JOINT VENTURES |  | 1,486 |  | 60 |  | 1,546 |
| Equity in earnings of operating joint ventures, net of tax |  | 67 |  | 0 |  | 67 |
| INCOME (LOSS) FROM CONTINUING OPERATIONS |  | 1,553 |  | 60 |  | 1,613 |
| NET INCOME (LOSS) |  | 1,544 |  | 60 |  | 1,604 |
| NET INCOME (LOSS) ATTRIBUTABLE TO PRUDENTIAL FINANCIAL, INC. | \$ | 1,534 | \$ | 60 | \$ | 1,594 |
| EARNINGS PER SHARE |  |  |  |  |  |  |
| Financial Services Businesses |  |  |  |  |  |  |
| Basic: |  |  |  |  |  |  |
| Income from continuing operations attributable to Prudential Financial, Inc. per share of |  |  |  |  |  |  |
| Common Stock | \$ | 3.12 | \$ | 0.12 | \$ | 3.24 |
| Net income attributable to Prudential Financial, Inc. per share of Common Stock | \$ | 3.10 | \$ | 0.12 | \$ | 3.22 |
| Diluted: |  |  |  |  |  |  |
| Income from continuing operations attributable to Prudential Financial, Inc. per share of |  |  |  |  |  |  |
| Common Stock |  | 3.08 | \$ | 0.11 | \$ | 3.19 |
| Net income attributable to Prudential Financial, Inc. per share of Common Stock | \$ | 3.06 | \$ | 0.12 | \$ | 3.18 |
| Closed Block Business |  |  |  |  |  |  |
| Basic and Diluted: |  |  |  |  |  |  |
| Income from continuing operations attributable to Prudential Financial, Inc. per share of Class B Stock |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| Net income attributable to Prudential Financial, Inc. per share of |  |  |  |  |  |  |
| Class B stock |  | 10.50 | \$ | 1.50 | \$ | 12.00 |

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## PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

|  | Nine Months Ended September 30, 2011 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | As Previously Reported | Effect of Change (in millions) |  | As Currently Reported |  |
| REVENUES |  |  |  |  |  |
| Premiums | \$ 17,892 | \$ | (28) | \$ | 17,864 |
| Asset management fees and other income | 3,823 |  | 23 |  | 3,846 |
| Total revenues | 37,350 |  | (5) |  | 37,345 |
| BENEFITS AND EXPENSES |  |  |  |  |  |
| Amortization of deferred policy acquisition costs | 2,888 |  | (513) |  | 2,375 |
| General and administrative expenses | 7,138 |  | 600 |  | 7,738 |
| Total benefits and expenses | 33,140 |  | 87 |  | 33,227 |
| INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME |  |  |  |  |  |
| TAXES AND EQUITY IN EARNINGS OF OPERATING JOINT VENTURES | 4,210 |  | (92) |  | 4,118 |
| Income tax expense | 1,370 |  | (58) |  | 1,312 |
| INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE EQUITY IN |  |  |  |  |  |
| EARNINGS OF OPERATING JOINT VENTURES | 2,840 |  | (34) |  | 2,806 |
| Equity in earnings of operating joint ventures, net of tax | 183 |  | (2) |  | 181 |
| INCOME (LOSS) FROM CONTINUING OPERATIONS | 3,023 |  | (36) |  | 2,987 |
| NET INCOME (LOSS) | 3,044 |  | (36) |  | 3,008 |
| NET INCOME (LOSS) ATTRIBUTABLE TO PRUDENTIAL FINANCIAL, INC. | \$ 2,980 | \$ | (36) | \$ | 2,944 |
| EARNINGS PER SHARE |  |  |  |  |  |
| Financial Services Businesses |  |  |  |  |  |
| Basic: |  |  |  |  |  |
| Income (loss) from continuing operations attributable to Prudential Financial, Inc. per share of Common Stock | \$ 5.97 | \$ | (0.09) | \$ | 5.88 |
| Net income (loss) attributable to Prudential Financial, Inc. per share of Common Stock | \$ 6.01 | \$ | (0.09) | \$ | 5.92 |
| Diluted: |  |  |  |  |  |
| Income (loss) from continuing operations attributable to Prudential Financial, Inc. per share of Common Stock | \$ 5.89 | \$ | (0.09) | \$ | 5.80 |
| Net income (loss) attributable to Prudential Financial, Inc. per share of Common Stock | \$ 5.93 | \$ | (0.08) | \$ | 5.85 |
| Closed Block Business |  |  |  |  |  |
| Basic and Diluted: |  |  |  |  |  |
| Income from continuing operations attributable to Prudential Financial, Inc. per share of Class B Stock | \$ 15.00 | \$ | 4.50 | \$ | 19.50 |
| Net income attributable to Prudential Financial, Inc. per share of Class B Stock | \$ 15.00 | \$ | 4.50 | \$ | 19.50 |

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## PRUDENTIAL FINANCIAL, INC.

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

## Unaudited Interim Consolidated Statement of Cash Flows:

$\left.\begin{array}{l|cc|c} & \begin{array}{c}\text { Nine Months Ended September 30, 2011 } \\ \text { Effect of } \\ \text { Change Currently } \\ \text { Reported }\end{array} \\ \text { (in millions) }\end{array}\right]$

## 3. ACQUISITIONS AND DISPOSITIONS

## Acquisition of The Hartford s Individual Life Insurance Business

On September 27, 2012, the Company announced that Prudential Insurance entered into an agreement to acquire The Hartford s Individual Life Insurance Business through a reinsurance transaction. The Company will pay The Hartford cash consideration of $\$ 615$ million, primarily in the form of a ceding commission to provide reinsurance for approximately 700,000 life insurance policies with net retained face amount in force of approximately $\$ 135$ billion. The transaction is expected to close in early 2013, subject to regulatory approvals and customary closing conditions.

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

On February 1, 2011, Prudential Financial completed the acquisition from American International Group, Inc. ( AIG ) of AIG Star Life Insurance Co., Ltd. ( Star ), AIG Edison Life Insurance Company ( Edison ), AIG Financial Assurance Japan K.K., and AIG Edison Service Co., Ltd. (collectively, the Star and Edison Businesses ) pursuant to the stock purchase agreement dated September 30, 2010 between Prudential Financial and AIG. The total purchase price was $\$ 4,709$ million, comprised of $\$ 4,213$ million in cash and $\$ 496$ million in assumed third party debt, substantially all of which is expected to be repaid, over time, with excess capital of the acquired entities. The acquisition of these businesses included the purchase by the Company of all of the shares of these entities, which became indirect wholly-owned subsidiaries of the Company. All acquired entities are Japanese corporations and their businesses are in Japan. On January 1, 2012, Star and Edison were merged into the Gibraltar Life Insurance Company, Ltd.

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The Star and Edison Businesses primarily distributed individual life insurance, fixed annuities and certain accident and health products with fixed benefits through captive agents, independent agents, and banks. The addition of these operations to the Company s existing businesses increases its scale in the Japanese insurance market and provides complementary distribution opportunities.

Prudential Financial made a Section 338(g) election under the Internal Revenue Code with respect to the acquisition resulting in the acquired entities being treated for U.S. tax purposes as newly-incorporated companies. Under such election, the U.S. tax basis of the assets acquired and liabilities assumed of the Star and Edison Businesses were adjusted as of February 1, 2011 to reflect the consequences of the Section 338(g) election.

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## PRUDENTIAL FINANCIAL, INC.

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

Although the acquisition of the Star and Edison Businesses included the acquisition of multiple entities, the Company views this as a single acquisition and reports it as such in the following disclosures.

Net Assets Acquired

The following table presents an allocation of the purchase price to assets acquired and liabilities assumed at February 1, 2011 (the Acquisition Date ):

|  | (in millions) |
| :--- | ---: |
| Total invested assets at fair value(1) | 43,103 |
| Cash and cash equivalents | 1,813 |
| Accrued investment income | 348 |
| Value of business acquired | 3,769 |
| Goodwill | 173 |
| Other assets(1) | 880 |
| Total assets acquired | 50,086 |
| Future policy benefits | 22,202 |
| Policyholders account balances(2) | 22,785 |
| Long-term debt | 496 |
| Other liabilities | 390 |
| Total liabilities assumed | 45,873 |
| Net assets acquired | $\$$ |

(1) Total invested assets, at fair value, include $\$ 55$ million of related party assets. Other assets include $\$ 86$ million of related party assets.
(2) Includes investment contracts reported at fair value, which exceeded the account value by $\$ 646$ million.

## Value of Business Acquired

Value of business acquired ( VOBA ), which is established in accordance with purchase accounting guidance, is an intangible asset associated with the acquired in force insurance contracts representing the difference between the fair value and carrying value of the liabilities, determined as of the acquisition date. The fair value of the liabilities, and hence VOBA, reflects the cost of the capital attributable to the acquired insurance contracts. VOBA is amortized over the expected life of the contracts in proportion to either gross premiums or gross profits, depending on the

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type of contract. Total gross profits include both actual experience as it arises and estimates of gross profits for future periods. The Company regularly evaluates and adjusts the VOBA balance with a corresponding charge or credit to earnings for the effects of actual gross profits and changes in assumptions regarding estimated future gross profits. VOBA is reported as a component of Other assets and the amortization of VOBA is reported in General and administrative expenses. The proportion of the VOBA balance attributable to each of the product groups, as of the acquisition date, was as follows: $48 \%$ related to accident and health insurance products, $45 \%$ related to individual life insurance, and $7 \%$ related to fixed annuities.

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## PRUDENTIAL FINANCIAL, INC.

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

The following table provides estimated future amortization of VOBA, net of interest, assuming September 30, 2012 end of period foreign currency exchange rates remain constant, relating to the Star and Edison Businesses for the periods indicated.

|  | (in millions) |
| :--- | ---: |
| Remainder of 2012 | $\$$ |
| 2013 | $\$$ |
| 2014 | $\$ 54$ |
| 2015 | $\$$ |
| 2016 | $\$ 09$ |
| 2017 and thereafter | $\$$ |

Information regarding the change in VOBA is as follows:

|  | (in millions) |
| :--- | :---: |
| Balance as of January 1, 2012 | $\$$ |
| Amortization | $(378)$ |
| Interest | 32 |
| Foreign currency translation | $(33)$ |

Balance as of September 30, 2012 \$ 3,111

## Goodwill

As a result of the acquisition of the Star and Edison Businesses, the Company recognized an asset for goodwill representing the excess of the acquisition cost over the net fair value of the assets acquired and liabilities assumed. Goodwill resulting from the acquisition of the Star and Edison Businesses amounted to $\$ 173$ million. Based on the Company s final calculation of the $338(\mathrm{~g})$ election the Company determined that none of the goodwill is tax deductible. In accordance with U.S. GAAP, goodwill is not amortized but rather is tested at least annually for impairment. The test is performed at the reporting unit level which for this acquisition is the International Insurance segment s Gibraltar Life and Other operations.

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## PRUDENTIAL FINANCIAL, INC.

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

## Supplemental Unaudited Pro Forma Information

The following supplemental information presents selected unaudited pro forma information for the Company assuming the acquisition had occurred as of January 1, 2010. This pro forma information does not purport to represent what the Company s actual results of operations would have been if the acquisition had occurred as of the date indicated or what such results would be for any future periods. The pro forma information does not reflect the impact of future events that may occur, including but not limited to, expense efficiencies arising from the acquisition and also does not give effect to certain one-time charges that the Company expects to incur, such as restructuring and integration costs.
$\left.\left.\begin{array}{l|c} & \begin{array}{c}\text { Nine Months Ended } \\ \text { September 30, } \\ \text { 2011 }\end{array} \\ \text { (in millions, except } \\ \text { per share } \\ \text { amounts) }\end{array}\right] \begin{array}{l}38,665 \\ \hline \text { Total revenues }\end{array}\right], 152$

## Discontinued Operations

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

|  | Three Months Ended <br> September 30, <br> 2011 <br> (in millions) | Nine Months Ended <br> September 30, <br> 2012 |
| :--- | :---: | :---: | :---: | :---: |
| 2011 |  |  |


| Global commodities business | 0 | (2) | 0 | 16 |
| :---: | :---: | :---: | :---: | :---: |
| Other | 0 | 0 | 0 | 0 |
| Income (loss) from discontinued operations before income taxes | (3) | 1 | 19 | 37 |
| Income tax expense (benefit) | (1) | 10 | 7 | 16 |
| Income (loss) from discontinued operations, net of taxes | \$ (2) | \$ (9) | \$ 12 | \$ 21 |

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## PRUDENTIAL FINANCIAL, INC.

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

On April 6, 2011, the Company entered into a stock and asset purchase agreement with Jefferies Group, Inc. ( Jefferies ), pursuant to which the Company agreed to sell to Jefferies all of the issued and outstanding shares of capital stock of the Company s subsidiaries that conducted its global commodities business (the Global Commodities Business ) and certain assets that were primarily used in connection with the Global Commodities Business. Subsidiaries included in the sale were Prudential Bache Commodities, LLC, Prudential Bache Securities, LLC, Bache Commodities Limited, and Bache Commodities (Hong Kong) Ltd. On July 1, 2011, the Company completed the sale and received cash proceeds of $\$ 422$ million. In addition to the earnings for this business, included in the table above for the three and nine months ended September 30, 2011, are after-tax losses of $\$ 10$ million and $\$ 17$ million, respectively, recorded in connection with the sale of this business. This consisted of pre-tax losses of $\$ 6$ million and $\$ 18$ million and income tax expense of $\$ 4$ million and income tax benefit of $\$ 1$ million, for the three and nine months ended September 30, 2011, respectively.

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

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

The Company s Unaudited Interim Consolidated Statements of Financial Position include total assets and total liabilities related to discontinued businesses as follows:
\(\left.\begin{array}{lccc} \& September 30, \& December 31, <br>

2012\end{array}\right)\) 2011 | (in millions) |
| :--- |

## 4. INVESTMENTS

## Fixed Maturities and Equity Securities

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

| Amortized | Gross | September 30, 2012 <br> Gross <br> Cost | Unrealized | Enrealized |
| :---: | :---: | :---: | :---: | :---: | | Fair |
| :---: |
| Value |$\quad$| Other-than- |
| :---: |
| temporary |



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## PRUDENTIAL FINANCIAL, INC.

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

(1) Includes credit tranched securities collateralized by sub-prime mortgages, auto loans, credit cards, education loans, and other asset types.
(2) Includes publicly-traded agency pass-through securities and collateralized mortgage obligations.
(3) Represents the amount of other-than-temporary impairment losses in Accumulated other comprehensive income (loss), or AOCI, which were not included in earnings. Amount excludes $\$ 649$ million of net unrealized gains on impaired securities relating to changes in the value of such securities subsequent to the impairment measurement date.
$\left.\begin{array}{lccccccc} & & \text { September 30, 2012 } & & \begin{array}{c}\text { Other-than- } \\ \text { temporary } \\ \text { Impairments } \\ \text { in }\end{array} \\ \text { AOCI(4) }\end{array}\right]$
(1) Excludes notes with amortized cost of $\$ 1,000$ million (fair value, $\$ 1,052$ million) which have been offset with the associated payables under a netting agreement.
(2) Includes credit tranched securities primarily collateralized by non-sub-prime mortgages.
(3) Includes publicly-traded agency pass-through securities and collateralized mortgage obligations.
(4) Represents the amount of other-than-temporary impairment losses in AOCI, which were not included in earnings. Amount excludes $\$ 1$ million of net unrealized losses on impaired securities relating to changes in the value of such securities subsequent to the impairment measurement date.

December 31, 2011(3)

|  | December 31, 2011(3) |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Amortized Cost | Gross Unrealized Gains |  | Gross Unrealized Losses (in millions) |  | Fair Value |  | Other-thantemporary Impairments in $\mathrm{AOCI}(4)$ |  |
| Fixed maturities, available-for-sale |  |  |  |  |  |  |  |  |  |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | \$ 12,270 | \$ | 2,880 | \$ | 18 | \$ | 15,132 | \$ | 0 |
| Obligations of U.S. states and their political subdivisions | 2,410 |  | 332 |  | 2 |  | 2,740 |  | 0 |
| Foreign government bonds | 72,508 |  | 4,696 |  | 169 |  | 77,035 |  | 0 |
| Corporate securities | 119,967 |  | 10,200 |  | 3,055 |  | 127,112 |  | (22) |
| Asset-backed securities(1) | 12,346 |  | 172 |  | 1,825 |  | 10,693 |  | $(1,199)$ |
| Commercial mortgage-backed securities | 11,519 |  | 669 |  | 108 |  | 12,080 |  | 8 |
| Residential mortgage-backed securities(2) | 9,404 |  | 531 |  | 79 |  | 9,856 |  | (13) |


| Total fixed maturities, available-for-sale | $\$ 240,424$ | $\$$ | 19,480 | $\$$ | 5,256 | $\$ 254,648$ | $\$$ | $(1,226)$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Equity securities, available-for-sale | $\$ 16,922$ | $\$$ | 1,061 | $\$$ | 448 | $\$$ | 7,535 |  |

(1) Includes credit tranched securities collateralized by sub-prime mortgages, auto loans, credit cards, education loans, and other asset types.
(2) Includes publicly-traded agency pass-through securities and collateralized mortgage obligations.
(3) Prior period s amounts are presented on a basis consistent with the current period presentation.
(4) Represents the amount of other-than-temporary impairment losses in AOCI, which were not included in earnings. Amount excludes $\$ 223$ million of net unrealized gains on impaired securities relating to changes in the value of such securities subsequent to the impairment measurement date.

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## PRUDENTIAL FINANCIAL, INC.

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

$\left.\begin{array}{lccccccc} & & \text { December 31, 2011 } & & \begin{array}{c}\text { Other-than- } \\ \text { temporary } \\ \text { Impairments } \\ \text { in }\end{array} \\ \text { AOCI(4) }\end{array}\right]$
(1) Excludes notes with amortized cost of $\$ 500$ million (fair value, $\$ 519$ million) which have been offset with the associated payables under a netting agreement.
(2) Includes credit tranched securities primarily collateralized by non-sub-prime mortgages.
(3) Includes publicly-traded agency pass-through securities and collateralized mortgage obligations.
(4) Represents the amount of other-than-temporary impairment losses in AOCI, which were not included in earnings.

The amortized cost and fair value of fixed maturities by contractual maturities at September 30, 2012, are as follows:

|  | Available-for-Sale |  | Held-to-Maturity |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Amortized Cost | Fair Value (in mil | Amortized Cost <br> s) | Fair Value |
| Due in one year or less | \$ 13,704 | \$ 13,843 | \$ 0 | \$ 0 |
| Due after one year through five years | 44,625 | 46,376 | 74 | 77 |
| Due after five years through ten years | 54,970 | 60,226 | 421 | 431 |
| Due after ten years(1) | 105,294 | 120,633 | 1,916 | 2,013 |
| Asset-backed securities | 12,012 | 11,180 | 1,115 | 1,187 |
| Commercial mortgage-backed securities | 11,364 | 12,116 | 336 | 393 |
| Residential mortgage-backed securities | 8,506 | 9,007 | 858 | 918 |
| Total(1) | \$ 250,475 | \$ 273,381 | \$4,720 | \$5,019 |

[^1]
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Actual maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Asset-backed, commercial mortgage-backed and residential mortgage-backed securities are shown separately in the table above, as they are not due at a single maturity date.

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## PRUDENTIAL FINANCIAL, INC.

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

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

|  | Three Months Ended <br> September 30, <br> $\mathbf{2 0 1 1}$ <br> (in millions) | Nine Months Ended <br> September 30, <br> 2012 |
| :--- | :---: | :---: | :---: | :---: | :---: |
| 2011 |  |  |

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

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

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## PRUDENTIAL FINANCIAL, INC.

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

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

|  | Three Months Ended September 30, 2012 | Nin | Ended <br> r 30, |
| :---: | :---: | :---: | :---: |
|  | (in millions) |  |  |
| Balance, beginning of period | \$ 1,433 | \$ | 1,475 |
| Credit loss impairments previously recognized on securities which matured, paid down, prepaid or were sold during the period | (48) |  | (133) |
| Credit loss impairments previously recognized on securities impaired to fair value during the period(1) | (10) |  | (69) |
| Credit loss impairment recognized in the current period on securities not previously impaired | 1 |  | 31 |
| Additional credit loss impairments recognized in the current period on securities previously impaired | 22 |  | 80 |
| Increases due to the passage of time on previously recorded credit losses | 16 |  | 45 |
| Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected | (8) |  | (23) |
| Balance, end of period | \$ 1,406 | \$ | 1,406 |


|  | Three Months Ended September 30, 2011 | Nin | $\begin{aligned} & \text { Ended } \\ & \text { r 30, } \end{aligned}$ |
| :---: | :---: | :---: | :---: |
|  | (in millions) |  |  |
| Balance, beginning of period | \$ 1,419 | \$ | 1,493 |
| Credit loss impairments previously recognized on securities which matured, paid down, prepaid or were sold during the period | (57) |  | (294) |
| Credit loss impairments previously recognized on securities impaired to fair value during the period(1) | 0 |  | (31) |
| Credit loss impairment recognized in the current period on securities not previously impaired | 8 |  | 34 |
| Additional credit loss impairments recognized in the current period on securities previously impaired | 34 |  | 192 |
| Increases due to the passage of time on previously recorded credit losses | 16 |  | 43 |
| Accretion of credit loss impairments previously recognized due to an increase in cash flows expected to be collected | (7) |  | (24) |
| Balance, end of period | \$ 1,413 | \$ | 1,413 |

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## PRUDENTIAL FINANCIAL, INC.

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

## Trading Account Assets Supporting Insurance Liabilities

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

|  | September 30, 2012 |  | December 31, 2011(3) |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Amortized Cost | Fair Value (in | Amortized Cost ions) | Fair Value |
| Short-term investments and cash equivalents | \$ 640 | \$ 640 | \$ 951 | \$ 951 |
| Fixed maturities: |  |  |  |  |
| Corporate securities | 11,122 | 12,153 | 10,369 | 11,113 |
| Commercial mortgage-backed securities | 1,951 | 2,095 | 2,157 | 2,247 |
| Residential mortgage-backed securities(1) | 1,799 | 1,880 | 1,786 | 1,844 |
| Asset-backed securities(2) | 1,227 | 1,150 | 1,504 | 1,367 |
| Foreign government bonds | 736 | 756 | 599 | 608 |
| U.S. government authorities and agencies and obligations of U.S. states | 408 | 455 | 413 | 440 |
| Total fixed maturities | 17,243 | 18,489 | 16,828 | 17,619 |
| Equity securities | 1,029 | 1,003 | 1,050 | 911 |
| Total trading account assets supporting insurance liabilities | \$ 18,912 | \$ 20,132 | \$ 18,829 | \$ 19,481 |

(1) Includes publicly-traded agency pass-through securities and collateralized mortgage obligations.
(2) Includes credit tranched securities collateralized by sub-prime mortgages, auto loans, credit cards, education loans and other asset types.
(3) Prior period $s$ amounts are presented on a basis consistent with the current period presentation.

The net change in unrealized gains and losses from trading account assets supporting insurance liabilities still held at period end, recorded within Asset management fees and other income included $\$ 288$ million and $\$ 12$ million of gains during the three months ended September 30, 2012 and 2011, respectively, and $\$ 568$ million and $\$ 120$ million of gains during the nine months ended September 30, 2012 and 2011, respectively.

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## PRUDENTIAL FINANCIAL, INC.

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

## Other Trading Account Assets

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

|  | September 30, 2012 |  | December 31, 2011 |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Amortized Cost | Fair Value (in | Amortized Cost ions) | Fair Value |
| Short-term investments and cash equivalents | \$ 83 | \$ 85 | \$ 4 | \$ 3 |
| Fixed maturities: |  |  |  |  |
| Asset-backed securities | 416 | 314 | 698 | 652 |
| Residential mortgage-backed securities | 0 | 0 | 186 | 96 |
| Corporate securities | 670 | 675 | 557 | 555 |
| Commercial mortgage-backed securities | 121 | 91 | 155 | 110 |
| U.S. government authorities and agencies and obligations of U.S. states | 34 | 21 | 41 | 31 |
| Foreign government bonds | 52 | 52 | 47 | 47 |
| Total fixed maturities | 1,293 | 1,153 | 1,684 | 1,491 |
| Other | 1 | 4 | 15 | 19 |
| Equity securities | 1,524 | 1,557 | 1,682 | 1,621 |
| Subtotal | \$ 2,901 | \$ 2,799 | \$ 3,385 | \$ 3,134 |
| Derivative instruments |  | 3,075 |  | 2,411 |
| Total other trading account assets | \$ 2,901 | \$ 5,874 | \$ 3,385 | \$ 5,545 |

The net change in unrealized gains and losses from other trading account assets, excluding derivative instruments, still held at period end, recorded within Asset management fees and other income included $\$ 62$ million of gains and $\$ 126$ million of losses during the three months ended September 30, 2012 and 2011, respectively, and $\$ 149$ million of gains and $\$ 23$ million of losses during the nine months ended September 30, 2012 and 2011, respectively.

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## PRUDENTIAL FINANCIAL, INC.

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

## Concentrations of Financial Instruments

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

As of September 30, 2012 and December 31, 2011, the Company s exposure to concentrations of credit risk of single issuers greater than $10 \%$ of the Company s stockholders equity included securities of the U.S. government, certain U.S. government agencies and certain securities guaranteed by the U.S. government, as well as the securities disclosed below.

|  | September 30, 2012 <br> Amortized <br> Cost | Dair <br> Value <br> (in millions) | December 31, 2011 <br> Amortized <br> Cost | Fair <br> Value |
| :--- | ---: | ---: | ---: | ---: |
| Investments in Japanese government and government agency securities: | $\$ 65,817$ | $\$ 70,647$ | $\$ 60,323$ | $\$ 63,846$ |
| Fixed maturities, available-for-sale | 1,242 | 1,382 | 1,260 | 1,388 |
| Fixed maturities, held-to-maturity | 552 | 569 | 471 | 483 |
| Trading account assets supporting insurance liabilities | 41 | 41 | 40 | 40 |
| Other trading account assets | 0 | 0 | 0 | 0 |
| Short-term investments | 2,316 | 2,316 | 0 | 0 |
| Cash equivalents | $\$ 69,968$ | $\$ 74,955$ | $\$ 62,094$ | $\$ 65,757$ |
| Total |  |  |  | 0 |


|  | September 30, 2012 <br> Amortized <br> Cost <br> Vair <br> Value <br> (in millions) | December 31, 2011 <br> Cost | Fair <br> Value |  |
| :--- | ---: | ---: | ---: | ---: |
| Investments in South Korean government and government agency securities: | $\$ 5,405$ | $\$ 6,618$ | $\$ 4,678$ | $\$ 5,240$ |
| Fixed maturities, available-for-sale | 0 | 0 | 0 | 0 |
| Fixed maturities, held-to-maturity | 0 | 0 | 17 | 18 |
| Trading account assets supporting insurance liabilities | 2 | 2 | 2 | 2 |
| Other trading account assets | 0 | 0 | 0 | 0 |
| Short-term investments | 0 | 0 | 0 | 0 |
| Cash equivalents |  |  |  |  |
|  | $\$ 5,407$ | $\$ 6,620$ | $\$ 4,697$ | $\$ 5,260$ |

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## PRUDENTIAL FINANCIAL, INC.

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

## Commercial Mortgage and Other Loans

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

|  | September 30, 2012 |  |  | December 31, 2011 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | $\begin{gathered} \text { Amount } \\ \text { (in millions) } \end{gathered}$ |  | $\begin{gathered} \% \text { of } \\ \text { Total } \end{gathered}$ | Amount (in millions) |  | \% of Total |
| Commercial and agricultural mortgage loans by property type: |  |  |  |  |  |  |
| Office |  | 6,655 | 19.5\% | \$ | 6,391 | 19.8\% |
| Retail |  | 8,182 | 24.0 |  | 7,309 | 22.7 |
| Apartments/Multi-Family |  | 5,312 | 15.5 |  | 5,277 | 16.4 |
| Industrial |  | 7,493 | 21.9 |  | 7,049 | 21.8 |
| Hospitality |  | 1,509 | 4.4 |  | 1,486 | 4.6 |
| Other |  | 2,827 | 8.3 |  | 2,707 | 8.4 |
| Total commercial mortgage loans |  | 31,978 | 93.6 |  | 30,219 | 93.7 |
| Agricultural property loans |  | 2,169 | 6.4 |  | 2,046 | 6.3 |
| Total commercial and agricultural mortgage loans by property type |  | 34,147 | 100.0\% |  | 32,265 | 100.0\% |
| Valuation allowance |  | (274) |  |  | (313) |  |
| Total net commercial and agricultural mortgage loans by property type |  | 33,873 |  |  | 31,952 |  |


| Other loans |  |  |
| :--- | :---: | :---: |
| Uncollateralized loans | 1,939 | 2,323 |
| Residential property loans | 901 | 1,034 |
| Other collateralized loans | 151 | 176 |
| Total other loans | 2,991 | 3,533 |
| Valuation allowance | $(42)$ | $(54)$ |
| Total net other loans | 2,949 | 3,479 |
| Total commercial mortgage and other loans $(1)$ | $\$ 36,822$ | $\$ 35,431$ |

(1) Includes loans held at fair value.

The commercial mortgage and agricultural property loans are geographically dispersed throughout the United States, Canada and Asia with the largest concentrations in California (26\%), New York (11\%) and Texas (8\%) at September 30, 2012.

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

|  | Commercial <br> Mortgage <br> Loans | Agricultural <br> Property <br> Loans | September 30, 2012 <br> Residential <br> Property <br> Loans | Other <br> Collateralized <br> Loans | Uncollateralized <br> Loans | Total |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |

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## PRUDENTIAL FINANCIAL, INC.

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

|  | Commercial <br> Mortgage <br> Loans | Agricultural <br> Property <br> Loans | December 31, 2011 <br> Other <br> Property <br> Loans | Collateralized <br> Loans | Uncollateralized <br> Loans | Total |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |

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

|  | Commercial <br> Mortgage <br> Loans | Agricultural <br> Property <br> Loans | September 30, 2012 <br> Residential <br> Property <br> Loans | Cother <br> Collateralized <br> Loans | Uncollateralized <br> Loans | Total |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |

Recorded Investment:(1)

| Ending balance gross of reserves: individually evaluated for impairment | 1,260 | \$ | 49 | \$ | 0 | \$ | 98 | \$ | 8 | \$ | 1,415 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Ending balance gross of reserves: collectively evaluated for impairment | 30,718 |  | 2,120 |  | 901 |  | 53 |  | 1,931 |  | 35,723 |
| Ending balance gross of reserves: loans acquired with deteriorated credit quality | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Total ending balance, gross of reserves | \$ 31,978 | \$ | 2,169 | \$ | 901 | \$ | 151 | \$ | 1,939 |  | 37,138 |

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## PRUDENTIAL FINANCIAL, INC.

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

|  | Commercial <br> Mortgage Loans |  | Agricultural Property Loans |  | December 31, 2011  <br> Residential Other <br> Property Collateralized <br> Loans Loans <br>  (in millions) |  |  |  | Uncollateralized Loans |  | Total |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Allowance for Credit Losses: |  |  |  |  |  |  |  |  |  |  |  |  |
| Ending balance: individually evaluated for impairment | \$ | 120 | \$ | 11 | \$ | 0 | \$ | 18 | \$ | 0 | \$ | 149 |
| Ending balance: collectively evaluated for impairment |  | 174 |  | 8 |  | 16 |  | 0 |  | 20 |  | 218 |
| Ending balance: loans acquired with deteriorated credit quality |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Total ending balance | \$ | 294 | \$ | 19 | \$ | 16 | \$ | 18 | \$ | 20 | \$ | 367 |
| Recorded Investment:(1) |  |  |  |  |  |  |  |  |  |  |  |  |
| Ending balance gross of reserves: individually evaluated for impairment | \$ | 1,903 | \$ | 45 | \$ | 0 | \$ | 110 | \$ | 92 | \$ | 2,150 |
| Ending balance gross of reserves: collectively evaluated for impairment |  | 28,316 |  | 2,001 |  | 1,034 |  | 66 |  | 2,231 |  | 33,648 |
| Ending balance gross of reserves: loans acquired with deteriorated credit quality |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Total ending balance, gross of reserves |  | 30,219 | \$ | 2,046 | \$ | 1,034 | \$ | 176 | \$ | 2,323 |  | 35,798 |

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

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## PRUDENTIAL FINANCIAL, INC.

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

Impaired loans include those loans for which it is probable that all amounts due will not be collected according to the contractual terms of the loan agreement. Impaired commercial mortgage and other loans identified in management s specific review of probable loan losses and the related allowance for losses, as of the dates indicated are as follows:
$\left.\begin{array}{lcccccc} \\ & & & \text { As of September 30, 2012 } \\ \text { Average } \\ \text { Recorded } \\ \text { Investment } \\ \text { Before }\end{array}\right)$

| Total with related allowance | \$ 337 | \$ | 341 | \$ | 113 | \$ | 428 | \$ | 10 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Total: |  |  |  |  |  |  |  |  |  |
| Commercial mortgage loans(4) | \$ 341 | \$ | 491 | \$ | 89 | \$ | 454 | \$ | 14 |
| Agricultural property loans | 17 |  | 17 |  | 12 |  | 16 |  | 0 |
| Residential property loans | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Other collateralized loans | 18 |  | 18 |  | 12 |  | 20 |  | 0 |
| Uncollateralized loans | 5 |  | 13 |  | 0 |  | 5 |  | 0 |
| Total | \$ 381 | \$ | 539 | \$ | 113 | \$ | 495 | \$ | 14 |

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## PRUDENTIAL FINANCIAL, INC.

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

(1) Recorded investment reflects the balance sheet carrying value gross of related allowance.
(2) Average recorded investment represents the average of the beginning-of-period and all subsequent quarterly end-of-period balances.
(3) The interest income recognized is for the year-to-date income regardless of when the impairments occurred.
(4) Includes the impact of loans acquired from the Star Business for which the balance sheet carrying value had been previously written down.

|  | As of December 31, 2011 |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Recorded Investment(1) | Unpaid Principal Balance |  | $\begin{aligned} & \text { Related } \\ & \text { Allowance } \\ & \quad \text { (in millions) } \end{aligned}$ |  | Average Recorded Investment Before Allowance(2) |  | InterestIncomeRecognized(3) |  |
| With no related allowance recorded: |  |  |  |  |  |  |  |  |  |
| Commercial mortgage loans: |  |  |  |  |  |  |  |  |  |
| Industrial | \$ 0 | \$ | 0 | \$ | 0 | \$ | 0 | \$ | 0 |
| Retail | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Office(4) | 2 |  | 84 |  | 0 |  | 1 |  | 0 |
| Apartments/Multi-Family | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Hospitality | 0 |  | 0 |  | 0 |  | 23 |  | 0 |
| Other | 17 |  | 17 |  | 0 |  | 11 |  | 1 |
| Total commercial mortgage loans | 19 |  | 101 |  | 0 |  | 35 |  | 1 |


| Agricultural property loans | 0 | 0 | 0 | 0 |
| :--- | :--- | :--- | :--- | :--- |
| Residential property loans | 0 | 0 | 0 | 0 |
| Other collateralized loans | 0 | 0 | 0 | 0 |
| Uncollateralized loans | 6 | 13 | 0 | 0 |
|  |  |  | 0 | 0 |
| Total with no related allowance | $\$ 25$ | $\$ 114$ | $\$$ | 0 |

With an allowance recorded:
Commercial mortgage loans:

| Industrial | \$ 54 | \$ | 54 | \$ | 19 | \$ | 36 | \$ | 1 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Retail | 89 |  | 89 |  | 11 |  | 114 |  | 3 |
| Office | 47 |  | 47 |  | 3 |  | 49 |  | 0 |
| Apartments/Multi-Family | 102 |  | 102 |  | 19 |  | 197 |  | 4 |
| Hospitality | 129 |  | 129 |  | 55 |  | 178 |  | 0 |
| Other | 92 |  | 92 |  | 13 |  | 100 |  | 2 |
| Total commercial mortgage loans | 513 |  | 513 |  | 120 |  | 674 |  | 10 |
| Agricultural property loans | 19 |  | 19 |  | 11 |  | 14 |  | 0 |
| Residential property loans | 0 |  | 0 |  | 0 |  | 5 |  | 0 |
| Other collateralized loans | 21 |  | 21 |  | 18 |  | 31 |  | 2 |

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| Uncollateralized loans | 0 |  | 0 |  | 0 |  | 13 |  | 0 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Total with related allowance | \$ 553 | \$ | 553 | \$ | 149 | \$ | 737 | \$ | 12 |
| Total: |  |  |  |  |  |  |  |  |  |
| Commercial mortgage loans(4) | \$ 532 | \$ | 614 | \$ | 120 | \$ | 709 | \$ | 11 |
| Agricultural property loans | 19 |  | 19 |  | 11 |  | 15 |  | 0 |
| Residential property loans | 0 |  | 0 |  | 0 |  | 5 |  | 0 |
| Other collateralized loans | 21 |  | 21 |  | 18 |  | 31 |  | 2 |
| Uncollateralized loans | 6 |  | 13 |  | 0 |  | 19 |  | 0 |
| Total | \$ 578 | \$ | 667 | \$ | 149 | \$ | 779 | \$ | 13 |

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## PRUDENTIAL FINANCIAL, INC.

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

(1) Recorded investment reflects the balance sheet carrying value gross of related allowance.
(2) Average recorded investment represents the average of the beginning-of-period and all subsequent quarterly end-of-period balances.
(3) The interest income recognized is for the year-to-date income regardless of when the impairments occurred.
(4) Includes the impact of loans acquired from the Star Business for which the balance sheet carrying value had been previously written down.

The net carrying value of commercial and other loans held for sale by the Company as of September 30, 2012 and December 31, 2011 was $\$ 180$ million and $\$ 514$ million, respectively. In all of these transactions, the Company pre-arranges that it will sell the loan to an investor. As of September 30, 2012 and December 31, 2011, all of the Company s commercial and other loans held for sale were collateralized, with collateral primarily consisting of office buildings, retail properties, apartment complexes and industrial buildings.

The following tables set forth the credit quality indicators as of September 30, 2012, based upon the recorded investment gross of allowance for credit losses.

## Commercial mortgage loans Industrial

|  | $\begin{aligned} & \text { Greater than } \\ & 2.0 \mathrm{X} \end{aligned}$ |  | Debt Service Coverage Ratio September 30, 2012 |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | 1.8X to 2.0X |  | 1.5X to <1.8X |  | $\text { 1.2X to }<1.5 \mathrm{X}$ <br> (in millions) |  | 1.0X to <1.2X |  | $\begin{gathered} \text { Less than } \\ 1.0 \mathrm{X} \end{gathered}$ |  | Total |
| Loan-to-Value Ratio |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 0\%-49.99\% | \$ |  | \$ | 208 | \$ | 209 | \$ | 263 | \$ | 22 | \$ | 31 | \$ 1,475 |
| 50\%-59.99\% |  | 530 |  | 86 |  | 259 |  | 413 |  | 34 |  | 92 | 1,414 |
| 60\%-69.99\% |  | 653 |  | 145 |  | 272 |  | 546 |  | 405 |  | 94 | 2,115 |
| 70\%-79.99\% |  | 425 |  | 429 |  | 329 |  | 180 |  | 217 |  | 152 | 1,732 |
| 80\%-89.99\% |  | 0 |  | 0 |  | 19 |  | 106 |  | 150 |  | 296 | 571 |
| 90\%-100\% |  | 0 |  | 0 |  | 0 |  | 0 |  | 17 |  | 121 | 138 |
| Greater than 100\% |  | 0 |  | 0 |  | 0 |  | 16 |  | 6 |  | 26 | 48 |
| Total Industrial |  | 2,350 | \$ | 868 | \$ | 1,088 | \$ | 1,524 | \$ | 851 | \$ | 812 | \$ 7,493 |

## Commercial mortgage loans Retail

Debt Service Coverage Ratio September 30, 2012

| Greater than |  |  |  |  | Less than |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| 2.0X | 1.8X to 2.0X | 1.5X to $<1.8 \mathrm{X}$ | 1.2X to $<1.5 \mathrm{X}$ | 1.0X to <1.2X | 1.0X | Total |


| Loan-to-Value Ratio | (in millions) |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Loan-to-Value Ratio |  |  |  |  |  |  |  |  |  |  |  |
| 0\%-49.99\% | \$ 1,313 | \$ | 657 | \$ | 221 | \$ | 157 | \$ | 37 | \$ | 4 | \$ 2,389 |
| 50\%-59.99\% | 634 |  | 673 |  | 316 |  | 119 |  | 27 |  | 12 | 1,781 |
| 60\%-69.99\% | 1,268 |  | 463 |  | 914 |  | 430 |  | 54 |  | 21 | 3,150 |
| 70\%-79.99\% | 0 |  | 0 |  | 120 |  | 479 |  | 14 |  | 19 | 632 |
| 80\%-89.99\% | 0 |  | 0 |  | 0 |  | 23 |  | 52 |  | 2 | 77 |
| 90\%-100\% | 0 |  | 0 |  | 0 |  | 27 |  | 13 |  | 33 | 73 |
| Greater than $100 \%$ | 0 |  | 0 |  | 0 |  | 43 |  | 0 |  | 37 | 80 |
| Total Retail | \$ 3,215 | \$ | 1,793 | \$ | 1,571 | \$ | 1,278 | \$ | 197 | \$ | 128 | \$8,182 |

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## PRUDENTIAL FINANCIAL, INC.

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

## Commercial mortgage loans Office

|  | Greater than 2.0X | 1.8X to 2.0X |  | Debt Service Coverage Ratio September 30, 2012 |  |  |  |  |  | $\begin{gathered} \text { Less than } \\ 1.0 X \end{gathered}$ |  | Total |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  | 1.5 X to $<1.8 \mathrm{X}$ |  | $\text { 1.2X to }<1.5 \mathrm{X}$ <br> (in millions) |  | 1.0X to <1.2X |  |  |  |  |
| Loan-to-Value Ratio |  |  |  |  |  |  |  |  |  |  |  |  |
| 0\%-49.99\% | \$ 1,790 | \$ | 405 | \$ | 363 | \$ | 93 | \$ | 52 | \$ | 23 | \$ 2,726 |
| 50\%-59.99\% | 604 |  | 61 |  | 404 |  | 71 |  | 12 |  | 64 | 1,216 |
| 60\%-69.99\% | 930 |  | 389 |  | 207 |  | 319 |  | 82 |  | 9 | 1,936 |
| 70\%-79.99\% | 169 |  | 0 |  | 0 |  | 20 |  | 256 |  | 22 | 467 |
| 80\%-89.99\% | 20 |  | 0 |  | 0 |  | 128 |  | 41 |  | 79 | 268 |
| 90\%-100\% | 0 |  | 0 |  | 0 |  | 0 |  | 15 |  | 21 | 36 |
| Greater than 100\% | 0 |  | 0 |  | 0 |  | 0 |  | 1 |  | 5 | 6 |
| Total Office | \$ 3,513 | \$ | 855 | \$ | 974 | \$ | 631 | \$ | 459 | \$ | 223 | \$ 6,655 |

## Commercial mortgage loans Apartments/Multi-Family

|  | $\begin{aligned} & \text { Greater than } \\ & \text { 2.0X } \end{aligned}$ |  | Debt Service Coverage Ratio September 30, 2012 |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | 1.8X to 2.0X |  | 1.5X to <1.8X |  | $\text { 1.2X to }<1.5 X$ <br> (in millions) |  | 1.0X to <1.2X |  | $\begin{gathered} \text { Less than } \\ 1.0 X \end{gathered}$ |  | Total |
| Loan-to-Value Ratio |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 0\%-49.99\% | \$ | 810 | \$ | 259 | \$ | 263 | \$ | 327 | \$ | 104 | \$ | 29 | \$ 1,792 |
| 50\%-59.99\% |  | 269 |  | 90 |  | 171 |  | 190 |  | 28 |  | 19 | 767 |
| 60\%-69.99\% |  | 507 |  | 0 |  | 271 |  | 402 |  | 115 |  | 16 | 1,311 |
| 70\%-79.99\% |  | 344 |  | 47 |  | 267 |  | 374 |  | 113 |  | 0 | 1,145 |
| 80\%-89.99\% |  | 0 |  | 0 |  | 0 |  | 0 |  | 152 |  | 52 | 204 |
| 90\%-100\% |  | 0 |  | 0 |  | 0 |  | 15 |  | 2 |  | 23 | 40 |
| Greater than 100\% |  | 0 |  | 0 |  | 0 |  | 18 |  | 0 |  | 35 | 53 |
| Total Apartments/Multi-Family |  | 1,930 | \$ | 396 | \$ | 972 | \$ | 1,326 | \$ | 514 | \$ | 174 | \$ 5,312 |

## Commercial mortgage loans Hospitality

|  | Debt Service Coverage Ratio September 30, 2012 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Greater than 2.0X | 1.8X to 2.0X | 1.5 X to $<1.8 \mathrm{X}$ | 1.2X to $<1.5 \mathrm{X}$ | 1.0X to <1.2X | Less than |


| Loan-to-Value Ratio | (in millions) |  |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Loan-to-Value Ratio |  |  |  |  |  |  |  |  |  |  |  |  |
| 0\%-49.99\% | \$ 312 | \$ | 117 | \$ | 67 | \$ | 0 | \$ | 60 | \$ | 0 | \$ | 556 |
| 50\%-59.99\% | 150 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 150 |
| 60\%-69.99\% | 73 |  | 48 |  | 24 |  | 263 |  | 11 |  | 0 |  | 419 |
| 70\%-79.99\% | 0 |  | 0 |  | 0 |  | 150 |  | 0 |  | 0 |  | 150 |
| 80\%-89.99\% | 0 |  | 0 |  | 0 |  | 21 |  | 0 |  | 60 |  | 81 |
| 90\%-100\% | 0 |  | 0 |  | 68 |  | 2 |  | 0 |  | 13 |  | 83 |
| Greater than 100\% | 0 |  | 0 |  | 0 |  | 0 |  | 10 |  | 60 |  | 70 |
| Total Hospitality | \$ 535 | \$ | 165 | \$ | 159 | \$ | 436 | \$ | 81 | \$ | 133 |  | 1,509 |

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## PRUDENTIAL FINANCIAL, INC.

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

## Commercial mortgage loans Other

|  | Greater than 2.0X | Debt Service Coverage Ratio September 30, 2012 |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | 1.8X to 2.0X |  | 1.5X to <1.8X |  | $\begin{aligned} & 1.2 \mathrm{X} \text { to }<1.5 \mathrm{X} \\ & \text { (in millions) } \end{aligned}$ |  | 1.0X to <1.2X |  | $\begin{aligned} & \text { Less than } \\ & \text { 1.0X } \end{aligned}$ |  | Total |
| Loan-to-Value Ratio |  |  |  |  |  |  |  |  |  |  |  |  |
| 0\%-49.99\% | \$ 264 | \$ | 0 | \$ | 91 | \$ | 23 | \$ | 4 | \$ | 0 | \$ 382 |
| 50\%-59.99\% | 171 |  | 274 |  | 233 |  | 71 |  | 9 |  | 0 | 758 |
| 60\%-69.99\% | 252 |  | 111 |  | 321 |  | 296 |  | 66 |  | 0 | 1,046 |
| 70\%-79.99\% | 283 |  | 48 |  | 0 |  | 98 |  | 12 |  | 0 | 441 |
| 80\%-89.99\% | 0 |  | 0 |  | 0 |  | 60 |  | 0 |  | 6 | 66 |
| 90\%-100\% | 0 |  | 0 |  | 0 |  | 0 |  | 16 |  | 52 | 68 |
| Greater than 100\% | 0 |  | 0 |  | 19 |  | 12 |  | 3 |  | 32 | 66 |
| Total Other | \$ 970 | \$ | 433 | \$ | 664 | \$ | 560 | \$ | 110 | \$ | 90 | \$ 2,827 |

## Commercial mortgage loans Agricultural Properties

|  | $\begin{aligned} & \text { Greater than } \\ & \text { 2.0X } \end{aligned}$ | Debt Service Coverage Ratio September 30, 2012 |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | 1.8X to 2.0X |  | 1.5X to <1.8X |  | $\begin{gathered} 1.2 \mathrm{X} \text { to }<1.5 \mathrm{X} \\ \text { (in millions) } \end{gathered}$ |  | 1.0X to <1.2X |  | $\begin{aligned} & \text { Less than } \\ & 1.0 \mathrm{X} \end{aligned}$ |  | Total |
| Loan-to-Value Ratio |  |  |  |  |  |  |  |  |  |  |  |  |
| 0\%-49.99\% | \$ 517 | \$ | 184 | \$ | 299 | \$ | 406 | \$ | 149 | \$ | 2 | \$ 1,557 |
| 50\%-59.99\% | 58 |  | 15 |  | 140 |  | 33 |  | 0 |  | 0 | 246 |
| 60\%-69.99\% | 139 |  | 6 |  | 177 |  | 0 |  | 0 |  | 0 | 322 |
| 70\%-79.99\% | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 | 0 |
| 80\%-89.99\% | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 44 | 44 |
| 90\%-100\% | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 | 0 |
| Greater than 100\% | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 | 0 |
| Total Agricultural | \$ 714 | \$ | 205 | \$ | 616 | \$ | 439 | \$ | 149 | \$ | 46 | \$ 2,169 |

Commercial mortgage and agricultural loans

Debt Service Coverage Ratio September 30, 2012

| Greater than |  |  |  | Less than |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| 2.0X | 1.8 X to 2.0 X | 1.5 X to $<1.8 \mathrm{X}$ | 1.2 X to $<1.5 \mathrm{X}$ | 1.0 X to $<1.2 \mathrm{X}$ | 1.0 X | Total |


| Loan-to-Value Ratio (in millions) |  |  |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 0\%-49.99\% | \$ | 5,748 | \$ | 1,830 | \$ | 1,513 | \$ | 1,269 | \$ | 428 | \$ | 89 | \$ 10,877 |
| 50\%-59.99\% |  | 2,416 |  | 1,199 |  | 1,523 |  | 897 |  | 110 |  | 187 | 6,332 |
| 60\%-69.99\% |  | 3,822 |  | 1,162 |  | 2,186 |  | 2,256 |  | 733 |  | 140 | 10,299 |
| 70\%-79.99\% |  | 1,221 |  | 524 |  | 716 |  | 1,301 |  | 612 |  | 193 | 4,567 |
| 80\%-89.99\% |  | 20 |  | 0 |  | 19 |  | 338 |  | 395 |  | 539 | 1,311 |
| 90\%-100\% |  | 0 |  | 0 |  | 68 |  | 44 |  | 63 |  | 263 | 438 |
| Greater than 100\% |  | 0 |  | 0 |  | 19 |  | 89 |  | 20 |  | 195 | 323 |
| Total Commercial Mortgage and Agricultural |  | 13,227 | \$ | 4,715 | \$ | 6,044 | \$ | 6,194 | \$ | 2,361 | \$ | 1,606 | \$ 34,147 |

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## PRUDENTIAL FINANCIAL, INC.

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

The following tables set forth the credit quality indicators as of December 31, 2011, based upon the recorded investment gross of allowance for credit losses.

## Commercial mortgage loans Industrial

|  | Greater than 2.0X |  | Debt Service Coverage Ratio December 31, 2011 |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | 1.8X to 2.0X |  | 1.5X to <1.8X |  | $\text { 1.2X to }<1.5 \mathrm{X}$ <br> (in millions) |  | 1.0X to <1.2X |  | $\begin{aligned} & \text { Less than } \\ & \text { 1.0X } \end{aligned}$ |  | Total |
| Loan-to-Value Ratio |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 0\%-49.99\% | \$ |  | \$ | 311 | \$ | 211 | \$ | 254 | \$ | 19 | \$ | 48 | \$ 1,470 |
| 50\%-59.99\% |  | 299 |  | 86 |  | 315 |  | 246 |  | 73 |  | 46 | 1,065 |
| 60\%-69.99\% |  | 922 |  | 287 |  | 380 |  | 308 |  | 373 |  | 105 | 2,375 |
| 70\%-79.99\% |  | 175 |  | 86 |  | 136 |  | 448 |  | 402 |  | 95 | 1,342 |
| 80\%-89.99\% |  | 0 |  | 0 |  | 0 |  | 106 |  | 114 |  | 236 | 456 |
| 90\%-100\% |  | 19 |  | 0 |  | 0 |  | 0 |  | 0 |  | 162 | 181 |
| Greater than 100\% |  | 16 |  | 0 |  | 0 |  | 0 |  | 19 |  | 125 | 160 |
| Total Industrial |  | 2,058 | \$ | 770 | \$ | 1,042 | \$ | 1,362 | \$ | 1,000 | \$ | 817 | \$7,049 |

## Commercial mortgage loans Retail

|  | Greater than 2.0X | 1.8X to 2.0X |  | Debt Service Coverage Ratio December 31, 2011 |  |  |  |  |  | $\begin{aligned} & \text { Less than } \\ & \text { 1.0X } \end{aligned}$ |  | Total |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  | 1.5X to <1.8X |  | $\begin{aligned} & 1.2 \mathrm{X} \text { to }<1.5 \mathrm{X} \\ & \text { (in millions) } \end{aligned}$ |  | 1.0X to <1.2X |  |  |  |  |
| Loan-to-Value Ratio |  |  |  |  |  |  |  |  |  |  |  |  |
| 0\%-49.99\% | \$ 1,188 | \$ | 251 | \$ | 523 | \$ | 87 | \$ | 18 | \$ | 3 | \$ 2,070 |
| 50\%-59.99\% | 627 |  | 507 |  | 590 |  | 54 |  | 48 |  | 3 | 1,829 |
| 60\%-69.99\% | 351 |  | 539 |  | 739 |  | 485 |  | 82 |  | 17 | 2,213 |
| 70\%-79.99\% | 0 |  | 47 |  | 289 |  | 608 |  | 18 |  | 0 | 962 |
| 80\%-89.99\% | 0 |  | 31 |  | 0 |  | 9 |  | 17 |  | 23 | 80 |
| 90\%-100\% | 0 |  | 0 |  | 18 |  | 14 |  | 16 |  | 40 | 88 |
| Greater than 100\% | 0 |  | 0 |  | 0 |  | 21 |  | 46 |  | 0 | 67 |
| Total Retail | \$ 2,166 | \$ | 1,375 | \$ | 2,159 | \$ | 1,278 | \$ | 245 | \$ | 86 | \$7,309 |

Commercial mortgage loans Office

|  | $\begin{aligned} & \text { Greater than } \\ & \text { 2.0X } \end{aligned}$ | Debt Service Coverage Ratio December 31, 2011 |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | 1.8X to 2.0X |  | 1.5X to <1.8X |  | 1.2X to $<1.5 \mathrm{X}$ (in millions) |  | 1.0X to <1.2X |  | $\begin{aligned} & \text { Less than } \\ & \text { 1.0X } \end{aligned}$ |  | Total |
| Loan-to-Value Ratio |  |  |  |  |  |  |  |  |  |  |  |  |
| 0\%-49.99\% | \$ 1,756 | \$ | 365 | \$ | 181 | \$ | 132 | \$ | 23 | \$ | 31 | \$ 2,488 |
| 50\%-59.99\% | 572 |  | 106 |  | 210 |  | 198 |  | 16 |  | 9 | 1,111 |
| 60\%-69.99\% | 612 |  | 412 |  | 79 |  | 460 |  | 61 |  | 38 | 1,662 |
| 70\%-79.99\% | 65 |  | 0 |  | 31 |  | 15 |  | 618 |  | 15 | 744 |
| 80\%-89.99\% | 0 |  | 0 |  | 0 |  | 138 |  | 52 |  | 54 | 244 |
| 90\%-100\% | 0 |  | 0 |  | 16 |  | 0 |  | 0 |  | 18 | 34 |
| Greater than $100 \%$ | 0 |  | 0 |  | 17 |  | 71 |  | 8 |  | 12 | 108 |
| Total Office | \$ 3,005 | \$ | 883 | \$ | 534 | \$ | 1,014 | \$ | 778 | \$ | 177 | \$ 6,391 |

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## PRUDENTIAL FINANCIAL, INC.

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

## Commercial mortgage loans Apartments/Multi-Family

|  | Greater than 2.0X | Debt Service Coverage Ratio December 31, 2011 |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | 1.8X to 2.0X |  | 1.5X to $<1.8 \mathrm{X}$ |  | $\begin{aligned} & 1.2 \mathrm{X} \text { to }<1.5 \mathrm{X} \\ & \text { (in millions) } \end{aligned}$ |  | 1.0X to <1.2X |  | $\begin{aligned} & \text { Less than } \\ & \text { 1.0X } \end{aligned}$ |  | Total |
| Loan-to-Value Ratio |  |  |  |  |  |  |  |  |  |  |  |  |
| 0\%-49.99\% | \$ 726 | \$ | 176 | \$ | 272 | \$ | 172 | \$ | 215 | \$ | 61 | \$ 1,622 |
| 50\%-59.99\% | 95 |  | 16 |  | 257 |  | 156 |  | 59 |  | 31 | 614 |
| 60\%-69.99\% | 425 |  | 18 |  | 341 |  | 356 |  | 76 |  | 88 | 1,304 |
| 70\%-79.99\% | 107 |  | 99 |  | 146 |  | 729 |  | 130 |  | 47 | 1,258 |
| 80\%-89.99\% | 0 |  | 15 |  | 0 |  | 107 |  | 0 |  | 52 | 174 |
| 90\%-100\% | 0 |  | 0 |  | 13 |  | 16 |  | 2 |  | 77 | 108 |
| Greater than 100\% | 0 |  | 0 |  | 0 |  | 36 |  | 21 |  | 140 | 197 |
| Total Apartments/Multi-Family | \$ 1,353 | \$ | 324 | \$ | 1,029 | \$ | 1,572 | \$ | 503 | \$ | 496 | \$ 5,277 |

## Commercial mortgage loans Hospitality

|  | $\begin{aligned} & \text { Greater than } \\ & \text { 2.0X } \end{aligned}$ | Debt Service Coverage Ratio December 31, 2011 |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | 1.8X to 2.0X |  | 1.5X to <1.8X |  | $\begin{gathered} \text { 1.2X to }<1.5 \mathrm{X} \\ \text { (in millions) } \end{gathered}$ |  | 1.0X to <1.2X |  | $\begin{aligned} & \text { Less than } \\ & 1.0 \mathrm{X} \end{aligned}$ |  | Total |  |
| Loan-to-Value Ratio |  |  |  |  |  |  |  |  |  |  |  |  |  |
| 0\%-49.99\% | \$ 143 | \$ | 158 | \$ | 0 | \$ | 115 | \$ | 22 | \$ | 0 | \$ | 438 |
| 50\%-59.99\% | 51 |  | 0 |  | 0 |  | 9 |  | 57 |  | 0 |  | 117 |
| 60\%-69.99\% | 0 |  | 6 |  | 45 |  | 350 |  | 11 |  | 0 |  | 412 |
| 70\%-79.99\% | 6 |  | 0 |  | 0 |  | 0 |  | 117 |  | 61 |  | 184 |
| 80\%-89.99\% | 0 |  | 0 |  | 77 |  | 49 |  | 37 |  | 36 |  | 199 |
| 90\%-100\% | 0 |  | 0 |  | 19 |  | 0 |  | 21 |  | 15 |  | 55 |
| Greater than $100 \%$ | 0 |  | 0 |  | 0 |  | 0 |  | 2 |  | 79 |  | 81 |
| Total Hospitality | \$ 200 | \$ | 164 | \$ | 141 | \$ | 523 | \$ | 267 | \$ | 191 |  | ,486 |

## Commercial mortgage loans Other

| Greater than | Debt Service Coverage Ratio December 31, 2011 |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  |  | Less than |  |
| 2.0X | 1.8X to 2.0X | 1.5X to $<1.8 \mathrm{X}$ | 1.2 X to $<1.5 \mathrm{X}$ | 1.0X to $<1.2 \mathrm{X}$ | 1.0X | Total |


| Loan-to-Value Ratio | (in millions) |  |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Loan-to-Value Ratio |  |  |  |  |  |  |  |  |  |  |  |  |
| 0\%-49.99\% | \$ 333 | \$ | 31 | \$ | 6 | \$ | 74 | \$ | 1 | \$ | 1 | \$ | 446 |
| 50\%-59.99\% | 50 |  | 185 |  | 20 |  | 7 |  | 0 |  | 0 |  | 262 |
| 60\%-69.99\% | 111 |  | 173 |  | 280 |  | 295 |  | 118 |  | 7 |  | 984 |
| 70\%-79.99\% | 286 |  | 0 |  | 202 |  | 286 |  | 13 |  | 0 |  | 787 |
| 80\%-89.99\% | 0 |  | 0 |  | 61 |  | 21 |  | 15 |  | 5 |  | 102 |
| 90\%-100\% | 0 |  | 19 |  | 0 |  | 0 |  | 16 |  | 15 |  | 50 |
| Greater than 100\% | 0 |  | 0 |  | 0 |  | 0 |  | 2 |  | 74 |  | 76 |
| Total Other | \$780 | \$ | 408 | \$ | 569 | \$ | 683 | \$ | 165 | \$ | 102 |  | ,707 |

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## PRUDENTIAL FINANCIAL, INC.

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

## Commercial mortgage loans Agricultural Properties

|  | Debt Service Coverage Ratio December 31, 2011 |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Greater than 2.0X | 1.8X to 2.0X |  | 1.5X to <1.8X |  | $\begin{gathered} 1.2 \mathrm{X} \text { to }<1.5 \mathrm{X} \\ \text { (in millions) } \end{gathered}$ |  | 1.0X to <1.2X |  | $\begin{aligned} & \text { Less than } \\ & \mathbf{1 . 0 x} \end{aligned}$ |  | Total |
| Loan-to-Value Ratio |  |  |  |  |  |  |  |  |  |  |  |  |
| 0\%-49.99\% | \$ 383 | \$ | 123 | \$ | 340 | \$ | 427 | \$ | 154 | \$ | 0 | \$ 1,427 |
| 50\%-59.99\% | 70 |  | 120 |  | 8 |  | 39 |  | 0 |  | 3 | 240 |
| 60\%-69.99\% | 155 |  | 5 |  | 181 |  | 0 |  | 0 |  | 0 | 341 |
| 70\%-79.99\% | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 | 0 |
| 80\%-89.99\% | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 | 0 |
| 90\%-100\% | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 38 | 38 |
| Greater than $100 \%$ | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 | 0 |
| Total Agricultural | \$ 608 | \$ | 248 | \$ | 529 | \$ | 466 | \$ | 154 | \$ | 41 | \$ 2,046 |

## Commercial mortgage and agricultural loans



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## PRUDENTIAL FINANCIAL, INC.

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

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


|  | Current |  | As of December 31, 2011 |  |  |  |  |  |  |  |  |  | Total Commercial Mortgage and Other Loans |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | $\begin{aligned} & \text { 30-59 Days } \\ & \text { Past } \\ & \text { Due } \end{aligned}$ |  | 60-89 Days <br> Past <br> Due |  | Greater <br> Than <br> 90 <br> Days - <br> Accruing <br> (in millions) |  | Greater <br> Than 90 <br> Days - Not <br> Accruing |  | Total Past Due |  |  |  |
| Commercial mortgage loans: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Industrial | \$ | 7,047 | \$ | 0 | \$ | 2 | \$ | 0 | \$ | 0 | \$ | 2 | \$ | 7,049 |
| Retail |  | 7,294 |  | 0 |  | 0 |  | 0 |  | 15 |  | 15 |  | 7,309 |
| Office |  | 6,369 |  | 5 |  | 0 |  | 0 |  | 17 |  | 22 |  | 6,391 |
| Apartments/Multi-Family |  | 5,207 |  | 0 |  | 0 |  | 0 |  | 70 |  | 70 |  | 5,277 |
| Hospitality |  | 1,486 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 1,486 |
| Other |  | 2,657 |  | 13 |  | 10 |  | 0 |  | 27 |  | 50 |  | 2,707 |
| Total commercial mortgage loans |  | 30,060 |  | 18 |  | 12 |  | 0 |  | 129 |  | 159 |  | 30,219 |
| Agricultural property loans |  | 2,005 |  | 0 |  | 1 |  | 1 |  | 39 |  | 41 |  | 2,046 |

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| Residential property loans | 988 |  | 22 |  | 6 |  | 0 |  | 18 |  | 46 |  | 1,034 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Other collateralized loans | 174 |  | 0 |  | 0 |  | 0 |  | 2 |  | 2 |  | 176 |
| Uncollateralized loans | 2,323 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 2,323 |
| Total | \$ 35,550 | \$ | 40 | \$ | 19 | \$ | 1 | \$ | 188 | \$ | 248 | \$ | 35,798 |

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## PRUDENTIAL FINANCIAL, INC.

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

Nonaccrual loans are those on which the accrual of interest has been suspended after the loans become 90 days delinquent as to principal or interest payments, or earlier when the Company has doubts about collectability and loans for which a loan specific reserve has been established. See Note 2 for further discussion regarding nonaccrual status loans. The following table sets forth commercial mortgage and other loans on nonaccrual status as of the dates indicated, based upon the recorded investment gross of allowance for credit losses:


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

The following tables provide information about commercial mortgage and other loans involved in a troubled debt restructuring as of the dates indicated. The pre-modification outstanding recorded investment has been adjusted for any partial payoffs, and the table excludes troubled debt restructurings where we have received assets, other than loans, in full satisfaction of the loan. See Note 2 for additional information relating to the accounting for troubled debt restructurings.

|  | Three Months Ended September 30, 2012 <br> Adjusted <br> Pre-Modification <br> Outstanding <br> Recorded <br> Investment | Nost-Modification <br> Outstanding <br> Recorded <br> Investment | Nine Months Ended September 30, 2012 <br> Adjusted <br> Pre-Modification <br> Outstanding <br> Recorded <br> Investment | Post-Modification <br> Outstanding <br> Recorded |
| :--- | :---: | :---: | :---: | :---: | :---: |
| Investment |  |  |  |  |

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| Retail | 0 |  | 0 |  | 0 |  | 0 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Office | 0 |  | 0 |  | 5 |  | 5 |
| Apartments/Multi-Family | 0 |  | 0 |  | 0 |  | 0 |
| Hospitality | 0 |  | 0 |  | 0 |  | 0 |
| Other | 0 |  | 0 |  | 15 |  | 13 |
| Total commercial mortgage loans | 0 |  | 0 |  | 20 |  | 18 |
| Agricultural property loans | 0 |  | 0 |  | 0 |  | 0 |
| Residential property loans | 0 |  | 0 |  | 0 |  | 0 |
| Other collateralized loans | 0 |  | 0 |  | 0 |  | 0 |
| Uncollateralized loans | 0 |  | 0 |  | 0 |  | 0 |
| Total | \$ 0 | \$ | 0 | \$ | 20 | \$ | 18 |

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## PRUDENTIAL FINANCIAL, INC.

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

The amount of payment defaults during the period on commercial mortgage and other loans that were modified as a troubled debt restructuring within the last 12 months was less than $\$ 1$ million as of September 30, 2012.

As of September 30, 2012, the Company committed to fund $\$ 6$ million to borrowers that have been involved in a troubled debt restructuring.

## Net Investment Income

Net investment income for the three and nine months ended September 30, 2012 and 2011 was from the following sources:

|  | Three Months Ended <br> September 30, <br> $\mathbf{2 0 1 1}$ <br> (in millions) |  | Nine Months Ended <br> September 30, <br> 2012 |
| :--- | ---: | ---: | ---: | ---: |
| 2012 |  |  |  |

Realized Investment Gains (Losses), Net

Realized investment gains (losses), net, for the three and nine months ended September 30, 2012 and 2011, were from the following sources:

|  | Three Months Ended September 30, |  |  | Nine Months Ended September 30, |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2012 |  | 2011 | 2012 |  | 2011 |
|  | (in millions) |  |  |  |  |  |
| Fixed maturities | \$ (53) | \$ | (2) | \$ (148) |  | \$ 2 |
| Equity securities | 40 |  | (54) | 3 |  | 126 |
| Commercial mortgage and other loans | 28 |  | 46 | 49 |  | 80 |
| Investment real-estate | 4 |  | (4) | (63) |  | (16) |
| Joint ventures and limited partnerships | (3) |  | (19) | (1) |  | 39 |
| Derivatives(1) | $(1,458)$ |  | 2,557 | (903) |  | 2,693 |
| Other | (3) |  | 4 | (3) |  | 22 |
| Realized investment gains (losses), net | \$ $(1,445)$ |  | 2,528 | \$ $(1,066)$ |  | \$ 2,946 |

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

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## PRUDENTIAL FINANCIAL, INC.

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

## Net Unrealized Investment Gains (Losses)

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

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

|  | Net Unrealized Gains (Losses) on Investments | Deferred Policy Acquisition Costs, <br> Deferred Sales <br> Inducements, and Value of Business Acquired |  | Future <br> Policy Benefits |  | Policyholders Dividends millions) |  | Deferred Income Tax (Liability) Benefit |  | Accumulated Other <br> Comprehensive Income (Loss) <br> Related To Net <br> Unrealized Investment Gains (Losses) |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Balance, December 31, 2011 | \$ $(1,003)$ | \$ | 16 | \$ | 14 | \$ | 466 | \$ | 269 | \$ | (238) |
| Net investment gains (losses) on investments arising during the period | 406 |  |  |  |  |  |  |  | (142) |  | 264 |
| Reclassification adjustment for (gains) losses included in net income | 244 |  |  |  |  |  |  |  | (85) |  | 159 |
| Reclassification adjustment for OTTI losses excluded from net income(1) | (90) |  |  |  |  |  |  |  | 32 |  | (58) |
| Impact of net unrealized investment (gains) losses on deferred policy acquisition costs, deferred sales inducements and value of business acquired |  |  | (6) |  |  |  |  |  | 2 |  | (4) |
| Impact of net unrealized investment (gains) losses on future policy benefits |  |  |  |  | (6) |  |  |  | (2) |  | (8) |
| Impact of net unrealized investment (gains) losses on policyholders dividends |  |  |  |  |  |  | (232) |  | 81 |  | (151) |
| Balance, September 30, 2012 | \$ (443) | \$ | 10 | \$ | 8 | \$ | 234 | \$ | 155 | \$ | (36) |

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

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## PRUDENTIAL FINANCIAL, INC.

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

All Other Net Unrealized Investment Gains and Losses in AOCI
$\left.\begin{array}{llllll} & & & & \begin{array}{c}\text { Accumulated } \\ \text { Other }\end{array} \\ \text { Comprehensive } \\ \text { Income } \\ \text { (Loss) }\end{array}\right)$
(1) Includes cash flow hedges. See Note 14 for information on cash flow hedges.
(2) Represents transfers out related to the portion of OTTI losses recognized during the period that were not recognized in earnings for securities with no prior OTTI loss.

The table below presents net unrealized gains (losses) on investments by asset class as of the dates indicated:
$\left.\begin{array}{lccc} & \begin{array}{c}\text { September 30, } \\ \text { 2012 }\end{array} & \begin{array}{c}\text { December 31, } \\ \text { 2011 }\end{array} \\ \text { (in millions) }\end{array}\right)$

| Equity securities, available-for-sale | 1,321 | 613 |
| :--- | ---: | ---: |
| Derivatives designated as cash flow hedges(1) | $(125)$ | $(86)$ |
| Other investments(2) | $(26)$ | $(6)$ |
|  |  |  |
| Net unrealized gains (losses) on investments | $\$ 24,076$ | $\$$ |

(1) See Note 14 for more information on cash flow hedges.
(2) As of September 30, 2012, includes $\$ 80$ million of net unrealized losses on held-to-maturity securities that were previously transferred from available-for-sale. Also includes net unrealized gains on certain joint ventures that are included in Other assets.

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## PRUDENTIAL FINANCIAL, INC.

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

## Duration of Gross Unrealized Loss Positions for Fixed Maturities

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

|  | Less than twelve monthsGrossEnrealized |  |  |  | September 30, 2012Twelve months or moreGrossUnrealizedFair Value $\left.\begin{array}{c}\text { Lin millions) }\end{array}\right)$ Losses |  |  |  | Fair Value |  |  | ealized <br> osses |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Fixed maturities(1) |  |  |  |  |  |  |  |  |  |  |  |  |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | \$ |  | \$ | 9 | \$ | 55 | \$ | 5 | \$ | 498 | \$ | 14 |
| Obligations of U.S. states and their political subdivisions |  | 88 |  | 1 |  | 5 |  | 1 |  | 93 |  | 2 |
| Foreign government bonds |  | 3,649 |  | 54 |  | 302 |  | 36 |  | 3,951 |  | 90 |
| Corporate securities |  | 9,072 |  | 210 |  | 9,708 |  | 1,519 |  | 18,780 |  | 1,729 |
| Commercial mortgage-backed securities |  | 530 |  | 8 |  | 308 |  | 31 |  | 838 |  | 39 |
| Asset-backed securities |  | 989 |  | 17 |  | 4,303 |  | 1,015 |  | 5,292 |  | 1,032 |
| Residential mortgage-backed securities |  | 101 |  | 3 |  | 315 |  | 41 |  | 416 |  | 44 |
| Total |  | 4,872 | \$ | 302 |  | 14,996 | \$ | 2,648 |  | 29,868 | \$ | 2,950 |

(1) Includes $\$ 561$ million of fair value and $\$ 70$ million of gross unrealized losses at September 30, 2012, on securities classified as held-to-maturity, a portion of which are not reflected in Accumulated other comprehensive income (loss).

|  | Less than twelve months  <br> Gross  <br> Fair Value Unrealized <br> Losses  |  | December 31, 2011Twelve months or moreGrossUnrealizedFair Value $\quad$ Losses(in millions) |  |  | Fair Value |  |  | oss <br> alized <br> sses |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Fixed maturities(1) |  |  |  |  |  |  |  |  |  |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | \$ 870 | \$ | \$ 130 | \$ | 10 | \$ | 1,000 | \$ | 18 |
| Obligations of U.S. states and their political subdivisions | 7 | 0 | 46 |  | 2 |  | 53 |  | 2 |
| Foreign government bonds | 4,017 | 182 | 306 |  | 27 |  | 4,323 |  | 209 |
| Corporate securities | 21,419 | 1,144 | 9,691 |  | 1,969 |  | 31,110 |  | 3,113 |
| Commercial mortgage-backed securities | 917 | 61 | 362 |  | 47 |  | 1,279 |  | 108 |
| Asset-backed securities | 2,746 | 40 | 4,134 |  | 1,785 |  | 6,880 |  | 1,825 |
| Residential mortgage-backed securities | 422 | 19 | 378 |  | 60 |  | 800 |  | 79 |

$\begin{array}{lllllllllll}\text { Total } & \$ 30,398 & \$ & 1,454 & \$ 15,047 & \$ & 3,900 & \$ 45,445 & \$ & 5,354\end{array}$
(1) Includes $\$ 706$ million of fair value and $\$ 98$ million of gross unrealized losses at December 31, 2011, on securities classified as held-to-maturity, a portion of which are not reflected in Accumulated other comprehensive income (loss).

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## PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

The gross unrealized losses at September 30, 2012 and December 31, 2011, are composed of $\$ 2,036$ million and $\$ 3,535$ million, respectively, related to high or highest quality securities based on NAIC or equivalent rating and $\$ 914$ million and $\$ 1,819$ million, respectively, related to other than high or highest quality securities based on NAIC or equivalent rating. At September 30, 2012, $\$ 1,718$ million of the gross unrealized losses represented declines in value of greater than $20 \%, \$ 173$ million of which had been in that position for less than six months, as compared to $\$ 3,478$ million at December 31, 2011, that represented declines in value of greater than $20 \%, \$ 871$ million of which had been in that position for less than six months. At September 30, 2012, the $\$ 2,648$ million of gross unrealized losses of twelve months or more were concentrated in asset-backed securities, and in the finance, utilities, and consumer non-cyclical sectors of the Company s corporate securities. At December 31, 2011, the $\$ 3,900$ million of gross unrealized losses of twelve months or more were concentrated in asset-backed securities, and in the manufacturing, finance, and public utilities sectors of the Company s corporate securities. In accordance with its policy described in Note 2, the Company concluded that an adjustment to earnings for other-than-temporary impairments for these securities was not warranted at September 30, 2012 or December 31, 2011. These conclusions are based on a detailed analysis of the underlying credit and cash flows on each security. The gross unrealized losses are primarily attributable to foreign currency movements, credit spread widening and increased liquidity discounts. At September 30, 2012, the Company does not intend to sell the securities and it is not more likely than not that the Company will be required to sell the securities before the anticipated recovery of its remaining amortized cost basis.

## Duration of Gross Unrealized Loss Positions for Equity Securities

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

|  | September 30, 2012 |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  |  |  |  |  |  |  |  |
|  | Gross |  |  | Gross |  |  |  | Total |  |  |
|  |  |  | lized |  |  | Un |  |  |  | alized |
|  | Fair Value |  |  | Fair | Value (in |  |  | Fair Value |  | sses |
| Equity securities, available-for-sale | \$ 1,320 | \$ | 139 | \$ | 0 | \$ | 0 | \$ 1,320 | \$ | 139 |


|  |  |  |  | December 31, 2011 <br> Twelve months or more Gross |  |  | Total |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Fair <br> Value |  | oss ses | $\underset{\text { Val }}{\mathrm{Fa}}$ | Unrealized <br> Losses <br> ions) |  | Fair <br> Value | Gross Unrealized Losses |  |
| Equity securities, available-for-sale | \$ 2,602 | \$ | 448 | \$ | \$ | 0 | \$ 2,602 | \$ | 448 |

At September 30, 2012, $\$ 63$ million of the gross unrealized losses represented declines of greater than $20 \%, \$ 58$ million of which had been in that position for less than six months. At December 31, 2011, $\$ 236$ million of the gross unrealized losses represented declines of greater than $20 \%, \$ 225$ million of which had been in that position for less than six months. In accordance with its policy described in Note 2, the Company concluded that an adjustment for other-than-temporary impairments for these equity securities was not warranted at September 30, 2012 or

December 31, 2011.

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# PRUDENTIAL FINANCIAL, INC. 

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

## 5. VARIABLE INTEREST ENTITIES

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

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

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

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

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

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## PRUDENTIAL FINANCIAL, INC.

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

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

|  | $\begin{gathered} \text { September 30, } \\ 2012 \end{gathered}$ |  | er 31, |
| :---: | :---: | :---: | :---: |
| Fixed maturities, available-for-sale | \$ 86 | \$ | 83 |
| Other trading account assets | 502 |  | 271 |
| Commercial mortgage and other loans | 139 |  | 154 |
| Other long-term investments | 23 |  | 19 |
| Cash and cash equivalents | 74 |  | 275 |
| Accrued investment income | 0 |  | 1 |
| Other assets | 30 |  | 17 |
| Total assets of consolidated VIEs | \$ 854 | \$ | 820 |
| Other liabilities | \$ 660 | \$ | 723 |
| Total liabilities of consolidated VIEs | \$ 660 | \$ | 723 |

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

## Other Consolidated Variable Interest Entities

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

|  | September 2012 |  | ber 31, |
| :---: | :---: | :---: | :---: |
|  | (in millions) |  |  |
| Fixed maturities, available-for-sale | \$ 127 | \$ | 129 |
| Fixed maturities, held-to-maturity | 1,177 |  | 1,191 |
| Trading account assets supporting insurance liabilities | 7 |  | 8 |
| Other long-term investments | 10 |  | 141 |
| Accrued investment income | 5 |  | 5 |
| Total assets of consolidated VIEs | \$ 1,326 | \$ | 1,474 |
| Other liabilities | \$ | \$ | 0 |
| Total liabilities of consolidated VIEs | \$ | \$ | 0 |

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## PRUDENTIAL FINANCIAL, INC.

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

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

The funding agreements represent an intercompany transaction that is eliminated upon consolidation. However, in recognition of the security interest in such funding agreements, the trust s medium-term note liability of $\$ 2,298$ million and $\$ 3,197$ million at September 30, 2012 and December 31, 2011, respectively, is classified within Policyholders account balances. Creditors of the trust have recourse to Prudential Insurance if the trust fails to make contractual payments on the medium-term notes. The Company has not provided material financial or other support that was not contractually required to the trust.

## Unconsolidated Variable Interest Entities

The Company has determined that it is not the primary beneficiary of certain VIEs for which it is the investment manager, including certain CDOs and other investment structures, as it does not have both (1) the power to direct the activities of the VIE that most significantly impact the economic performance of the entity and (2) the obligation to absorb losses of the entity that could be potentially significant to the VIE or the right to receive benefits from the entity that could be potentially significant. The Company s maximum exposure to loss resulting from its relationship with unconsolidated VIEs for which it is the investment manager is limited to its investment in the VIEs, which was $\$ 521$ million and $\$ 534$ million at September 30, 2012 and December 31, 2011, respectively. These investments are reflected in Fixed maturities, available-for-sale, Other trading account assets, at fair value and Other long-term investments. The fair value of assets held within these unconsolidated VIEs was $\$ 8,056$ million and $\$ 7,720$ million as of September 30, 2012 and December 31, 2011, respectively. There are no liabilities associated with these unconsolidated VIEs on the Company s balance sheet.

In the normal course of its activities, the Company will invest in joint ventures and limited partnerships. These ventures include hedge funds, private equity funds and real estate-related funds and may or may not be VIEs. The Company s maximum exposure to loss on these investments, both VIEs and non-VIEs, is limited to the amount of its investment. The Company has determined that it is not required to consolidate these entities because either (1) it does not control them or (2) it does not have the obligation to absorb losses of the entities that could be potentially significant to the entities or the right to receive benefits from the entities that could be potentially significant. The Company classifies these investments as Other long-term investments and its maximum exposure to loss associated with these entities was $\$ 4,690$ million and $\$ 4,486$ million as of September 30, 2012 and December 31, 2011, respectively.

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

Included among these structured investments are asset-backed securities issued by VIEs that manage investments in the European market. In addition to a stated coupon, each investment provides a return based on the VIE s portfolio of assets and related investment activity. The market value of these VIEs was approximately

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## PRUDENTIAL FINANCIAL, INC.

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

$\$ 2.2$ billion and $\$ 2.6$ billion as of September 30, 2012 and December 31, 2011, respectively, and these VIEs were financed primarily through the issuance of notes similar to those purchased by the Company. The Company generally accounts for these investments as available-for-sale fixed maturities containing embedded derivatives that are bifurcated and marked-to-market through Realized investment gains (losses), net, based upon the change in value of the underlying portfolio. The Company s variable interest in each of these VIEs represents less than $50 \%$ of the only class of variable interests issued by the VIE. The Company s maximum exposure to loss from these interests was $\$ 312$ million and $\$ 664$ million at September 30, 2012 and December 31, 2011, respectively, which includes the fair value of the embedded derivatives.

## 6. CLOSED BLOCK

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

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

The excess of Closed Block Liabilities over Closed Block Assets at the date of the demutualization (adjusted to eliminate the impact of related amounts in 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, which would be intended to increase future actual earnings until the actual cumulative earnings equaled the expected cumulative earnings.

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## PRUDENTIAL FINANCIAL, INC.

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

As of September 30, 2012 and December 31, 2011, the Company recognized a policyholder dividend obligation of $\$ 781$ million and $\$ 762$ million, respectively, to Closed Block policyholders for the excess of actual cumulative earnings over the expected cumulative earnings. Additionally, accumulated net unrealized investment gains that have arisen subsequent to the establishment of the Closed Block were reflected as a policyholder dividend obligation of $\$ 5,582$ million and $\$ 3,847$ million at September 30, 2012 and December 31, 2011, respectively, to be paid to Closed Block policyholders unless offset by future experience, with an offsetting amount reported in Accumulated other comprehensive income (loss). See the table below for changes in the components of the policyholder dividend obligation for the nine months ended September 30, 2012.

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:
$\left.\begin{array}{lrr} & \begin{array}{c}\text { September 30, } \\ \text { 2012 }\end{array} & \begin{array}{c}\text { December 31, } \\ \text { 2011 }\end{array} \\ \text { (in millions) }\end{array}\right)$

| Closed Block Assets |  |  |
| :--- | ---: | ---: |
| Fixed maturities, available-for-sale, at fair value | 42,782 | 42,024 |
| Other trading account assets, at fair value | 269 |  |
| Equity securities, available-for-sale, at fair value | 3,171 | 3,122 |
| Commercial mortgage and other loans | 8,914 | 8,322 |
| Policy loans | 5,150 | 5,296 |
| Other long-term investments | 2,116 | 2,080 |
| Short-term investments | 1,390 | 485 |
| Total investments | 63,737 | 61,598 |
| Cash and cash equivalents | 739 | 1,006 |
| Accrued investment income | 590 | 571 |
| Other Closed Block assets | 305 | 284 |
| Total Closed Block Assets | 65,371 | 63,459 |
|  |  | $2,9,982$ |

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## PRUDENTIAL FINANCIAL, INC.

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

Information regarding the policyholder dividend obligation is as follows:
$\left.\begin{array}{l|c} & \begin{array}{c}\text { Nine Months Ended } \\ \text { September 30, } \\ \mathbf{2 0 1 2}\end{array} \\ \text { (in millions) }\end{array}\right)$

Closed Block revenues and benefits and expenses for the three and nine months ended September 30, 2012 and 2011 were as follows:

|  | Three Months Ended September 30, |  | Nine Months Ended September 30, |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2012 | 2011 | 2012 | 2011 |
|  | (in millions) |  |  |  |
| Revenues |  |  |  |  |
| Premiums | \$ 646 | \$ 666 | \$ 2,060 | \$ 2,129 |
| Net investment income | 710 | 731 | 2,177 | 2,221 |
| Realized investment gains (losses), net | 74 | 243 | 220 | 495 |
| Other income | 15 | (2) | 14 | 30 |
| Total Closed Block revenues | 1,445 | 1,638 | 4,471 | 4,875 |
| Benefits and Expenses |  |  |  |  |
| Policyholders benefits | 776 | 827 | 2,565 | 2,557 |
| Interest credited to policyholders account balances | 34 | 35 | 103 | 104 |
| Dividends to policyholders | 478 | 639 | 1,454 | 1,848 |
| General and administrative expenses | 122 | 129 | 372 | 392 |
| Total Closed Block benefits and expenses | 1,410 | 1,630 | 4,494 | 4,901 |
| Closed Block revenues, net of Closed Block benefits and expenses, before income taxes and discontinued operations | 35 | 8 | (23) | (26) |
| Income tax benefit | 29 | 5 | (36) | (32) |
| Closed Block revenues, net of Closed Block benefits and expenses and income taxes, before discontinued operations | 6 | 3 | 13 | 6 |
| Income (loss) from discontinued operations, net of taxes | (1) | 0 | (2) | 0 |

Closed Block revenues, net of Closed Block benefits and expenses, income taxes and discontinued operations
\$ $3 \quad 11$ 11 \$ 6

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## PRUDENTIAL FINANCIAL, INC.

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

## 7. EQUITY

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

|  |  | Common Stock <br> Held In <br> Treasury <br> (in millions) | Class B Stock <br> Issued and <br> Outstanding |  |
| :--- | ---: | :---: | :---: | :---: |
| Balance, December 31, 2011 | 660.1 | 192.1 | 468.0 | 0.0 |
| Common Stock issued | 0.0 | 0.0 | 0.0 |  |
| Common Stock acquired | 0.0 | 11.5 | $(11.5)$ | 0.0 |
| Stock-based compensation programs(1) | 0.0 | $(5.5)$ | 5.5 | 0.0 |
| Balance, September 30, 2012 | 660.1 | 198.1 | 462.0 | 2.0 |

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

In June 2011, Prudential Financial s Board of Directors authorized the Company to repurchase at management s discretion up to $\$ 1.5$ billion of its outstanding Common Stock through June 2012. Under this authorization, 28.6 million shares of the Company s Common Stock were repurchased at a total cost of $\$ 1.5$ billion, of which 8.8 million shares were repurchased in the first six months of 2012 at a total cost of $\$ 500$ million.

In June 2012, Prudential Financial s Board of Directors authorized the Company to repurchase at management s discretion up to $\$ 1.0$ billion of its outstanding Common Stock through June 2013. As of September 30, 2012, 2.7 million shares of the Company s Common Stock were repurchased under this authorization at a total cost of $\$ 150$ million.

The balance of and changes in each component of Accumulated other comprehensive income (loss) attributable to Prudential Financial, Inc. for the nine months ended September 30, 2012 and 2011 are as follows (net of taxes):

| Accumulated Other Comprehensive Income (Loss) Attributable to |  |  |  |
| :---: | :---: | :---: | :---: |
| Foreign Currency | Prudential Financial, Inc. |  |  |
| Translation | Net | Pension and | Total |
| Adjustment | Unrealized | Postretirement | Accumulated |
|  | Investment Gains | Unrecognized Net | Other |
|  |  |  | Periodic |


|  |  |  | Benefit <br> (Cost) | Income <br> (Loss) |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Balance, December 31, 2011 |  |  |  | (in millions) |

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## PRUDENTIAL FINANCIAL, INC.

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


(1) Includes cash flow hedges of $\$(81)$ million and $\$(55)$ million as of September 30, 2012 and December 31, 2011, respectively, and $\$(66)$ million and $\$(169)$ million as of September 30, 2011 and December 31, 2010, respectively. See Note 4 for additional information regarding unrealized investment gains (losses), including the split between amounts related to fixed maturity securities on which an other-than-temporary impairment loss has been recognized, and all other unrealized investment gains (losses).

## 8. EARNINGS PER SHARE

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

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

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

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## PRUDENTIAL FINANCIAL, INC.

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

## Common Stock

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

|  | Income | Three Months Ended September 30, |  |  |  |  | Per Share Amount |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | 2012 <br> Weighted <br> Average Shares |  | r Share mount ns, except | Income <br> er share | 2011 <br> Weighted <br> Average Shares unts) |  |  |
| Basic earnings per share |  |  |  |  |  |  |  |  |
| Income (loss) from continuing operations attributable to the Financial Services Businesses | \$ (635) | \$ 1,581 |  |  |  |  |  |  |
| Direct equity adjustment | 4 | 8 |  |  |  |  |  |  |
| Less: Income attributable to noncontrolling interests | 25 | 10 |  |  |  |  |  |  |
| Less: Earnings allocated to participating unvested share-based payment awards | 0 | 21 |  |  |  |  |  |  |
| Income (loss) from continuing operations attributable to the Financial Services Businesses available to holders of Common |  |  |  |  |  |  |  |  |
| Effect of dilutive securities and compensation programs(1) |  |  |  |  |  |  |  |  |
| Add: Earnings allocated to participating unvested share-based payment awards Basic | \$ 0 | \$ 21 |  |  |  |  |  |  |
| Less: Earnings allocated to participating unvested share-based payment awards Diluted | 0 | 20 |  |  |  |  |  |  |
| Stock options |  | 0.0 |  |  | 2.5 |  |  |  |
| Deferred and long-term compensation programs |  | 0.0 |  |  | 0.5 |  |  |  |
| Exchangeable Surplus Notes | 0 | 0.0 |  |  | 4 | 5.1 |  |  |
| 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 |  |  |  |  | \$ 1,563 | 489.3 | \$ 3.19 |  |
|  | \$ (656) | 464.4 | \$ | (1.41) |  |  |  |  |

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## PRUDENTIAL FINANCIAL, INC.

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

|  | Nine Months Ended September 30, |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Income | 2012 <br> Weighted Average Shares | Per Share Amount |  | Income | 2011 <br> Weighted <br> Average Shares ounts) | Per Share Amount |  |
| Basic earnings per share |  | (in millions, except per share amounts) |  |  |  |  |  |  |
| Income from continuing operations attributable to the Financial Services Businesses | \$ 591 |  |  |  | \$ 2,923 |  |  |  |
| Direct equity adjustment | 20 |  |  |  | 25 |  |  |  |
| Less: Income attributable to noncontrolling interests | 51 |  |  |  | 64 |  |  |  |
| Less: Earnings allocated to participating unvested share-based payment awards | 6 |  |  |  | 39 |  |  |  |
| Income from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment | \$ 554 | 466.6 | \$ | 1.19 | \$ 2,845 | 484.0 | \$ | 5.88 |
| Effect of dilutive securities and compensation programs(2) |  |  |  |  |  |  |  |  |
| Add: Earnings allocated to participating unvested share-based payment awards Basic | \$ 6 |  |  |  | \$ 39 |  |  |  |
| Less: Earnings allocated to participating unvested share-based payment awards Diluted | 6 |  |  |  | 38 |  |  |  |
| Stock options |  | 2.1 |  |  |  | 3.1 |  |  |
| Deferred and long-term compensation programs |  | 0.5 |  |  |  | 0.5 |  |  |
| Exchangeable Surplus Notes | 0 | 0.0 |  |  | 13 | 5.1 |  |  |
| Diluted earnings per share(2) |  |  |  |  |  |  |  |  |
| Income from continuing operations attributable to the Financial Services Businesses available to holders of Common Stock after direct equity adjustment | \$ 554 | 469.2 | \$ | 1.18 | \$ 2,859 | 492.7 | \$ | 5.80 |

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

Unvested share-based payment awards that contain nonforfeitable rights to dividends are participating securities and included in the computation of earnings per share pursuant to the two-class method. Under this method, earnings of the Financial Services Businesses attributable to Prudential Financial, Inc. are allocated between Common Stock and the participating awards, as if the awards were a second class of stock. For the three months ended September 30, 2012, undistributed earnings were not allocated to participating unvested share-based payment awards as these awards do not participate in losses. Undistributed earnings allocated to participating unvested share-based payment awards for the three
months ended September 30, 2011 were based on 6.3 million of such awards weighted for the period they were outstanding. Undistributed earnings allocated to

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## PRUDENTIAL FINANCIAL, INC.

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

participating unvested share-based payment awards for the nine months ended September 30, 2012 and 2011 were based on 4.7 million and 6.6 million of such awards, respectively, weighted for the period they were outstanding. The computation of earnings per share of Common Stock excludes the dilutive impact of participating unvested share-based awards based on the application of the two-class method.

For the three months ended September 30, 2012, 20.1 million options and 5.1 million shares related to deferred and long-term compensation programs, weighted for the portion of the period they were outstanding, 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, 2011, 12.1 million options, weighted for the portion of the period they were outstanding, with a weighted average exercise price of $\$ 71.15$ 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, 2012 and 2011, 13.1 million and 10.3 million options, respectively, weighted for the portion of the period they were outstanding, with a weighted average exercise price of $\$ 70.11$ and $\$ 73.75$ per share, respectively, were excluded from the computation of diluted earnings per share because the options, based on application of the treasury stock method, were antidilutive.

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

## Class B Stock

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

|  | Income | 2012 <br> Weighted Average Shares | ree Months <br> Per Share Amount illions, exce | ed Septe <br> Income er share | er 30, 2011 Weighted Average Shares ounts) |  | er Share Amount |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Basic earnings per share |  |  |  |  |  |  |  |
| Income from continuing operations attributable to the Closed |  |  |  |  |  |  |  |
| Block Business | \$ 44 |  |  | \$ 32 |  |  |  |
| Less: Direct equity adjustment | 4 |  |  | 8 |  |  |  |
| Income from continuing operations attributable to the Closed |  |  |  |  |  |  |  |
| Block Business available to holders of Class B Stock after direct equity adjustment | \$ 40 | 2.0 | \$ 20.00 | \$ 24 | 2.0 |  | 12.00 |

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## PRUDENTIAL FINANCIAL, INC.

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



## 9. SHORT-TERM AND LONG-TERM DEBT

## Commercial Paper

The Company issues commercial paper under the two programs described below. At September 30, 2012 and December 31, 2011, the weighted average maturity of total commercial paper outstanding was 17 and 21 days, respectively.

Prudential Financial has a commercial paper program with an authorized capacity of $\$ 3.0$ billion. Prudential Financial commercial paper borrowings generally have been used to fund the working capital needs of Prudential Financial s subsidiaries and provide short-term liquidity at Prudential Financial.

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

The table below presents the Company s total outstanding commercial paper borrowings as of the dates indicated:

|  | September 30, <br> 2012 | December 31, <br> (in millions) |  |
| :--- | :---: | :---: | :---: |
| Prudential Financial | $\$ 264$ | $\$$ | 296 |
| Prudential Funding, LLC | 700 | 870 |  |
| Total outstanding commercial paper borrowings | $\$ 964$ | $\$$ | 1,166 |

## Federal Home Loan Bank of New York

Prudential Insurance is a member of the Federal Home Loan Bank of New York, or FHLBNY. Membership allows Prudential Insurance access to the FHLBNY s financial services, including the ability to obtain collateralized loans and to issue collateralized funding agreements that can be used as an alternative source of

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## PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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

NJDOBI permits Prudential Insurance to pledge collateral to the FHLBNY in an amount of up to 5\% of its prior year-end statutory net admitted assets, excluding separate account assets. Based on Prudential Insurance s statutory net admitted assets as of December 31, 2011, the 5\% limitation equates to a maximum amount of pledged assets of $\$ 7.7$ billion and an estimated maximum borrowing capacity (after taking into account required collateralization levels and purchases of activity-based stock) of approximately $\$ 6.3$ billion. Nevertheless, FHLBNY borrowings are subject to the FHLBNY s discretion and to the availability of qualifying assets at Prudential Insurance.

As of September 30, 2012, Prudential Insurance had pledged qualifying assets with a fair value of $\$ 2.9$ billion, which supported outstanding collateralized advances of $\$ 924$ million and collateralized funding agreements of $\$ 1.5$ billion with maturities ranging from 2013 to 2018.

As of September 30, 2012, $\$ 199$ million of the FHLBNY outstanding advances is reflected in Short-term debt and matures in December 2012 and the remaining $\$ 725$ million is in Long-term debt and matures in December 2015. The funding agreements issued to the FHLBNY, which are reflected in Policyholders account balances, have priority claim status above debt holders of Prudential Insurance. The fair value of qualifying assets that were available to Prudential Insurance but not pledged amounted to $\$ 2.9$ billion as of September 30, 2012.

## Federal Home Loan Bank of Boston

Prudential Retirement Insurance and Annuity Company, or PRIAC, is member of the Federal Home Loan Bank of Boston, or FHLBB. Membership allows PRIAC access to collateralized advances which will be classified in Short-term debt or Long-term debt, depending on the maturity date of the obligation. PRIAC s membership in FHLBB requires the ownership of member stock and borrowings from FHLBB require the purchase of activity-based stock in an amount between $3.0 \%$ and $4.5 \%$ of outstanding borrowings depending on the maturity date of the obligation. As of September 30, 2012, PRIAC had no advances outstanding under the FHLBB facility.

The Connecticut Department of Insurance, or CTDOI, permits PRIAC to pledge up to $\$ 2.6$ billion in qualifying assets to secure FHLBB borrowings through December 31, 2013. PRIAC must seek re-approval from CTDOI prior to borrowing additional funds after that date. Based on available eligible assets as of September 30, 2012, PRIAC had an estimated maximum borrowing capacity, after taking into consideration required collateralization levels and required purchases of activity-based FHLBB stock, of approximately $\$ 1.6$ billion.

## Credit Facilities

As of September 30, 2012, Prudential Financial and Prudential Funding maintained an aggregate of $\$ 3,750$ million of unsecured committed credit facilities, which includes a $\$ 2,000$ million five-year credit facility on which Prudential Financial is the sole borrower. These facilities have remaining terms ranging from 2.25 years to

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## PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

4.25 years. There were no outstanding borrowings under these credit facilities as of September 30, 2012 or as of the date of this filing. Each of the facilities is available to the applicable borrowers up to the aggregate committed credit and may be used for general corporate purposes, including as backup liquidity for the Company s commercial paper programs discussed above. Prudential Financial expects that it may borrow under the five-year credit facility from time to time to fund its working capital needs and those of its subsidiaries. In addition, up to $\$ 300$ million of the five-year facility may be drawn in the form of standby letters of credit that can be used to meet the Company s operating needs.

The credit facilities contain representations and warranties, covenants and events of default that are customary for facilities of this type; however, borrowings under the facilities are not contingent on our credit ratings nor subject to material adverse change clauses. Borrowings are conditioned on the continued satisfaction of customary conditions, including the maintenance at all times of consolidated net worth, relating to the Company s Financial Services Businesses only, of at least $\$ 18.985$ billion, which for this purpose is calculated as U.S. GAAP equity, excluding Accumulated other comprehensive income (loss) and excluding equity of noncontrolling interests. As of September 30, 2012 and December 31, 2011, the consolidated net worth of the Company s Financial Services Businesses exceeded the minimum amount required to borrow under the credit facilities.

## Sale of Asset-Backed Notes

On March 30, 2012, Prudential Insurance sold, in a Rule 144A private placement, $\$ 1.0$ billion aggregate principal amount of $2.997 \%$ notes with a final maturity of September 30, 2015. The notes are secured by the assets of a trust, consisting of approximately $\$ 2.8$ billion aggregate principal balance of residential mortgage-backed securities deposited into the trust by Prudential Insurance. Payments of interest and principal on the notes will be made only to the extent of funds available to the trust in accordance with a priority of payments set forth in the indenture governing the notes. Prudential Financial guaranteed to the holders of the notes the timely payment of all principal and interest due on the notes and any make-whole payments that may become due as a result of the payment of principal on the notes prior to its scheduled payment date.

## Termination of Existing Replacement Capital Covenants and Execution of New Replacement Capital Covenant

On April 11, 2012, the Company terminated the replacement capital covenants that were entered into in 2008 in connection with its issuance of $\$ 600$ million of $8.875 \%$ fixed-to-floating rate junior subordinated notes (the $8.875 \%$ junior subordinated notes ) and $\$ 920$ million of $9.0 \%$ junior subordinated notes. The Company received the consent of holders of a majority in principal amount of its $6.625 \%$ medium-term notes due 2037, as was required for the termination of the replacement capital covenants. The Company also entered into a new replacement capital covenant with respect to the $8.875 \%$ junior subordinated notes only. The new replacement capital covenant was entered into for the benefit of the holders of the Company s $5.90 \%$ medium-term notes due March 2036 and requires that the Company not repay, redeem or purchase the $8.875 \%$ junior subordinated notes prior to June 15,2038 unless it has received proceeds from the sale or issuance of common stock or other qualifying securities that have certain characteristics that are at least as equity-like as the $8.875 \%$ junior subordinated notes. However, the terms of the new replacement capital covenant will not apply in certain instances, including (i) if Standard \& Poor s upgrades the Company s corporate credit rating by at least one notch above A+ or (ii) if the Company repurchases or redeems up to $10 \%$ of the outstanding principal amount of the $8.875 \%$ junior subordinated notes in any one-year period, provided that no more than $25 \%$ of the outstanding principal amount of the $8.875 \%$ junior subordinated notes are repurchased or redeemed in any ten-year period.

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# PRUDENTIAL FINANCIAL, INC. 

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

## Surplus Notes

During 2011, a captive reinsurance subsidiary entered into agreements providing for the issuance and sale of up to $\$ 1$ billion of ten-year fixed-rate surplus notes. In June 2012, this subsidiary entered into another agreement for the issuance of up to an additional $\$ 500$ million of ten-year fixed rate surplus notes. At September 30, 2012, $\$ 750$ million of surplus notes were outstanding under this facility. Under the agreements, the subsidiary received debt securities, with a principal amount equal to the surplus notes issued, which are redeemable under certain circumstances, including upon the occurrence of specified stress events affecting the subsidiary. Because valid rights of set-off exist, interest and principal payments on the surplus notes and on the debt securities are settled on a net basis, and the surplus notes are reflected in the Company s total consolidated borrowings on a net basis. Prudential Financial agreed that it or one of its affiliates will make capital contributions to the subsidiary in order to reimburse it for any investment losses in excess of specified amounts. Surplus notes issued under this facility are subordinated to policyholder obligations, and the payment of principal on the surplus notes may only be made with prior insurance regulatory approval. The payment of interest on the surplus notes has been approved by the regulator, subject to the ability of the regulator to withdraw that approval.

## Medium-term Notes

Prudential Financial maintains a Medium-term Notes, Series D program under its shelf registration statement with an authorized issuance capacity of $\$ 20$ billion. As of September 30, 2012, the outstanding balance of Medium-term notes was $\$ 13.2$ billion, a decrease of $\$ 0.9$ billion from December 31, 2011, driven by $\$ 850$ million of maturities.

## Retail Medium-term Notes

Prudential Financial maintains a retail medium-term notes program, including the InterNotes ${ }^{\circledR}$ program, under its shelf registration statement with an authorized issuance capacity of $\$ 5.0$ billion. As of September 30, 2012, the outstanding balance of retail notes was $\$ 1.6$ billion. In the third quarter of 2012, the Company redeemed $\$ 959$ million of its outstanding retail notes with an average interest rate of approximately $6 \%$.

## Junior Subordinated Notes

On August 9, 2012, Prudential Financial issued $\$ 1.0$ billion of $5.875 \%$ fixed-to-floating rate junior subordinated notes in a public offering. The notes are considered hybrid capital securities that receive enhanced equity treatment from the rating agencies. The notes have a maturity date of September 15, 2042. Interest is payable semi-annually at a fixed rate of $5.875 \%$ until September 15, 2022, from which date interest is payable quarterly at a floating rate of 3-month LIBOR plus $4.175 \%$. Prudential Financial has the right to defer interest payments on the notes for a period of up to five years, during which time interest will be compounded. At the end of five years following the commencement of a deferral period,

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Prudential Financial must pay all accrued and unpaid deferred interest, including compounded interest. If all deferred interest (including compounded interest thereon) on the notes has been paid, Prudential Financial can again defer interest payments on the notes. Prudential Financial may redeem the notes, in whole but not in part, at any time prior to September 15, 2022, within 90 days after the occurrence of a tax event , a rating agency event or a regulatory capital event at a redemption price equal to (i) in the case of a tax event or a rating agency event , their principal amount or, if greater, a make-whole redemption price plus accrued and unpaid interest or (ii) in the case of a regulatory capital event , their principal amount plus accrued and unpaid interest. On or after September 15, 2022, Prudential Financial may redeem the notes, in whole or in part, at their principal amount plus accrued and unpaid interest.

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## PRUDENTIAL FINANCIAL, INC.

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

## 10. EMPLOYEE BENEFIT PLANS

## Pension and Other Postretirement Plans

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

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

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

$\left.\begin{array}{lllll} & & \text { Nine Months Ended September 30, } \\ \text { Other } \\ \text { Postretirement } \\ \text { Benefits }\end{array}\right)$

| Interest cost | 355 | 365 | 76 | 81 |
| :--- | :---: | :---: | :---: | :---: |
| Expected return on plan assets | $(543)$ | $(539)$ | $(66)$ | $(72)$ |
| Amortization of prior service cost | 10 | 18 | $(9)$ | $(9)$ |
| Amortization of actuarial (gain) loss, net | 80 | 30 | 41 | 27 |
| Special termination benefits | 7 | 3 | 0 | 0 |
|  |  |  |  |  |
| Net periodic (benefit) cost | $\$ 1$ | $\$ 40$ | $\$ 53$ | $\$$ |

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# PRUDENTIAL FINANCIAL, INC. 

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

## 11. SEGMENT INFORMATION

## Segments

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

## Adjusted Operating Income

In managing the Financial Services Businesses, the Company analyzes the operating performance of each segment using adjusted operating income. Adjusted operating income does not equate to income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures or net income as determined in accordance with U.S. GAAP but is the measure of segment profit or loss used by the Company to evaluate segment performance and allocate resources, and consistent with authoritative guidance, is the measure of segment performance presented below. Adjusted operating income is calculated by adjusting each segment s income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures for the following items, which are described in greater detail below:
realized investment gains (losses), net, and related charges and adjustments;
net investment gains and losses on trading account assets supporting insurance liabilities and changes in experience-rated contractholder liabilities due to asset value changes;
the contribution to income/loss of divested businesses that have been or will be sold or exited, including businesses that have been placed in wind down status, but that did not qualify for discontinued operations accounting treatment under U.S. GAAP; and
equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests.

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

Financial Services Businesses.

As described in Note 1, during the second quarter of 2012, the Company recorded two out of period adjustments that resulted in a decrease of $\$ 122$ million to Income from continuing operations before income taxes and equity in earnings of operating joint ventures. The adjustments resulted in a decrease in adjusted operating income of $\$ 106$ million for the nine months ended September 30, 2012, including a reduction of $\$ 61$ million to the Asset Management segment and a reduction of $\$ 45$ million to the Corporate and Other operations of the Financial Services Businesses resulting from the increase in reserves. In addition, the reserves adjustment resulted in a reduction of $\$ 16$ million to the Closed Block Business which was excluded from adjusted operating income.

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## PRUDENTIAL FINANCIAL, INC.

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

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

Realized investment gains (losses), net

Adjusted operating income excludes Realized investment gains (losses), net, except for certain items described below. Significant activity excluded from adjusted operating income includes impairments and credit-related gains and losses from sales of securities, the timing of which depends largely on market credit cycles and can vary considerably across periods, and interest rate-related gains and losses from sales of securities, which are largely subject to the Company s discretion and influenced by market opportunities, as well as the Company s tax and capital profile. Additionally, certain gains and losses pertaining to derivative contracts that do not qualify for hedge accounting treatment are also excluded from adjusted operating income. Trends in the underlying profitability of the Company s businesses can be more clearly identified without the fluctuating effects of these transactions.

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

|  | Three Months Ended <br> September 30, <br> $\mathbf{2 0 1 1}$ <br> (in millions) |  |  | Nine Months Ended <br> September 30, <br> $\mathbf{2 0 1 2}$ |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| 2011 |  |  |  |  |

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

Current Period Yield Adjustments. The Company uses interest rate and currency swaps and other derivatives to manage interest and currency exchange rate exposures arising from mismatches between assets and liabilities, including duration mismatches. For derivative contracts that do

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not qualify for hedge accounting treatment, the periodic swap settlements, as well as certain other derivative related yield adjustments are recorded in Realized investment gains (losses), net , and are included in adjusted operating income to reflect the after-hedge yield of the underlying instruments. In certain instances, when these derivative contracts are terminated or offset before their final maturity, the resulting realized gains or losses are recognized in adjusted operating income over periods that generally approximate the expected terms of the derivatives or underlying instruments in order for adjusted operating income to reflect the after-hedge yield of the underlying instruments. Included in the amounts

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## PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

shown in the table above are gains on certain derivatives contracts that were terminated or offset in prior periods of $\$ 16$ million and $\$ 13$ million for the three months ended September 30, 2012 and 2011, respectively, and $\$ 46$ million and $\$ 37$ million for the nine months ended September 30, 2012 and 2011, respectively. Additionally, as of September 30, 2012, there was a $\$ 593$ million deferred net gain related to certain derivative contracts that were terminated or offset in prior periods, primarily in the International Insurance segment.

Principal Source of Earnings. The Company conducts certain activities for which realized investment gains and losses are a principal source of earnings for its businesses and therefore included in adjusted operating income, particularly within the Company s Asset Management segment. For example, Asset Management s strategic investing business makes investments for sale or syndication to other investors or for placement or co-investment in the Company s managed funds and structured products. The realized investment gains and losses associated with the sale of these strategic investments, as well as related derivative results, are a principal activity for this business and included in adjusted operating income. In addition, the realized investment gains and losses associated with loans originated by the Company s commercial mortgage operations, as well as related derivative results and retained mortgage servicing rights, are a principal activity for this business and included in adjusted operating income. The amounts shown in the table above for the nine months ended September 30, 2012 reflect the impact of the Asset Management segment s out of period adjustment discussed above.

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

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

|  | Three Months Ended September 30, |  |  | Nine Months Ended September 30, |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2012 |  | 2011 | 2012 |  | 2011 |
|  | (in millions) |  |  |  |  |  |
| Net gains (losses) from: |  |  |  |  |  |  |
| Other trading account assets | \$ 26 | \$ | (104) | \$ 59 |  | (47) |
| Foreign currency exchange movements | \$ (347) | \$ | 1,316 | \$ (223) |  | 1,093 |
| Other activities | \$ (8) | \$ | (49) | \$ 30 |  | (103) |

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

Foreign Currency Exchange Movements. The Company has certain assets and liabilities for which, under U.S. GAAP, the changes in value, including those associated with changes in foreign currency exchange rates during the period, are recorded in Asset management fees and other

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income. To the extent the foreign currency exposure on these assets and liabilities is economically hedged or considered part of the Company s capital funding strategies for its international subsidiaries, the change in value included in Asset management fees and other income is excluded from adjusted operating income. The amounts in the table above are largely driven by non-yen denominated insurance liabilities in the Company s Japanese insurance operations. The insurance liabilities are supported by investments denominated in corresponding currencies, including a significant portion designated as available-for-sale. While these non-yen denominated assets and liabilities are economically hedged, under U.S. GAAP, unrealized gains and losses on available-for-sale investments, including those arising

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## PRUDENTIAL FINANCIAL, INC.

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

from foreign currency exchange rate movements, are recorded in Accumulated other comprehensive income (loss), while the non-yen denominated liabilities are re-measured for foreign currency exchange rate movements, and the related change in value is recorded in earnings within Asset management fees and other income. Due to this non-economic volatility that is reflected in U.S. GAAP earnings, the change in value recorded within Asset management fee and other income is excluded from adjusted operating income.

Included in the $\$ 1,093$ million net gain for the nine months ended September 30, 2011 is an out of period adjustment recorded in the first quarter of 2011 that decreased income from continuing operations before equity in earnings of operating joint ventures by $\$ 95$ million.

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

In connection with the settlement of disputes arising out of the Chapter 11 bankruptcy petition filed by Lehman Brothers Holdings Inc., the Company recorded additional losses of $\$ 65$ million in the first quarter of 2011 related to a portion of its counterparty exposure on derivative transactions it had previously held with Lehman Brothers and its affiliates. These losses are recorded within Asset management fees and other income within the Company s Corporate and Other operations. Consistent with the exclusion of credit-related losses recorded in Realized investment gains (losses), net , the impact of this settlement is excluded from adjusted operating income. In the second quarter of 2012, the Company recorded a $\$ 12$ million estimated recovery of this settlement, which is also excluded from adjusted operating income.

The Company records an adjustment for non-performance risk that relates to the uncollateralized portion of certain derivative contracts between a subsidiary of the Company and third parties. These adjustments are recorded within Asset management fees and other income. Consistent with the exclusion of the mark-to-market on derivatives recorded in Realized investment gains (losses), net , the impact of the non-performance risk is excluded from adjusted operating income. The net impact of the non-performance risk was to exclude from adjusted operating income net losses of $\$ 2$ million and $\$ 45$ million for the three months ended September 30, 2012 and 2011, respectively, and net gains of $\$ 32$ million and net losses of $\$ 33$ million for the nine months ended September 30, 2012 and 2011, respectively.

## Related charges

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

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

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

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

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## PRUDENTIAL FINANCIAL, INC.

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

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

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

Adjusted operating income excludes net investment gains and losses on trading account assets supporting insurance liabilities, which is consistent with the exclusion of realized investment gains and losses with respect to other investments supporting insurance liabilities managed on a consistent basis. In addition, to be consistent with the historical treatment of charges related to realized investment gains and losses on investments, adjusted operating income also excludes the change in contractholder liabilities due to asset value changes in the pool of investments (including changes in the fair value of commercial mortgage and other loans) supporting these experience-rated contracts, which are reflected in Interest credited to policyholders account balances. These adjustments are in addition to the exclusion from adjusted operating income of net investment gains and losses on the related derivatives and commercial mortgage and other loans through Realized investment gains (losses), net, and related charges and adjustments, as discussed above. The result of this approach is that adjusted operating income for these products includes net fee revenue and interest spread the Company earns on these experience-rated contracts, and excludes changes in fair value of the pool of investments, both realized and unrealized, that are expected to ultimately accrue to the contractholders.

## Divested businesses

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

In July 2012, the Company announced its decision to cease sales of group long-term care insurance reflecting the challenging economics of the long-term care market including the continued low interest rate environment as well as its desire to focus resources on its core group life and disability businesses. The Company discontinued sales of group long-term care products effective August 1, 2012, or a later date as may be required by specific state law. The Company notified its clients of its intent to continue to accept enrollments on existing group long-term care contracts through June 30, 2013 or later as required by contractual provisions. In March 2012, the Company also discontinued sales of individual long-term care products. As a result of the decision to wind down this business, the Company has reflected the results of the long-term care insurance business, previously reported within the Group Insurance segment, as a divested business for all periods presented.

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

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

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## PRUDENTIAL FINANCIAL, INC.

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

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

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, 20122011 |  |
| :---: | :---: | :---: | :---: | :---: |
| Adjusted Operating Income before income taxes for Financial Services Businesses by Segment: |  |  |  |  |
| Individual Annuities | \$ 207 | \$ (192) | \$ 735 | \$ 289 |
| Retirement | 110 | 111 | 413 | 454 |
| Asset Management | 187 | 123 | 356 | 504 |
| Total U.S. Retirement Solutions and Investment Management Division | 504 | 42 | 1,504 | 1,247 |
| Individual Life | 112 | 111 | 285 | 344 |
| Group Insurance | 35 | 45 | 28 | 121 |
| Total U.S. Individual Life and Group Insurance Division | 147 | 156 | 313 | 465 |
| International Insurance | 783 | 660 | 2,070 | 1,788 |
| Total International Insurance Division | 783 | 660 | 2,070 | 1,788 |
| Corporate Operations | (452) | (349) | $(1,079)$ | (858) |
| Total Corporate and Other | (452) | (349) | $(1,079)$ | (858) |
| Adjusted Operating Income before income taxes for Financial Services Businesses | 982 | 509 | 2,808 | 2,642 |
| Reconciling items: |  |  |  |  |
| Realized investment gains (losses), net, and related adjustments | $(1,951)$ | 3,385 | $(1,609)$ | 3,175 |
| Charges related to realized investment gains (losses), net | 648 | $(1,568)$ | 498 | $(1,732)$ |
| Investment gains (losses) on trading account assets supporting insurance liabilities, net | 264 | 10 | 502 | 170 |
| Change in experience-rated contractholder liabilities due to asset value changes | (254) | 68 | (446) | (76) |
| Divested businesses | (685) | 43 | (657) | 49 |
| Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests | (40) | (87) | (27) | (201) |

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Income (loss) from continuing operations before income taxes and equity in earnings of
operating joint ventures for Financial Services Businesses

Income from continuing operations before income taxes and equity in earnings of operating joint ventures for Closed Block Business

Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures
\$ (967) \$ 2,406 \$ 1,166 \$ 4,118

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## PRUDENTIAL FINANCIAL, INC.

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

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

The summary below presents revenues for the Company s reportable segments:

|  | Three Months Ended <br> September 30, <br> $\mathbf{2 0 1 1}$ <br> (in millions) | Nine Months Ended <br> September 30, <br> $\mathbf{2 0 1 2}$ |
| :--- | ---: | ---: | ---: | ---: | ---: |
| 2011 |  |  |

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

|  | Three Months Ended September 30, |  | Nine Months Ended September 30, |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2012 | 2011 | 2012 |  | 2011 |
|  | (in millions) |  |  |  |  |
| Asset Management segment intersegment revenues | \$ 136 | \$ 122 | \$ 395 |  | 353 |

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## PRUDENTIAL FINANCIAL, INC.

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

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

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

|  | $\begin{gathered} \text { September } 30 \\ 2012 \end{gathered}$ | ons | mber 31, <br> 2011 |
| :---: | :---: | :---: | :---: |
| Individual Annuities | \$ 145,994 | \$ | 123,394 |
| Retirement | 135,572 |  | 131,947 |
| Asset Management | 39,848 |  | 37,307 |
| Total U.S. Retirement Solutions and Investment Management Division | 321,414 |  | 292,648 |
| Individual Life | 45,784 |  | 43,061 |
| Group Insurance | 36,274 |  | 33,756 |
| Total U.S. Individual Life and Group Insurance Division | 82,058 |  | 76,817 |
| International Insurance | 186,261 |  | 168,961 |
| Total International Insurance Division | 186,261 |  | 168,961 |
| Corporate Operations | 10,576 |  | 12,574 |
| Total Corporate and Other | 10,576 |  | 12,574 |
| Total Financial Services Businesses | 600,309 |  | 551,000 |
| Closed Block Business | 71,389 |  | 69,244 |
| Total | \$ 671,698 | \$ | 620,244 |

## 12. INCOME TAXES

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

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they are fully utilized. The completion of review or the expiration of the statute of limitations for a given audit period could result in an adjustment to the liability for income taxes. The statute of limitations for the 2004 through 2006 tax years will expire in June 2013, unless extended. The statute of limitations for the 2007 through 2008 tax years will expire in December 2013, unless extended. Tax years 2009 through 2011 are still open for IRS examination. It is reasonably possible that the total amount of unrecognized tax benefits will decrease anywhere from $\$ 0$ to $\$ 83$ million within the next 12 months due to the completion of the IRS examination for tax years 2007 through 2010.

During 2004 through 2006, the Company entered into two transactions that involved, among other things, the payment of foreign income taxes that were credited against the Company s U.S. tax liability. On May 23, 2011, the IRS issued notices of proposed adjustments disallowing the foreign tax credits claimed and related transaction expenses. The total amount of the proposed adjustments for the transactions was approximately $\$ 200$ million of tax and penalties. During the fourth quarter of 2011, the Company reached agreement with the IRS on the resolution of the proposed foreign tax credits disallowance. The impact to the 2011 results attributable to the settlement was an increase to tax expense of approximately $\$ 93$ million. The settlement of the foreign tax credit

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# PRUDENTIAL FINANCIAL, INC. 

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

transactions for 2004 through 2006 marked the conclusion of the IRS audits for those years. As a result, all unrecognized tax positions plus interest relating to tax years prior to 2007 were recognized in 2011. As such, 2011 benefited from a reduction to the liability for unrecognized tax benefits of $\$ 70$ million, including the impact from the foreign tax credit disallowance.

The dividends received deduction ( DRD ) reduces the amount of dividend income subject to U.S. tax and is a significant component of the difference between the Company s effective tax rate and the federal statutory tax rate of $35 \%$. The DRD for the current period was estimated using information from 2011, current year results, and was adjusted to take into account the current year s equity market performance. The actual current year DRD can vary from the estimate based on factors such as, but not limited to, changes in the amount of dividends received that are eligible for the DRD, changes in the amount of distributions received from mutual fund investments, changes in the account balances of variable life and annuity contracts, and the Company s taxable income before the DRD.

In August 2007, the IRS released Revenue Ruling 2007-54, which included, among other items, guidance on the methodology to be followed in calculating the DRD related to variable life insurance and annuity contracts. In September 2007, the IRS released Revenue Ruling 2007-61. Revenue Ruling 2007-61 suspended Revenue Ruling 2007-54 and informed taxpayers that the U.S. Treasury Department and the IRS intend to address through new guidance the issues considered in Revenue Ruling 2007-54, including the methodology to be followed in determining the DRD related to variable life insurance and annuity contracts. On February 13, 2012, the Obama Administration released the General Explanations of the Administration s Revenue Proposals. One proposal would change the method used to determine the amount of the DRD. A change in the DRD, including the possible retroactive or prospective elimination of this deduction through guidance or legislation, could increase actual tax expense and reduce the Company s consolidated net income. These activities had no impact on the Company s results in 2011 or first nine months of 2012.

For tax years 2007 through 2011, the Company is participating in the IRS s Compliance Assurance Program ( CAP ). Under CAP, the IRS assigns an examination team to review completed transactions contemporaneously during these tax years in order to reach agreement with the Company on how they should be reported in the tax returns. If disagreements arise, accelerated resolutions programs are available to resolve the disagreements in a timely manner before the tax returns are filed. It is management s expectation this program will shorten the time period between the filing of the Company s federal income tax returns and the IRS s completion of its examination of the returns.

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## PRUDENTIAL FINANCIAL, INC.

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

Total income tax expense includes additional tax expense related to the utilization of deferred tax assets recorded in the Statement of Financial Position as of the acquisition date for Prudential Gibraltar Financial Life Insurance Company, Ltd. ( PGFL ) and the Star and Edison Businesses. The balance of additional U.S. GAAP tax expense to be recognized in the future related to the utilization of opening balance sheet deferred tax assets is as follows:
$\left.\begin{array}{l|ccc} & & \begin{array}{c}\text { Star and } \\ \text { Edison } \\ \text { Businesses } \\ \text { (in millions) }\end{array} \\ \text { Total }\end{array}\right]$

On January 1, 2012, the Star and Edison Businesses merged into Gibraltar Life Insurance Company, Ltd. The majority of additional U.S. tax expense recognized in the first nine months of 2012 is a result of the merger. The annual amount of additional tax expense related to the utilization of opening balance sheet deferred tax assets will be significantly lower in the future. As a result, the remaining $\$ 102$ million of the additional tax expense will be recognized over an extended period of time.

## 13. FAIR VALUE OF ASSETS AND LIABILITIES

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. The authoritative guidance around fair value 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 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. The Company s Level 1 assets and

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

Level 2 Fair value is based on significant inputs, other than quoted prices included in Level 1, that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability through corroboration with observable market data. Level 2 inputs include quoted market prices in active markets for similar assets and liabilities, quoted market prices in markets that are not active for identical or similar assets or liabilities, and other market observable inputs. The Company s Level 2 assets and liabilities

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## PRUDENTIAL FINANCIAL, INC.

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

include: fixed maturities (corporate public and private bonds, most government securities, certain asset-backed and mortgage-backed securities, etc.), certain equity securities (mutual funds, which do not actively trade and are priced based on a net asset value), certain commercial mortgage loans, short-term investments and certain cash equivalents (primarily commercial paper), and certain over-the-counter derivatives.

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

The Company has established policies and guidelines that require the establishment of valuation methodologies and consistent application of such methodologies. These policies and guidelines govern the use of inputs and price source hierarchies and provide controls around the valuation processes. These controls include appropriate review and analysis of prices against market activity or indicators of reasonableness, approval of price source changes, price overrides, methodology changes and classification of fair value hierarchy levels. The valuation policies and guidelines are reviewed and updated as appropriate.

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## PRUDENTIAL FINANCIAL, INC.

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

Assets and Liabilities by Hierarchy Level The tables below present the balances of assets and liabilities measured at fair value on a recurring basis, as of the dates indicated.
$\left.\begin{array}{lrrrrr} & & 2 & \text { As of September 30, 2012 } \\ \text { Level 3 } \\ \text { Netting(1) }\end{array}\right)$ Total

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| Cash equivalents | 1,999 | 7,368 | 0 |  | 9,367 |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Other assets | 64 | 113 | 8 |  | 185 |
| Subtotal excluding separate account assets | 16,068 | 314,956 | 8,511 | $(11,537)$ | 327,998 |
| Separate account assets(3) | 40,889 | 186,282 | 20,339 |  | 247,510 |
| Total assets | \$ 56,957 | \$ 501,238 | \$ 28,850 | \$ $(11,537)$ | \$ 575,508 |
| Future policy benefits | 0 | \$ 0 | \$ 3,638 | \$ | \$ 3,638 |
| Other liabilities | 0 | 8,460 | 395 | $(8,290)$ | 565 |
| Total liabilities | \$ 0 | \$ 8,460 | \$ 4,033 | \$ (8,290) | \$ 4,203 |

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## PRUDENTIAL FINANCIAL, INC.

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

|  | As of December 31, 2011 (4) |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Level 1 | Level 2 | Level 3 (in millions) | Netting(1) | Total |
| Fixed maturities, available-for-sale: |  |  |  |  |  |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | \$ 0 | \$ 15,066 | \$ 66 | \$ | \$ 15,132 |
| Obligations of U.S. states and their political subdivisions | 0 | 2,740 | 0 |  | 2,740 |
| Foreign government bonds | 0 | 77,010 | 25 |  | 77,035 |
| Corporate securities | 12 | 125,650 | 1,450 |  | 127,112 |
| Asset-backed securities | 0 | 8,165 | 2,528 |  | 10,693 |
| Commercial mortgage-backed securities | 0 | 11,935 | 145 |  | 12,080 |
| Residential mortgage-backed securities | 0 | 9,840 | 16 |  | 9,856 |
| Subtotal | 12 | 250,406 | 4,230 |  | 254,648 |
| Trading account assets supporting insurance liabilities: |  |  |  |  |  |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | 0 | 177 | 9 |  | 186 |
| Obligations of U.S. states and their political subdivisions | 0 | 254 | 0 |  | 254 |
| Foreign government bonds | 0 | 608 | 0 |  | 608 |
| Corporate securities | 0 | 11,004 | 109 |  | 11,113 |
| Asset-backed securities | 0 | 1,010 | 357 |  | 1,367 |
| Commercial mortgage-backed securities | 0 | 2,226 | 21 |  | 2,247 |
| Residential mortgage-backed securities | 0 | 1,842 | 2 |  | 1,844 |
| Equity securities | 769 | 122 | 20 |  | 911 |
| Short-term investments and cash equivalents | 684 | 267 | 0 |  | 951 |
| Subtotal | 1,453 | 17,510 | 518 |  | 19,481 |
| Other trading account assets: |  |  |  |  |  |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | 0 | 31 | 0 |  | 31 |
| Obligations of U.S. states and their political subdivisions | 0 | 0 | 0 |  | 0 |
| Foreign government bonds | 2 | 45 | 0 |  | 47 |
| Corporate securities | 14 | 502 | 39 |  | 555 |
| Asset-backed securities | 0 | 593 | 59 |  | 652 |
| Commercial mortgage-backed securities | 0 | 96 | 14 |  | 110 |
| Residential mortgage-backed securities | 0 | 94 | 2 |  | 96 |
| Equity securities | 305 | 40 | 1,276 |  | 1,621 |
| All other(2) | 15 | 13,547 | 93 | $(11,222)$ | 2,433 |
| Subtotal | 336 | 14,948 | 1,483 | $(11,222)$ | 5,545 |
| Equity securities, available-for-sale | 5,004 | 2,171 | 360 |  | 7,535 |
| Commercial mortgage and other loans | 0 | 514 | 86 |  | 600 |
| Other long-term investments | 193 | (11) | 1,110 |  | 1,292 |
| Short-term investments | 5,506 | 3,254 | 0 |  | 8,760 |
| Cash equivalents | 2,667 | 6,762 | 0 |  | 9,429 |
| Other assets | 3 | 86 | 9 |  | 98 |
| Subtotal excluding separate account assets | 15,174 | 295,640 | 7,796 | $(11,222)$ | 307,388 |


| Separate account assets(3) | 40,319 | 158,703 |  | 19,358 |  |  | 218,380 |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Total assets | $\$ 55,493$ | $\$ 454,343$ | $\$ 27,154$ | $\$(11,222)$ | $\$ 525,768$ |  |  |  |
| Future policy benefits | $\$$ | 0 | $\$$ | 0 | $\$ 2,886$ | $\$$ |  | $\$ 2,886$ |
| Other liabilities |  | 0 |  | 8,013 | 285 | $(7,854)$ | 444 |  |
| Total liabilities | $\$$ | 0 | $\$$ | 8,013 | $\$ 3,171$ | $\$(7,854)$ | $\$$ | 3,330 |

(1) Netting amounts represent cash collateral of $\$ 3,247$ million and $\$ 3,368$ million as of September 30, 2012 and December 31, 2011, respectively, and the impact of offsetting asset and liability positions held with the same counterparty.

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## PRUDENTIAL FINANCIAL, INC.

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

(2) Primarily represents derivative assets.
(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 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.
(4) Includes reclassifications to conform to current period presentation.

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

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

Internally-developed valuations or indicative broker quotes are also used to determine fair value in circumstances where vendor pricing is not available, or where the Company ultimately concludes that pricing information received from the independent pricing service is not reflective of market activity. If the Company concludes the values from both pricing services and brokers are not reflective of market activity, it may over-ride the information from the pricing service or broker with an internally-developed valuation. As of September 30, 2012 and December 31, 2011, over-rides on a net basis were not material. These estimates may use significant unobservable inputs, which reflect the Company s own assumptions about the inputs market participants would use in pricing the asset. Pricing service over-rides, internally-developed valuations and indicative broker quotes are generally included in Level 3 in the fair value hierarchy.

The fair value of private fixed maturities, which are comprised of investments in private placement securities, originated by internal private asset managers, are primarily determined using a discounted cash flow model. In cases where these models primarily use observable inputs, the securities have been reflected within Level 2. For certain private fixed maturities, the discounted cash flow model may also incorporate significant unobservable inputs, which reflect the Company s own assumptions about the inputs market participants would use in pricing the asset. In these cases, a Level 3 classification is used.

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

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Trading Account Assets Trading account assets (including trading account assets supporting insurance liabilities) consist primarily of public corporate bonds, treasuries, equity securities and derivatives whose fair values are determined consistent with similar instruments described above under Fixed Maturity Securities and below under Equity Securities and Derivative Instruments.

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## PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

Equity Securities Equity securities consist principally of investments in common and preferred stock of publicly traded companies, perpetual preferred stock, privately traded securities, as well as mutual fund shares. The fair values of most publicly traded equity securities are based on quoted market prices in active markets for identical assets and are classified within Level 1 in the fair value hierarchy. Estimated fair values for most privately traded equity securities are determined using valuation and discounted cash flow models that require a substantial level of judgment. As these models may use unobservable inputs, most privately traded equity securities are classified within Level 3 . The fair values of mutual fund shares that transact regularly (but do not trade in active markets because they are not publicly available) are based on transaction prices of identical fund shares and are classified within Level 2 in the fair value hierarchy. The fair values of perpetual preferred stock are based on inputs obtained from independent pricing services that are primarily based on indicative broker quotes, as the directly observable market inputs are not available. As a result, the fair values of perpetual preferred stock are classified as Level 3.

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

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

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

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

The fair value of real estate held in consolidated investment funds is determined through an independent appraisal process. The appraisals generally utilize a discounted cash flow model. The cash flow approach is supplemented with replacement cost estimates and comparable recent sales data when available. These appraisals and the related assumptions are updated at least annually. Since many of the assumptions utilized are

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unobservable and are considered to be significant inputs to the valuation, the real estate investments within other long-term investments have been reflected within Level 3 in the fair value hierarchy.

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## PRUDENTIAL FINANCIAL, INC.

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

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

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

The majority of the Company s derivative positions is traded in the over-the-counter ( OTC ) derivative market and are classified within Level 2 in the fair value hierarchy. OTC derivatives classified within Level 2 are valued using models that utilize actively quoted or observable market input values from external market data providers, third-party pricing vendors and/or recent trading activity. The Company s policy is to use mid-market pricing in determining its best estimate of fair value. The fair values of most OTC derivatives, including interest rate and cross currency swaps, currency forward contracts, commodity swaps, commodity forward contracts, single name credit default swaps, loan commitments held for sale and to-be-announced (or TBA) forward contracts on highly rated mortgage-backed securities issued by U.S. government sponsored entities are determined using discounted cash flow models. The fair values of European style option contracts are determined using Black-Scholes option pricing models. These models key inputs include the contractual terms of the respective contract, along with significant observable inputs, including interest rates, currency rates, credit spreads, equity prices, index dividend yields, non-performance risk, volatility and other factors.

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

Derivatives classified as Level 3 include first-to-default credit basket swaps, look-back equity options and other structured products. These derivatives are valued based upon models with some significant unobservable market inputs or inputs from less actively traded markets. The fair values of first-to-default credit basket swaps are derived from relevant observable inputs (e.g. individual credit default spreads, interest rates and recovery rates), and unobservable model-specific input values such as correlation between different credits within the same basket. Look-back equity options and other structured options and derivatives are valued using simulation models such as the Monte Carlo and other techniques. The input values for look-back equity options are derived from observable market indices (e.g. interest rates, dividend yields and equity indices), and unobservable model-specific input values including certain volatility parameters. Level 3 methodologies are validated through periodic comparison of the Company sfair values to broker-dealer values.

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Cash Equivalents and Short-Term Investments Cash equivalents and short-term investments include money market instruments, commercial paper and other highly liquid debt instruments. Certain money market instruments are valued using unadjusted quoted prices in active markets that are accessible for identical assets and are primarily classified as Level 1. The remaining instruments in the Cash Equivalents and Short-term Investments category are typically not traded in active markets; however, their fair values are generally based on

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## PRUDENTIAL FINANCIAL, INC.

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

market observable inputs and, accordingly, these investments have primarily been classified within Level 2 in the fair value hierarchy.

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

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

Future Policy Benefits The liability for future policy benefits primarily includes general account liabilities for guarantees on variable annuity contracts, including guaranteed minimum accumulation benefits (GMAB), guaranteed minimum withdrawal benefits (GMWB ) and guaranteed minimum income and withdrawal benefits ( GMIWB ), accounted for as embedded derivatives. The fair values of the GMAB, GMWB and GMIWB liabilities are calculated as the present value of future expected benefit payments to customers less the present value of assessed rider fees attributable to the embedded derivative feature. This methodology could result in either a liability or contra-liability balance, given changing capital market conditions and various policyholder behavior assumptions. Since there is no observable active market for the transfer of these obligations, the valuations are calculated using internally-developed models with option pricing techniques. The models are based on a risk neutral valuation framework and incorporate premiums for risks inherent in valuation techniques, inputs, and the general uncertainty around the timing and amount of future cash flows. The determination of these risk premiums requires the use of management judgment.

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

Capital market inputs and actual policyholders account values are updated each quarter based on capital market conditions as of the end of the quarter, including interest rates, equity markets and implied volatility. In the risk neutral valuation, interest rates are used to both grow the policyholders account values and discount all projected future cash flows. The Company s discount rate assumption is based on the LIBOR swap curve, and is adjusted for NPR, as discussed below. Assuming all other assumptions remain unchanged, a decline in interest rates will generally cause account values to grow more slowly, increasing future expected benefit payments, as well as decreasing the discounting impact in the present value calculation, both of which would cause increases in the fair value of the liability. The opposite impacts occur as interest rates rise. Implied volatility also impacts the estimate of future expected benefit payments, as discussed below.

Actuarial assumptions are reviewed at least annually, and updated based upon historical experience giving consideration to any observable market data, including available industry studies or market transactions such as acquisitions and reinsurance transactions. Assumptions relating

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to contractholder behavior such as lapse, benefit utilization, withdrawal, and mortality rates, are based on experience by product type and/or year of contract issuance, as well as available industry studies. Unless a material change in contractholder behavior or mortality experience that the Company feels is indicative of a long term trend is observed in an interim period, assumptions related to contractholder behavior and mortality are generally updated in the third quarter of each

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## PRUDENTIAL FINANCIAL, INC.

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

year by considering recent experience that has occurred during the period from the most recent update to the expected amounts or updates to industry studies. These assumptions require the use of management judgment and are discussed in further detail below.

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

|  | As of September 30, 2012 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Internal(1) | External(2) (in millions) |  |  | Total |
| U.S. Treasury securities and obligations of U.S. government authorities and agencies | \$ 0 | \$ | 75 |  | \$ 75 |
| Foreign government bonds | 3 |  | 0 |  | 3 |
| Corporate securities | 1,034 |  | 776 |  | 1,810 |
| Asset-backed securities | 294 |  | 3,304 |  | 3,598 |
| Commercial mortgage-backed securities | 85 |  | 191 |  | 276 |
| Residential mortgage-backed securities | 3 |  | 10 |  | 13 |
| Equity securities | 123 |  | 1,491 |  | 1,614 |
| Commercial mortgage and other loans | 68 |  | 0 |  | 68 |
| Other long-term investments | 8 |  | 1,006 |  | 1,014 |
| Other assets | 40 |  | 0 |  | 40 |
| Subtotal excluding separate account assets(3) | 1,658 |  | 6,853 |  | 8,511 |
| Separate account assets | 19,646 |  | 693 |  | 20,339 |
| Total assets | \$ 21,304 | \$ | 7,546 |  | \$ 28,850 |
| Future policy benefits | \$ 3,638 | \$ | 0 |  | \$ 3,638 |
| Other liabilities | 1 |  | 394 |  | 395 |
| Total liabilities | \$ 3,639 | \$ | 394 |  | \$ 4,033 |

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## PRUDENTIAL FINANCIAL, INC.

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

Quantitative Information Regarding Internally-Priced Level 3 Assets and Liabilities The table below presents quantitative information on significant internally-priced Level 3 assets and liabilities for which the investment risks associated with market value changes are borne by the Company.

(1) EBITDA multiples represent multiples of earnings before interest, taxes, depreciation and amortization, and are amounts used when the reporting entity has determined that market participants would use such multiples when pricing the investments.
(2) Range reflects the mortality rate for the vast majority of business with living benefits, with policyholders ranging from 35 to 90 years old. While the majority of living benefits have a minimum age requirement, certain benefits do not have an age restriction. This results in contractholders for certain benefits with mortality rates approaching $0 \%$.

Sensitivity to Changes in Unobservable Inputs The following is a general description of sensitivities of significant unobservable inputs and their impact on the fair value measurement, for the assets and liabilities reflected in the table above.

Corporate Securities Internally-priced corporate securities classified in Level 3 include certain below investment grade watchlist and distressed fixed maturity securities. For securities where discounted cash flows are used, the primary unobservable input is an internally-developed discount rate. Significant increases (decreases) in the discount rate would result in a significantly lower (higher) fair value measurement. In certain cases, the Company uses an estimated liquidation value of the borrower or underlying assets. The Company also applies market comparables, such as earnings before interest, taxes, depreciation and amortization (EBITDA) multiples for certain securities. In isolation, an increase (decrease) in the value of these inputs would result in a higher (lower) fair value measurement.

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## PRUDENTIAL FINANCIAL, INC.

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


#### Abstract

Asset-Backed Securities Asset-backed securities classified in Level 3 are primarily valued internally using a discounted cash flow technique. Unobservable inputs are the prepayment rate, default rate, loss severity, liquidity premium and comparable security spreads. In isolation, an increase in prepayment rate or a decrease in default rate or loss severity would generally result in an increase in fair value, although the interrelationships between these inputs depend on specific market conditions. However, in stressed markets, prepayment rates tend to decrease, while default rates and loss severities tend to increase. These changes will result in a decrease in fair value. In other cases where a liquidity premium and/or comparable security spreads and yields are used, a significant increase in either of these inputs can produce a significant decrease in fair value.


Future Policy Benefits Future policy benefits classified as Level 3 are calculated using internally-developed models with option pricing techniques. The models are based on a risk neutral valuation framework and incorporate premiums for risks inherent in valuation techniques, inputs and the general uncertainty around the timing and amount of future cash flows. As described above, the significant unobservable inputs to the valuation models for the embedded derivatives associated with the optional living benefit features of the Company s variable annuity products include various assumptions that are actuarially determined, including lapse rates, benefit utilization rates, withdrawal rates and mortality rates as well as volatility assumptions and assumptions used to reflect NPR.

The Company s dynamic lapse rate assumption adjusts the base lapse rate at the contract level based on a comparison of the actuarially calculated guaranteed amount and the current policyholder account value as well as other factors, such as the applicability of any surrender charges. The dynamic lapse adjustment reduces the base lapse rate based on the magnitude of the difference between the guaranteed amount and the account value. In-the-money contracts are those with a guaranteed benefit in excess of the current policyholder account value. Since in-the-money contracts are less likely to lapse, the dynamic lapse adjustment will reduce the lapse rate assumption for these contracts. For less in-the-money contracts, the lapse rate assumption will be closer to the base lapse rate. Lapse rates are also generally assumed to be lower for the period where surrender charges apply. A higher base lapse rate is applied to contracts in the year the surrender charge period expires.

To reflect NPR, the Company incorporates an additional spread over LIBOR into the discount rate used in the valuations of the embedded derivatives associated with its optional living benefit features. Since insurance liabilities are senior to debt, the Company believes that reflecting the financial strength ratings of the Company s insurance subsidiaries in the valuation of the liability or asset appropriately takes into consideration NPR. The additional spread over LIBOR is determined taking into consideration publicly available information relating to the financial strength of the Company s insurance subsidiaries, as indicated by the credit spreads associated with funding agreements issued by these subsidiaries. The Company adjusts these credit spreads to remove any illiquidity risk premium, which is subject to a floor based on a percentage of the credit spread. This additional spread is applied at an individual contract level and only to those individual living benefit contracts in a liability position and generally not to those in a contra-liability position. An increase in the spread over LIBOR increases the discounting impact in the present value calculation and will generally cause a decrease in the fair value of the liability.

The Company s benefit utilization rate assumption estimates the percentage of contracts that will utilize the benefit during the contract duration, including the estimated timing of the first lifetime income withdrawal by the contractholder. These assumptions vary based on the product type, the age of the contractholder and the age of the contract. The utilization rate varies by product, based on the availability of an enhanced guarantee after a certain waiting period. For example, the utilization rates for a product with the opportunity to double the guaranteed value after a 10,12 or 20 year accumulation period are adjusted based on contractholder experience related to such enhancement. Generally, the Company assumes a certain percentage of contractholders will utilize the guaranteed benefit (depending on the product type, contractholder age and contract age) and will begin

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## PRUDENTIAL FINANCIAL, INC.

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

lifetime withdrawals at various time intervals from contract inception, with the remaining contractholders either beginning lifetime withdrawals immediately or never utilizing the benefit. The impact of changes in these assumptions is highly dependent on the contract type and age of the contractholder at the time of the sale and the timing of the first lifetime income withdrawal.

The Company s withdrawal rate assumption estimates the magnitude of annual contractholder withdrawals relative to the maximum allowable amount under the contract. Larger differences in the withdrawal rate assumption compared to the contractual guaranteed income withdrawal percentage, either positive or negative, will generally result in a decrease in the fair value of the liability. Prior to the exhaustion of the contractholder s total account value, the Company assumes contractholders will withdraw a certain percentage of the maximum allowable amount under the contract and will withdraw the maximum once the contractholder account value is completely exhausted.

Based on historical experience, the Company applies a set of age specific mortality rate adjustments compared to standard industry tables. For newly issued contracts, lower mortality rates are assumed in early durations. A mortality improvement assumption is also incorporated into the overall mortality table. Since the variable annuity living benefits generally provide for a minimum withdrawal benefit for life, increases in mortality rates will decrease the fair value of the liability, with the reverse being true with decreases in mortality rates.

Market volatility also impacts the estimate of future expected benefit payments. The Company uses an equity volatility curve based on third-party inputs. The curve starts with first year implied volatility and grades to a long-term realized volatility. The first year implied volatility determines the overall slope of the equity volatility curve. An increase in implied volatility will generally increase future expected benefit payments, causing an increase in the fair value of the liability.

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

Real Estate and Other Invested Assets Separate account assets include $\$ 18,467$ million of investments in real estate as of September 30, 2012 that are classified as Level 3 and reported at fair value. In general, these fair value estimates are based on property appraisal reports prepared by independent real estate appraisers. Key inputs and assumptions to the appraisal process include rental income and expense amounts, related growth rates, discount rates and capitalization rates. In cases where real estate investments are made through indirect investments, fair value is generally determined by the Company s equity in net assets of the entities. The debt associated with real estate, other invested assets and the Company s equity position in entities are externally valued. Because of the subjective nature of inputs and the judgment involved in the appraisal process, real estate investments and their corresponding debt are typically included in the Level 3 classification. Key unobservable inputs to real estate valuation include capitalization rates, which range from $4.75 \%$ to $10.5 \%$ ( $6.57 \%$ weighted average) and discount rates, which range from $6.25 \%$ to $12.0 \%$ ( $7.90 \%$ weighted average). Key unobservable inputs to real estate debt valuation include yield to maturity, which ranges from $2.17 \%$ to $7.64 \%$ ( $4.75 \%$ weighted average) and market spread over base rate, which ranges from $1.81 \%$ to $4.51 \%$ ( $3.30 \%$ weighted average).

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## PRUDENTIAL FINANCIAL, INC.

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

Commercial Mortgage Loans Separate account assets include $\$ 1,107$ million of commercial mortgage loans as of September 30, 2012 that are classified as Level 3 and reported at fair value. Commercial mortgage loans are primarily valued internally using discounted cash flow techniques, as described further under Fair Value of Financial Instruments. The primary unobservable input used is the spread to discount cash flows, which range from $1.70 \%$ to $5.67 \%$ ( $2.05 \%$ weighted average). In isolation, an increase (decrease) in the value of this input would result in a lower (higher) fair value measurement.

Transfers between Levels 1 and 2 Periodically there are transfers between Level 1 and Level 2 for foreign common stocks held in the Company s Separate Account. In certain periods, an adjustment may be made to the fair value of these assets beyond the quoted market price to reflect events that occurred between the close of foreign trading markets and the close of U.S. trading markets for the respective day. Such an adjustment was made at June 30, 2012, wherein $\$ 2.9$ billion of separate account equity investments transferred from Level 1 to Level 2 . No such adjustments were made at September 30, 2012, March 31, 2012 or December 31, 2011. During the three months ended September 30, 2012, $\$ 2.1$ billion of transfers from Level 2 to Level 1 were made for these Separate Account assets, resulting in a net basis of $\$ 0.8$ billion of assets transferred from Level 1 to Level 2 for the nine months ended September 30, 2012. During the three and nine months ended September 30, 2011, $\$ 2.6$ billion of transfers from Level 1 to Level 2 were made for these Separate Account assets.

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## PRUDENTIAL FINANCIAL, INC.

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

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

|  | Three Months Ended September 30, 2012 |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Fixed Maturities Available-For-Sale U.S. <br> Government Authorities | Fixed Maturities Available-For-Sale U.S. States |  | Fixed Maturities Available-For-Sale Foreign Government Bonds |  | Fixed <br> Maturities <br> Available- <br> For-Sale - <br> Corporate <br> Securities millions) |  | Fixed Maturities <br> Available- <br> For-Sale - <br> Asset- <br> Backed <br> Securities |  | Fixed Maturities Available-For-Sale Commercial MortgageBacked Securities |  |
| Fair Value, beginning of period | \$ 66 | \$ | 0 | \$ | 21 | \$ | 1,635 | \$ | 3,069 | \$ | 186 |
| Total gains (losses) (realized/unrealized): |  |  |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |  |  |
| Realized investment gains (losses), net | 0 |  | 0 |  | 0 |  | 0 |  | 10 |  | 2 |
| Included in other comprehensive income (loss) | 0 |  | 0 |  | 0 |  | 46 |  | 22 |  | 7 |
| Net investment income | 0 |  | 0 |  | 0 |  | 2 |  | 7 |  | 1 |
| Purchases | 0 |  | 0 |  | 0 |  | 100 |  | 793 |  | 10 |
| Sales | 0 |  | 0 |  | 0 |  | (91) |  | (381) |  | (2) |
| Issuances | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Settlements | 0 |  | 0 |  | 0 |  | (42) |  | (105) |  | (7) |
| Foreign currency translation | 0 |  | 0 |  | 0 |  | 3 |  | 2 |  | 0 |
| Other(4) | 0 |  | 0 |  | (5) |  | 5 |  | 0 |  | 0 |
| Transfers into Level 3(1) | 0 |  | 0 |  | 0 |  | 59 |  | 35 |  | 0 |
| Transfers out of Level 3(1) | 0 |  | 0 |  | (13) |  | (41) |  | (253) |  | (14) |
| Fair Value, end of period | \$ 66 | \$ | 0 | \$ | 3 | \$ | 1,676 | \$ | 3,199 | \$ | 183 |
| Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2): |  |  |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |  |  |
| Realized investment gains (losses), net | \$ 0 | \$ | 0 | \$ | 0 | \$ | 0 | \$ | 3 | \$ | 0 |

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## PRUDENTIAL FINANCIAL, INC.

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

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## PRUDENTIAL FINANCIAL, INC.

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

|  | Trading <br> Account <br> Assets <br> Supporting Insurance LiabilitiesEquity Securities | Three Months Ended September 30, 2012 |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | Other <br> Trading <br> Account <br> Assets- <br> Corporate <br> Securities |  | Other <br> Trading <br> Account <br> Assets- <br> Asset- <br> Backed <br> Securities (in millions) |  | Other <br> Trading Account AssetsCommercial MortgageBacked Securities |  | Other <br> Trading Account Assets- <br> Residential MortgageBacked Securities |  |
| Fair Value, beginning of period | \$ 19 | \$ | 37 | \$ | 54 | \$ | 12 | \$ | 1 |
| Total gains (losses) (realized/unrealized): |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |
| Asset management fees and other income | 0 |  | 0 |  | 2 |  | 1 |  | 0 |
| Net investment income | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Purchases | 0 |  | (1) |  | 0 |  | 0 |  | 0 |
| Sales | 0 |  | , |  | (1) |  | (2) |  | 0 |
| Issuances | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Settlements | 0 |  | 0 |  | (1) |  | (1) |  | 0 |
| Foreign currency translation | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Other(4) | 0 |  | 0 |  | 1 |  | 0 |  | (1) |
| Transfers into Level 3(1) | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Transfers out of Level 3(1) | 0 |  | 0 |  | (1) |  | 0 |  | 0 |
| Fair Value, end of period | \$ 19 | \$ | 38 | \$ | 54 | \$ | 10 | \$ | 0 |
| Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2): |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |
| Asset management fees and other income | \$ 0 | \$ | 0 | \$ | 1 | \$ | 0 | \$ | 0 |

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## PRUDENTIAL FINANCIAL, INC.

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

|  | Other <br> Trading <br> Account <br> Assets- <br> Equity <br> Securities |  |  | Equity Securities Available-for-Sale (in millions) |  | Commercial <br> Mortgage and Other Loans |  | Other <br> Long-term Investments |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Fair Value, beginning of period | \$ 1,222 | \$ | 45 | \$ | 355 | \$ | 37 | \$ | 1,042 |
| Total gains (losses) (realized/unrealized): |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |
| Realized investment gains (losses), net | 1 |  | (16) |  | (1) |  | 2 |  | 3 |
| Asset management fees and other income | 20 |  | 1 |  | 0 |  | 0 |  | 5 |
| Included in other comprehensive income (loss) | 0 |  | 0 |  | (6) |  | 0 |  | 0 |
| Net investment income | 0 |  | 0 |  | 0 |  | 0 |  | (1) |
| Purchases | 0 |  | 0 |  | 6 |  | 0 |  | 44 |
| Sales | (2) |  | 0 |  | (9) |  | 0 |  | (3) |
| Issuances | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Settlements | (32) |  | , |  | 0 |  | 29 |  | (45) |
| Foreign currency translation | 7 |  | 0 |  | 1 |  | 0 |  | 0 |
| Other(4) | 0 |  | 0 |  | 0 |  | 0 |  | 11 |
| Transfers into Level 3(1) | 33 |  | 0 |  | 0 |  | 0 |  | 0 |
| Transfers out of Level 3(1) | 0 |  | 0 |  | 0 |  | 0 |  | (42) |
| Fair Value, end of period | \$ 1,249 | \$ | 32 | \$ | 346 | \$ | 68 | \$ | 1,014 |

Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2):
Included in earnings:

| Realized investment gains (losses), net | $\$$ | 0 | $\$$ | $(16)$ | $\$$ | 0 | $\$$ | 2 | $\$$ | 0 |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Asset management fees and other income | $\$$ | 22 | $\$$ | 1 | $\$$ | 0 | $\$$ | 0 | $\$$ | 20 |

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## PRUDENTIAL FINANCIAL, INC.

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

|  | Short-term Investments | Three Months Ended September 30, 2012 |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | Other Assets |  | Separate <br> Account <br> Assets(3) <br> (in millions) | Future <br> Policy Benefits | Other <br> Liabilities |  |
| Fair Value, beginning of period | \$ 5 | \$ | 8 | \$ 20,698 | \$ $(3,054)$ | \$ | (298) |
| Total gains (losses) (realized/unrealized): |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |
| Realized investment gains (losses), net | (5) |  | 0 | 0 | (408) |  | (8) |
| Interest credited to policyholders account balances | 0 |  | 0 | 303 | 0 |  | 0 |
| Purchases | 0 |  | 0 | 310 | 0 |  | 0 |
| Sales | 0 |  | 0 | (184) | 0 |  | 0 |
| Issuances | 0 |  | 0 | 0 | (176) |  | (390) |
| Settlements | 0 |  | 0 | (592) | 0 |  | 301 |
| Transfers into Level 3(1) | 0 |  | 0 | 29 | 0 |  | 0 |
| Transfers out of Level 3(1) | 0 |  | 0 | (225) | 0 |  | 0 |
| Fair Value, end of period | \$ 0 | \$ | 8 | \$ 20,339 | \$ $(3,638)$ | \$ | (395) |
| Unrealized gains (losses) for the period relating to those Level 3 assets and liabilities that were still held at the end of the period(2): |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |
| Realized investment gains (losses), net | \$ (5) | \$ | 0 | \$ 0 | \$ (448) | \$ | (6) |
| Interest credited to policyholders account balances | \$ 0 | \$ | 0 | \$ 146 | \$ 0 | \$ | 0 |

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## PRUDENTIAL FINANCIAL, INC.

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

|  | Nine Months Ended September 30, 2012 |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Fixed <br> Maturities <br> Available- <br> For-SaleU.S. <br> Government Authorities | Fixed Maturities Available-For- SaleU.S. States |  | Fixed <br> Maturities <br> Available- <br> For-Sale- <br> Foreign <br> Government Bonds |  | Fixed Maturities Available-For-SaleCorporate Securities illions) |  | Fixed Maturities <br> Available- <br> For-Sale- <br> Asset- <br> Backed <br> Securities |  | Fixed Maturities Available-For-SaleCommercial MortgageBacked Securities |  |
| Fair Value, beginning of period | \$ 66 | \$ | 0 | \$ | 25 | \$ | 1,450 | \$ | 2,528 | \$ | 145 |
| Total gains (losses) (realized/unrealized): |  |  |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |  |  |
| Realized investment gains (losses), net | 0 |  | 0 |  | 0 |  | (25) |  | 18 |  | 2 |
| Included in other comprehensive income (loss) | 0 |  | 0 |  | 0 |  | 176 |  | 52 |  | 18 |
| Net investment income | 0 |  | 0 |  | 0 |  | 6 |  | 22 |  | (2) |
| Purchases | 0 |  | 10 |  | 0 |  | 321 |  | 1,964 |  | 43 |
| Sales | 0 |  | 0 |  | 0 |  | (130) |  | (425) |  | (2) |
| Issuances | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Settlements | (2) |  | 0 |  | 0 |  | (228) |  | (450) |  | (11) |
| Foreign currency translation | 0 |  | 0 |  | 0 |  | (3) |  | (8) |  | (1) |
| Other(4) | 2 |  | 0 |  | (5) |  | 3 |  | 0 |  | 0 |
| Transfers into Level 3(1) | 0 |  | 0 |  | 7 |  | 276 |  | 35 |  | 37 |
| Transfers out of Level 3(1) | 0 |  | (10) |  | (24) |  | (170) |  | (537) |  | (46) |
| Fair Value, end of period | \$ 66 | \$ | 0 | \$ | 3 | \$ | 1,676 | \$ | 3,199 | \$ | 183 |
| Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2): |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |  |  |
| Realized investment gains (losses), net | \$ 0 | \$ | 0 | \$ | 0 | \$ | (1) | \$ | 9 | \$ | 0 |

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## PRUDENTIAL FINANCIAL, INC.

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

|  | Nine Months Ended September 30, 2012 |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Fixed <br> Maturities <br> Available- <br> For-Sale- <br> Residential <br> MortgageBacked Securities | Trading <br> Account Assets <br> Supporting Insurance LiabilitiesU.S. <br> Government Authorities |  | Trading Account Assets Supporting Insurance LiabilitiesCorporate Securities |  | Trading Account Assets Supporting Insurance Liabilities-AssetBacked Securities illions) |  | Trading <br> Account Assets <br> Supporting Insurance LiabilitiesCommercial MortgageBacked Securities |  | Trading Account Assets Supporting Insurance LiabilitiesResidential MortgageBacked Securities |  |
| Fair Value, beginning of period | \$ 16 | \$ | 9 | \$ | 109 | \$ | 357 | \$ | 21 | \$ | 2 |
| Total gains (losses) (realized/unrealized): |  |  |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |  |  |
| Asset management fees and other income | 0 |  | 0 |  | (5) |  | 10 |  | 1 |  | 0 |
| Net investment income | 1 |  | 0 |  | 0 |  | 4 |  | 0 |  | 0 |
| Purchases | 0 |  | 0 |  | 16 |  | 128 |  | 18 |  | 0 |
| Sales | 0 |  | 0 |  | (8) |  | (5) |  | 0 |  | 0 |
| Issuances | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Settlements | (6) |  | (2) |  | (15) |  | (87) |  | (1) |  | 0 |
| Other(4) | 0 |  | , |  | (2) |  | 0 |  | 0 |  | 0 |
| Transfers into Level 3(1) | 0 |  | 0 |  | 5 |  | 3 |  | 80 |  | 0 |
| Transfers out of Level 3(1) | 0 |  | 0 |  | (4) |  | (65) |  | (36) |  | 0 |
| Fair Value, end of period | \$ 11 | \$ | 9 | \$ | 96 | \$ | 345 | \$ | 83 | \$ | 2 |
| Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2): |  |  |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |  |  |
| Asset management fees and other income | \$ 0 | \$ | 0 | \$ | (10) | \$ | 9 | \$ | 1 | \$ | 0 |

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## PRUDENTIAL FINANCIAL, INC.

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

|  | Trading <br> Account Assets Supporting Insurance LiabilitiesEquity Securities | Nine Months Ended September 30, 2012 |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | Other <br> Trading <br> Account <br> Assets- <br> Corporate <br> Securities |  | Other <br> Trading <br> Account <br> Assets- <br> Asset- <br> Backed <br> Securities (in millions) |  | Other <br> Trading <br> Account <br> Assets- <br> Commercial <br> Mortgage- <br> Backed <br> Securities |  | Other <br> Trading Account AssetsResidential MortgageBacked Securities |  |
| Fair Value, beginning of period | \$ 20 | \$ | 39 | \$ | 59 | \$ | 14 | \$ | 2 |
| Total gains (losses) (realized/unrealized): |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |
| Asset management fees and other income | 0 |  | 0 |  | 3 |  | 0 |  | 1 |
| Net investment income | 0 |  | 0 |  | 1 |  | 1 |  | 0 |
| Purchases | 0 |  | 1 |  | 0 |  | 0 |  | 0 |
| Sales | 0 |  | (2) |  | (4) |  | (4) |  | (1) |
| Issuances | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Settlements | 0 |  | 0 |  | (3) |  | (2) |  | (1) |
| Foreign currency translation | 0 |  | 0 |  | (1) |  | 0 |  | 0 |
| Other(4) | 0 |  | 0 |  | 1 |  | 0 |  | (1) |
| Transfers into Level 3(1) | 0 |  | 0 |  | 0 |  | 2 |  | 0 |
| Transfers out of Level 3(1) | (1) |  | 0 |  | (2) |  | (1) |  | 0 |
| Fair Value, end of period | \$ 19 | \$ | 38 | \$ | 54 | \$ | 10 | \$ | 0 |
| Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2): |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |
| Asset management fees and other income | \$ 1 | \$ | 0 | \$ | 2 | \$ | 0 | \$ | 0 |

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## PRUDENTIAL FINANCIAL, INC.

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

|  | Other <br> Trading <br> Account <br> Assets- <br> Equity <br> Securities |  | $\begin{aligned} & \text { Nine I } \\ & \text { her } \\ & \text { ding } \\ & \text { ount } \\ & \text { ts-All } \\ & \text { her } \\ & \text { ivity } \end{aligned}$ |  | ed Septe <br> uity <br> rities <br> lable- <br> Sale <br> millions) |  | 012 <br> rcial <br> gage <br> d <br> er <br> ns |  | ther g-term stments |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Fair Value, beginning of period | \$ 1,276 | \$ | 93 | \$ | 360 | \$ | 86 | \$ | 1,110 |
| Total gains (losses) (realized/unrealized): |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |
| Realized investment gains (losses), net | 0 |  | (65) |  | 1 |  | 2 |  | 6 |
| Asset management fees and other income | 54 |  | 1 |  | 0 |  | 0 |  | 73 |
| Included in other comprehensive income (loss) | 0 |  | 0 |  | 21 |  | 0 |  | 0 |
| Net investment income | 0 |  | 0 |  | 0 |  | 0 |  | 5 |
| Purchases | 13 |  | 0 |  | 68 |  | 0 |  | 159 |
| Sales | (31) |  | 0 |  | (17) |  | 0 |  | (23) |
| Issuances | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Settlements | (88) |  | 6 |  | 0 |  | (20) |  | (261) |
| Foreign currency translation | (11) |  | 0 |  | (2) |  | 0 |  | 2 |
| Other(4) | 3 |  | (3) |  | 0 |  | 0 |  | 7 |
| Transfers into Level 3(1) | 33 |  | 0 |  | 5 |  | 0 |  | 0 |
| Transfers out of Level 3(1) | 0 |  | 0 |  | (90) |  | 0 |  | (64) |
| Fair Value, end of period | \$ 1,249 | \$ | 32 | \$ | 346 | \$ | 68 | \$ | 1,014 |
| Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2): |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |
| Realized investment gains (losses), net | \$ (1) | \$ | (65) | \$ | 0 | \$ | 1 | \$ | 1 |
| Asset management fees and other income | \$ 53 | \$ | 1 | \$ | 0 | \$ | 0 | \$ | 40 |

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## PRUDENTIAL FINANCIAL, INC.

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

|  | Short-term investments |  | Nine Months Ended September 30, 2012 |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | Other Assets |  | Separate <br> Account <br> Assets(3) <br> (in millions) | Future <br> Policy Benefits | Other <br> Liabilities |  |
| Fair Value, beginning of period |  | 0 | \$ | 9 | \$ 19,358 | \$ $(2,886)$ | \$ | (285) |
| Total gains (losses) (realized/unrealized): |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |
| Realized investment gains (losses), net |  | (9) |  | 0 | 0 | (255) |  | (25) |
| Asset management fees and other income |  | 0 |  | 2 | 0 | 0 |  | 0 |
| Interest credited to policyholders account balances |  | 0 |  | 0 | 1,518 | 0 |  | 0 |
| Purchases |  | 9 |  | 0 | 2,154 | 0 |  | 0 |
| Sales |  |  |  | (3) | (647) | 0 |  | 0 |
| Issuances |  | 0 |  | 0 | 0 | (497) |  | (401) |
| Settlements |  | 0 |  | 0 | $(1,617)$ | 0 |  | 319 |
| Other(4) |  | 0 |  | 0 | 0 | 0 |  | (3) |
| Transfers into Level 3(1) |  | 0 |  | 0 | 245 | 0 |  | 0 |
| Transfers out of Level 3(1) |  | 0 |  | 0 | (672) | 0 |  | 0 |
| Fair Value, end of period |  | 0 | \$ | 8 | \$ 20,339 | \$ $(3,638)$ | \$ | (395) |
| Unrealized gains (losses) for the period relating to those Level 3 assets and liabilities that were still held at the end of the period(2): |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |
| Realized investment gains (losses), net |  | (9) | \$ | 0 | \$ 0 | \$ (340) | \$ | (25) |
| Asset management fees and other income |  | 0 | \$ | 2 | \$ 0 | \$ 0 | \$ | 0 |
| Interest credited to policyholders account balances |  | 0 | \$ | 0 | \$ 902 | \$ 0 | \$ | 0 |

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## PRUDENTIAL FINANCIAL, INC.

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

|  | Three Months Ended September 30, 2011 |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Fixed <br> Maturities Available For Sale-U.S. Government Authorities |  |  | Fixed Maturities Available For SaleCorporate Securities |  | Fixed Maturities Available For Sale-AssetBacked Securities millions) |  | Fixed <br> Maturities Available <br> For Sale- <br> Commercial <br> MortgageBacked Securities |  | Fixed Maturities Available For SaleResidential MortgageBacked Securities |  |
| Fair Value, beginning of period | \$ 0 | \$ | 27 | \$ | 1,278 | \$ | 2,933 | \$ | 105 | \$ | 20 |
| Total gains (losses) (realized/unrealized): |  |  |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |  |  |
| Realized investment gains (losses), net | 0 |  | 0 |  | (6) |  | 6 |  | 0 |  | 0 |
| Included in other comprehensive income (loss) | 0 |  | 0 |  | (10) |  | (34) |  | (8) |  | (1) |
| Net investment income | 0 |  | 0 |  | 2 |  | 5 |  | (3) |  | 0 |
| Purchases | 66 |  | 0 |  | 11 |  | 234 |  | 0 |  | 1 |
| Sales | 0 |  | 0 |  | (24) |  | (80) |  | (4) |  | (1) |
| Issuances | 0 |  | 0 |  | 28 |  | 0 |  | 0 |  | 0 |
| Settlements | 0 |  | 0 |  | (40) |  | (100) |  | (3) |  | 1 |
| Foreign currency translation | 0 |  | 0 |  | 7 |  | 48 |  | 6 |  | 0 |
| Transfers into Level 3(1) | 0 |  | 0 |  | 49 |  | 17 |  | 5 |  | 0 |
| Transfers out of Level 3(1) | 0 |  | 0 |  | (87) |  | (298) |  | (5) |  | 0 |
| Fair Value, end of period | \$ 66 | \$ | 27 | \$ | 1,208 | \$ | 2,731 | \$ | 93 | \$ | 20 |
| Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2): |  |  |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |  |  |
| Realized investment gains (losses), net | \$ 0 | \$ | 0 | \$ | (3) | \$ | 2 | \$ | 1 | \$ | 0 |

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## PRUDENTIAL FINANCIAL, INC.

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

|  | Trading <br> Account <br> Assets <br> Supporting <br> Insurance <br> LiabilitiesU.S. <br> Government Authorities | Trading Account Assets Supporting Insurance LiabilitiesCorporate Securities |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  | Trading <br> Account Assets Supporting Insurance Liabilities-Asset-Backed Securities (in millions) |  | Trading <br> Account Assets Supporting Insurance LiabilitiesCommercial MortgageBacked Securities |  | Trading Account Assets Supporting Insurance LiabilitiesResidential MortgageBacked Securities |  |
| Fair Value, beginning of period | \$ 0 | \$ | 84 | \$ | 410 | \$ | 14 | \$ | 2 |
| Total gains (losses) (realized/unrealized): |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |
| Asset management fees and other income | 0 |  | (1) |  | (4) |  | 0 |  | 0 |
| Net investment income | 0 |  | 0 |  | 1 |  | 0 |  | 0 |
| Purchases | 9 |  | 0 |  | 16 |  | 0 |  | 0 |
| Sales | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Issuances | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Settlements | 0 |  | (4) |  | (35) |  | 0 |  | 0 |
| Transfers into Level 3(1) | 0 |  | 15 |  | 0 |  | 0 |  | 0 |
| Transfers out of Level 3(1) | 0 |  | (2) |  | (38) |  | (10) |  | 0 |
| Fair Value, end of period | \$ 9 | \$ | 92 | \$ | 350 | \$ | 4 | \$ | 2 |
| Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2): |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |
| Asset management fees and other income | \$ 0 | \$ | (2) | \$ | (4) | \$ | 0 | \$ | 0 |

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## PRUDENTIAL FINANCIAL, INC.

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

|  | Trading <br> Account <br> Assets <br> Supporting <br> Insurance <br> Liabilities- <br> Equity <br> Securities | Three Months Ended September 30, 2011 |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | Other <br> Trading <br> Account <br> Assets- <br> Corporate <br> Securities |  | Other <br> Trading <br> Account <br> Assets - <br> Asset- <br> Backed <br> Securities (in millions) |  | Other <br> Trading Account AssetsCommercial MortgageBacked Securities |  | Other <br> Trading Account AssetsResidential MortgageBacked Securities |  |
| Fair Value, beginning of period | \$ 58 | \$ | 40 | \$ | 77 | \$ | 18 | \$ | 15 |
| Total gains (losses) (realized/unrealized): |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |
| Asset management fees and other income | (7) |  | 2 |  | (7) |  | (1) |  | (3) |
| Net investment income | 0 |  | 0 |  | 1 |  | 0 |  | (1) |
| Purchases | 1 |  | 1 |  | 0 |  | 0 |  | 0 |
| Sales | (2) |  | (3) |  | (6) |  | (6) |  | 4 |
| Issuances | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Settlements | 0 |  | 0 |  | (2) |  | 0 |  | 0 |
| Foreign currency translation | 1 |  | 0 |  | 4 |  | 2 |  | 1 |
| Other(4) | 0 |  | (1) |  | 1 |  | 14 |  | (14) |
| Transfers into Level 3(1) | 0 |  | 0 |  | 0 |  | 3 |  | (1) |
| Transfers out of Level 3(1) | 0 |  | 0 |  | (1) |  | (1) |  | 1 |
| Fair Value, end of period | \$ 51 | \$ | 39 | \$ | 67 | \$ | 29 | \$ | 2 |
| Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2): |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |
| Asset management fees and other income | \$ (7) | \$ | 1 | \$ | (7) | \$ | (4) | \$ | 0 |

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## PRUDENTIAL FINANCIAL, INC.

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

|  | Other <br> Trading <br> Account <br> Assets- <br> Equity <br> Securities |  | Three Other Trading Account AssetsAll Other Activity |  | hs Ended Sept <br> Equity Securities Available for Sale (in millions) |  | Commercial Mortgage and Other Loans |  | Other Long-term Investments |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Fair Value, beginning of period |  |  | \$ | 94 | \$ | 1,661 | \$ | 144 | \$ | 1,230 |
| Total gains (losses) (realized/unrealized): |  |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |  |
| Realized investment gains (losses), net |  | 0 |  | 74 |  | (2) |  | 9 |  | 1 |
| Asset management fees and other income |  | (67) |  | 0 |  | 0 |  | 0 |  | (12) |
| Included in other comprehensive income (loss) |  | 0 |  | 0 |  | 14 |  | 0 |  | 0 |
| Net investment income |  | 0 |  | 0 |  | 0 |  | 0 |  | (11) |
| Purchases |  | 5 |  | 0 |  | 4 |  | 0 |  | 103 |
| Sales |  | (28) |  | 0 |  | 5 |  | 0 |  | (1) |
| Issuances |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Settlements |  | (13) |  | (7) |  | (40) |  | (57) |  | (1) |
| Foreign currency translation |  | 33 |  | 0 |  | 50 |  | 0 |  | 9 |
| Other(4) |  | 1,277 |  | 0 |  | 1,280) |  | 0 |  | 0 |
| Transfers into Level 3(1) |  | 0 |  | 0 |  | (2) |  | 0 |  | 0 |
| Transfers out of Level 3(1) |  | 0 |  | 0 |  | 2 |  | 0 |  | 0 |
| Fair Value, end of period |  | 1,372 | \$ | 161 | \$ | 412 | \$ | 96 | \$ | 1,318 |
| Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2): |  |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |  |
| Realized investment gains (losses), net | \$ | 0 | \$ | 74 | \$ | (3) | \$ | 8 | \$ | 0 |
| Asset management fees and other income |  | (73) | \$ | 1 | \$ | 0 | \$ | 0 | \$ | (20) |

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## PRUDENTIAL FINANCIAL, INC.

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



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## PRUDENTIAL FINANCIAL, INC.

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

|  | Nine Months Ended September 30, 2011 |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Fixed Maturities Available For Sale U.S. <br> Government Authorities |  | Fixed <br> Maturities Available <br> For Sale Foreign Government Bonds |  | Fixed Maturities Available For Sale Corporate Securities |  | Fixed Maturities Available For Sale AssetBacked Securities illions) |  | Fixed <br> Maturities Available For Sale Commercial MortgageBacked Securities |  | Fixed Maturities Available <br> For Sale Residential MortgageBacked Securities |  |
| Fair Value, beginning of period | \$ | 0 | \$ | 27 | \$ | 1,187 | \$ | 1,753 | \$ | 130 | \$ | 23 |
| Total gains (losses) (realized/unrealized): |  |  |  |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |  |  |  |
| Realized investment gains (losses), net |  | 0 |  | 0 |  | (33) |  | 32 |  | (35) |  | 0 |
| Included in other comprehensive income (loss) |  | 0 |  | 0 |  | (12) |  | 0 |  | 7 |  | (1) |
| Net investment income |  | 0 |  | 0 |  | 8 |  | 20 |  | 2 |  | 0 |
| Purchases |  | 66 |  | 0 |  | 435 |  | 1,239 |  | 5 |  | 1 |
| Sales |  | 0 |  | 0 |  | (89) |  | (413) |  | (20) |  | (1) |
| Issuances |  | 0 |  | 0 |  | 32 |  | 0 |  | 0 |  | 0 |
| Settlements |  | 0 |  | 0 |  | (278) |  | (237) |  | (36) |  | (1) |
| Foreign currency translation |  | 0 |  | 0 |  | 10 |  | 64 |  | 9 |  | 0 |
| Other(4) |  | 0 |  | 0 |  | 146 |  | 502 |  | 31 |  | (1) |
| Transfers into Level 3(1) |  | 0 |  | 0 |  | 234 |  | 250 |  | 5 |  | 0 |
| Transfers out of Level 3(1) |  | 0 |  | 0 |  | (432) |  | (479) |  | (5) |  | 0 |
| Fair Value, end of period |  | 66 | \$ | 27 | \$ | 1,208 | \$ | 2,731 | \$ | 93 | \$ | 20 |

Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2):
Included in earnings:
Realized investment gains (losses), net
$\$ 0$
\$

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## PRUDENTIAL FINANCIAL, INC.

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

|  | Nine Months Ended September 30, 20 |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Trading <br> Account Assets Supporting Insurance LiabilitiesU.S. <br> Government Authorities | Trading Account Assets Supporting Insurance LiabilitiesCorporate Securities |  | Trading <br> Account <br> Assets <br> Supporting <br> Insurance <br> Liabilities- <br> Asset- <br> Backed <br> Securities <br> (in millions) |  | Trading Account Assets Supporting Insurance LiabilitiesCommercial MortgageBacked Securities |  | Trading Account Assets Supporting Insurance LiabilitiesResidential MortgageBacked Securities |  |
| Fair Value, beginning of period | \$ 0 | \$ | 82 | \$ | 226 | \$ | 5 | \$ | 18 |
| Total gains (losses) (realized/unrealized): |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |
| Asset management fees and other income | 0 |  | (2) |  | 0 |  | 0 |  | 0 |
| Net investment income | 0 |  | 0 |  | 3 |  | 0 |  | 0 |
| Purchases | 9 |  | 49 |  | 269 |  | 10 |  | 0 |
| Sales | 0 |  | (11) |  | (23) |  | 0 |  | 0 |
| Issuances | 0 |  | 1 |  | 0 |  | 0 |  | 0 |
| Settlements | 0 |  | (35) |  | (82) |  | (1) |  | (1) |
| Other(4) | 0 |  | 0 |  | 15 |  | 0 |  | (15) |
| Transfers into Level 3(1) | 0 |  | 25 |  | 0 |  | 0 |  | 0 |
| Transfers out of Level 3(1) | 0 |  | (17) |  | (58) |  | (10) |  | 0 |
| Fair Value, end of period | \$9 | \$ | 92 | \$ | 350 | \$ | 4 | \$ | 2 |
| Unrealized gains (losses) for the period relating to those |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |
| Asset management fees and other income | \$ 0 | \$ | (2) | \$ | 0 | \$ | 0 | \$ | 0 |

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## PRUDENTIAL FINANCIAL, INC.

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

|  | Trading <br> Account <br> Assets <br> Supporting <br> Insurance <br> Liabilities- <br> Equity <br> Securities |  | Nine Months Ended September 30, 2011 |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | Other <br> Trading <br> Account <br> Assets- <br> Corporate <br> Securities |  | Other <br> Trading <br> Account <br> Assets- <br> Asset- <br> Backed <br> Securities (in millions) |  | Other <br> Trading Account AssetsCommercial MortgageBacked Securities |  | Other <br> Trading Account Assets- <br> Residential MortgageBacked Securities |  |
| Fair Value, beginning of period | \$ | 4 | \$ | 35 | \$ | 54 | \$ | 19 | \$ | 18 |
| Total gains (losses) (realized/unrealized): |  |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |  |
| Asset management fees and other income |  | (6) |  | 2 |  | 0 |  | 4 |  | 0 |
| Net investment income |  | 0 |  | 0 |  | 2 |  | 1 |  | 0 |
| Purchases |  | 5 |  | 9 |  | 0 |  | 0 |  | 0 |
| Sales |  | (29) |  | (7) |  | (16) |  | (12) |  | (2) |
| Issuances |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Settlements |  | 0 |  | 0 |  | (8) |  | (2) |  | (1) |
| Foreign currency translation |  | 1 |  | 0 |  | ) |  | 2 |  | 1 |
| Other(4) |  | 0 |  | (1) |  | 1 |  | 14 |  | (14) |
| Transfers into Level 3(1) |  | 76 |  | 1 |  | 39 |  | 5 |  | 0 |
| Transfers out of Level 3(1) |  | 0 |  | 0 |  | (11) |  | (2) |  | 0 |
| Fair Value, end of period |  | 51 | \$ | 39 | \$ | 67 | \$ | 29 | \$ | 2 |
| Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2): |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |
| Asset management fees and other income |  | (6) | \$ | 2 | \$ | (3) | \$ | 0 | \$ | 0 |

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## PRUDENTIAL FINANCIAL, INC.

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

|  | Other <br> Trading <br> Account <br> Assets- <br> Equity Securities |  | Nine Other <br> Trading Account Assets-All Other Activity |  | Ended Septe <br> Equity Securities Available for Sale (in millions) |  | Commercial Mortgage and Other Loans |  | Other <br> Long-term <br> Investments |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Fair Value, beginning of period | \$ |  | \$ | 134 | \$ | 355 | \$ | 212 | \$ | 768 |
| Total gains (losses) (realized/unrealized): |  |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |  |
| Realized investment gains (losses), net |  | 0 |  | 37 |  | (17) |  | 15 |  | 5 |
| Asset management fees and other income |  | (54) |  | 4 |  | 0 |  | 0 |  | 55 |
| Included in other comprehensive income (loss) |  | 0 |  | 0 |  | 42 |  | 0 |  | 0 |
| Net investment income |  | 0 |  | 0 |  | 0 |  | 0 |  | (10) |
| Purchases |  | 6 |  | 0 |  | 45 |  | 0 |  | 236 |
| Sales |  | (30) |  | 0 |  | (40) |  | 0 |  | (7) |
| Issuances |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Settlements |  | (15) |  | (14) |  | (41) |  | (131) |  | (8) |
| Foreign currency translation |  | 36 |  | 0 |  | 79 |  | 0 |  | 12 |
| Other(4) |  | 1,277 |  | 0 |  | (831) |  | 0 |  | 267 |
| Transfers into Level 3(1) |  | 126 |  | 0 |  | 822 |  | 0 |  | 0 |
| Transfers out of Level 3(1) |  | 0 |  | 0 |  | (2) |  | 0 |  | 0 |
| Fair Value, end of period |  | 1,372 | \$ | 161 | \$ | 412 | \$ | 96 | \$ | 1,318 |
| Unrealized gains (losses) for the period relating to those Level 3 assets that were still held at the end of the period(2): |  |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |  |
| Realized investment gains (losses), net | \$ | 0 | \$ | 37 | \$ | (25) | \$ | 15 | \$ | 2 |
| Asset management fees and other income | \$ | (59) | \$ | 4 | \$ | 0 | \$ | 0 | \$ | 16 |

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## PRUDENTIAL FINANCIAL, INC.

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

|  | Other <br> Assets | Nine Months E <br> Separate <br> Account <br> Assets(3) | d Septembe <br> Future <br> Policy <br> Benefits <br> illions) | Other <br> Liabilities |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Fair Value, beginning of period | \$ 9 | \$ 15,792 | \$ 204 | \$ | (3) |
| Total gains (losses) (realized/unrealized): |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |
| Realized investment gains (losses), net | 0 | 0 | $(2,854)$ |  | (7) |
| Interest credited to policyholders account balances | 0 | 2,334 | 0 |  | 0 |
| Purchases | 0 | 2,121 | 0 |  | 0 |
| Sales | 0 | $(1,062)$ | 0 |  | 0 |
| Issuances | 0 | 3 | (366) |  | 0 |
| Settlements | 0 | (861) | (2) |  | 7 |
| Transfers into Level 3(1) | 0 | 161 | 0 |  | 0 |
| Transfers out of Level 3(1) | 0 | (638) | 0 |  | 0 |
| Fair Value, end of period | \$ 9 | \$ 17,850 | \$ $(3,018)$ | \$ | (3) |
| Unrealized gains (losses) for the period relating to those Level 3 assets and liabilities that were still held at the end of the period(2): |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |
| Realized investment gains (losses), net | \$ 0 | \$ 0 | \$ $(2,864)$ | \$ | (8) |
| Interest credited to policyholders account balances | \$ 0 | \$ 1,605 | \$ 0 | \$ | 0 |

(1) Transfers into or out of Level 3 are generally reported as the value as of the beginning of the quarter in which the transfer occurs.
(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.
(4) For the nine months ended September 30, 2011, Other primarily represents reclasses of certain assets between reporting categories and assets acquired through the Star and Edison acquisition. For all other periods, Other primarily represents reclasses of certain assets between reporting categories.

Transfers Transfers into Level 3 are generally the result of unobservable inputs utilized within valuation methodologies and the use of broker quotes (that cannot be validated) for which information from third party pricing services (that can be validated) was previously utilized. Transfers out of Level 3 are generally due to the use of observable inputs in valuation methodologies as well as the utilization of pricing service information for certain assets that the Company is able to validate. Significant transfers into and/or out of Level 3 are discussed below:

For the nine months ended September 30, 2012, the majority of the Equity Securities Available-for-Sale transfers out of Level 3 were due to the determination that the pricing inputs for certain equity securities did not have a material liquidity discount and therefore, should be classified as Level 1, not Level 3. For the nine months ended September 30, 2011, the majority of the Equity Securities Available for Sale, Trading Account Assets Supporting Insurance Liabilities Equity Securities and Other Trading Account Assets Equity Securities transfers into Level 3 were due to the determination that the pricing inputs for perpetual preferred stocks provided by third party pricing services were primarily based on indicative broker quotes which could not always be verified against directly observable market information.

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## PRUDENTIAL FINANCIAL, INC.

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

## Derivative Fair Value Information

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

|  | As of September 30, 2012 |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Level 1 |  | Level 2 |  | Level 3 |  | N) ${ }^{\text {Netting(1) }}$ | Total |  |
| Derivative assets: |  |  |  |  |  |  |  |  |  |
| Interest Rate | \$ | 4 |  | 13,367 | \$ | 10 | \$ | \$ | 13,381 |
| Currency |  | 0 |  | 123 |  | 0 |  |  | 123 |
| Credit |  | 0 |  | 20 |  | 0 |  |  | 20 |
| Currency/Interest Rate |  | 0 |  | 536 |  | 0 |  |  | 536 |
| Equity |  | 88 |  | 633 |  | 26 |  |  | 1,047 |
| Netting(1) |  |  |  |  |  |  | $(11,537)$ |  | $(11,537)$ |
| Total derivative assets |  |  |  | 14,679 | \$ | 36 | \$ $(11,537)$ | \$ | 3,570 |
| Derivative liabilities: |  |  |  |  |  |  |  |  |  |
| Interest Rate | \$ | 2 |  | 7,233 | \$ | 3 | \$ | \$ | 7,238 |
| Currency |  | 0 |  | 207 |  | 0 |  |  | 207 |
| Credit |  | 0 |  | 99 |  | 0 |  |  | 99 |
| Currency/Interest Rate |  | 0 |  | 781 |  | 0 |  |  | 781 |
| Equity |  | 0 |  | 221 |  | 0 |  |  | 221 |
| Netting(1) |  |  |  |  |  |  | $(8,290)$ |  | $(8,290)$ |
| Total derivative liabilities |  | 2 |  | 8,541 | \$ | 3 | \$ $(8,290)$ | \$ | 256 |


|  | As of December 31, 2011 |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Level 1 | Level 2 | $\underset{\text { Level } 3 \underset{\text { (in millions) }}{\text { Netting(1) }}}{ }$ |  |  | Total |  |
| Derivative assets: |  |  |  |  |  |  |  |
| Interest Rate | \$ 10 | \$ 12,383 | \$ | 5 | \$ | \$ | 12,398 |
| Currency | 0 | 219 |  | 0 |  |  | 219 |
| Credit | 0 | 56 |  | 1 |  |  | 57 |
| Currency/Interest Rate | 0 | 562 |  | 0 |  |  | 562 |
| Equity | 149 | 365 |  | 83 |  |  | 597 |
| Netting(1) |  |  |  |  | $(11,222)$ |  | $(11,222)$ |
| Total derivative assets | \$ 159 | \$ 13,585 | \$ | 89 | \$ $(11,222)$ | \$ | 2,611 |


| Derivative liabilities: |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Interest Rate | \$ | 9 | \$ | 6,587 | \$ | 6 | \$ |  | \$ | 6,602 |
| Currency |  | 0 |  | 297 |  | 0 |  |  |  | 297 |
| Credit |  | 0 |  | 130 |  | 0 |  |  |  | 130 |
| Currency/Interest Rate |  | 0 |  | 928 |  | 0 |  |  |  | 928 |
| Equity |  | 0 |  | 246 |  | 0 |  |  |  | 246 |
| Netting(1) |  |  |  |  |  |  |  | $(7,854)$ |  | $(7,854)$ |
| Total derivative liabilities | \$ | 9 | \$ | 8,188 | \$ | 6 | \$ | $(7,854)$ | \$ | 349 |

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

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## PRUDENTIAL FINANCIAL, INC.

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

Changes in Level 3 derivative assets and liabilities The following tables provide a summary of the changes in fair value of Level 3 derivative assets and liabilities, as well as the portion of gains or losses included in income, attributable to unrealized gains or losses related to those assets and liabilities still held at the end of the reporting period.

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

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## PRUDENTIAL FINANCIAL, INC.

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

|  | Three Months Ended September 30, 2011 |  |  |  |  |  | Nine Months Ended September 30, 2011 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | ivative ssetsquity | Derivative AssetsCredit |  | Derivative LiabilitiesInterest Rate |  | Derivative AssetsEquity lions) | Derivative AssetsCredit |  | Derivative LiabilitiesInterest Rate |  |
| Fair Value, beginning of period |  | 82 | \$ | 2 | \$ | (7) | \$ 127 | \$ | 0 | \$ | (12) |
| Total gains (losses) (realized/unrealized): |  |  |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |  |  |
| Realized investment gains (losses), net |  | 75 |  | 1 |  | 0 | 34 |  | 3 |  | 5 |
| Asset management fees and other income |  | 0 |  | 0 |  | 0 | 0 |  | 0 |  | 0 |
| Purchases |  | 0 |  | 0 |  | 0 | 0 |  | 0 |  | 0 |
| Sales |  | 0 |  | 0 |  | 0 | 0 |  | 0 |  | 0 |
| Issuances |  | 0 |  | 0 |  | 0 | 0 |  | 0 |  | 0 |
| Settlements |  | (7) |  | 0 |  | 0 | (11) |  | 0 |  | 0 |
| Transfers into Level 3(1) |  | 0 |  | 0 |  | 0 | 0 |  | 0 |  | 0 |
| Transfers out of Level 3(1) |  | 0 |  | 0 |  | 0 | 0 |  | 0 |  | 0 |
| Fair Value, end of period |  | 150 | \$ | 3 | \$ | (7) | \$ 150 | \$ | 3 | \$ | (7) |
| Unrealized gains (losses) for the period relating to those level 3 assets that were still held at the end of the period: |  |  |  |  |  |  |  |  |  |  |  |
| Included in earnings: |  |  |  |  |  |  |  |  |  |  |  |
| Realized investment gains (losses), net | \$ | 75 | \$ | 1 | \$ | 0 | \$ 34 | \$ | 3 | \$ | 5 |
| Asset management fees and other income |  | 0 | \$ | 0 | \$ | 0 | \$ 0 | \$ | 0 | \$ | 0 |

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

Nonrecurring Fair Value Measurements Certain assets and liabilities are measured at fair value on a nonrecurring basis. Nonrecurring fair value reserve adjustments resulted in $\$ 0$ million and $\$ 2$ million of net gains being recorded for the three and nine months ended September 30, 2012, respectively on certain commercial mortgage loans. The carrying value of these loans as of September 30, 2012 was $\$ 62$ million. Similar commercial mortgage loan reserve adjustments of $\$ 1$ million and $\$ 4$ million in net gains were recorded for the three and nine months ended September 30, 2011, respectively. The reserve adjustments were based on discounted cash flows utilizing market rates and were classified as Level 3 in the hierarchy.

Impairments of $\$ 20$ million and $\$ 4$ million were recorded for the three months ended September 30, 2012 and 2011, respectively, and $\$ 91$ million and $\$ 18$ million for the nine months ended September 30, 2012 and 2011, respectively, for real estate and property and equipment related investments. These impairments were based primarily on appraised value. All impairments were classified as Level 3 in the valuation hierarchy. Impairments of $\$ 1$ million and $\$ 4$ million were recorded for the three months ended September 30, 2012 and 2011, respectively, and $\$ 3$ million and $\$ 5$ million for the nine months ended September 30, 2012 and 2011, respectively, on certain cost method investments. These fair value adjustments were based on inputs classified as Level 3 in the valuation hierarchy. The methodologies utilized were primarily discounted estimated future cash flows and, where appropriate, valuations provided by the general partners taking into consideration deal and management fee expenses. Impairments of $\$ 5$ million and $\$ 4$ million were recorded for the three months ended

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## PRUDENTIAL FINANCIAL, INC.

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

September 30, 2012 and 2011 respectively, and $\$ 12$ million and $\$ 8$ million for the nine months ended September 30, 2012 and 2011, respectively on mortgage servicing rights. These were based on internal models and classified as Level 3 in the hierarchy.

An impairment of $\$ 29$ million was recorded for the three and nine months ended September 30, 2012 related to the write-off of an intangible asset related to an acquired business. The method utilized was primarily discounted cash flows based on assumptions and inputs specific to the Company, and are therefore classified as Level 3 in the hierarchy.

Fair Value Option The following table presents information regarding changes in fair values recorded in earnings for commercial mortgage loans, other long-term investments and other liabilities where the fair value option has been elected.

|  | Three Months Ended <br> September 30, <br> 2011 <br> (in millions) | Nine Months Ended <br> September 30, <br> 2012 |
| :--- | :--- | :---: | :---: | :---: | :---: |
| 2012 |  |  |

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

Interest income on commercial mortgage loans is included in net investment income. The Company recorded $\$ 4$ million and $\$ 2$ million for the three months ended September 30, 2012 and 2011, respectively, and $\$ 9$ million and $\$ 9$ million for the nine months ended September 30, 2012 and 2011, respectively, of interest income on fair value option loans. Interest income on these loans is recorded based on the effective interest rates as determined at the closing of the loan.

The fair values and aggregate contractual principal amounts of commercial mortgage loans, for which the fair value option has been elected, were $\$ 248$ million and $\$ 246$ million, respectively, as of September 30, 2012, and $\$ 603$ million and $\$ 598$ million, respectively, as of December 31, 2011. As of September 30, 2012, loans that were in nonaccrual status had fair values of $\$ 20$ million and aggregate contractual principal amounts of $\$ 23$ million, respectively.

The fair value of other long-term investments was $\$ 462$ million as of September 30, 2012 and $\$ 366$ million as of December 31, 2011.

The fair value and aggregate contractual principal amounts of other liabilities, for which the fair value option has been elected, were $\$ 394$ million and $\$ 391$ million, respectively, as of September 30, 2012, and $\$ 282$ million and $\$ 294$ million, respectively as of December 31, 2011. Interest expense recorded for these liabilities was $\$ 2$ million and $\$ 8$ million, respectively, for the three and nine months ended September 30, 2012.

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## PRUDENTIAL FINANCIAL, INC.

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

## Fair Value of Financial Instruments

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

|  | September 30, 2012 |  |  |  |  |  |  |  | December 31, 2011 |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Level 1 | Level 20 |  | Value | Total (in millions) |  | Carrying <br> Amount(1) <br> Total |  | Fair <br> Value <br> Total | Carrying Amount Total |
|  |  |  |  | Level 3 |  |  |  |  |  |  |
| Assets: |  |  |  |  |  |  |  |  |  |  |
| Fixed maturities, held-to-maturity | \$ 0 | \$ | 3,144 | \$ 1,875 | \$ | 5,019 | \$ | 4,720 | \$ 5,354 | \$ 5,107 |
| Commercial mortgage and other loans | 0 |  | 798 | 38,957 |  | 39,755 |  | 36,574 | 37,138 | 34,831 |
| Policy loans | 0 |  | 0 | 14,724 |  | 14,724 |  | 11,701 | 14,858 | 11,559 |
| Short-term investments | 0 |  | 51 | 0 |  | 51 |  | 51 | 356 | 356 |
| Cash and cash equivalents | 3,623 |  | 916 | 0 |  | 4,539 |  | 4,539 | 4,822 | 4,822 |
| Accrued investment income | 0 |  | 2,870 | 0 |  | 2,870 |  | 2,870 | 2,793 | 2,793 |
| Other assets | 56 |  | 1,893 | 682 |  | 2,631 |  | 2,631 | 3,105 | 3,105 |
| Total assets | \$ 3,679 | \$ | 9,672 | \$ 56,238 | \$ | 69,589 | \$ | 63,086 | \$ 68,426 | \$ 62,573 |
| Liabilities: |  |  |  |  |  |  |  |  |  |  |
| Policyholders account balances-investment contracts | \$ 0 | \$ | 41,770 | \$ 63,525 |  | 105,295 | \$ | 102,293 | \$ 103,184 | \$ 102,245 |
| Securities sold under agreements to repurchase | 0 |  | 8,033 | 0 |  | 8,033 |  | 8,033 | 6,218 | 6,218 |
| Cash collateral for loaned securities | 0 |  | 3,376 | 0 |  | 3,376 |  | 3,376 | 2,973 | 2,973 |
| Short-term debt | 0 |  | 3,044 | 0 |  | 3,044 |  | 3,013 | 2,346 | 2,336 |
| Long-term debt | 961 |  | 20,838 | 4,597 |  | 26,396 |  | 23,845 | 25,828 | 24,622 |
| Bank customer liabilities(2) | 0 |  | 0 | 0 |  | 0 |  | 0 | 1,745 | 1,730 |
| Other liabilities | 0 |  | 4,723 | 914 |  | 5,637 |  | 5,670 | 5,876 | 5,907 |
| Separate account liabilities-investment contracts | 0 |  | 75,295 | 20,618 |  | 95,913 |  | 95,913 | 89,492 | 89,492 |
| Total liabilities | \$ 961 |  | 57,079 | \$ 89,654 |  | 247,694 | \$ | 242,143 | \$ 237,662 | \$ 235,523 |

[^5]The fair values presented above have been determined by using available market information and by applying market valuation methodologies, as described in more detail below.

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# PRUDENTIAL FINANCIAL, INC. 

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

## Fixed Maturities, Held-to-Maturity

The fair values of public fixed maturity securities are generally based on prices from third-party pricing services, which are reviewed to validate reasonableness. However, for certain public fixed maturity securities and investments in private placement fixed maturity securities, this information is either not available or not reliable. For these public fixed maturity securities, the fair value is based on indicative broker quotes, if available, or determined using a discounted cash flow model or internally-developed values. For private fixed maturities fair value is determined using a discounted cash flow model. In determining the fair value of certain fixed maturity securities, the discounted cash flow model may also use unobservable inputs, which reflect the Company s own assumptions about the inputs market participants would use in pricing the security.

## Commercial Mortgage and Other Loans

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

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

## Policy Loans

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

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

## Policyholders Account Balances Investment Contracts

Only the portion of policyholders account balances related to products that are investment contracts (those without significant mortality or morbidity risk) are reflected in the table above. For fixed deferred annuities, single premium endowments, payout annuities and other similar contracts without life contingencies, fair values

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# PRUDENTIAL FINANCIAL, INC. 

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

are derived using discounted projected cash flows based on interest rates that are representative of the Company s financial strength ratings, and hence reflect the Company s own non-performance risk. For guaranteed investment contracts, funding agreements, structured settlements without life contingencies and other similar products, fair values are derived using discounted projected cash flows based on interest rates being offered for similar contracts with maturities consistent with those of the contracts being valued. For those balances that can be withdrawn by the customer at any time without prior notice or penalty, the fair value is the amount estimated to be payable to the customer as of the reporting date, which is generally the carrying value. For defined contribution and defined benefit contracts and certain other products, the fair value is the market value of the assets supporting the liabilities.

## Securities Sold Under Agreements to Repurchase

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

## Cash Collateral for Loaned Securities

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

## Debt

The fair value of short-term and long-term debt, as well as debt of consolidated VIEs, is generally determined by either prices obtained from independent pricing services, which are validated by the Company, or discounted cash flow models. With the exception of the debt of consolidated VIEs which is non-recourse to the Company, these fair values consider the Company s own non-performance risk. Discounted cash flow models predominately use market observable inputs such as the borrowing rates currently available to the Company for debt and financial instruments with similar terms and remaining maturities. For commercial paper issuances and other debt with a maturity of less than 90 days, the carrying value approximates fair value. Debt of consolidated VIEs is reflected within Other liabilities.

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

## Bank Customer Liabilities

The carrying amount for certain deposits (interest and non-interest demand, savings and money market accounts) approximates or equals their fair values. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates being offered on certificates at the reporting dates to a schedule of aggregated expected monthly maturities. Bank customer liabilities are reflected within Other liabilities. During 2012, the Company divested bank customer liabilities as part of a previously announced decision to limit banking operations to trust services.

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# PRUDENTIAL FINANCIAL, INC. 

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

## Other Liabilities

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

## Separate Account Liabilities Investment Contracts

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

## 14. DERIVATIVE INSTRUMENTS

Types of Derivative Instruments and Derivative Strategies used in a non-dealer or broker capacity

## Interest Rate Contracts

Interest rate swaps and exchange-traded futures and options are used by the Company to reduce risks from changes in interest rates, manage interest rate exposures arising from mismatches between assets and liabilities (including duration mismatches) and to hedge against changes in the value of assets it owns or anticipates acquiring or selling. Swaps may be attributed to specific assets or liabilities or may be used on a portfolio basis. Under interest rate swaps, the Company agrees with other parties to exchange, at specified intervals, the difference between fixed-rate and floating-rate interest amounts calculated by reference to an agreed upon notional principal amount. Generally, no cash is exchanged at the outset of the contract and no principal payments are made by either party. These transactions are entered into pursuant to master agreements that provide for a single net payment to be made by one counterparty at each due date.

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

## Equity Contracts

Equity index options are contracts which will settle in cash based on differentials in the underlying indices at the time of exercise and the strike price. The Company uses combinations of purchases and sales of equity index options to hedge the effects of adverse changes in equity indices within a predetermined range. These hedges do not qualify for hedge accounting.

## Foreign Exchange Contracts

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

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# PRUDENTIAL FINANCIAL, INC. 

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

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

Under currency swaps, the Company agrees with other parties to exchange, at specified intervals, the difference between one currency and another at an exchange rate and calculated by reference to an agreed principal amount. Generally, the principal amount of each currency is exchanged at the beginning and termination of the currency swap by each party. These transactions are entered into pursuant to master agreements that provide for a single net payment to be made by one counterparty for payments made in the same currency at each due date.

## Credit Contracts

Credit derivatives are used by the Company to enhance the return on the Company s investment portfolio by creating credit exposure similar to an investment in public fixed maturity cash instruments. With credit derivatives the Company sells credit protection on an identified name, or a basket of names in a first to default structure, and in return receives a quarterly premium. With single name credit default derivatives, this premium or credit spread generally corresponds to the difference between the yield on the referenced name s public fixed maturity cash instruments and swap rates, at the time the agreement is executed. With first to default baskets, the premium generally corresponds to a high proportion of the sum of the credit spreads of the names in the basket. If there is an event of default by the referenced name or one of the referenced names in a basket, as defined by the agreement, then the Company is obligated to pay the counterparty the referenced amount of the contract and receive in return the referenced defaulted security or similar security. See credit derivatives written section for discussion of guarantees related to credit derivatives written. In addition to selling credit protection the Company has purchased credit protection using credit derivatives in order to hedge specific credit exposures in the Company s investment portfolio.

## Other Contracts

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

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Loan Commitments. In its mortgage operations, the Company enters into commitments to fund commercial mortgage loans at specified interest rates and other applicable terms within specified periods of time. These commitments are legally binding agreements to extend credit to a counterparty. Loan commitments for loans that will be held for sale are recognized as derivatives and recorded at fair value. The determination of the fair value of loan commitments accounted for as derivatives considers various factors including, among others, terms of the related loan, the intended exit strategy for the loans based upon either securitization valuation models or investor

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## PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

purchase commitments, prevailing interest rates, origination income or expense, and the value of service rights. Loan commitments that relate to the origination of mortgage loans that will be held for investment are not accounted for as derivatives and accordingly are not recognized in the Company s financial statements. See Note 15 for a further discussion of these loan commitments.

Embedded Derivatives. The Company sells variable annuity products, which may include guaranteed benefit features that are accounted for as embedded derivatives. These embedded derivatives are marked to market through Realized investment gains (losses), net based on the change in value of the underlying contractual guarantees, which are determined using valuation models. The Company maintains a portfolio of derivative instruments that is intended to economically hedge the risks related to the above products features. The derivatives may include, but are not limited to equity options, total return swaps, interest rate swap options, caps, floors, and other instruments. In addition, some variable annuity products feature an automatic rebalancing element, also referred to as an asset transfer feature, to minimize risks inherent in the Company s guarantees which reduces the need for derivatives.

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

Synthetic Guarantees. The Company sells fee-based synthetic guaranteed investment contracts, which include investment-only, stable value contracts, to qualified pension plans. The assets are owned by the trustees of such plans, who invest the assets under the terms of investment guidelines agreed to with the Company. The contracts contain a guarantee of a minimum rate of return on participant balances supported by the underlying assets, and a guarantee of liquidity to meet certain participant-initiated plan cash flow requirements. These contracts are accounted for as derivatives, recorded at fair value and classified as interest rate derivatives.

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## PRUDENTIAL FINANCIAL, INC.

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

The table below provides a summary of the gross notional amount and fair value of derivatives contracts used in a non-dealer or broker capacity, excluding embedded derivatives which are recorded with the associated host, by the primary underlying. Many derivative instruments contain multiple underlyings. The fair value amounts below represent the gross fair value of derivative contracts prior to taking into account the netting effects of master netting agreements and cash collateral held with the same counterparty. This netting impact results in total derivative assets of $\$ 3,570$ million and $\$ 2,611$ million as of September 30, 2012 and December 31, 2011, respectively, and total derivative liabilities of $\$ 256$ million and $\$ 349$ million as of September 30, 2012 and December 31, 2011, respectively, reflected in the Unaudited Interim Consolidated Statement of Financial Position.

| Primary Underlying/ Instrument Type | September 30, 2012 |  |  |  | December 31, 2011 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Notional <br> Amount | Fair Value |  |  | Notional <br> Amount ons) | Fair Value |  |  |  |
|  |  | Assets |  | iabilities (in m |  |  | Assets |  | abilities |
| Qualifying Hedges: |  |  |  |  |  |  |  |  |  |
| Interest Rate |  |  |  |  |  |  |  |  |  |
| Interest Rate Swaps | \$ 3,438 | \$ 29 | \$ | (450) | \$ 5,048 | \$ | 62 | \$ | (468) |
| Foreign Currency |  |  |  |  |  |  |  |  |  |
| Foreign Currency Forwards | 902 | 10 |  | (16) | 753 |  | 6 |  | (4) |
| Currency/Interest Rate |  |  |  |  |  |  |  |  |  |
| Foreign Currency Swaps | 6,098 | 214 |  | (417) | 4,807 |  | 227 |  | (438) |
| Total Qualifying Hedges | \$ 10,438 | \$ 253 |  | (883) | \$ 10,608 | \$ | 295 | \$ | (910) |
| Non-Qualifying Hedges: |  |  |  |  |  |  |  |  |  |
| Interest Rate |  |  |  |  |  |  |  |  |  |
| Interest Rate Swaps | \$ 132,018 | \$ 10,117 | \$ | $(3,478)$ | \$ 107,560 | \$ | 9,357 | \$ | $(3,084)$ |
| Interest Rate Futures | 7,402 | 5 |  | (2) | 6,192 |  | 10 |  | (9) |
| Interest Rate Options | 538 | 9 |  | (1) | 601 |  | 13 |  | (3) |
| Interest Rate Forwards | 810 | 6 |  | 0 | 2,139 |  | 6 |  | 0 |
| Synthetic GICs | 61,657 | 10 |  | 0 | 46,844 |  | 4 |  | 0 |
| Foreign Currency |  |  |  |  |  |  |  |  |  |
| Foreign Currency Forwards | 14,623 | 99 |  | (179) | 16,228 |  | 176 |  | (335) |
| Foreign Currency Options | 97 | 18 |  | 0 | 98 |  | 23 |  | 0 |
| Currency/Interest Rate |  |  |  |  |  |  |  |  |  |
| Foreign Currency Swaps | 5,181 | 226 |  | (293) | 5,390 |  | 224 |  | (399) |
| Credit |  |  |  |  |  |  |  |  |  |
| Credit Default Swaps | 2,549 | 22 |  | (99) | 3,298 |  | 58 |  | (130) |
| Equity |  |  |  |  |  |  |  |  |  |
| Equity Futures | 7,421 | 388 |  | 0 | 2,114 |  | 149 |  | 0 |
| Equity Options | 41,434 | 640 |  | (56) | 14,951 |  | 415 |  | (66) |
| Total Return Swaps | 5,166 | 30 |  | (154) | 6,797 |  | 34 |  | (175) |
| Total Non-Qualifying Hedges | \$ 278,896 | \$ 11,570 | \$ | $(4,262)$ | \$ 212,212 |  | 10,469 | \$ | $(4,201)$ |
| Total Derivatives(1) | \$ 289,334 | \$ 11,823 | \$ | $(5,145)$ | \$ 222,820 |  | 10,764 | \$ | $(5,111)$ |

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(1) Excludes embedded derivatives which contain multiple underlyings. The fair value of these embedded derivatives was a net liability of $\$ 3,742$ million as of September 30, 2012 and a net liability of $\$ 3,131$ million as of December 31, 2011, included in Future policy benefits and Fixed maturities, available-for-sale.

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## PRUDENTIAL FINANCIAL, INC.

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

## Cash Flow, Fair Value and Net Investment Hedges

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

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

Three Months Ended September 30, 2012

|  | Realized <br> Investment Gains/ (Losses) |  | Net <br> Investment Income |  | Other <br> Income |  | Interest Expense lions) |  | Interest <br> Credited <br> To <br> Policyholders <br> Account <br> Balances |  | Accumulated <br> Other <br> Comprehensive Income(1) |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Qualifying Hedges |  |  |  |  |  |  |  |  |  |  |  |  |
| Fair value hedges |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest Rate | \$ | 6 | \$ | (23) | \$ | 0 | \$ | 1 | \$ | 5 | \$ | 0 |
| Currency |  | 0 |  | (1) |  | 0 |  | 0 |  | 0 |  | 0 |
| Total fair value hedges |  | 6 |  | (24) |  | 0 |  | 1 |  | 5 |  | 0 |
| Cash flow hedges |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest Rate |  | 0 |  | 0 |  | 0 |  | (5) |  | 0 |  | 2 |
| Currency/Interest Rate |  | 0 |  | (1) |  | (3) |  | 0 |  | 0 |  | (119) |
| Total cash flow hedges |  | 0 |  | (1) |  | (3) |  | (5) |  | 0 |  | (117) |
| Net investment hedges |  |  |  |  |  |  |  |  |  |  |  |  |
| Currency(2) |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | (6) |
| Currency/Interest Rate |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | (10) |
| Total net investment hedges |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | (16) |
| Non-qualifying hedges |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest Rate |  | 86 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Currency |  | (119) |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Currency/Interest Rate |  | (19) |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |

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| Credit | (8) | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Equity | (983) | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Embedded Derivatives | (418) | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Total non-qualifying hedges | $(1,461)$ | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Total | \$ $(1,455)$ | (25) | \$ | (3) | \$ | (4) | \$ | 5 | \$ | (133) |

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## PRUDENTIAL FINANCIAL, INC.

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

|  | Nine Months Ended September 30, 2012 |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Realized <br> Investment Gains/ (Losses) |  | Net <br> Investment Income |  | Other Income |  | Interest <br> Expense <br> lions) |  | Interest Credited To <br> Policyholders <br> Account <br> Balances |  | Accumulated <br> Other <br> Comprehensive Income(1) |  |
| Qualifying Hedges |  |  |  |  |  |  |  |  |  |  |  |  |
| Fair value hedges |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest Rate | \$ | (6) | \$ | (71) | \$ | 0 | \$ | 4 | \$ | 26 | \$ | 0 |
| Currency |  | 2 |  | (3) |  | 0 |  | 0 |  | 0 |  | 0 |
| Total fair value hedges |  | (4) |  | (74) |  | 0 |  | 4 |  | 26 |  | 0 |
| Cash flow hedges |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest Rate |  | 0 |  | 0 |  | 0 |  | (14) |  | 0 |  | 8 |
| Currency/Interest Rate |  | 0 |  | (4) |  | (5) |  | 0 |  | 0 |  | (47) |
| Total cash flow hedges |  | 0 |  | (4) |  | (5) |  | (14) |  | 0 |  | (39) |
| Net investment hedges |  |  |  |  |  |  |  |  |  |  |  |  |
| Currency(2) |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | (8) |
| Currency/Interest Rate |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 78 |
| Total net investment hedges |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 70 |
| Non-qualifying hedges |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest Rate |  | 1,303 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Currency |  | (46) |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Currency/Interest Rate |  | 97 |  | 0 |  | 1 |  | 0 |  | 0 |  | 0 |
| Credit |  | (36) |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Equity |  | $(1,983)$ |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Embedded Derivatives |  | (241) |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Total non-qualifying hedges |  | (906) |  | 0 |  | 1 |  | 0 |  | 0 |  | 0 |
| Total |  | (910) | \$ | (78) | \$ | (4) | \$ | (10) | \$ | 26 | \$ | 31 |

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PRUDENTIAL FINANCIAL, INC.

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

|  | Three Months Ended September 30, 2011 |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Realized <br> Investment Gains/ (Losses) | Net <br> Investment Income |  | Other Income |  | Interest <br> Expense <br> illions) |  | Interest Credited To <br> Policyholders <br> Account <br> Balances |  | Accumulated <br> Other <br> Comprehensive Income(1) |  |
| Qualifying Hedges |  |  |  |  |  |  |  |  |  |  |  |
| Fair value hedges |  |  |  |  |  |  |  |  |  |  |  |
| Interest Rate | \$ (115) | \$ | (28) | \$ | 0 | \$ | 3 | \$ | 14 | \$ | 0 |
| Currency | 47 |  | (1) |  | 0 |  | 0 |  | 0 |  | 0 |
| Total fair value hedges | (68) |  | (29) |  | 0 |  | 3 |  | 14 |  | 0 |
| Cash flow hedges |  |  |  |  |  |  |  |  |  |  |  |
| Interest Rate | 0 |  | 0 |  | 0 |  | (5) |  | 0 |  | (15) |
| Currency/Interest Rate | 0 |  | (4) |  | 22 |  | 0 |  | 0 |  | 272 |
| Total cash flow hedges | 0 |  | (4) |  | 22 |  | (5) |  | 0 |  | 257 |
| Net investment hedges |  |  |  |  |  |  |  |  |  |  |  |
| Currency(2) | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 3 |
| Currency/Interest Rate | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | (30) |
| Total net investment hedges | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | (27) |
| Non-qualifying hedges |  |  |  |  |  |  |  |  |  |  |  |
| Interest Rate | 4,213 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Currency | 292 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Currency/Interest Rate | 73 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Credit | 9 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Equity | 1,329 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Embedded Derivatives | $(3,360)$ |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Total non-qualifying hedges | 2,556 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Total | \$ 2,488 | \$ | (33) | \$ | 22 | \$ | (2) | \$ | 14 | \$ | 230 |

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## PRUDENTIAL FINANCIAL, INC.

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

|  | Nine Months Ended September 30, 2011 |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Realized <br> Investment Gains/ (Losses) |  | Net <br> Investment Income |  | Other <br> Income |  | Interest Expense lions) |  | Interest <br> Credited To <br> Policyholders <br> Account <br> Balances |  | Accumulated <br> Other <br> Comprehensive Income(1) |  |
| Qualifying Hedges |  |  |  |  |  |  |  |  |  |  |  |  |
| Fair value hedges |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest Rate | \$ | (119) | \$ | (87) | \$ | 0 | \$ | 7 | \$ | 44 | \$ | 0 |
| Currency |  | 15 |  | (4) |  | 0 |  | 0 |  | 0 |  | 0 |
| Total fair value hedges |  | (104) |  | (91) |  | 0 |  | 7 |  | 44 |  | 0 |
| Cash flow hedges |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest Rate |  | 0 |  | 0 |  | 0 |  | (15) |  | (1) |  | (9) |
| Currency/Interest Rate |  | 0 |  | (10) |  | 23 |  | 0 |  | 0 |  | 168 |
| Total cash flow hedges |  | 0 |  | (10) |  | 23 |  | (15) |  | (1) |  | 159 |
| Net investment hedges |  |  |  |  |  |  |  |  |  |  |  |  |
| Currency (2) |  | (9) |  | 0 |  | 0 |  | 0 |  | 0 |  | (4) |
| Currency/Interest Rate |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | (4) |
| Total net investment hedges |  | (9) |  | 0 |  | 0 |  | 0 |  | 0 |  | (8) |
| Non-qualifying hedges |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest Rate |  | 4,615 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Currency |  | 128 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Currency/Interest Rate |  | 24 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Credit |  | (29) |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Equity |  | 848 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Embedded Derivatives |  | $(2,865)$ |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Total non-qualifying hedges |  | 2,721 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Total |  | 2,608 | \$ | (101) | \$ | 23 | \$ | (8) | \$ | 43 | \$ | 151 |

(1) Amounts deferred in Accumulated other comprehensive income (loss).
(2) Relates to the sale of equity method investments.

For the three and nine months ended September 30, 2012, the ineffective portion of derivatives accounted for using hedge accounting was not material to the Company s results of operations and there were no material amounts reclassified into earnings relating to instances in which the

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Company discontinued cash flow hedge accounting because the forecasted transaction did not occur by the anticipated date or within the additional time period permitted by the authoritative guidance for the accounting for derivatives and hedging. In addition, there were no instances in which the Company discontinued fair value hedge accounting due to a hedged firm commitment no longer qualifying as a fair value hedge.

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

|  |  | (in millions) |
| :--- | :---: | :---: |
| Balance, December 31, 2011 | $\$$ | $(86)$ |
| Net deferred gains/(losses) on cash flow hedges from January 1 to September 30, 2012 | $(62)$ |  |
| Amount reclassified into current period earnings | 23 |  |
| Balance, September 30, 2012 | $\$$ | $(125)$ |

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## PRUDENTIAL FINANCIAL, INC.

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

Using September 30, 2012 values, it is anticipated that a pre-tax loss of approximately $\$ 22$ million will be reclassified from Accumulated other comprehensive income (loss) to earnings during the subsequent twelve months ending September 30, 2013, offset by amounts pertaining to the hedged items. As of September 30, 2012, the Company does not have any qualifying cash flow hedges of forecasted transactions other than those related to the variability of the payment or receipt of interest or foreign currency amounts on existing financial instruments. The maximum length of time for which these variable cash flows are hedged is 19 years. Income amounts deferred in Accumulated other comprehensive income (loss) as a result of cash flow hedges are included in Net unrealized investment gains (losses) in the Consolidated Statements of Equity.

For effective net investment hedges, the amounts, before applicable taxes, recorded in the cumulative translation adjustment account within Accumulated other comprehensive income (loss) was \$(31) million and \$(102) million as of September 30, 2012 and December 31, 2011.

## Credit Derivatives Written

The following table sets forth the Company s exposure from credit derivatives where the Company has written credit protection, by NAIC rating of the underlying credits as of September 30, 2012 and December 31, 2011. The Company s maximum amount at risk under these credit derivatives listed below assumes the value of the underlying referenced securities become worthless. These credit derivatives generally have maturities of less than 5 years. The table excludes a credit derivative related to surplus notes issued by a subsidiary of Prudential Insurance and embedded derivatives contained in externally-managed investments in the European market.
$\left.\begin{array}{lcccccc} & & \begin{array}{c}\text { September 30, 2012 } \\ \text { Single Name } \\ \text { Fair Value } \\ \text { (in millions) }\end{array} & \begin{array}{c}\text { December 31, 2011 } \\ \text { Single Name } \\ \text { Notion }\end{array} \\ \text { NAIC Designation } \\ \text { Notue }\end{array}\right)$

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## PRUDENTIAL FINANCIAL, INC.

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

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

| Industry | September 30, 2012 |  |  | December 31, 2011 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | (in millions) |  |  |  |  |  |
| Corporate Securities: |  |  |  |  |  |  |
| Consumer Non-cyclical | \$ 120 | \$ | 1 | \$ 120 | \$ | 1 |
| Capital Goods | 90 |  | 0 | 90 |  | 1 |
| Basic Industry | 40 |  | 0 | 40 |  | 0 |
| Transportation | 25 |  | 0 | 25 |  | 0 |
| Consumer Cyclical | 20 |  | 0 | 20 |  | 0 |
| Energy | 20 |  | 0 | 20 |  | 0 |
| Communication | 5 |  | 0 | 5 |  | 0 |
| Finance | 0 |  | 0 | 500 |  | 1 |
| Total Credit Derivatives | \$ 320 | \$ | 1 | \$ 820 | \$ | 3 |

In addition to the above, the Company entered into a credit derivative that will require the Company to make certain payments in the event of deterioration in the value of the surplus notes issued by a subsidiary of Prudential Insurance. The notional of this credit derivative is $\$ 500$ million and the fair value as of September 30, 2012 and December 31, 2011 was a liability of $\$ 46$ million and $\$ 77$ million, respectively. No collateral was pledged in either period.

The Company holds certain externally-managed investments in the European market which contain embedded derivatives whose fair values are primarily driven by changes in credit spreads. These investments are medium-term notes that are collateralized by investment portfolios primarily consisting of investment grade European fixed income securities, including corporate bonds and asset-backed securities, and derivatives, as well as varying degrees of leverage. The notes have a stated coupon and provide a return based on the performance of the underlying portfolios and the level of leverage. The Company invests in these notes to earn a coupon through maturity, consistent with its investment purpose for other debt securities. The notes are accounted for under U.S. GAAP as available-for-sale fixed maturity securities with bifurcated embedded derivatives (total return swaps). Changes in the value of the fixed maturity securities are reported in Equity under the heading Accumulated Other Comprehensive Income (Loss) and changes in the market value of the embedded total return swaps are included in current period earnings in Realized investment gains (losses), net. The Company s maximum exposure to loss from these investments was $\$ 312$ million and $\$ 664$ million at September 30, 2012 and December 31, 2011, respectively.

In addition to writing credit protection, the Company has purchased credit protection using credit derivatives in order to hedge specific credit exposures in the Company s investment portfolio. As of September 30, 2012 and December 31, 2011, the Company had $\$ 1.729$ billion and $\$ 1.978$ billion of outstanding notional amounts, respectively, reported at fair value as a liability of $\$ 32$ million and an asset of $\$ 2$ million, respectively.

Types of Derivative Instruments and Derivative Strategies used in a dealer or broker capacity

Futures, forwards and options contracts, and swap agreements, were also used in a derivative dealer or broker capacity in the Company s commodities operations, prior to the sale of this business to Jefferies on July 1, 2011, to facilitate transactions of clients, hedge proprietary trading activities and as a means of risk management.

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# PRUDENTIAL FINANCIAL, INC. 

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

These derivatives allowed the Company to structure transactions to manage its exposure to commodities and securities prices, foreign exchange rates and interest rates. Risk exposures were managed through diversification, by controlling position sizes and by entering into offsetting positions.

The fair value of the Company s derivative contracts used in a derivative dealer or broker capacity were reported on a net-by-counterparty basis in the Company s Consolidated Statements of Financial Position when management believes a legal right of setoff exists under an enforceable netting agreement.

Realized and unrealized gains and losses from marking-to-market the derivatives used in proprietary positions were recognized on a trade date basis and reported in Income from discontinued operations, net of taxes. The pre-tax amounts reported in Income (loss) from discontinued operations, net of taxes for these derivatives were gains of $\$ 0$ million and $\$ 63$ million for the three and nine months ended September 30, 2011.

## Counterparty Credit Risk

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

The credit exposure of the Company s over-the-counter ( OTC ) derivative transactions is represented by the contracts with a positive fair value (market value) at the reporting date. To reduce credit exposures, the Company seeks to (i) enter into OTC derivative transactions pursuant to master agreements that provide for a netting of payments and receipts with a single counterparty (ii) enter into agreements that allow the use of credit support annexes (CSAs ), which are bilateral rating-sensitive agreements that require collateral postings at established threshold levels. Likewise, the Company effects exchange-traded futures and options transactions through regulated exchanges and these transactions are settled on a daily basis, thereby reducing credit risk exposure in the event of non-performance by counterparties to such financial instruments.

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

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Certain of the Company s derivative agreements with some of its counterparties contain credit-rating related triggers. If the Company scredit rating were to fall below a certain level, the counterparties to the derivative instruments could request termination at the then fair value of the derivative or demand immediate full collateralization on derivative instruments in net liability positions. If a downgrade occurred and the derivative positions were terminated, the Company anticipates it would be able to replace the derivative positions with other counterparties in the normal course of business. The aggregate fair value of all derivative instruments with credit-risk-related contingent features that are in a net liability position were $\$ 133$ million as of September 30, 2012. In the normal course of business the Company has posted collateral related to these instruments of $\$ 123$ million as of September 30, 2012. If the credit-risk-related contingent features underlying these agreements had been triggered on September 30, 2012, the Company estimates that it would be required to post a maximum of $\$ 10$ million of additional collateral to its counterparties.

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## PRUDENTIAL FINANCIAL, INC.

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

## 15. COMMITMENTS AND GUARANTEES, CONTINGENT LIABILITIES AND LITIGATION AND REGULATORY MATTERS

## Commitments and Guarantees

## Commercial Mortgage Loan Commitments

|  | As of September 30, <br> 2012 <br> (in millions) |
| :--- | :---: |
| Total outstanding mortgage loan commitments | $\$$ |
| Portion of commitment where prearrangement to sell to investor exists | $\$$ |

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

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

|  | As of September 30, <br> 2012 <br> (in millions) |
| :--- | :---: |
| Expected to be funded from the general account and other operations outside the separate | $\$$ |
| accounts(1) | $\$$ |
| Expected to be funded from separate accounts | $\$$ |

(1) Includes a remaining commitment of $\$ 212$ million related to the Company $s$ agreement to co-invest with the Fosun Group (Fosun) in a private equity fund, managed by Fosun, for the Chinese marketplace.

The Company has other commitments to purchase or fund investments, some of which are contingent upon events or circumstances not under the Company s control, including those at the discretion of the Company s counterparties. The Company anticipates a portion of these commitments will ultimately be funded from its separate accounts. Some of the separate account commitments have recourse to Prudential Insurance if the separate accounts are unable to fund the amounts when due.

|  | As of September 30, <br> 2012 <br> (in millions) |
| :--- | :---: | :---: |
| Total remaining available credit lines | $\$ \quad 9$ |

In connection with the sale of the real estate brokerage franchise and relocation business, the Company agreed to provide the buyer with transitional financing for the transferred relocation services business. The Company originally provided three credit facilities: two six month facilities that were repaid and expired on June 6, 2012 and a three year facility that was repaid and terminated on October 26, 2012.

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## PRUDENTIAL FINANCIAL, INC.

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

## Guarantees of Investee Debt

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

A number of guarantees provided by the Company relate to real estate investments held in its separate accounts, in which entities that the separate account has invested in have borrowed funds, and the Company has guaranteed their obligations. The Company provides these guarantees to assist these entities in obtaining financing. The Company s maximum potential exposure under these guarantees is mostly limited to the assets of the separate account. The exposure that is not limited to the separate account assets relates mostly to guarantees limited to fraud, criminal activity or other bad acts. These guarantees generally expire at various times over the next thirteen years. At September 30, 2012, the Company s assessment is that it is unlikely payments will be required. Any payments that may become required under these guarantees would either first be reduced by proceeds received by the creditor on a sale of the underlying collateral, or would provide rights to obtain the underlying collateral.

## Indemnification of Securities Lending Transactions

|  | As of September 30, <br> 2012 <br> (in millions) |
| :--- | :--- |
| Indemnification provided to mutual fund and separate account clients for securities lending | $\$$ |
| Fair value of related collateral associated with above indemnifications | $\$$ |
| Accrued liability associated with guarantee | $\$$ |

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

## Credit Derivatives Written

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

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## PRUDENTIAL FINANCIAL, INC.

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

## Guarantees of Global Commodities Business

|  | As of September 30, <br> 2012 <br> (in millions) |  |
| :--- | :---: | :---: |
| Exposure under the guarantees | $\$$ | 4 |
| Accrued liability associated with guarantees | $\$$ | 0 |

In conjunction with the sale of the Global Commodities Business, the Company entered into a guarantees transition and collateral agreement with Jefferies, pursuant to which the Company agreed to keep these guarantees outstanding until January 2013, including with respect to business conducted by the transferred entities with beneficiaries of these guarantees subsequent to the closing date. Jefferies has agreed to indemnify the Company for any amounts payable under the guarantees and, under certain conditions, provide collateral for such obligation. As of September 30, 2012, no collateral has been provided by Jefferies.

## Guarantees of Asset Values

|  | As of September 30, <br> 2012 <br> (in millions) |
| :--- | ---: |
| Guaranteed value of third parties assets | $\$$ |
| Fair value of collateral supporting these assets | $\$$ |
| Asset associated with guarantee, carried at fair value | $\$$ |

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

## Guarantees of Credit Enhancements

## As of September 30,

2012
(in millions)

| Guarantees of credit enhancements of debt instruments associated with commercial real |  |
| :--- | :--- |
| estate assets | $\$$ |
| Fair value of properties and associated tax credits that secure the guarantee | $\$$ |
| Accrued liability associated with guarantee | $\$$ |

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

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## PRUDENTIAL FINANCIAL, INC.

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

## Indemnification of Serviced Mortgage Loans

|  | As of September 30, <br> 2012 <br> (in millions) |
| :--- | ---: |
| Maximum exposure under indemnification agreements for mortgage loans serviced by the <br> Company | $\$$ |
| First-loss exposure portion of above | $\$$ |

As part of the commercial mortgage activities of the Company s Asset Management segment, the Company provides commercial mortgage origination, underwriting and servicing for certain government sponsored entities, such as Fannie Mae and Freddie Mac. The Company has agreed to indemnify the government sponsored entities for a portion of the credit risk associated with certain of the mortgages it services through a delegated authority arrangement. Under these arrangements, the Company originates multi-family mortgages for sale to the government sponsored entities based on underwriting standards they specify, and makes payments to them for a specified percentage share of losses they incur on certain loans serviced by the Company. The Company s percentage share of losses incurred generally varies from $2 \%$ to $20 \%$ of the loan balance, and is typically based on a first-loss exposure for a stated percentage of the loan balance, plus a shared exposure with the government sponsored entity for any losses in excess of the stated first-loss percentage, subject to a contractually specified maximum percentage. The Company services $\$ 8,066$ million of mortgages subject to these loss-sharing arrangements as of September 30, 2012, all of which are collateralized by first priority liens on the underlying multi-family residential properties. As of September 30, 2012, these mortgages had an average debt service coverage ratio of 1.75 times and an average loan-to-value ratio of $63 \%$. The Company s total share of losses related to indemnifications that were settled was $\$ 2$ million and $\$ 1$ million, for the nine months ended September 30, 2012 and 2011, respectively.

## Contingent Consideration

|  | As of September <br> 30, <br> 2012 |
| :--- | :---: |
| Maximum potential contingent consideration associated with acquisitions | $\$$(in millions) |

In connection with the Company s initial investment in an operating joint venture, the Company has agreed to pay additional consideration in future periods, contingent upon the attainment of defined operating objectives. The arrangement will be resolved over the following nine months. Any payment would result in an increase to the Company s investment in the operating joint venture. The Company considers the likelihood that the defined operating objectives will be met to be remote.

## Other Guarantees

|  | As of September 30, <br> 2012 <br> (in millions) |  |
| :--- | :---: | :---: |
| Other guarantees where amount can be determined | $\$$ | 438 |
| Accrued liability for other guarantees and indemnifications | $\$$ | 9 |

The Company is also subject to other financial guarantees and indemnity arrangements. The Company has provided indemnities and guarantees related to acquisitions, dispositions, investments and other transactions that are triggered by, among other things, breaches of representations, warranties or covenants provided by the

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## PRUDENTIAL FINANCIAL, INC.

Notes to Unaudited Interim Consolidated Financial Statements (Continued)

Company. These obligations are typically subject to various time limitations, defined by the contract or by operation of law, such as statutes of limitation. In some cases, the maximum potential obligation is subject to contractual limitations, while in other cases such limitations are not specified or applicable. Included above are $\$ 299$ million of yield maintenance guarantees related to certain investments the Company sold. The Company does not expect to make any payments on these guarantees and is not carrying any liabilities associated with these guarantees.

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

## Contingent Liabilities

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

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

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

## Litigation and Regulatory Matters

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

The Company establishes accruals for litigation and regulatory matters when it is probable that a loss has been incurred and the amount of that loss can be reasonably estimated. For litigation and regulatory matters where a loss may be reasonably possible, but not probable, or is probable but not reasonably estimable, no accrual is established but the matter, if material, is disclosed, including matters discussed below. The Company estimates that as of September 30, 2012, the aggregate range of reasonably possible losses in excess of accruals established for those litigation and regulatory matters for which such an estimate currently can be made is $\$ 0$ to

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## PRUDENTIAL FINANCIAL, INC.

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

approximately $\$ 250$ million. This estimate is not an indication of expected loss, if any, or the Company s maximum possible loss exposure on such matters. The Company reviews relevant information with respect to its litigation and regulatory matters on a quarterly and annual basis and updates its accruals, disclosures and estimates of reasonably possible loss based on such reviews.

## Individual Life and Group Insurance

In September 2012, the State of West Virginia, through its State Treasurer, filed a lawsuit, State of West Virginia ex. Rel. John D. Perdue v. Prudential Insurance Company of America, in the Circuit Court of Putnam County, West Virginia. The complaint alleges violations of the West Virginia Uniform Unclaimed Property Fund Act by failing to properly identify and report all unclaimed insurance policy proceeds which should either be paid to beneficiaries or escheated to West Virginia. The complaint seeks to examine the records of Prudential Insurance to determine compliance with the West Virginia Uniform Unclaimed Property Fund Act, and to assess penalties and costs in an undetermined amount.

In January 2012, a qui tam action on behalf of the State of Illinois, Total Asset Recovery Services v. Met Life Inc, et al., Prudential Financial, Inc., The Prudential Insurance Company of America, and Prudential Holdings, LLC, filed in the Circuit Court of Cook County, Illinois, was served on the Company. The complaint alleges that the Company failed to escheat life insurance proceeds to the State of Illinois in violation of the Illinois False Claims Whistleblower Reward and Protection Act and seeks injunctive relief, compensatory damages, civil penalties, treble damages, prejudgment interest, attorneys fees and costs. In April 2012, the Company filed a motion to dismiss the complaint. In September 2012, the complaint was withdrawn without prejudice. In March 2012, a qui tam action on behalf of the State of Minnesota, Total Asset Recovery v. MetLife Inc., et al., Prudential Financial Inc., The Prudential Insurance Company of America and Prudential Holdings, Inc., filed in the Fourth Judicial District, Hennepin County, in the State of Minnesota was served on the Company. The complaint alleges that the Company failed to escheat life insurance proceeds to the State of Minnesota in violation of the Minnesota False Claims Act and seeks injunctive relief, compensatory damages, civil penalties, treble damages, prejudgment interest, attorneys fees and costs. In June 2012, the Company filed a motion to dismiss the complaint.

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

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## PRUDENTIAL FINANCIAL, INC.

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

The Company is one of several companies subpoenaed by the New York Attorney General regarding its unclaimed property procedures. Additionally, the New York State Department of Financial Services ( NYDFS ) has requested that 172 life insurers (including the Company) provide data to the NYDFS regarding use of the SSMDF. The New York Office of Unclaimed Funds recently notified the Company that it intends to conduct an audit of the Company s compliance with New York s unclaimed property laws. The Minnesota Attorney General has also requested information regarding the Company $s$ use of the SSMDF and its claim handling procedures and the Company is one of several companies subpoenaed by the Minnesota Department of Commerce, Insurance Division. In February 2012, the Massachusetts Office of the Attorney General requested information regarding the Company s unclaimed property procedures.

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

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

In January 2011, a purported state-wide class action, Garcia v. The Prudential Insurance Company of America was dismissed by the Second Judicial District Court, Washoe County, Nevada. The complaint was brought on behalf of Nevada beneficiaries of individual life insurance policies for which, unless the beneficiaries elected another settlement method, death benefits were placed in retained asset accounts. The complaint alleges that by failing to disclose material information about the accounts, the Company wrongfully delayed payment and improperly retained undisclosed profits, and seeks damages, injunctive relief, attorneys fees and pre and post-judgment interest. In February 2011, plaintiff appealed the dismissal to the Nevada Supreme Court. As previously reported, in December 2009, an earlier purported nationwide class action raising substantially similar allegations brought by the same plaintiff in the United States District Court for the District of New Jersey, Garcia v. Prudential Insurance Company of America, was dismissed. In December 2010, a purported state-wide class action complaint, Phillips v. Prudential Financial, Inc., was filed in state court and removed to the United States District Court for the Southern District of Illinois. The complaint makes allegations under Illinois law, substantially similar to the Garcia cases, on behalf of a class of Illinois residents whose death benefit claims were settled by retained assets accounts. In March 2011, the complaint was amended to drop the Company as a defendant and add Pruco Life Insurance Company as a defendant and is now captioned Phillips v. Prudential Insurance and Pruco Life Insurance Company. In November 2011, the complaint was dismissed. In December 2011, plaintiffs appealed the dismissal.

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## PRUDENTIAL FINANCIAL, INC.

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

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

In February 2011, a fifth amended complaint was filed in the United States District Court for the District of New Jersey in Clark v. Prudential Insurance Company. The complaint brought on behalf of a purported class of California, Indiana, Ohio and Texas residents who purchased individual health insurance policies alleges that Prudential Insurance failed to disclose that it had ceased selling this type of policy in 1981 and that, as a result, premiums would increase significantly. The complaint alleges claims of fraudulent misrepresentation and omission, breach of the duty of good faith and fair dealing, and California s Unfair Competition Law and seeks compensatory and punitive damages. The matter was originally filed in 2008 and certain of the claims in the first four complaints were dismissed. In February 2012, plaintiffs filed a motion for class certification. That motion is pending decision by the court. In July 2012, Prudential Insurance moved for summary judgment on certain of plaintiffs claims.

In April 2009, Schultz v. The Prudential Insurance Company of America, a purported nationwide class action on behalf of participants claiming disability benefits under certain employee benefit plans insured by Prudential, was filed in the United States District Court for the Northern District of Illinois. As amended, the complaint alleges that Prudential Insurance and the defendant plans violated ERISA by characterizing family Social Security benefits as loss of time benefits that were offset against Prudential contract benefits. The complaint seeks a declaratory judgment that the offsets were improper, damages and other relief. The Company has agreed to indemnify the named defendant plans. In April 2011, Schultz was dismissed with prejudice, and plaintiffs appealed to the Seventh Circuit Court of Appeals. In March 2012, the court affirmed the dismissal.

From November 2002 to March 2005, eleven separate complaints were filed against the Company and the law firm of Leeds Morelli \& Brown in New Jersey state court and in the New Jersey Superior Court, Essex County as Lederman v. Prudential Financial, Inc., et al. The complaints allege that an alternative dispute resolution agreement entered into among Prudential Insurance, over 235 claimants who are current and former Prudential Insurance employees, and Leeds Morelli \& Brown (the law firm representing the claimants) was illegal and that Prudential Insurance conspired with Leeds Morelli \& Brown to commit fraud, malpractice, breach of contract, and violate racketeering laws by advancing legal fees to the law firm with the purpose of limiting Prudential s liability to the claimants. In February 2010, the New Jersey Supreme Court assigned the cases for centralized case management to the Superior Court, Bergen County. The Company participated in a court-ordered mediation that resulted in a settlement involving 193 of the remaining 235 plaintiffs. The amounts paid to the 193 plaintiffs were within existing reserves for this matter. The remaining plaintiffs continue to pursue their individual lawsuits, and have filed offers of judgment totaling approximately $\$ 90$ million. In June 2012, the court granted summary judgment against an additional plaintiff reducing to 39 the number of plaintiffs asserting claims against the Company.

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## PRUDENTIAL FINANCIAL, INC.

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

## Retirement Solutions and Investment Management

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 sfiduciary 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. 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 U.S. Retirement Solutions and Investment Management 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 United States District Court for the Southern District of New York denied the State Street defendants motion to dismiss claims for damages and other relief under Section 502(a)(2) of ERISA, but dismissed the claims 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 February 2010, State Street reached a settlement with the SEC over charges that it misled investors about their exposure to sub-prime investments, resulting in significant investor losses in mid-2007. Under the settlement, State Street paid approximately $\$ 313$ million in disgorgement, pre-judgment interest, penalty and compensation into a Fair Fund that was distributed to injured investors and consequently, State Street paid PRIAC, for deposit into its separate accounts, approximately $\$ 52.5$ million. By the terms of the settlement, State Street s payment to PRIAC does not resolve any claims PRIAC has against State Street or SSgA in connection with the losses in the investment funds SSgA managed, and the penalty component of State Street s SEC settlement cannot be used to offset or reduce compensatory damages in the action against State Street and SSgA. In June 2010, PRIAC moved for partial summary judgment on State Street s counterclaims. At the same time, State Street moved for summary judgment on PRIAC s complaint. In March 2011, the district court denied State Street s motion for summary judgment and denied in part and granted in part PRIAC s motion for partial summary judgment on State Street s counterclaims. In October 2011, the court held a bench trial to determine whether State Street had breached its fiduciary duty to PRIAC s plan clients. In February 2012, the court issued a decision holding that State Street breached its fiduciary duty to the plans under ERISA to manage the investment funds prudently and to diversify them. The court held that PRIAC did not prove that State Street breached its duty of loyalty to the plans under ERISA. The court held that State Street s breaches caused the plans losses in the amount of $\$ 76.7$ million and, after crediting State Street for an earlier payment, awarded $\$ 28.1$ million in damages in addition to the amount previously recovered as a result of the SEC settlement. The court has not yet ruled on State Street s counterclaims and has reserved judgment on PRIAC s requests for pre-judgment interest and attorney s fees. In May 2012, the Company filed a motion seeking partial summary judgment to dismiss State Street s counterclaims.

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## PRUDENTIAL FINANCIAL, INC.

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

Other Matters

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

In October 2012, the Board of Directors received a shareholder demand letter (the Demand ), containing allegations of wrongdoing similar to those alleged in the Silverman complaint. The Demand alleges that the Company s Senior Management: (i) breached their fiduciary duties of loyalty and good faith in connection with the management, operation and oversight of the Company s business; (ii) breached their fiduciary duty of good faith to establish and maintain adequate internal controls; and (iii) breached their fiduciary duties by disseminating false, misleading and/or incomplete information, all in connection with the Company s alleged failure to use the SSDMF and to pay beneficiaries and escheat funds to states. The Demand requests that the Board of Directors: (a) undertake an independent internal investigation into Senior Management s violations of New Jersey and/or federal law; and (b) commence a civil action against each member of Senior Management to recover for the benefit of the Company the amount of damages sustained by the Company as a result of the alleged breaches described above.

In August 2012, a purported class action lawsuit, City of Sterling Heights General Employees Retirement System v. Prudential Financial, Inc., et al., was filed in the United States District Court for the District of New Jersey, alleging violations of federal securities law. The complaint names as defendants the Company s Chief Executive Officer, the Chief Financial Officer, the Principal Accounting Officer and certain Company Board of Directors. The complaint alleges that knowingly false and misleading statements were made regarding the Company s current and future financial condition based on, among other things, the alleged failure to disclose: (i) potential liability for benefits that should either have been paid to policyholders or their beneficiaries, or escheated to applicable states; and (ii) the extent of the Company s exposure for alleged state and federal law violations concerning the settlement of claims and the escheatment of unclaimed property. The complaint seeks an undetermined amount of damages, interest, attorneys fees and costs.

In October 2006, a purported class action lawsuit, Bouder v. Prudential Financial, Inc. and Prudential Insurance Company of America, was filed in the United States District Court for the District of New Jersey, claiming that Prudential failed to pay overtime to insurance agents in violation of federal and Pennsylvania law, and that improper deductions were made from these agents wages in violation of state law. The complaint seeks back overtime pay and statutory damages, recovery of improper deductions, interest, and attorneys fees. In March 2008, the court conditionally certified a nationwide class on the federal overtime claim. Separately, in March 2008, a purported nationwide class action lawsuit was filed in the United States District Court for the Southern District of California, Wang v. Prudential Financial, Inc. and Prudential Insurance, claiming that the Company failed to pay its agents overtime and provide other benefits in violation of California and federal law and seeking compensatory and punitive damages in unspecified amounts. In September 2008, Wang was transferred to the United States District Court for the District of New Jersey and consolidated with the Bouder

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# PRUDENTIAL FINANCIAL, INC. 

Notes to Unaudited Interim Consolidated Financial Statements (Continued)


#### Abstract

matter. Subsequent amendments to the complaint have resulted in additional allegations involving purported violations of an additional nine states overtime and wage payment laws. In February 2010, Prudential moved to decertify the federal overtime class that had been conditionally certified in March 2008 and moved for summary judgment on the federal overtime claims of the named plaintiffs. In July 2010, plaintiffs filed a motion for class certification of the state law claims. In August 2010, the district court granted Prudential s motion for summary judgment, dismissing the federal overtime claims. The motion for class certification of the state law claims is pending.


In April 2012, the Company filed two actions in New Jersey state court captioned The Prudential Insurance Company of America, et al. v. JP Morgan Chase, et al. and The Prudential Insurance Company of America, et al. v. Morgan Stanley, et al. Both matters seek to recover damages attributable to Company and affiliate entities and funds investments in residential mortgage-backed securities ( RMBS ). Among other allegations stemming from the defendants origination, underwriting and sales of RMBS, the complaints assert claims of common law fraud, negligent misrepresentation, breaches of the New Jersey Uniform Securities Act and breaches of the New Jersey Civil RICO statute. The complaints seek unspecified damages. In August 2012, the Company filed four additional actions in New Jersey state court captioned The Prudential Insurance Company of America, et al. v. Nomura Securities International, Inc., et al., The Prudential Insurance Company of America, et al. v. Barclays Bank PLC, et al,, The Prudential Insurance Company of America, et al. v. Goldman Sachs \& Company, et al. and The Prudential Insurance Company of America, et al. v. RBS Financial Products, Inc., et al. upon the same grounds and seeking the same damages, as articulated above.

## Summary

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

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## PRUDENTIAL FINANCIAL, INC.

## Unaudited Interim Supplemental Combining Statements of Financial Position

September 30, 2012 and December 31, 2011 (in millions)

|  | September 30, 2012 |  |  |  | December 31, 2011 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Financial Services Businesses | Closed <br> Block <br> Business | Consolidated |  | Financial Services Businesses | Closed <br> Block <br> Business |  | nsolidated |
| ASSETS |  |  |  |  |  |  |  |  |
| Fixed maturities, available-for-sale, at fair value | \$ 226,015 | \$ 47,366 | \$ | 273,381 | \$ 208,132 | \$ 46,516 | \$ | 254,648 |
| Fixed maturities, held-to-maturity, at amortized cost | 4,720 | 0 |  | 4,720 | 5,107 | 0 |  | 5,107 |
| Trading account assets supporting insurance liabilities, at fair value | 20,132 | 0 |  | 20,132 | 19,481 | 0 |  | 19,481 |
| Other trading account assets, at fair value | 5,610 | 264 |  | 5,874 | 5,228 | 317 |  | 5,545 |
| Equity securities, available-for-sale, at fair value | 4,821 | 3,171 |  | 7,992 | 4,413 | 3,122 |  | 7,535 |
| Commercial mortgage and other loans | 27,057 | 9,765 |  | 36,822 | 26,391 | 9,040 |  | 35,431 |
| Policy loans | 6,551 | 5,150 |  | 11,701 | 6,263 | 5,296 |  | 11,559 |
| Other long-term investments | 6,133 | 2,022 |  | 8,155 | 5,830 | 1,990 |  | 7,820 |
| Short-term investments | 7,825 | 1,470 |  | 9,295 | 8,593 | 528 |  | 9,121 |
| Total investments | 308,864 | 69,208 |  | 378,072 | 289,438 | 66,809 |  | 356,247 |
| Cash and cash equivalents | 13,102 | 804 |  | 13,906 | 13,201 | 1,050 |  | 14,251 |
| Accrued investment income | 2,230 | 640 |  | 2,870 | 2,177 | 616 |  | 2,793 |
| Deferred policy acquisition costs | 13,250 | 416 |  | 13,666 | 12,056 | 461 |  | 12,517 |
| Other assets | 15,353 | 321 |  | 15,674 | 15,748 | 308 |  | 16,056 |
| Separate account assets | 247,510 | 0 |  | 247,510 | 218,380 | 0 |  | 218,380 |
| TOTAL ASSETS | \$ 600,309 | \$ 71,389 | \$ | 671,698 | \$ 551,000 | \$ 69,244 | \$ | 620,244 |

LIABILITIES AND EQUITY
LIABILITIES

|  | $\$ 132,209$ | $\$ 50,953$ | $\$$ | 183,162 | $\$ 119,248$ | $\$ 51,423$ | $\$$ |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: |

## COMMITMENTS AND CONTINGENT LIABILITIES

| EQUITY |  |  |  |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Accumulated other comprehensive income | 9,416 | 234 | 9,650 | 5,250 | 168 | 5,418 |
| Other attributed equity | 27,715 | 1,310 | 29,025 | 27,567 | 1,268 | 28,835 |
|  |  |  |  |  |  |  |
| Total attributed equity | 37,131 | 1,544 | 38,675 | 32,817 | 1,436 | 34,253 |


| Noncontrolling interests | 691 | 0 | 691 | 588 | 0 | 588 |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Total equity | 37,822 | 1,544 | 39,366 | 33,405 | 1,436 | 34,841 |  |
| TOTAL LIABILITIES AND EQUITY | $\$ 600,309$ | $\$ 71,389$ | $\$$ | 671,698 | $\$ 551,000$ | $\$ 69,244$ | $\$$ |

## See Notes to Unaudited Interim Supplemental Combining Financial Information

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## PRUDENTIAL FINANCIAL, INC.

## Unaudited Interim Supplemental Combining Statements of Operations

Three Months Ended September 30, 2012 and 2011 (in millions)

|  | Three Months Ended September 30, |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Financial Services Businesses |  | $\begin{gathered} 2012 \\ \text { Closed } \\ \text { Block } \\ \text { Business } \end{gathered}$ |  | Consolidated |  | Financial <br> Services <br> Businesses |  | $\begin{gathered} 2011 \\ \text { Closed } \\ \text { Block } \\ \text { Business } \end{gathered}$ |  | Consolidated |  |
| REVENUES |  |  |  |  |  |  |  |  |  |  |  |  |
| Premiums | \$ | 8,382 | \$ | 645 | \$ | 9,027 | \$ | 5,417 | \$ | 667 | \$ | 6,084 |
| Policy charges and fee income |  | 1,224 |  | 0 |  | 1,224 |  | 958 |  | 0 |  | 958 |
| Net investment income |  | 2,665 |  | 768 |  | 3,433 |  | 2,543 |  | 790 |  | 3,333 |
| Asset management fees and other income |  | 888 |  | 17 |  | 905 |  | 2,030 |  | (2) |  | 2,028 |
| Realized investment gains (losses), net: |  |  |  |  |  |  |  |  |  |  |  |  |
| Other-than-temporary impairments on fixed maturity securities |  | (267) |  | (159) |  | (426) |  | (275) |  | (127) |  | (402) |
| Other-than-temporary impairments on fixed maturity securities transferred to Other Comprehensive Income |  | 185 |  | 146 |  | 331 |  | 174 |  | 112 |  | 286 |
| Other realized investment gains (losses), net |  | $(1,437)$ |  | 87 |  | $(1,350)$ |  | 2,389 |  | 255 |  | 2,644 |
| Total realized investment gains (losses), net |  | $(1,519)$ |  | 74 |  | $(1,445)$ |  | 2,288 |  | 240 |  | 2,528 |
| Total revenues |  | 11,640 |  | 1,504 |  | 13,144 |  | 13,236 |  | 1,695 |  | 14,931 |
| BENEFITS AND EXPENSES |  |  |  |  |  |  |  |  |  |  |  |  |
| Policyholders benefits |  | 8,800 |  | 776 |  | 9,576 |  | 5,380 |  | 828 |  | 6,208 |
| Interest credited to policyholders account balances |  | 1,023 |  | 34 |  | 1,057 |  | 1,428 |  | 35 |  | 1,463 |
| Dividends to policyholders |  | 39 |  | 478 |  | 517 |  | 40 |  | 639 |  | 679 |
| Amortization of deferred policy acquisition costs |  | 173 |  | 9 |  | 182 |  | 1,501 |  | 9 |  | 1,510 |
| General and administrative expenses |  | 2,641 |  | 138 |  | 2,779 |  | 2,527 |  | 138 |  | 2,665 |
| Total benefits and expenses |  | 12,676 |  | 1,435 |  | 14,111 |  | 10,876 |  | 1,649 |  | 12,525 |


| INCOME (LOSS) FROM CONTINUING |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| OPERATIONS BEFORE INCOME TAXES AND |  |  |  |  |  |  |
| EQUITY IN EARNINGS OF OPERATING JOINT |  |  |  |  |  |  |
| VENTURES | $(1,036)$ | 69 | (967) | 2,360 | 46 | 2,406 |
| Income tax expense (benefit) | (356) | 25 | (331) | 846 | 14 | 860 |
| INCOME (LOSS) FROM CONTINUING |  |  |  |  |  |  |
| OPERATIONS BEFORE EQUITY IN EARNINGS OF |  |  |  |  |  |  |
| OPERATING JOINT VENTURES | (680) | 44 | (636) | 1,514 | 32 | 1,546 |
| Equity in earnings of operating joint ventures, net of taxes | 45 | 0 | 45 | 67 | 0 | 67 |

INCOME (LOSS) FROM CONTINUING

| OPERATIONS | $(635)$ | 44 | $(591)$ | 1,581 | 32 | 1,613 |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |

Income (loss) from discontinued operations, net of taxes
(1)
(1)
(2)
(9) 0
(9)

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## PRUDENTIAL FINANCIAL, INC.

## Unaudited Interim Supplemental Combining Statements of Operations

Nine Months Ended September 30, 2012 and 2011 (in millions)

|  | Ended Septemb |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Financial Services Businesses | 2012 <br> Closed <br> Block <br> Business | Consolidated |  | Financial Services Businesses | 2011 <br> Closed <br> Block <br> Business | Consolidated |  |
| REVENUES |  |  |  |  |  |  |  |  |
| Premiums | \$ 21,297 | \$ 2,059 | \$ | 23,356 | \$ 15,735 | \$ 2,129 | \$ | 17,864 |
| Policy charges and fee income | 3,335 | 0 |  | 3,335 | 2,911 | 0 |  | 2,911 |
| Net investment income | 7,757 | 2,354 |  | 10,111 | 7,376 | 2,402 |  | 9,778 |
| Asset management fees and other income | 3,141 | 26 |  | 3,167 | 3,816 | 30 |  | 3,846 |
| Realized investment gains (losses), net: |  |  |  |  |  |  |  |  |
| Other-than-temporary impairments on fixed maturity securities | (799) | (546) |  | $(1,345)$ | $(1,004)$ | (602) |  | $(1,606)$ |
| Other-than-temporary impairments on fixed maturity securities transferred to Other Comprehensive Income | 561 | 484 |  | 1,045 | 695 | 538 |  | 1,233 |
| Other realized investment gains (losses), net | $(1,046)$ | 280 |  | (766) | 2,770 | 549 |  | 3,319 |
| Total realized investment gains (losses), net | $(1,284)$ | 218 |  | $(1,066)$ | 2,461 | 485 |  | 2,946 |
| Total revenues | 34,246 | 4,657 |  | 38,903 | 32,299 | 5,046 |  | 37,345 |
| BENEFITS AND EXPENSES |  |  |  |  |  |  |  |  |
| Policyholders benefits | 20,881 | 2,565 |  | 23,446 | 15,119 | 2,557 |  | 17,676 |
| Interest credited to policyholders account balances | 3,167 | 103 |  | 3,270 | 3,373 | 104 |  | 3,477 |
| Dividends to policyholders | 109 | 1,454 |  | 1,563 | 113 | 1,848 |  | 1,961 |
| Amortization of deferred policy acquisition | 1,165 | 29 |  | 1,194 | 2,347 | 28 |  | 2,375 |
| General and administrative expenses | 7,855 | 409 |  | 8,264 | 7,320 | 418 |  | 7,738 |
| Total benefits and expenses | 33,177 | 4,560 |  | 37,737 | 28,272 | 4,955 |  | 33,227 |
| INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND EQUITY IN |  |  |  |  |  |  |  |  |
| EARNINGS OF OPERATING JOINT VENTURES | 1,069 | 97 |  | 1,166 | 4,027 | 91 |  | 4,118 |
| Income tax expense | 536 | 36 |  | 572 | 1,285 | 27 |  | 1,312 |
|  |  |  |  |  |  |  |  |  |
| BEFORE EQUITY IN EARNINGS OF OPERATING |  |  |  |  |  |  |  |  |
| JOINT VENTURES | 533 | 61 |  | 594 | 2,742 | 64 |  | 2,806 |
| Equity in earnings of operating joint ventures, net of taxes | 58 | 0 |  | 58 | 181 | 0 |  | 181 |
| INCOME FROM CONTINUING OPERATIONS | 591 | 61 |  | 652 | 2,923 | 64 |  | 2,987 |
| Income (Loss) from discontinued operations, net of taxes | 14 | (2) |  | 12 | 21 | 0 |  | 21 |
| NET INCOME | 605 | 59 |  | 664 | 2,944 | 64 |  | 3,008 |
| Less: Income attributable to noncontrolling interests | 51 | 0 |  | 51 | 64 | 0 |  | 64 |

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See Notes to Unaudited Interim Supplemental Combining Financial Information

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## PRUDENTIAL FINANCIAL, INC.

## Notes to Unaudited Interim Supplemental Combining Financial Information

## 1. BASIS OF PRESENTATION

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

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

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

## 2. ALLOCATION OF RESULTS

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

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

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

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## PRUDENTIAL FINANCIAL, INC.

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

Income taxes are allocated between the Financial Services Businesses and the Closed Block Business as if they were separate companies based on the taxable income or losses and other tax characterizations of each business. If a business generates benefits, such as net operating losses, it is entitled to record such tax benefits to the extent they are expected to be utilized on a consolidated basis.

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

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

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

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ITEM 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, 2012, compared with December 31, 2011, and its consolidated results of operations for the three and nine months ended September 30, 2012 and 2011. You should read the following analysis of our consolidated financial condition and results of operations in conjunction with the MD\&A, the Risk Factors section, and the audited Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2011, as well as the statements under Forward-Looking Statements and the Unaudited Interim Consolidated Financial Statements included elsewhere in this Quarterly Report on Form 10-Q.

## Overview

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

## Financial Services Businesses

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

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

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

## Closed Block Business

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

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individual life insurance policies and annuities included in the Closed Block by allocating assets that will be used exclusively for payment of benefits, including policyholder dividends, expenses and taxes with respect to these products. See Note 6 to the Unaudited Interim Consolidated Financial Statements and Business Demutualization and Separation of the Businesses in our 2011 Annual Report on Form 10-K for more information on the Closed Block.

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## Executive Summary

Prudential Financial, a financial services leader with approximately $\$ 1.005$ trillion of assets under management as of September 30, 2012, has operations in the United States, Asia, Europe and Latin America. Through our subsidiaries and affiliates, we offer a wide array of financial products and services, including life insurance, annuities, retirement-related services, mutual funds and investment management. We offer these products and services to individual and institutional customers through one of the largest distribution networks in the financial services industry.

Effective January 1, 2012, the Company adopted the amended authoritative guidance issued by the FASB to address which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral. The Company has applied the retrospective method of adoption. Accordingly, all financial information presented has been revised to reflect the retrospective adoption of the amended guidance. For further information, see Accounting Policies and Pronouncements Adoption of New Accounting Pronouncements.

On June 1, 2012, we announced the signing of an agreement with General Motors Co., pursuant to which we would assume certain of its pension benefit obligations to U.S. salaried retiree plan participants and beneficiaries that are covered by the agreement. At closing on November 1, 2012, we issued a group annuity contract to the General Motors Salaried Pension Trust, and assumed responsibility for providing specified benefits to certain participants. In addition, on October 17, 2012, we signed an agreement with Verizon Communications Inc., pursuant to which we will assume certain of its pension benefit obligations to U.S. salaried retiree plan participants and beneficiaries that are covered by the agreement. Upon fulfillment of certain conditions and closing, which are expected to occur in December 2012, we will issue a group annuity contract to the Verizon Management Pension Plan, and will assume responsibility for making payments to participants who retired and started receiving pension benefits before January 1, 2010. These pension risk transfer transactions significantly expand the size of our existing payout annuity business.

On June 12, 2012, Prudential Financial s Board of Directors authorized the Company to repurchase at management s discretion up to $\$ 1.0$ billion of its outstanding Common Stock during the period from July 1, 2012 through June 30, 2013. As of September 30, 2012, 2.7 million shares of our Common Stock were repurchased under this authorization for a total cost of $\$ 150$ million. The timing and amount of any share repurchases will be determined by management based upon market conditions and other considerations, and such repurchases may be effected in the open market, through derivative, accelerated repurchase and other negotiated transactions and through prearranged trading plans designed to comply with Rule 10b5-1(c) under the Exchange Act. The Company exhausted all of the $\$ 1.5$ billion share repurchase authorization established in June 2011.

In July 2012, we announced our decision to cease sales of group long-term care insurance reflecting the challenging economics of the long-term care market including the continued low interest rate environment as well as our desire to focus our resources on our core group life and disability businesses. We discontinued sales of group long-term care products effective August 1,2012 , or a later date as may be required by specific state law. We notified our clients of our intent to continue to accept enrollments on existing group long-term care contracts through June 30, 2013 or later as required by contractual provisions. In March 2012, we also discontinued sales of our individual long-term care products. As a result of our decision to wind down this business, we have reflected the results of the long-term care insurance business, previously reported within the Group Insurance segment, as a divested business for all periods presented.

On September 27, 2012, we announced that Prudential Insurance agreed to acquire The Hartford s Individual Life Insurance Business through a reinsurance transaction. Under the terms of the agreement, we will pay $\$ 615$ million, primarily in the form of a ceding commission to provide reinsurance for approximately 700,000 life insurance policies with net retained face amount in force of approximately $\$ 135$ billion. We expect to close the transaction in early 2013, subject to regulatory approvals and customary closing conditions.

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On October 19, 2012, Prudential Financial received notice that it is under consideration by the Financial Stability Oversight Council (the Council ) for a proposed determination that it should be subject to stricter prudential regulatory standards and supervision by the Board of Governors of the Federal Reserve System pursuant to the Dodd-Frank Act (a Covered Company ). The notice of consideration indicates that Prudential Financial is being reviewed in stage 3 of the three-stage process described in the Council s interpretative guidance for Covered Company determinations and does not constitute a notice of a proposed determination. The Company is entitled, under the applicable regulations, to contest such consideration. We intend to continue our discussions with regulators about the differences between banks and insurance companies as they consider which companies should be designated. Nevertheless, the Council may determine to issue to Prudential Financial a written notice of determination that it is a Covered Company, in which event we would be entitled to request a nonpublic evidentiary hearing before the Council. The prudential standards under the Dodd-Frank Act include requirements regarding risk-based capital and leverage, liquidity, stress-testing, overall risk management, resolution plans, early remediation, and credit concentration; and may also include additional standards regarding capital, public disclosure, short-term debt limits, and other related subjects as appropriate. See Business Regulation and Risk Factors in our 2011 Annual Report on Form 10-K for more information regarding the potential impact of the Dodd-Frank Act on the Company, including as a result of these stricter prudential standards.

Prudential Bank \& Trust, FSB has limited its operations to trust services. On October 31, 2012, the Board of Governors of the Federal Reserve System approved Prudential Financial s application to deregister as a savings and loan holding company, effective as of that date.

On November 7, 2012, Prudential Financial declared an annual dividend for 2012 of $\$ 1.60$ per share of Common Stock, reflecting an increase of approximately $10 \%$ from the 2011 Common Stock dividend. The Company also announced that it will move to a quarterly Common Stock dividend schedule beginning in the first quarter of 2013.

## Impact of Low Interest Rate Environment

The low interest rate environment in the U.S. has resulted in our current reinvestment yields being lower than the overall portfolio income yield, primarily for our investments in fixed maturity securities and commercial mortgage loans. With the Federal Reserve Board s decision to keep interest rates low through at least 2014, our portfolio income yields are expected to continue to decline in future periods.

Within our domestic Financial Services Businesses, financial results of business with long-duration contracts with fixed and guaranteed crediting rates, or floors that limit crediting rate reductions are most impacted by a prolonged low interest rate environment. Also impacted are financial results of business with long duration products that do not have stated crediting rate guarantees but for which underlying assets may have to be reinvested at interest rates that are lower than portfolio rates, such as group annuities, structured settlements and term insurance.

For the domestic Financial Services Businesses general account, we expect approximately $10 \%$ of the fixed maturity securities and commercial mortgage loans to mature annually through 2014. The domestic Financial Services Businesses general account has approximately $\$ 123$ billion of such assets (based on net carrying value) as of September 30, 2012. As these assets mature, the current average portfolio income yield for fixed maturities and commercial mortgage loans of approximately $5 \%$ is expected to decline due to reinvesting in a lower interest rate environment.

Our disciplined approach in our asset-liability management, which includes our duration management and crediting rate strategies, has helped mitigate the unfavorable impact that the current interest rate environment has on our net interest margins for our domestic Financial Services Businesses. Our interest rate exposure is also mitigated by our business mix, as we have relatively limited exposure to lines of business in which net interest

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margin plays a more prominent role in product profitability. These lines of business include long-term care, fixed annuities and universal life, which represents a limited portion of our individual life business in force. In addition, within our Retirement business, a substantial portion of our stable value account values have very low crediting rate floors.

Our Japanese insurance operations have experienced a prolonged low interest rate environment for many years. These operations issue recurring payment and single premium products that are denominated in both Japanese yen and U.S. dollars, as well as fixed annuity products that are denominated in U.S. dollars. For the Japanese yen-denominated products, the exposure to decreased interest rates is limited as our Japanese insurance operations have considered the prolonged low interest rate environment in product pricing, and a rigorous asset-liability management program, which includes our duration management and crediting rate strategies, further limits our exposure. For the U.S. dollar-denominated recurring payment products, our exposure to low interest rates in the U.S. is also limited by our asset-liability management program. For the U.S. dollar-denominated single premium and fixed annuity products, the risk of reduced interest rates is limited, as new fixed annuity contracts are re-priced frequently and pricing for other products is reviewed and updated regularly to reflect current market interest rates.

## Performance Highlights

Net loss of our Financial Services Businesses attributable to Prudential Financial, Inc. for the three months ended September 30, 2012 was $\$ 661$ million, compared to net income of $\$ 1,562$ million for the three months ended September 30, 2011. Net income of our Financial Services Businesses attributable to Prudential Financial, Inc. for nine months ended September 30, 2012 and 2011 was $\$ 554$ million and $\$ 2,880$ million, respectively.

Pre-tax adjusted operating income for the Financial Services Businesses for the three and nine months ended September 30, 2012 was $\$ 982$ million and $\$ 2,808$ million, respectively, compared to $\$ 509$ million and $\$ 2,642$ million for the three and nine months ended September 30, 2011, respectively. See below under Results of Operations for a discussion of adjusted operating income.

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Our financial condition and results of operations as of and for the three and nine months ended September 30, 2012 and 2011 reflect the following:

|  | Three Months Ended September 30, |  |  |  | Nine Months Ended September 30, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | 2012 |  | 2011 |  | 2012 |  | 2011 |
|  | (in millions) |  |  |  |  |  |  |  |
| Individual Annuities: |  |  |  |  |  |  |  |  |
| Gross sales | \$ | 5,926 |  | 4,487 | \$ | 16,243 |  | 15,871 |
| Net flows |  | 3,961 |  | 2,479 |  | 10,181 |  | 9,194 |
| Account values (at end of period) |  |  |  |  |  | 132,705 |  | 106,689 |
| Retirement: |  |  |  |  |  |  |  |  |
| Full Service: |  |  |  |  |  |  |  |  |
| Gross deposits and sales | \$ | 3,478 |  | 3,966 |  | 12,487 |  | 12,942 |
| Net additions (withdrawals) |  | (585) |  | (160) |  | $(2,350)$ |  | (325) |
| Account values (at end of period) |  |  |  |  |  | 146,934 |  | 134,198 |
| Institutional Investment Products: |  |  |  |  |  |  |  |  |
| Gross sales | \$ | 2,957 | \$ | 5,571 | \$ | 15,813 |  | 16,948 |
| Net additions (withdrawals) |  | 1,418 |  | 4,070 |  | 9,904 |  | 12,882 |
| Account values (at end of period) |  |  |  |  |  | 104,646 |  | 80,513 |
| Asset Management: |  |  |  |  |  |  |  |  |
| Gross additions(1) |  | 19,200 |  | 16,800 |  | 61,700 |  | 51,100 |
| Net flows(1) |  | 5,100 |  | 2,600 |  | 17,500 |  | 15,300 |
| Assets under management (at end of period) |  |  |  |  |  | 670,200 |  | 599,400 |
| International Insurance: |  |  |  |  |  |  |  |  |
| Annualized new business premiums(2) | \$ | 900 | \$ | 810 | \$ | 2,846 |  | 2,241 |
| Individual Life: |  |  |  |  |  |  |  |  |
| Annualized new business premiums | \$ | 98 | \$ | 70 | \$ | 268 | \$ | 203 |
| Group Insurance: |  |  |  |  |  |  |  |  |
| Annualized new business premiums | \$ | 46 | \$ | 40 | \$ | 381 | \$ | 566 |

(1) Includes third party institutional and retail activity. Excludes money market activity.
(2) On a constant exchange rate basis.

## Results of Operations

We analyze performance of the segments and Corporate and Other operations of the Financial Services Businesses using a measure called adjusted operating income. See Consolidated Results of Operations Segment Measures for a discussion of adjusted operating income and its use as a measure of segment operating performance.

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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, 2012 and 2011 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. Results for the nine months ended September 30, 2012 reflect the impact of two adjustments related to prior periods. For further information, see Note 1 to the Unaudited Interim Consolidated Financial Statements.


Results for the three and nine months ended September 30, 2012 presented above reflect the following:

Individual Annuities segment results for the third quarter and first nine months of 2012 increased in comparison to the prior year periods, primarily reflecting a favorable comparative impact from adjustments to the estimated profitability of the business. These adjustments were driven by the net impacts of market performance, and annual reviews and updates of economic and actuarial assumptions

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and other refinements. Excluding these items, the increases reflect higher asset-based fee income, primarily due to higher average variable annuity account values, net of an increased level of distribution and amortization costs, partially offset by higher general and administrative expenses, net of capitalization.

Retirement segment results for the third quarter and first nine months of 2012 decreased in comparison to the prior year periods. The decrease in both periods includes the impact of a charge in the third quarter of 2012 resulting from the write off of an intangible asset related to an acquired business, partially offset by favorable comparative impacts from adjustments to the amortization of deferred policy acquisition costs and the value of business acquired. These adjustments were primarily driven by the impacts on the estimated profitability of the business based on an annual review and update of economic and actuarial assumptions. The decrease for the first nine months of 2012 also reflects costs incurred related to the divestiture of bank deposits previously held by Prudential Bank \& Trust, FSB as a result of our decision to limit its operations to trust services. Excluding these items, results for the third quarter of 2012 increased in comparison to the prior year period, and results for the first nine months of 2012 decreased in comparison to the prior year period. The increase for the third quarter of 2012 compared to the prior year period primarily reflects higher net investment spread results and higher asset-based fee income, partially offset by an unfavorable comparative reserve impact from case experience. The decrease for the first nine months of 2012 compared to the prior year period primarily reflects lower net investment spread results and an unfavorable comparative reserve impact from case experience, partially offset by higher asset-based fee income and lower general and administrative expenses, net of capitalization.

Asset Management segment results for the third quarter of 2012 increased in comparison to the third quarter of 2011 primarily from a greater contribution from the segment $s$ incentive, transaction, strategic investing and commercial mortgage activities. Current quarter results also benefited from higher asset management fees reflecting growth in assets under management, net of expenses. Asset Management segment results decreased in the first nine months of 2012 compared to the first nine months of 2011 primarily due to a lower contribution from the segment $s$ incentive, transaction, strategic investing and commercial mortgage activities, which reflected a charge in the current year for an impairment of a real estate-related investment, compared to a gain in the prior year on the partial sale of a real estate seed investment. The lower contribution from these activities, as well as higher expenses in the current year offset the benefit from higher asset management fees.

Individual Life segment results for the third quarter of 2012 were relatively unchanged from the third quarter of 2011, and results for the first nine months of 2012 decreased in comparison to the first nine months of 2011. Results for both periods reflect unfavorable comparative impacts from adjustments to the amortization of deferred policy acquisition costs and unearned revenue reserves and to the reserves for the guaranteed minimum death benefit feature in certain contracts. These adjustments were primarily driven by the impact of certain changes in our estimated profitability of the business related to our annual review and update of economic and actuarial assumptions. Excluding these items, results for the third quarter of 2012 increased from the third quarter of 2011, driven by improved mortality experience, and results decreased for the nine month comparative period primarily reflecting more unfavorable mortality experience. Both the three month and nine month periods benefited from favorable equity markets on separate account fund performance.

Group Insurance segment results decreased in both the third quarter and first nine month of 2012 compared to prior year periods. Results for both periods reflect unfavorable comparative variances from reserve refinements, including the impact of annual actuarial assumption updates. Excluding these items, results for the third quarter of 2012 increased from the third quarter of 2011 driven by improved investment income, partly offset by less favorable group life claims experience, while results decreased for the first nine months of 2012 compared to the prior year period reflecting less favorable group disability and group life underwriting results and higher expenses, including an unfavorable comparative impact for updates to premium tax estimates.

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International Insurance segment results for the third quarter of 2012 improved from the third quarter of 2011. Results from the segment s Life Planner operations improved in the current period, primarily reflecting business growth, the favorable impact from our annual review and update of assumptions used in estimating the profitability of our business and a net favorable impact from foreign currency exchange rates including the impact of the Company s currency hedging programs. Results from the segment s Gibraltar Life and Other operations also improved in the current year quarter primarily driven by business growth, greater cost savings from business integration synergies associated with the acquisition of the Star and Edison businesses, and a net favorable impact from foreign currency exchange rates. Offsetting these items was a greater benefit in the year-ago quarter than the current quarter from partial sales of our indirect interest in China Pacific Group. International Insurance segment results increased in the first nine months of 2012 in comparison to the prior year period. Results from the segment s Life Planner operations reflect the impact of continued business growth, the favorable impact from our annual review and update of assumptions used in estimating the profitability of our business and a net favorable impact from foreign currency exchange rates. Improved results from the segment s Gibraltar Life and Other operations reflect business growth, greater cost savings from business integration synergies, and the absence of claims and expenses associated with the 2011 earthquake in Japan. Offsetting these favorable items was a greater benefit in the year-ago period than the 2012 period from partial sales of our indirect investment in China Pacific Group.

Corporate and Other operations resulted in an increased loss both for the third quarter of 2012 and the first nine months of 2012 compared to prior year periods reflecting higher levels of expenses in other corporate activities, greater interest expense, net of investment income, driven mainly by higher levels of capital debt and a lower contribution from income from our qualified pension plan.

Income from continuing operations before income taxes in the Closed Block Business for the third quarter and first nine months of 2012 increased in comparison to the prior year periods. The increase in the third quarter of 2012, compared to the third quarter of 2011 primarily reflects a benefit from a lower increase in the cumulative policyholder dividend obligation expense, as well as a lower increase in reserves for estimated payments arising from the use of new Social Security Master Death File matching criteria to identify deceased policy and contract holders, partially offset by a decrease in net realized investment gains. The increase in the first nine months of 2012, compared to the first nine months of 2011 also reflects a benefit from a lower increase in the cumulative policyholder dividend obligation expense, partially offset by a decrease in net realized investment gains and an increase in the change in reserves for estimated payments arising from the use of new Social Security Master Death File matching criteria to identify deceased policy and contract holders.

## 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 and require management s most difficult, subjective, or complex judgments:

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

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

Policyholder liabilities;

Pension and other postretirement benefits;

Taxes on income; and

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

In the first quarter of 2012, we revised the treatment of the results of the living benefits hedging program in our best estimate of total gross profits used to calculate the amortization of deferred policy acquisition costs ( DAC ) and deferred sales inducements ( DSI ) associated with certain of the variable annuity contracts of our Individual Annuities segment. In 2011, we included the difference between the change in the fair value of hedge positions and the change in the value of the hedge target liability, excluding the unhedged portion, in our best estimate of gross profits used to determine amortization rates only to the extent this net amount was determined by management to be other-than-temporary. Beginning with the first quarter of 2012, we are including these impacts in our best estimate of total gross profits used for determining amortization rates each quarter without regard to the permanence of the changes. The current period impact of resetting the amortization rates for this item is discussed within Results of Operations for Financial Services Businesses by Segment U.S. Retirement Solutions and Investment Management Division Individual Annuities Net impact of optional living benefit guarantees and related hedge positions. For a discussion of the unhedged portion, which represents the impact of temporarily hedging to an amount that differs from our hedge target based on the overall capital considerations of the Company and prevailing capital market conditions, see Corporate \& Other.

Additionally, in the third quarter of each year, we perform an annual comprehensive review and update of the assumptions used in estimating gross profits for future periods. The near-term future rate of return assumptions used in evaluating DAC and DSI for our domestic variable annuity and variable life insurance products are derived using a reversion to the mean approach, a common industry practice. Under this approach, we consider the actual historical economic returns over a period of time and initially adjust future projected returns over the next four years (the near-term ) so that the assets are projected to grow at the long-term expected rate of return for the entire period. If the near-term projected future rate of return is greater than our near-term maximum future rate of return, we use our maximum future rate of return.

As of September 30, 2012, our variable annuities business utilizes distinct rates of return for equity and fixed income investments. Assumptions for this business reflect an $8.0 \%$ long-term equity expected rate of return and a near-term mean reversion equity rate of return of $8.5 \%$. As of September 30, 2012, all contract groups within our variable annuities business utilized these rates, as the near-term mean reversion equity rate of return was less than our $13 \%$ maximum. Fixed income expected rates of return include a risk free return plus a credit spread and consider the duration and credit profile of the respective bond funds. Fixed income returns reflect a grading from current rates up to long term rates over a ten year period. The weighted average fixed income expected rate of return after the ten year grading period is $5.4 \%$.

As of September 30, 2012, our variable life insurance business utilizes blended rates of return, which are based on a long-term expected distribution of funds between equity and fixed income funds. Assumptions for this business reflect a long-term blended expected rate of return of $6.5 \%$, which includes an $8.1 \%$ long-term equity expected rate of return and a $4.5 \%$ fixed income expected rate of return. The $4.5 \%$ fixed income expected rate of return is a levelized rate, which blends current rates and long-term expected returns. Assumptions also reflect a near-term mean reversion blended rate of return of $5.8 \%$. As of September 30, 2012, all contract groups within our variable life insurance business utilize these rates, as the near-term equity rate of return was less than our $13 \%$ maximum.

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The weighted average rate of return assumptions for these businesses consider many factors specific to each business, including asset durations, asset allocations and other factors. We update the near term rates of return and our estimate of total gross profits each quarter to reflect the result of the reversion to the mean approach,

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which assumes a convergence to the long-term expected rates of return. These market performance related adjustments to our estimate of total gross profits result in cumulative adjustments to prior amortization, reflecting the application of the new required rate of amortization to all prior periods gross profits. The new required rate of amortization is also applied prospectively to future gross profits in calculating amortization in future periods.

Additional information on our policies for our critical accounting estimates listed above may be found in our Annual Report on Form 10-K for the year ended December 31, 2011, under Management s Discussion and Analysis of Financial Condition and Results of Operations Accounting Policies \& Pronouncements Application of Critical Accounting Estimates.

## Adoption of New Accounting Pronouncements

In October 2010, the FASB issued authoritative guidance to address which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral. The Company adopted this guidance effective January 1, 2012, and applied the retrospective method of adoption. Accordingly, prior period financial information has been adjusted to reflect the retrospective adoption of the amended guidance. The impact of the retrospective adoption of this guidance on previously reported December 31, 2011 balances was a reduction in deferred policy acquisition costs by $\$ 4.1$ billion for the Financial Services Businesses and by $\$ 0.2$ billion for the Closed Block Business, an increase in policy reserves for certain limited pay contracts by $\$ 0.2$ billion for the Financial Services Businesses, and a reduction in total equity by $\$ 2.8$ billion for the Financial Services Businesses and by $\$ 0.2$ billion for the Closed Block Business. The impact of the retrospective adoption of this guidance on previously reported income from continuing operations before income taxes for the three and nine months ended September 30, 2011 was an increase of $\$ 68$ million and a decrease of $\$ 105$ million for the Financial Services Businesses, respectively, and an increase of $\$ 4$ million and $\$ 13$ million for the Closed Block Business, respectively. The lower level of costs now qualifying for deferral will be only partially offset by a lower level of amortization of deferred policy acquisition costs, and, as such, will initially result in lower earnings in future periods, primarily within the International Insurance and Individual Annuities segments. The impact to the International Insurance segment largely reflects lower deferrals of allocated costs of its proprietary distribution system, while the impact to the Individual Annuities segment mainly reflects lower deferrals of its wholesaler costs. While the adoption of this amended guidance changes the timing of when certain costs are reflected in the Company s results of operations, it has no effect on the total acquisition costs to be recognized over time and has no impact on the Company s cash flows.

See Note 2 to our Unaudited Interim Consolidated Financial Statements for a discussion of newly adopted accounting pronouncements, including further discussion of the new authoritative guidance addressing which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral.

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## Consolidated Results of Operations

The following table summarizes net income for the Financial Services Businesses and the Closed Block Business for the periods presented.

|  | Three Months Ended September 30, |  | Nine Months Ended September 30, |  |
| :---: | :---: | :---: | :---: | :---: |
| Financial Services Businesses: |  |  |  |  |
| Revenues | \$ 11,640 | \$ 13,236 | \$ 34,246 | \$ 32,299 |
| Benefits and expenses | 12,676 | 10,876 | 33,177 | 28,272 |
| Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures for Financial Services Businesses | $(1,036)$ | 2,360 | 1,069 | 4,027 |
| Income tax expense (benefit) | (356) | 846 | 536 | 1,285 |
| Income (loss) from continuing operations before equity in earnings of operating joint ventures for Financial Services Businesses | (680) | 1,514 | 533 | 2,742 |
| Equity in earnings of operating joint ventures, net of taxes | 45 | 67 | 58 | 181 |
| Income (loss) from continuing operations for Financial Services Businesses | (635) | 1,581 | 591 | 2,923 |
| Income (loss) from discontinued operations, net of taxes | (1) | (9) | 14 | 21 |
| Net income (loss) Financial Services Businesses | (636) | 1,572 | 605 | 2,944 |
| Less: Income attributable to noncontrolling interests | 25 | 10 | 51 | 64 |
| Net income (loss) of Financial Services Businesses attributable to Prudential Financial, Inc. | \$ (661) | \$ 1,562 | \$ 554 | \$ 2,880 |
| Closed Block Business: |  |  |  |  |
| Revenues | \$ 1,504 | \$ 1,695 | \$ 4,657 | \$ 5,046 |
| Benefits and expenses | 1,435 | 1,649 | 4,560 | 4,955 |
| Income from continuing operations before income taxes for Closed Block Business | 69 | 46 | 97 | 91 |
| Income tax expense | 25 | 14 | 36 | 27 |
| Income from continuing operations for Closed Block Business | 44 | 32 | 61 | 64 |
| Income (loss) from discontinued operations, net of taxes | (1) | 0 | (2) | 0 |
| Net income Closed Block Business | 43 | 32 | 59 | 64 |
| Less: Income attributable to noncontrolling interests | 0 | 0 | 0 | 0 |
| Net income of Closed Block Business attributable to Prudential Financial, Inc. | \$ 43 | \$ 32 | \$ 59 | \$ 64 |
| Consolidated: |  |  |  |  |
| Net income (loss) attributable to Prudential Financial, Inc. | \$ (618) | \$ 1,594 | \$ 613 | \$ 2,944 |

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## Results of Operations Financial Services Businesses

2012 to 2011 Three Month Comparison. Income (loss) from continuing operations for the Financial Services Businesses decreased \$2,216 million, from income of $\$ 1,581$ million in the third quarter of 2011 to a loss of $\$ 635$ million in the third quarter of 2012. Results for the third quarter of 2012 compared to the third quarter of 2011 reflect the following:

Lower net pre-tax earnings of $\$ 1,663$ million resulting from the impact of foreign currency exchange rate movements on certain non-yen denominated assets and liabilities within our Japanese insurance operations, for which we economically hedge the foreign currency exposure, driven by the weakening of the yen against the Australian dollar in the third quarter of 2012 compared to a strengthening of the Japanese yen against the Australian and U.S. dollar in the prior year period;
$\$ 806$ million lower net pre-tax realized gains (losses), excluding the impact of the hedging program associated with certain variable annuities as described below, primarily reflecting lower gains from changes in the market value of derivatives used to manage duration in our general account investment portfolios as a result of changes in interest rates. Also contributing to the decline is the comparative impact of losses in the third quarter of 2012 compared to gains in the year-ago quarter resulting from changes in the market value of currency derivatives due to foreign currency exchange rate movements;

A $\$ 721$ million unfavorable variance, before income taxes, reflecting the net impact from market value changes on our embedded derivatives and related hedge positions associated with certain variable annuities, primarily driven by the impact of non-performance risk, partially offset by the impact of amortization of deferred policy acquisition and other costs as well as market value changes associated with derivatives under our capital hedge program; and

A $\$ 693$ million unfavorable variance, before taxes, from adjustments to deferred policy acquisition and other costs and the reserves for our long-term care products, reflecting updates to the estimated profitability of the business, driven by reductions to our long-term interest rate assumptions and updates to our morbidity assumptions, partially offset by expected future premium increases.

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

A $\$ 1,202$ decrease in income tax expense primarily reflecting the decline in pre-tax income from continuing operations; and

A $\$ 373$ million favorable variance, before taxes, from adjustments to deferred policy acquisition and other costs and the reserves for guaranteed minimum death and income benefit features of our variable annuity products, reflecting updates to the estimated profitability of the business, primarily resulting from market performance and the impact of an annual review and update of assumptions.

2012 to 2011 Nine Month Comparison. Income from continuing operations for the Financial Services Businesses decreased $\$ 2,332$ million, from $\$ 2,923$ million in the first nine months of 2011 to $\$ 591$ million in the first nine months of 2012 . Results for the first nine months of 2012 compared to the first nine months of 2011 reflect the following:

Lower net pre-tax earnings of $\$ 1,316$ million resulting from the impact of foreign currency exchange rate movements on certain non-yen denominated assets and liabilities within our Japanese insurance operations, for which we economically hedge the foreign currency exposure, driven by the weakening of the Japanese yen;

A $\$ 885$ million unfavorable variance, before income taxes, reflecting the net impact from market value changes on our embedded derivatives and related hedge positions associated with certain variable annuities, primarily driven by the impact of non-performance risk, partially offset by the impact of amortization of deferred policy acquisition and other costs as well as market value changes associated with derivatives under our capital hedge program;

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A $\$ 693$ million unfavorable variance, before taxes, from adjustments to deferred policy acquisition and other costs and the reserves for our long-term care products, reflecting updates to the estimated profitability of the business, driven by reductions to our long-term interest rate assumptions and updates to our morbidity assumptions, partially offset by expected future premium increases;

Lower net pre-tax realized gains (losses) of $\$ 575$ million, excluding the impact of the hedging program associated with certain variable annuities as described above, primarily reflecting lower gains from changes in the market value of derivatives used to manage duration in our general account investment portfolios as a result of changes in interest rates. Also contributing to the decline is the comparative impact of changes in the market value of currency derivatives due to foreign currency exchange rate movements; and

The comparative impact of a $\$ 237$ million pre-tax benefit in 2011 compared to a pre-tax benefit of $\$ 60$ million in 2012 reflecting partial sales of our indirect interest in China Pacific Insurance Group.

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

A decrease in income tax expense of $\$ 749$ million reflecting the decrease in pre-tax income from continuing operations, partly offset by the comparative impact of a $\$ 343$ million tax expense in 2012 compared to a $\$ 240$ million expense in 2011 relating to realization of a portion of the local deferred tax assets existing on the opening day balance sheet for the Star and Edison Businesses;

A $\$ 422$ million favorable variance, before taxes, from adjustments to deferred policy acquisition and other costs and the reserves for guaranteed minimum death and income benefit features of our variable annuity products, reflecting updates to the estimated profitability of the business, primarily resulting from market performance and the impact of an annual review and update of assumptions; and

A net increase in premiums and policy charges and fee income, net of an increase in policyholders benefits, including changes in reserves, primarily reflecting business growth, as well as the impact of currency fluctuations, in our International Insurance operations.

## Results of Operations Closed Block Business

For a discussion of the results of operations for the Closed Block Business, see Results of Operations of Closed Block Business, below.

## Segment Measures

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

See Note 11 to the Unaudited Interim Consolidated Financial Statements for further information on the presentation of segment results and our definition of adjusted operating income.

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## Results of Operations for Financial Services Businesses by Segment

## U.S. Retirement Solutions and Investment Management Division

## 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, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2012 |  | 2011 |  | 2012 |  | 2011 |
|  | (in millions) |  |  |  |  |  |  |
| Operating results: |  |  |  |  |  |  |  |
| Revenues | \$ 1,018 |  | 905 |  | 2,944 | \$ | 2,736 |
| Benefits and expenses | 811 |  | 1,097 |  | 2,209 |  | 2,447 |
| Adjusted operating income | 207 |  | (192) |  | 735 |  | 289 |
| Realized investment gains (losses), net, and related adjustments(1) | $(1,491)$ |  | 3,084 |  | $(1,101)$ |  | 3,387 |
| Related charges(2) | 682 |  | $(1,609)$ |  | 550 |  | $(1,774)$ |
| Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ (602) |  | 1,283 |  | 184 |  | 1,902 |

(1) Revenues exclude Realized investment gains (losses), net, and related adjustments, which include the net impact of optional living benefit guarantees and related hedge positions, as described below. See Realized Investment Gains and Losses.
(2) Revenues exclude charges which represent payments related to the market value adjustment features of certain of our annuity products. Benefits and expenses exclude charges which represent the unfavorable (favorable) impact of Realized investment gains (losses), net, on changes in reserves and the amortization of deferred policy acquisition costs, deferred sales inducements and value of business acquired.

## Adjusted Operating Income

2012 to 2011 Three Month Comparison. Adjusted operating income, as reported in the table above, includes the impact of certain changes in our estimated profitability of the business on the reserves for the guaranteed minimum death benefit (GMDB ) and guaranteed minimum income benefit ( GMIB ) features of our variable annuity products and on the amortization of deferred acquisition costs ( DAC ) and other costs. These items drove a $\$ 373$ million comparative increase in adjusted operating income, and are discussed in more detail below. Excluding these items, adjusted operating income increased $\$ 26$ million. This increase was driven by higher asset-based fees due to growth in average variable annuity account values, net of an increased level of distribution and amortization costs. This increase was partially offset by higher general and administrative expenses, net of capitalization, reflecting increased costs to support business expansion. See Account Values below for a further discussion of our account values and sales.

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As noted above, adjusted operating income includes a $\$ 373$ million comparative increase from the impact of certain changes in our estimated profitability of the business. The following table shows the impact of adjustments for market performance, current quarter experience and the annual review and update of assumptions performed in the third quarter, for the periods indicated.

|  | $\begin{gathered} \text { Three M } \\ \text { Amortization } \\ \text { DAC } \\ \text { and } \\ \text { Other } \\ \text { Costs }(1) \end{gathered}$ |  | d Sept <br> ves for DB / <br> B(2) | 30, 2012 <br> Total <br> (in | Three M ortization DAC and Other Costs(1) ons) |  | Septe <br> ves for <br> DB / <br> B(2) | 2011 Total |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Quarterly adjustments for market performance and current quarter experience | \$ 27 | \$ | 31 | \$ 58 | \$ (139) | \$ | (306) | \$ (445) |
| Annual review / assumption updates | 221 |  | (327) | (106) | (41) |  | 65 | 24 |
| Total adjustments for changes in the estimated profitability of the business | \$ 248 | \$ | (296) | \$ (48) | \$ (180) | \$ | (241) | \$ (421) |

(1) Amounts reflect (charges) or benefits for (increases) or decreases, respectively, in the amortization of DAC and other costs resulting from adjustments to our estimate of total gross profits.
(2) Amounts reflect (charges) or benefits for reserve (increases) or decreases, respectively, related to the GMDB / GMIB features of our variable annuity products.

The $\$ 58$ million of net benefits and $\$ 445$ million of net charges in the third quarter of 2012 and 2011, respectively, were primarily driven by the impact of market performance on customer accounts relative to our assumptions. Actual returns were higher than expected in the third quarter of 2012, which drove positive cumulative impacts to both the amortization of DAC and other costs and the reserves for the GMDB and GMIB features of our variable annuity contracts, and actual returns were lower than expected in the third quarter of 2011, which drove negative cumulative impacts for these items. The $\$ 106$ million net charge and $\$ 24$ million net benefit in the third quarter of 2012 and 2011, respectively, relate to our annual review and update of assumptions, and reflect the impact of industry studies and our actual experience. The $\$ 106$ million net charge in the third quarter of 2012 was driven by the impacts of updates to our economic assumptions, primarily reflecting reductions to our long-term interest and equity rate of return assumptions, as well as updates to actuarial assumptions and other refinements. The $\$ 24$ million net benefit in the third quarter of 2011 was also driven by the impacts of updates to both economic and actuarial assumptions.

In addition to the current period impacts reflected in the table above, the changes to the estimated profitability of our business will also drive changes in our GMDB and GMIB reserves and the amortization of DAC and other costs in future periods. Additionally, we include certain results of our living benefits hedging program in our best estimate of gross profits used to determine amortization rates, which also drives changes in the amortization of DAC and other costs in future periods. The table above excludes the current period impacts of resetting the amortization rates for this item, as both the results of our living benefits hedging program and related amortization of DAC and other costs are excluded from adjusted operating income, as described in Net impact of optional living benefit guarantees and related hedge positions. However, adjusted operating income in future periods includes the impact on amortization of applying the new rates to actual gross profits. The inclusion of unfavorable results from our living benefits hedging program in the second half of 2011 in our best estimate of gross profits has resulted in higher amortization rates and, therefore, an increase in amortization expense included in adjusted operating income in 2012. While a decrease in our best estimate of total gross profits accelerates amortization and decreases income in a given period, it does not affect our cash flow or liquidity position.

For weighted average rate of return assumptions as of September 30, 2012, see Accounting Policies \& Pronouncements Application of Critical Accounting Estimates. For additional information on our policy for amortizing DAC and other costs, and for estimating future expected claims costs associated with the GMDB and GMIB features of our variable annuity products, see our Annual Report on Form 10-K for the year ended December 31, 2011, under Management s Discussion and Analysis of Financial Condition and Results of Operations Accounting Policies \&

## Pronouncements Application of Critical Accounting Estimates.

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2012 to 2011 Nine Month Comparison. Adjusted operating income, as reported in the operating results table above, includes the impact of certain changes in our estimated profitability of the business on the reserves for the GMDB and GMIB features of our variable annuity products and on the amortization of DAC and other costs. These items drove a $\$ 422$ million comparative increase in adjusted operating income, and are discussed in more detail below. Excluding these items, adjusted operating income increased $\$ 24$ million. This increase was driven by higher asset-based fees due to growth in average variable annuity account values, net of an increased level of distribution and amortization costs. This increase was partially offset by higher general and administrative expenses, net of capitalization, reflecting increased costs to support business expansion. See Account Values below for a further discussion of our account values and sales.

As noted above, adjusted operating income includes a $\$ 422$ million net increase from the impact of certain changes in our estimated profitability of the business. The following table shows the impact of adjustments for market performance, current quarter experience and the annual review and update of assumptions performed in the third quarter, for the periods indicated.

(1) Amounts reflect (charges) or benefits for (increases) or decreases, respectively, in the amortization of DAC and other costs resulting from adjustments to our estimate of total gross profits.
(2) Amounts reflect (charges) or benefits for reserve (increases) or decreases, respectively, related to the GMDB / GMIB features of our variable annuity products.

The $\$ 130$ million net benefit and $\$ 422$ million net charge in the first nine months of 2012 and 2011, respectively, were primarily driven by the impacts of market performance on customer accounts relative to our assumptions. Overall, actual returns were higher than expected in the first nine months of 2012, which drove positive cumulative impacts to both the amortization of DAC and other costs and the reserves for the GMDB and GMIB features of our variable annuity contracts, and actual returns were lower than expected in the first nine months of 2011, which drove negative cumulative impacts for these items. The $\$ 106$ million net charge and $\$ 24$ million net benefit in the first nine months of 2012 and 2011, respectively, relate to our annual review and update of assumptions performed in the third quarter, as discussed above.

## Revenues

2012 to 2011 Three Month Comparison. Revenues, as shown in the table above under Operating Results, increased $\$ 113$ million, from $\$ 905$ million in the third quarter of 2011 to $\$ 1,018$ million in the third quarter of 2012 , primarily driven by a $\$ 114$ million increase in policy charges and fee income, and asset management fees and other income, due to growth in average variable annuity account values. See Account Values below for a further discussion of our account values and sales.

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2012 to 2011 Nine Month Comparison. Revenues increased $\$ 208$ million, from $\$ 2,736$ million in the first nine months of 2011 to $\$ 2,944$ million in first nine months of 2012, primarily driven by a $\$ 235$ million increase in policy charges and fee income, and asset management fees and other income, due to growth in average variable annuity account values.

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Benefits and Expenses

2012 to 2011 Three Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, decreased $\$ 286$ million, from $\$ 1,097$ million in the third quarter of 2011 to $\$ 811$ million in the third quarter of 2012. Absent the $\$ 373$ million net decrease related to the impacts of certain changes in our estimated of profitability of the business, discussed above, benefits and expenses increased $\$ 87$ million. General and administrative expenses, net of capitalization, increased $\$ 61$ million, driven by higher asset-based trail commissions, reflecting account value growth, as well as higher costs to support business expansion. The amortization of DAC increased $\$ 26$ million driven by higher gross profits primarily related to the increase in fee income discussed above, and higher amortization rates driven primarily by the inclusion of unfavorable results from our living benefits hedging program in the second half of 2011 in our best estimate of total gross profits used to determine amortization rates.

2012 to 2011 Nine Month Comparison. Benefits and expenses decreased $\$ 238$ million, from $\$ 2,447$ million in the first nine months of 2011 to $\$ 2,209$ million in the first nine months of 2012. Absent the $\$ 422$ million net decrease related to the impacts of certain changes in our estimated of profitability of the business, discussed above, benefits and expenses increased $\$ 184$ million. General and administrative expenses, net of capitalization, increased $\$ 130$ million, driven by higher asset-based trail commissions, reflecting account value growth, as well as higher costs to support business expansion. The amortization of DAC increased $\$ 78$ million driven by higher gross profits primarily related to the increase in fee income discussed above, and higher amortization rates driven primarily by the inclusion of unfavorable results from our living benefits hedging program in the second half of 2011 in our best estimate of total gross profits used to determine amortization rates.

## Account Values

For our individual annuities business, since most policy fees are determined by the level of separate account assets, fee income, which is a primary driver of our revenue, varies according to the level of account values. This results in changing fee streams due to net flows from new business sales, surrenders and withdrawals, and benefit payments, as well as the impact of market changes on account values. Additionally, our fee income drives other items such as our pattern of amortization of DAC and other costs. Net sales (redemptions) are sales minus redemptions or surrenders and withdrawals, as applicable. Sales do not correspond to revenues under U.S. GAAP, but are used as a relevant measure of business activity. The following tables set forth account value information for the periods indicated.
$\left.\begin{array}{lcccc} & \begin{array}{c}\text { Three Months Ended } \\ \text { September 30, } \\ \mathbf{2 0 1 1} \\ \text { (in millions) }\end{array} & \begin{array}{c}\text { Nine Months Ended } \\ \text { September 30, } \\ \text { 2012 }\end{array} \\ \text { 2011 }\end{array}\right]$

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|  | Three Months Ended |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | $\begin{gathered} \text { September 30, } \\ 2012 \end{gathered}$ | $\begin{gathered} \text { June 30, } \\ 2012 \end{gathered}$ | March 31, 2012 <br> (in millions) |  | $\begin{aligned} & \text { ember 31, } \\ & 2011 \end{aligned}$ |  | $\begin{aligned} & \text { ember } 30, \\ & 2011 \end{aligned}$ |
| Ending variable annuity account values(1)(2) | \$ 128,949 | \$ 120,326 | \$ 120,276 | \$ | 109,743 | \$ | 102,879 |
| Ending fixed annuity account values | \$ 3,756 | \$ 3,768 | \$ 3,778 | \$ | 3,792 | \$ | 3,810 |

(1) Variable annuities include only those sold as retail investment products. Investments sold through defined contribution plan products are included with such products within the Retirement segment.
(2) As of September 30, 2012, variable annuity account values are invested in equity portfolios (\$74 billion or 57\%), bond portfolios (\$39 billion or 30\%), market value adjusted or fixed-rate accounts ( $\$ 8$ billion or $7 \%$ ) and money market funds ( $\$ 8$ billion or 6\%).

As shown above, our account values are significantly impacted by net sales and the impact of market performance on customers accounts. The increase in gross sales for the three months ended September 30, 2012 compared to the prior year period was primarily driven by higher sales in advance of both our suspension of additional customer deposits for variable annuities with certain older optional living benefit riders, and our implementation of variable annuity product modifications for new sales to scale back benefits, increase pricing and close certain share classes in the third quarter of 2012 . The increase in gross sales for the nine months ended September 30, 2012 compared to the prior year period reflects similar increases from our suspension of additional customer deposits, while the comparative impact of higher sales in advance of our implementation of variable annuity product modifications in the third quarter of 2012 was offset by similar impacts in the prior year period from product modifications we implemented in the first quarter of 2011. Additionally, we have experienced a dynamic competitive landscape, as certain of our competitors have taken actions to implement product modifications which scale back benefits and to exit, or limit their presence in, the variable annuity marketplace, and our results may continue to be impacted by these actions. The decrease in surrenders and withdrawals for the three and nine months ended September 30, 2012 compared to the prior year periods reflects the continued retention of contracts that are in-the-money and the competitiveness of our inforce product offerings relative to substitute products currently available in the marketplace.

Over the past five quarters, our account values have generally been increasing due to net flows and market appreciation, with the exception of the second quarter of 2012, which was relatively flat due to the offsetting impact of positive net flow and market declines, and the third quarter of 2011 where market depreciation was only partially offset by positive net flows. These increases have driven corresponding increases in our asset-based fee income, net of an increased level of distribution and amortization costs.

## Variable Annuity Net Amount at Risk

The net amount at risk is generally defined as the present value of the guaranteed minimum benefit amount in excess of the contractholder $s$ current account balance, and excludes any reduction to this risk provided by our hedging program. Changes in the global financial markets can create volatility in the net amounts at risk embedded in our variable annuity products that include optional living benefit and GMDB features. As part of our risk management strategy, we hedge or limit our exposure to certain of the risks associated with these products, primarily through a combination of product design elements, such as an automatic rebalancing element, and externally purchased hedging instruments. Our hedging program is discussed below in Net impact of optional living benefit guarantees and related hedge positions. The return we realize from our variable annuity contracts can vary by contract based on our risk management strategy, including the impact of any capital market movements that we may hedge, the impact of that portion of our variable annuity contracts with the automatic rebalancing element, the impact of risks we have retained and the impact of risks that are not able to be hedged.

All new sales of optional living benefit features of our variable annuity products include an automatic rebalancing element, also referred to as an asset transfer feature. Our automatic rebalancing element occurs at the contractholder level, and transfers assets between certain variable investments selected by the annuity contractholder and, depending on the benefit feature, the fixed-rate account in the general account or a bond

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portfolio within the separate accounts. The automatic rebalancing element associated with currently-sold products transfers assets between certain variable investments selected by the annuity contractholder and a designated bond portfolio within the separate accounts. The transfers are based on the static mathematical formula used with the particular benefit which considers a number of factors, including, but not limited to, the impact of investment performance on the contractholder s total account value. In general, negative investment performance may result in transfers to either the fixed-rate account in the general account or a bond portfolio within the separate accounts, and positive investment performance may result in transfers to contractholder-selected variable investments. Overall, the automatic rebalancing element helps to mitigate our exposure to equity market risk and market volatility.

The following table sets forth the account values of our variable annuities with living benefit features and the net amount at risk of the living benefit features split between those that include an automatic rebalancing element and those that do not, as of the dates indicated.

|  | September 30, 2012 |  |  |  | December 31, 2011 |  |  | September 30, 2011 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | ccount <br> Value | Net Amount at Risk |  |  |  |  | Account <br> Value | Net Amount at Risk |  |
| Automatic rebalancing element(1) | \$ | 88,672 | \$ | 3,013 | \$ 70,341 | \$ | 4,238 | \$ 64,769 | \$ | 4,996 |
| No automatic rebalancing element |  | 15,529 |  | 1,701 | 15,300 |  | 2,361 | 14,753 |  | 2,934 |
| Total variable annuity account values with living benefit features |  | 104,201 | \$ | 4,714 | \$ 85,641 | \$ | 6,599 | \$ 79,522 | \$ | 7,930 |


|  |  |  |  |  |  | (\% of total) |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Automatic rebalancing element | $85 \%$ | $64 \%$ | $82 \%$ | $64 \%$ | $81 \%$ | $63 \%$ |
| No automatic rebalancing element | $15 \%$ | $36 \%$ | $18 \%$ | $36 \%$ | $19 \%$ | $37 \%$ |

(1) As of September 30, 2012, December 31, 2011 and September 30, 2011, asset values that have transferred to the general account or a separate account bond portfolio due to the automatic rebalancing element represent $12 \%$ or $\$ 10.9$ billion of the $\$ 88.7$ billion total account value, $30 \%$ or $\$ 20.9$ billion of the $\$ 70.3$ billion total account value and $37 \%$ or $\$ 23.7$ billion of the $\$ 64.8$ billion total account value, respectively.

The increase in account values that include an automatic rebalancing element as of September 30, 2012 compared to prior periods primarily reflects sales of our latest product offerings which include this feature. The decrease in the net amount at risk for these contracts as of September 30, 2012 compared to prior periods primarily reflects the impact of overall favorable equity markets in the first nine months of 2012.

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Our GMDBs provide a benefit payable in the event of death that, together with the existing contractholder $s$ account balance, is equal to the greater of a minimum return on the contract value or an enhanced value. The net amount at risk associated with the GMDBs provided by our variable annuity contracts shown below is the total amount of death benefit insurance, over and above the account value, that would be provided assuming the death of all insured as of the respective dates in the table. We have retained this mortality risk. A substantial portion of the account values associated with GMDBs are subject to an automatic rebalancing element because the contractholder also selected a living benefit feature which includes an automatic rebalancing element. All of the variable annuity account values with living benefit features shown in the table above also contain GMDBs. Since the living and death benefit features for these contracts cover the same insured life, the net amount at risk for living and death benefit features is not additive, as we have assumed both the mortality and longevity risk on these lives. An additional $\$ 21.7$ billion, $\$ 21.1$ billion and $\$ 20.5$ billion of variable annuity account values, as of September 30, 2012, December 31, 2011 and September 30, 2011, respectively, contain GMDBs, but no living benefit features. The following table sets forth the account values of our variable annuities with GMDBs and the net amount at risk of these benefits split between those that are affected by an automatic rebalancing element and those that are not, as of the dates indicated.

|  | September 30, 2012 |  |  | December 31, 2011 |  |  |  | September 30, 2011 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Account Value | N | Amount Risk |  | Account Value (\$ in |  | Amount Risk | Account Value | Ne | Amount Risk |
| Automatic rebalancing element | \$ 88,672 | \$ | 983 | \$ | 70,341 | \$ | 2,154 | \$ 64,769 | \$ | 3,042 |
| No automatic rebalancing element | 37,239 |  | 4,135 |  | 36,407 |  | 5,628 | 35,224 |  | 6,947 |
| Total variable annuity account values with death benefit features | \$ 125,911 | \$ | 5,118 |  | 106,748 | \$ | 7,782 | \$ 99,993 | \$ | 9,989 |


|  |  |  |  |  |  | (\% of total) |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Automatic rebalancing element | $70 \%$ | $19 \%$ | $66 \%$ | $28 \%$ | $65 \%$ | $30 \%$ |
| No automatic rebalancing element | $30 \%$ | $81 \%$ | $34 \%$ | $72 \%$ | $35 \%$ | $70 \%$ |

The increase in account values that include an automatic rebalancing element as of September 30, 2012 compared to prior periods primarily reflects sales of our latest product offerings which include this feature. The decrease in the net amount at risk for these contracts as of September 30, 2012 compared to prior periods primarily reflects the impact of overall favorable equity markets in the first nine months of 2012.

## Net impact of optional living benefit guarantees and related hedge positions

In addition to our automatic rebalancing element, we also manage capital markets risk associated with our optional living benefit guarantee through our hedging program. This program represents a balance among three objectives: 1) provide severe scenario protection, 2) minimize net income volatility associated with an internally defined hedge target liability, and 3) maintain capital efficiency. Through our hedge program, we purchase derivatives that replicate the net change in our hedge target, discussed further below. In addition to mitigating risk and income statement volatility, the hedging program is also focused on a long-term goal of accumulating assets that could be used to pay claims under these benefits irrespective of market path, recognizing that, under the terms of the contracts, we do not expect to begin payment of such claims until some point in the future. We hedge the capital market risks on approximately $\$ 98$ billion of the $\$ 104$ billion of variable annuity account values with living benefit features.

Under U.S. GAAP the liability for the optional living benefit features is accounted for as an embedded derivative and recorded at fair value. The fair value is calculated as the present value of future expected benefit payments to customers less the present value of assessed rider fees attributable to the feature using option pricing techniques. See Note 13 to the Unaudited Interim Consolidated Financial Statements for additional information regarding the methodology and assumptions used in calculating the fair value under U.S. GAAP.

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As noted above, our hedge program utilizes a hedge target that is grounded in a U.S. GAAP/capital markets valuation framework, with three notable modifications.

The impact of the market s perception of our own non-performance risk (NPR) is excluded to maximize protection against the entire projected claim irrespective of the possibility of our own default.

A credit spread is added to the risk-free rate of return assumption used under U.S. GAAP to estimate future growth of bond investments in the customer separate account funds to better replicate the projected returns within those funds.

The equity volatility assumption is adjusted to remove certain risk margins required under U.S. GAAP valuation which are used in the projection of customer account values, as we believe the impact driven by these margins can be temporary and does not reflect the true economic value.

Due to these modifications, we expect differences each period between the change in the value of the embedded derivative as defined by U.S. GAAP and the change in the value of the hedge positions used to replicate the hedge target, thus potentially increasing volatility in U.S. GAAP earnings. As of September 30, 2012, the fair value of the embedded derivative under U.S. GAAP was a $\$ 3.6$ billion liability. Excluding the impact of the cumulative adjustment for NPR of $\$ 5.7$ billion, the value of the embedded derivative was a $\$ 9.3$ billion liability. As of September 30, 2012, the value of our hedge target was a $\$ 7.2$ billion liability.

We enter into a range of exchange-traded and over the counter equity and interest rate derivatives. The instruments include, but are not limited to: interest rate swaps, swaptions, floors and caps as well as equity options, total return swaps and equity futures to hedge certain capital market risks present in our hedge target. As of September 30, 2012, the fair value of hedge positions was a $\$ 5.5$ billion asset. As noted above the hedge program is designed to replicate the changes in our hedge target.

Due to cash flow timing differences between our hedging instruments and the corresponding hedge target, as well as other factors, including updates to actuarial valuation assumptions, the amount of hedge assets compared to our hedge target measured as of any specific point in time may be different and is not expected to be fully offsetting. In addition to derivative assets held as part of the hedging program, we have cash, other invested assets and affiliated receivables available to cover affiliated loans, debt and the embedded derivative liability.

While we actively manage our hedge positions, changes in the fair value of these positions may not completely offset changes in the fair value of the hedge target. Additionally, updates to actuarial valuation assumptions, which typically occur annually in the third quarter, are generally not hedged and may result in differences between the assets and liabilities. The primary sources of the differences between the changes in the fair value of the hedge position and the hedge target, other than actuarial valuation assumption updates, fall into one of three categories:

Fund Performance In order to project future account value growth, we must make certain assumptions about how each underlying investment will perform. We map our funds to indices that are readily tradeable and have active derivative markets. The difference between the modeled investment performance and actual fund performance results in basis differences that can be either positive or negative.

Rebalancing Costs and Volatility There are costs associated with rebalancing hedge positions for basis differences between assets and liabilities. This also includes the impact of realized market volatility in excess of, or lower than, our long-term assumptions.

Liability Basis Reflects the impact of differences between the actual changes in the liability and the expected changes we have modeled and attempt to replicate with the hedge program. These differences arise due to the inherent complexities in predicting changes in the value of a long-dated, complex and path dependent benefit option.

The net impact of both the change in the fair value of the embedded derivative associated with our living benefit features and the change in the fair value of the related hedge positions are included in Realized investment gains (losses), net, and related adjustments and the related impact to the amortization of DAC and

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other costs is included in Related charges, both of which are excluded from adjusted operating income. The following table shows the net impact of changes in the embedded derivative and related hedge positions, as well as the related amortization of DAC and other costs, for the periods indicated.
$\left.\begin{array}{l|cccccc} & \begin{array}{c}\text { Three Months Ended } \\ \text { September 30, } \\ \text { 2012 }\end{array} & \begin{array}{c}\text { Nine Months Ended } \\ \text { September 30, } \\ \text { 2012 } \\ \text { (1) }\end{array} \\ \text { (in millions) }\end{array}\right)$
(1) Positive amount represents income; negative amount represents a loss.
(2) The unhedged portion represents the impact of temporarily hedging to an amount that differs from our hedge target based on the overall capital considerations of the Company and prevailing capital market conditions. Results exclude $\$ 139$ million and $\$(155)$ million for the three and nine months ended September 30, 2012, respectively, and $\$(1,428)$ million and $\$(1,459)$ million for the three and nine months ended September 30, 2011, respectively, related to this impact. Because the decision to temporarily hedge to an amount that differs from our hedge target is based on overall capital considerations of the Company as a whole, this impact is reported in Corporate \& Other operations. See Corporate \& Other.
(3) Represents the impact attributable to the difference between the value of the hedge target and the value of the embedded derivative as defined by U.S. GAAP, before adjusting for NPR. These differences include a credit spread that is added to the U.S. GAAP risk-free rate of return assumption, as well as certain risk margins embedded in the equity volatility assumption used to determine the fair value of the embedded derivative under U.S. GAAP.
(4) To reflect NPR, we incorporate an additional spread over LIBOR, which reflects the financial strength ratings of our insurance subsidiaries, into the discount rate used in the valuation of those individual living benefit contracts in a liability position and not to those in a contra-liability position. As of September 30 , 2012, the value of the embedded derivative, before the adjustment for NPR, was a net liability of $\$ 9.3$ billion. This net liability was comprised of $\$ 9.7$ billion of individual living benefit contracts in a liability position, net of $\$ 0.4$ billion of individual living benefit contracts in a contra-liability position.
(5) Related charge to amortization of DAC and other costs is excluded from adjusted operating income and included in operating results in Related charges.

2012 to 2011 Three Month Comparison. Market conditions in the third quarter of 2012 generally reflected improved capital markets performance, as well as lower levels of volatility. The $\$ 338$ million net benefit related to the net hedging impact, excluding unhedged portion and assumption updates, was primarily driven by positive fund performance, partially offset by rebalancing costs and volatility. The $\$ 912$ million net charge related to the impact of assumption updates on the hedge target was driven by updates to our policyholder behavior assumptions, primarily related to lapse and mortality rates, as well as policyholder utilization assumptions. The $\$ 560$ million net charge from

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changes in the NPR adjustment was driven by the tightening of our NPR credit

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spreads, partially offset by the impact of assumption updates which increased and lengthened expected claims. We also included these items in gross profits used to calculate the amortization of DAC, which resulted in a net benefit of $\$ 690$ million, including a $\$ 365$ million net benefit from the current period impact of incorporating the net hedging impact in our best estimate of gross profits used to set amortization rates. The resulting change in our amortization rates will impact adjusted operating income in future periods, as the new rates are applied to actual gross profits. For additional information regarding the net hedging impacts that are included in our best estimate of gross profits used to set amortization rates, see Accounting Policies \& Pronouncements Application of Critical Accounting Estimates.

Market conditions in the third quarter of 2011 generally reflected capital markets deterioration, as well as higher levels of volatility. The $\$ 871$ million charge related to the net hedging impact, excluding unhedged portion and assumption updates, was driven by negative fund performance, rebalancing costs and volatility and liability basis differences. The $\$ 4,794$ million net benefit due to changes in the NPR adjustment was driven by increases in the base embedded derivative liability before NPR primarily due to significant declines in risk-free interest rates, as well as the widening of our NPR credit spreads. We also included these items in gross profits used to calculate the amortization of DAC, which resulted in a net charge of $\$ 1,590$ million, including an $\$ 86$ million net charge from the current period impact of incorporating the cumulative net hedging impact in our best estimate of gross profits used to set amortization rates, based on our determination that these impacts were other-than-temporary.

For additional information regarding the methodologies used in determining the fair value of the embedded derivative liability associated with our living benefit features as defined by U.S. GAAP, and for calculating the impact of NPR, see Note 13 to the Unaudited Interim Consolidated Financial Statements and Valuation of Assets and Liabilities Fair Value of Assets and Liabilities Variable Annuity Optional Living Benefit Features. For information regarding the Capital Protection Framework we use to evaluate and support the risks of our hedging program, see

Liquidity and Capital Resources Liquidity and Capital Resources of Subsidiaries Domestic Insurance Subsidiaries.

2012 to 2011 Nine Month Comparison. Market conditions in the first nine months of 2012 generally reflected improved capital markets performance, as well as lower levels of volatility. The $\$ 435$ million net benefit related to the net hedging impact, excluding unhedged portion and assumption updates, was primarily driven by positive fund performance, partially offset by rebalancing costs and volatility. The $\$ 912$ million net charge related to the impact of assumption updates on the hedge target was driven by updates to our policyholder behavior assumptions, primarily related to lapse and mortality rates, as well as policyholder utilization assumptions. The $\$ 169$ million net benefit from changes in the NPR adjustment was driven by the higher base of embedded derivatives in a liability position driven by lower interest rates and the impact of assumption updates which increased and lengthened expected claims, partially offset by tightening of our NPR credit spreads. We also included these items in gross profits used to calculate the amortization of DAC, which resulted in a net benefit of $\$ 587$ million, including a $\$ 378$ million net benefit from the current period impact of incorporating the net hedging impact in our best estimate of gross profits used to set amortization rates.

Market conditions in the first nine months of 2011 generally reflected capital markets deterioration, as well as higher levels of volatility. The $\$ 915$ million net charge related to the net hedging impact, excluding unhedged portion and assumption updates, was driven by negative fund performance, rebalancing costs and volatility and liability basis differences. The $\$ 5,010$ million benefit due to changes in the NPR adjustment was driven by increases in the base embedded derivative liability before NPR primarily due to significant declines in risk-free interest rates, as well as the widening of our NPR credit spreads. We also included these items in gross profits used to calculate the amortization of DAC, which resulted in a net charge of $\$ 1,698$ million, including an $\$ 86$ million net charge from the current period impact of incorporating the cumulative net hedging impact in our best estimate of gross profits used to set amortization rates, based on our determination that these impacts were other-than-temporary.

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## Retirement

## Operating Results

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

|  | Three Months Ended September 30, 2012 2011 |  |  | Nine Months Ended September 30, 2012 2011 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Operating results: |  |  |  |  |  |  |
| Revenues | \$ 1,162 | \$ | 1,171 | \$ 3,511 | \$ | 3,625 |
| Benefits and expenses | 1,052 |  | 1,060 | 3,098 |  | 3,171 |
| Adjusted operating income | 110 |  | 111 | 413 |  | 454 |
| Realized investment gains (losses), net, and related adjustments(1) | (65) |  | 263 | (66) |  | 244 |
| Related charges(2) | 1 |  | (3) | 1 |  | (9) |
| Investment gains on trading account assets supporting insurance liabilities, net(3) | 268 |  | 119 | 436 |  | 306 |
| Change in experience-rated contractholder liabilities due to asset value changes(4) | (258) |  | (41) | (380) |  | (212) |
| Income from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ 56 | \$ | 449 | \$ 404 | \$ | 783 |

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

## Divestiture of Prudential Bank \& Trust, FSB Bank Deposits

During the second quarter of 2012, Prudential Bank \& Trust, FSB ( PB\&T ) divested bank deposits in connection with the previously announced decision to limit its operations to trust services. The divestiture resulted in $\$ 9$ million of losses from the sale and related transaction costs in the second quarter of 2012. Additionally, our results for the three and nine months ended September 30, 2012 reflect the loss of positive net investment spread earnings from the $\mathrm{PB} \& \mathrm{~T}$ deposits, which will continue in future periods.

## Adjusted Operating Income

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2012 to 2011 Three Month Comparison. Adjusted operating income decreased $\$ 1$ million, from $\$ 111$ million in the third quarter of 2011 to $\$ 110$ million in the third quarter of 2012. The decrease includes a $\$ 29$ million charge in the third quarter of 2012 to write off an intangible asset, due to the impact of the prolonged economic downturn on the expected results of a business we acquired in 2008. The decrease also includes the impact of certain changes in our estimated profitability of the business on the amortization of DAC and value of business acquired ( VOBA ). These changes resulted in net charges of $\$ 17$ million and $\$ 22$ million for the third quarter of 2012 and 2011, respectively, related to our annual review and update of economic and actuarial assumptions, and a net benefit of $\$ 4$ million and net charge of $\$ 2$ million, respectively, related to quarterly adjustments for current period experience. Collectively, the net charge of $\$ 13$ million in the third quarter of 2012 was primarily driven by a reduction to long-term interest and equity rate of return assumptions, while the net charge of $\$ 24$ million in the third quarter of 2011 was driven by changes to expense and net cash flow assumptions.

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Excluding these items, adjusted operating income increased $\$ 17$ million, primarily reflecting higher net investment spread results and higher asset-based fee income, partially offset by an unfavorable comparative reserve impact from case experience. Higher net investment spread results reflect the impacts of lower crediting rates driven by rate resets in the third quarter of 2012 and higher general account stable value account values in our full service business, as well as higher income from alternative investments and mark-to-market gains on our equity investments in certain separate accounts in our institutional investment products business. These increases were partially offset by the impacts of lower reinvestment rates and lower bank deposits, as discussed above. Higher asset-based fee income primarily reflects an increase in investment-only stable value account values in our institutional investment products business driven by net additions, partially offset by lower average full service fee-based retirement account values driven by net outflows. The unfavorable comparative reserve impact from case experience was primarily driven by higher mortality losses in the third quarter of 2012.

2012 to 2011 Nine Month Comparison. Adjusted operating income decreased $\$ 41$ million, from $\$ 454$ million in the first nine months of 2011 to $\$ 413$ million in the first nine months of 2012. The decrease includes a $\$ 29$ million charge in the third quarter of 2012 to write off an intangible asset, due to the impact of the prolonged economic downturn on the expected results of a business we acquired in 2008. The decrease also includes the impact of certain changes in our estimated profitability of the business on the amortization of DAC and VOBA. These changes resulted in net charges of $\$ 17$ million and $\$ 22$ million for the first nine months of 2012 and 2011, respectively, related to our annual review and update of economic and actuarial assumptions performed in the third quarter, and net charges of $\$ 2$ million and $\$ 3$ million, respectively, related to quarterly adjustments for current period experience. Collectively, the net charge of $\$ 19$ million in the first nine months of 2012 was primarily driven by a reduction to long-term interest and equity rate of return assumptions, while the net charge of $\$ 25$ million in the first nine months of 2011 was driven by changes to expense and net cash flow assumptions. The decrease in adjusted operating income for the first nine months of 2012 also includes a $\$ 9$ million charge in the second quarter of 2012 from costs related to the divestiture of bank deposits held by PB\&T, as discussed above.

Excluding these items, adjusted operating income decreased $\$ 9$ million, primarily reflecting lower net investment spread results and an unfavorable comparative reserve impact from case experience, partially offset by higher asset-based fee income and lower general and administrative expenses, net of capitalization. Lower net investment spread results reflect the impacts of lower reinvestment rates and lower bank deposits, as discussed above, partially offset by the impacts of lower crediting rates driven by rate resets in the first and third quarters of 2012 and higher general account stable value account values in our full service business, as well as higher income from alternative investments in our institutional investment products business. The unfavorable comparative reserve impact from case experience was primarily driven by mortality losses in the first nine months of 2012 compared with mortality gains in the first nine months of 2011. Higher asset-based fee income primarily reflects an increase in investment-only stable value account values in our institutional investment products business driven by net additions, partially offset by lower average full service fee-based retirement account values driven by net outflows. Lower general and administrative expenses, net of capitalization, primarily reflects costs incurred in the first quarter of 2011 related to certain legal matters.

## Revenues

2012 to 2011 Three Month Comparison. Revenues, as shown in the table above under Operating Results, decreased $\$ 9$ million, from $\$ 1,171$ million in the third quarter of 2011 to $\$ 1,162$ million in the third quarter of 2012 . Premiums decreased $\$ 25$ million, driven by lower sales of life-contingent structured settlements and single premium annuities, partially offset by higher premiums assumed on longevity reinsurance contracts. The overall decrease in premiums resulted in a corresponding decrease in policyholders benefits, including the change in policy reserves, as discussed below. Net investment income decreased $\$ 19$ million primarily reflecting lower portfolio yields and the impact of lower bank deposits, partially offset by the impact of higher general account stable value account values in our full service business and mark-to-market gains on our equity investments in certain separate accounts. Policy charges and fee income, and asset management fees and other

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income, increased $\$ 35$ million, primarily from higher asset-based fees reflecting the impacts of an increase in investment-only stable value account values in our institutional investment products business driven by net additions, partially offset by lower average full service fee-based retirement account values driven by net outflows. Also contributing to the increase in other income was higher income from alternative investments.

2012 to 2011 Nine Month Comparison. Revenues decreased $\$ 114$ million, from $\$ 3,625$ million in the first nine months of 2011 to $\$ 3,511$ million in the first nine months of 2012. Premiums decreased $\$ 100$ million, driven by lower sales of life-contingent structured settlements and non-participating group annuity separate accounts, partially offset by higher premiums assumed on longevity reinsurance contracts and higher sales of single premium annuities. The overall decrease in premiums resulted in a corresponding decrease in policyholders benefits, including the change in policy reserves, as discussed below. Net investment income decreased $\$ 73$ million primarily reflecting lower portfolio yields and the impact of lower bank deposits, partially offset by the impact of higher general account stable value account values in our full service business. Policy charges and fee income, and asset management fees and other income, increased $\$ 59$ million, primarily from higher asset-based fees reflecting the impacts of an increase in investment-only stable value account values in our institutional investment products business driven by net additions, partially offset by lower average full service fee-based retirement account values driven by net outflows. Also contributing to the increase in other income was higher income from alternative investments.

## Benefits and Expenses

2012 to 2011 Three Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, decreased $\$ 8$ million, from $\$ 1,060$ million in the third quarter of 2011 to $\$ 1,052$ million in the third quarter of 2012. Absent the $\$ 18$ million net increase in expenses from the intangible asset write off and certain changes in our estimated profitability of the business on the amortization of DAC and VOBA, discussed above, benefits and expenses decreased $\$ 26$ million. Policyholders benefits, including the change in policy reserves, decreased $\$ 16$ million, primarily reflecting a decrease in change in policy reserves associated with the decrease in premiums as discussed above, partially offset by an unfavorable comparative reserve impact from case experience. Interest credited to policyholders account balances decreased $\$ 9$ million, driven by the impacts of lower crediting rates from rate resets and lower bank deposits, partially offset by the impact of higher general account stable value account values in our full service business.

2012 to 2011 Nine Month Comparison. Benefits and expenses decreased $\$ 73$ million, from $\$ 3,171$ million in the first nine months of 2011 to $\$ 3,098$ million in the first nine months of 2012. Absent the $\$ 32$ million net increase in expenses from the intangible asset write off, certain changes in our estimated profitability of the business on the amortization of DAC and VOBA and the costs related to the divestiture of bank deposits, discussed above, benefits and expenses decreased $\$ 105$ million. Policyholders benefits, including the change in policy reserves, decreased $\$ 73$ million, primarily reflecting a decrease in change in policy reserves associated with the decrease in premiums as discussed above, partially offset by an unfavorable comparative reserve impact from case experience. The amortization of DAC decreased $\$ 20$ million primarily driven by a refinement in the first quarter of 2011 to the methodology applied in calculating amortization for certain structured settlement contracts, with an equally offsetting impact to interest credited to policyholders account balances. General and administrative expenses, net of capitalization, decreased $\$ 19$ million, primarily driven by costs incurred in the first quarter of 2011 related to certain legal matters and a decline in life-contingent structured settlement commissions. Interest credited to policyholders account balances increased $\$ 3$ million primarily driven by a refinement in the first quarter of 2011 to the methodology applied in calculating reserves for certain structured settlement contracts, as mentioned above. The increase also reflects the impact of higher general account stable value account values in our full service business, partially offset by the impacts of lower crediting rates driven by rate resets and lower bank deposits.

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Sales Results and Account Values

Our sales results and account values are significant drivers of our operating results. For our fee-based products, the income we earn varies with the level of fee-based account values, since many policy fees are determined by these values. For our spread-based products, both the investment income and interest we credit to policyholders vary with the level of general account values. To a lesser extent, these impacts drive other items such as our pattern of amortization of DAC and VOBA, and general and administrative expenses.

The following table shows the changes in the account values and net additions (withdrawals) of Retirement segment products for the periods indicated. Net additions (withdrawals) are deposits and sales or additions, as applicable, minus withdrawals and benefits. These concepts do not correspond to revenues under U.S. GAAP, but are used as a relevant measure of business activity. Account values include both internally- and externally-managed client balances as the total balances drive revenue for the Retirement segment. For more information on internally-managed balances see Asset Management.

|  | Three Months Ended September 30, |  | Nine Months Ended September 30, |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2012 | 2011 | 2012 | 2011 |
|  | (in millions) |  |  |  |
| Full Service(1): |  |  |  |  |
| Beginning total account value | \$ 142,405 | \$ 146,580 | \$ 139,430 | \$ 141,313 |
| Deposits and sales | 3,478 | 3,966 | 12,487 | 12,942 |
| Withdrawals and benefits | $(4,063)$ | $(4,126)$ | $(14,837)$ | $(13,267)$ |
| Change in market value, interest credited and interest income and other activity(2) | 5,114 | $(12,222)$ | 9,854 | $(6,790)$ |
| Ending total account value | \$ 146,934 | \$ 134,198 | \$ 146,934 | \$ 134,198 |
| Net additions (withdrawals) | \$ (585) | \$ (160) | \$ $(2,350)$ | \$ (325) |
| Institutional Investment Products(3): |  |  |  |  |
| Beginning total account value | \$ 102,443 | \$ 74,131 | \$ 90,089 | \$ 64,183 |
| Additions | 2,957 | 5,571 | 15,813 | 16,948 |
| Withdrawals and benefits(4) | $(1,539)$ | $(1,501)$ | $(5,909)$ | $(4,066)$ |
| Change in market value, interest credited and interest income | 1,509 | 2,176 | 3,999 | 3,848 |
| Other(5) | (724) | 136 | 654 | (400) |
| Ending total account value(6) | \$ 104,646 | \$ 80,513 | \$ 104,646 | \$ 80,513 |
| Net additions(6) | \$ 1,418 | \$ 4,070 | \$ 9,904 | \$ 12,882 |

(1) Ending total account value for the full service business includes assets of Prudential s retirement plans of $\$ 6.5$ billion and $\$ 5.6$ billion as of September 30 , 2012 and 2011, respectively.
(2) Change in market value, interest credited and interest income and other activity includes $\$(1.4)$ billion for the nine months ended September 30 , 2012 representing the divestiture of bank deposits held by $\mathrm{PB} \& \mathrm{~T}$, as a result of our decision to limit its operations to trust services.
(3) Ending total account value for the institutional investment products business includes assets of Prudential s defined benefit plan of $\$ 6.1$ billion and $\$ 5.8$ billion as of September 30, 2012 and 2011, respectively. Ending total account value for the institutional investment products business also includes $\$ 1.5$ billion as of both September 30, 2012 and 2011 related to collateralized funding agreements issued to the Federal Home Loan Bank of New York (FHLBNY), and $\$ 0.5$ billion and $\$ 0.6$ billion as of September 30, 2012 and 2011, respectively, related to affiliated funding agreements issued using the proceeds from the sale of Prudential Financial retail medium-term notes. For additional information regarding the FHLBNY and the retail medium-term notes program see, Liquidity and Capital Resources.
(4)

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Withdrawals and benefits includes $\$(9)$ million and $\$(902)$ million for the three and nine months ended September 30, 2012, respectively, and $\$(16)$ million and $\$(68)$ million for the three and nine months ended September 30, 2011, respectively, representing transfers of client balances from accounts we manage to externally-managed accounts. These withdrawals are offset within Other, as there is no net impact on ending account values for these transfers.

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(5) Other includes transfers from (to) the Asset Management segment of $\$ 131$ million for the three months ended September 30, 2012, and $\$(415)$ million for the nine months ended September 30, 2011. Other also includes $\$ 9$ million and $\$ 902$ million for the three and nine months ended September 30, 2012, respectively, and $\$ 16$ million and $\$ 68$ million for the three and nine months ended September 30, 2011, respectively, representing transfers of client balances from accounts we manage to externally-managed accounts. These transfers are offset within Withdrawals and benefits, as there is no net impact on ending account values for these transfers. Remaining amounts for all periods presented primarily represent changes in asset balances for externally-managed accounts.
(6) Ending total account value for the institutional investment products business includes investment-only stable value account values of $\$ 55.9$ billion and $\$ 33.4$ billion as of September 30, 2012 and 2011, respectively. Net additions for the institutional investment products business include investment-only stable value account value net additions of $\$ 2.0$ billion and $\$ 12.9$ billion for the three and nine months ended September 30, 2012, respectively, and $\$ 4.7$ billion and $\$ 14.5$ billion for the three and nine months ended September 30, 2011, respectively.

Account values in our full service business are significantly impacted by net flows and the impact of market performance on the value of customer funds. Accordingly, the increases in account values compared to the prior periods shown above primarily reflect equity market appreciation in 2012, partially offset by net withdrawals. Additionally, the change in account values compared to the 2011 periods also reflect the divestiture of bank deposits in the second quarter of 2012, as discussed above. The increase in net withdrawals for the three months ended September 30, 2012 compared to the prior year period was primarily due to lower plan sales, driven by lower sales volume and a decrease in the average size of new plans. The increase in net withdrawals for the nine months ended September 30, 2012 compared to the prior year period reflects similar impacts, as well as a higher volume of large plan lapses.

Account values in our institutional investment products business are also significantly impacted by net flows and the impact of market performance on the value of customer funds. Accordingly, the increases in account values compared to the prior periods shown above primarily reflect net additions and increases in the market value of customer funds driven by declines in fixed income yields. The decrease in net additions for the three months ended September 30, 2012 compared to the prior year period was primarily due to a decrease in overall sales volume, as well as in the average size of new fee-based investment-only stable value plans. The decrease in net additions for the nine months ended September 30, 2012 compared to the prior year period reflects similar impacts, as well as a transfer of client balances from accounts we manage to externally-managed accounts. Despite the declines in net additions of fee-based investment-only stable value plans, we believe this product remains competitively positioned.

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## Asset Management

## Operating Results

The following table sets forth the Asset Management segment s operating results for the periods indicated.

|  | Three Months Ended <br> September 30, <br> $\mathbf{2 0 1 1}$ | Nine Months Ended <br> September 30, <br> (in millions) |
| :--- | :---: | :---: | :---: | :---: | :---: |
| 2011 |  |  |

(1) Revenues exclude Realized investment gains (losses), net, and related adjustments. See Realized Investment Gains and Losses.
(2) Equity in earnings of operating joint ventures are included in adjusted operating income but excluded from income from continuing operations before income taxes and equity in earnings of operating joint ventures as they are reflected on a U.S. GAAP basis on an after-tax basis as a separate line in our Unaudited Interim Consolidated Statements of Operations. Earnings attributable to noncontrolling interests are excluded from adjusted operating income but included in income from continuing operations before income taxes and equity in earnings of operating joint ventures as they are reflected on a U.S. GAAP basis as a separate line in our Unaudited Interim Consolidated Statements of Operations. Earnings attributable to noncontrolling interests represent the portion of earnings from consolidated entities that relate to the equity interests of minority investors.

## Adjusted Operating Income

2012 to 2011 Three Month Comparison. Adjusted operating income increased $\$ 64$ million, from $\$ 123$ million in the third quarter of 2011 to $\$ 187$ million in the third quarter of 2012 primarily reflecting a greater contribution from the segment s incentive, transaction, strategic investing and commercial mortgage activities. Strategic investing results increased $\$ 32$ million primarily driven by appreciation in real estate co-investment values as well as improved performance in fixed income investments. Additionally, results increased $\$ 22$ million from performance-based incentive fees, net of direct expenses, reflecting higher fees in our public fixed income business primarily resulting from market value increases. Results for the third quarter of 2012 also reflect an increase in asset management fees, before associated expenses, primarily from institutional and retail customer assets as a result of higher asset values due to market appreciation and positive net asset flows since the third quarter of 2011.

These increases were partially offset by an increase in compensation costs, due to higher earnings subject to compensation and increased headcount, as well as increases in other costs supporting the business.

2012 to 2011 Nine Month Comparison. Adjusted operating income decreased $\$ 148$ million, from $\$ 504$ million in the first nine months of 2011 to $\$ 356$ million in the first nine months of 2012 reflecting lower contributions from the segment s strategic investing activities. The decrease in strategic investing activities reflects $\$ 101$ million of declines in values on certain real estate-related investments in the first nine months of 2012, including a $\$ 75$ million impairment on a single investment, of which $\$ 61$ million relates to prior periods. This compares to a $\$ 75$ million contribution from real estate strategic investing activities in the first nine months of 2011 primarily driven by a $\$ 61$ million gain on a partial sale of a real estate seed investment. Additionally, results for the first nine months of 2012 reflect an increase in operating expenses, largely related to increased compensation reflecting higher earnings subject to compensation and increased headcount, as well as increased expenses related to business growth and new fund launches.

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These decreases were partially offset by an increase in asset management fees, before associated expenses, primarily from institutional and retail customer assets as a result of higher asset values due to market appreciation and positive net asset flows since the third quarter of 2011.

## Revenues

The following tables set forth the Asset Management segment s revenues, presented on a basis consistent with the table above under Operating Results, by type.

|  | Three Months Ended September 30, <br> 2012 <br> 2011 |  |  | Nine Months Ended September 30, 2012 2011 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Revenues by type: |  |  |  |  |  |  |
| Asset management fees by source: |  |  |  |  |  |  |
| Institutional customers | \$ 191 | \$ | 178 | \$ 564 | \$ | 530 |
| Retail customers(1) | 126 |  | 107 | 359 |  | 319 |
| General account | 89 |  | 82 | 258 |  | 242 |
| Total asset management fees | 406 |  | 367 | 1,181 |  | 1,091 |
| Incentive fees | 25 |  | (5) | 25 |  | 8 |
| Transaction fees | 8 |  | 6 | 29 |  | 27 |
| Strategic investing | 32 |  | 0 | (47) |  | 100 |
| Commercial mortgage(2) | 48 |  | 34 | 110 |  | 106 |
| Other related revenues | 113 |  | 35 | 117 |  | 241 |
| Service, distribution and other revenues(3) | 115 |  | 111 | 358 |  | 385 |
| Total revenues | \$ 634 | \$ | 513 | \$ 1,656 | \$ | 1,717 |

(1) Consists of fees from: (a) individual mutual funds and both variable annuities and variable life insurance asset management revenues from our separate accounts; (b) funds invested in proprietary mutual funds through our defined contribution plan products; and (c) third party sub-advisory relationships. Revenues from fixed annuities and the fixed-rate accounts of both variable annuities and variable life insurance are included in the general account.
(2) Includes mortgage origination and spread lending revenues of our commercial mortgage origination and servicing business.
(3) Includes payments from Wells Fargo under an agreement dated as of July 30, 2004 implementing arrangements with respect to money market mutual funds in connection with the combination of our retail securities brokerage and clearing operations with those of Wells Fargo. The agreement extends for ten years after termination of the Wachovia Securities joint venture, which occurred on December 31, 2009. The revenue from Wells Fargo under this agreement was $\$ 17$ million and $\$ 19$ million in the three months ended September 30, 2012 and 2011, respectively, and $\$ 49$ million and $\$ 55$ million in the nine months ended September 30, 2012 and 2011, respectively.

2012 to 2011 Three Month Comparison. Revenues, as shown in the table above under Operating Results, increased $\$ 121$ million, from $\$ 513$ million in the third quarter of 2011 to $\$ 634$ million in the third quarter of 2012 . Asset management fees increased $\$ 39$ million primarily from the management of institutional and retail customer assets as a result of higher asset values due to market appreciation and positive net asset flows since the third quarter of 2011. Strategic investing revenues increased $\$ 32$ million driven by appreciation in real estate co-investments values and improved performance in fixed income investments. Performance-based incentive fees increased $\$ 30$ million reflecting higher fees in our public and private fixed income businesses primarily resulting from market value increases. Commercial mortgage revenues increased $\$ 14$ million reflecting higher agency fees due to higher production.

2012 to 2011 Nine Month Comparison. Revenues decreased $\$ 61$ million, from $\$ 1,717$ million in the first nine months of 2011 to $\$ 1,656$ million in the first nine months of 2012. Strategic investing revenues decreased $\$ 147$ million reflecting $\$ 95$ million of declines in values on certain real estate-related investments in the first nine months of 2012, including a $\$ 75$ million impairment on a single investment, as discussed above. This compares

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to an $\$ 86$ million contribution from real estate strategic investing activities in the first nine months of 2011, primarily driven by a $\$ 61$ million gain in the second quarter of 2011 on a partial sale of a real estate seed investment, as discussed above. Service, distribution and other revenues decreased $\$ 27$ million, which includes lower revenues for certain consolidated funds, which were fully offset by lower expenses related to the noncontrolling interest in these funds, as well as lower revenues from our wealth management platform.

Partially offsetting the decreases in revenue above was an increase in asset management fees of $\$ 90$ million primarily from the management of institutional and retail customer assets as a result of higher asset values due to market appreciation and positive net asset flows since the third quarter of 2011. Additionally, performance-based incentive fees increased $\$ 17$ million reflecting higher fees in our public fixed income business primarily resulting from market value increases. A portion of incentive-based fees are offset in incentive compensation expense in accordance with the terms of contractual agreements. Certain of our incentive fees continue to be subject to positive or negative future adjustment based on cumulative fund performance in relation to specified benchmarks. As of September 30, 2012, $\$ 87$ million in cumulative incentive fee revenue, net of compensation, is subject to future adjustment. Future incentive, transaction, strategic investing and commercial mortgage revenues will be impacted by the level and diversification of our strategic investments, the commercial real estate market, and other domestic and international market conditions.

## Expenses

2012 to 2011 Three Month Comparison. Expenses, as shown in the table above under Operating Results, increased $\$ 57$ million, from $\$ 390$ million in the third quarter of 2011 to $\$ 447$ million in the third quarter of 2012, driven primarily by an increase in compensation costs, due to higher earnings subject to compensation and increased headcount, as well as increases in other costs supporting the business. In addition, expenses related to revenues associated with certain consolidated funds increased.

2012 to 2011 Nine Month Comparison. Expenses increased $\$ 87$ million, from $\$ 1,213$ million in the first nine months of 2011 to $\$ 1,300$ million in the first nine months of 2012, primarily driven by an increase in compensation costs, due to higher earnings subject to compensation and increased headcount, as well as increased costs related to business growth and new fund launches. These increases were partially offset by lower expenses related to revenues associated with certain consolidated funds, as discussed above.

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Assets Under Management

The following tables set forth assets under management by asset class and source as of the dates indicated and net additions, excluding money market activity, by source for the periods indicated. In managing our business, we analyze assets under management, which do not correspond to U.S. GAAP assets, because the principal source of revenues is fees based on assets under management.

|  | $\begin{gathered} \text { September 30, } \\ 2012 \end{gathered}$ | December 31, 2011 (in billions) |  | $\begin{gathered} \text { September 30, } \\ 2011 \end{gathered}$ |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Assets Under Management (at fair market value): |  |  |  |  |  |
| Institutional customers: |  |  |  |  |  |
| Equity | \$ 49.1 | \$ | 44.2 | \$ | 42.2 |
| Fixed income | 220.5 |  | 197.2 |  | 189.6 |
| Real estate | 30.6 |  | 27.7 |  | 27.0 |
| Institutional customers(1)(2) | 300.2 |  | 269.1 |  | 258.8 |
| Retail customers: |  |  |  |  |  |
| Equity | 85.3 |  | 70.8 |  | 63.7 |
| Fixed income | 45.6 |  | 45.7 |  | 45.0 |
| Real estate | 1.4 |  | 1.4 |  | 1.4 |
| Retail customers(3) | 132.3 |  | 117.9 |  | 110.1 |
| General account: |  |  |  |  |  |
| Equity | 4.6 |  | 4.2 |  | 3.8 |
| Fixed income | 231.7 |  | 226.6 |  | 225.4 |
| Real estate | 1.4 |  | 1.3 |  | 1.3 |
| General account | 237.7 |  | 232.1 |  | 230.5 |
| Total assets under management | \$ 670.2 | \$ | 619.1 | \$ | 599.4 |


|  | Three Months Ended September 30, |  |  | Nine Months Ended September 30, |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2012 |  | 011 | 2012 |  | 2011 |
|  | (in billions) |  |  |  |  |  |
| Net additions (withdrawals), excluding money market activity: |  |  |  |  |  |  |
| Third Party: |  |  |  |  |  |  |
| Institutional customers(4) | \$ 3.4 | \$ | 2.1 | \$ 8.8 | \$ | 13.0 |
| Retail customers | 1.7 |  | 0.5 | 8.7 |  | 2.3 |
| Affiliated: |  |  |  |  |  |  |
| Institutional customers | 0.3 |  | (0.3) | (1.2) |  | (2.0) |
| Retail customers | (5.5) |  | 14.0 | (7.6) |  | 14.4 |
| General account(5) | (0.7) |  | 1.8 | (2.0) |  | 14.7 |
| Total net additions (withdrawals), excluding money market activity | \$ (0.8) | \$ | 18.1 | \$ 6.7 | \$ | 42.4 |

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(1) Consists of third-party institutional assets and group insurance contracts.
(2) As of September 30, 2012, December 31, 2011 and September 30, 2011, includes $\$ 34.8$ billion, $\$ 29.7$ billion and $\$ 26.1$ billion, respectively, of assets under management related to investment-only stable value products.
(3) Consists of: (a) individual mutual funds and both variable annuities and variable life insurance assets in our separate accounts; (b) funds invested in proprietary mutual funds through our defined contribution plan products; and (c) third-party sub-advisory relationships. Fixed annuities and the fixed-rate accounts of both variable annuities and variable life insurance are included in the general account.
(4) Three months ended September 30, 2012 and 2011, includes $\$ 0.6$ billion and $\$ 1.9$ billion, respectively, and the nine months ended September 30 , 2012 and 2011 , includes $\$ 4.1$ billion and $\$ 7.2$ billion, respectively, of net additions related to investment-only stable value products.
(5) The nine months ended September 30, 2011 includes $\$ 15.2$ billion in net additions from the acquisition of the Star and Edison Businesses.

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Assets under management increased $\$ 51.1$ billion from December 31, 2011 to September 30, 2012. Institutional assets under management increased $\$ 31.1$ billion from December 31, 2011 to September 30, 2012 driven by market appreciation of $\$ 23.2$ billion, as well as net additions of $\$ 8.8$ billion from third-party clients from positive flows into fixed income accounts, including $\$ 4.1$ billion of net additions associated with investment-only stable value products. Retail assets under management increased $\$ 14.4$ billion from December 31, 2011 to September 30, 2012 driven by market appreciation of $\$ 12.9$ billion, net additions of $\$ 8.7$ billion from third-party clients from positive flows into both fixed income and equity accounts, partially offset by net affiliated withdrawals of $\$ 7.6$ billion primarily from assets being transferred out of a fixed income fund due to the automatic rebalancing feature within certain variable annuity products. General account assets increased $\$ 5.6$ billion due largely to market appreciation of $\$ 10.1$ billion partially offset by net withdrawals primarily from fixed income funds.

Assets under management increased $\$ 70.8$ billion from September 30, 2011 to September 30, 2012. Institutional assets under management increased $\$ 41.4$ billion from September 30, 2011 to September 30, 2012 driven by market appreciation of $\$ 30.3$ billion, as well as net additions of $\$ 12.5$ billion from third-party clients, primarily from positive flows into fixed income accounts, including $\$ 6.9$ billion of net additions associated with investment-only stable value products. Retail assets under management increased $\$ 22.2$ billion from September 30, 2011 to September 30, 2012 from market appreciation of $\$ 19.7$ billion, net additions of $\$ 9.9$ billion from third-party clients primarily from positive flows into fixed income and equity accounts offset by net affiliated withdrawals of $\$ 7.5$ billion primarily from assets being transferred out of a fixed income fund due to the automatic rebalancing feature within certain variable annuity products. General account assets increased $\$ 7.2$ billion driven by market appreciation of $\$ 13.1$ billion offset by net withdrawals primarily from fixed income funds.

## Strategic Investments

The following table sets forth the strategic investments of the Asset Management segment at carrying value (including the value of derivative instruments used to mitigate equity market and currency risk) by asset class and source as of the dates indicated.

|  | $\underset{2012}{\text { September 30, }}$ 2011 |  |  |
| :---: | :---: | :---: | :---: |
| Co-Investments: |  |  |  |
| Real estate | \$ 462 | \$ | 461 |
| Fixed income | 25 |  | 25 |
| Seed Investments: |  |  |  |
| Real estate | 31 |  | 20 |
| Public equity | 208 |  | 166 |
| Fixed income | 204 |  | 195 |
| Loans Secured by Investor Equity Commitments or Fund Assets: |  |  |  |
| Real estate secured by investor equity | 0 |  | 42 |
| Real estate secured by fund assets | 0 |  | 95 |
| Total | \$ 930 | \$ | 1,004 |

In addition to the strategic investments above, the Asset Management segment s commercial mortgage operations maintains an interim loan portfolio. See General Account Investments Invested Assets of Other Entities and Operations Fixed Maturity Securities-Invested Assets of Other Entities and Operations Commercial Mortgage and Other Loans below for additional details.

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## U.S. Individual Life and Group Insurance Division

## Individual Life

## Operating Results

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

|  | Three Months Ended September 30, |  |  | Nine Months Ended September 30, |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2012 |  | 2011 | 2012 |  | 2011 |
|  | (in millions) |  |  |  |  |  |
| Operating results: |  |  |  |  |  |  |
| Revenues | \$ 948 |  | 643 | \$ 2,527 |  | 2,131 |
| Benefits and expenses | 836 |  | 532 | 2,242 |  | 1,787 |
| Adjusted operating income | 112 |  | 111 | 285 |  | 344 |
| Realized investment gains (losses), net, and related adjustments(1) | 13 |  | (44) | 36 |  | (46) |
| Income from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ 125 | \$ | 67 | \$ 321 |  | 298 |

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

Adjusted Operating Income

2012 to 2011 Three Month Comparison. Adjusted operating income for the third quarter of 2012 was relatively unchanged from the third quarter of 2011. Adjusted operating income includes $\$ 27$ million of net charges and $\$ 27$ million of net benefits in the third quarter of 2012 and 2011, respectively, reflecting the impact of certain changes in our estimated profitability of the business resulting from our annual review and update of economic and actuarial assumptions. This annual review covers assumptions used in our estimate of total gross profits which forms the basis for amortizing DAC and unearned revenue reserves ( URR ), as well as establishing the reserve for the GMDB feature in certain contracts. The $\$ 27$ million net charge in the third quarter of 2012 primarily reflects reductions to our long-term interest rate and equity return assumptions, which resulted in adjustments increasing both the amortization of DAC and URR and increasing the reserves for the GMDB features in certain contracts. The $\$ 27$ million net benefit in the third quarter of 2011 primarily reflects more favorable lapse and mortality experience.

Absent the effect of these items, adjusted operating income for the third quarter of 2012 increased $\$ 55$ million from the third quarter of 2011 driven by improved mortality experience, net of reinsurance, of $\$ 38$ million, which was favorable relative to expected levels in the current period and was unfavorable relative to expected levels in the third quarter of 2011. The increase in adjusted operating income also reflects a $\$ 17$ million benefit resulting from changes in our estimates of total gross profits arising from separate account fund performance that impacted the amortization of DAC and other costs. This benefit largely reflects the impact of equity markets on separate account fund performance in the respective periods. Higher than expected market returns in the third quarter of 2012 resulted in a net benefit of $\$ 2$ million compared to lower

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than expected market returns in the third quarter of 2011 which resulted in a $\$ 15$ million net expense.

For weighted average rate of return assumptions as of September 30, 2012 see Accounting Policies \& Pronouncements Application of Critical Accounting Estimates. For additional information on our policy for amortizing DAC and URR, and for estimating future expected claims costs associated with the GMDB feature of our variable insurance products, see our Annual Report on Form 10-K for the year ended December 31, 2011, under Management s Discussion and Analysis of Financial Condition and Results of Operations Accounting Policies \& Pronouncements Application of Critical Accounting Estimates.

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2012 to 2011 Nine Month Comparison. Adjusted operating income decreased $\$ 59$ million, from $\$ 344$ million in the first nine months of 2011 to $\$ 285$ million in the first nine months of 2012. Adjusted operating income includes $\$ 27$ million of net charges and $\$ 27$ million of net benefits in the first nine months of 2012 and 2011, respectively, reflecting the impact of certain changes in our estimated profitability of the business related to our annual review and update of economic and actuarial assumptions, as discussed above. Absent the effect of these items, adjusted operating income for the first nine months of 2012 decreased $\$ 5$ million from the first nine months of 2011 driven by mortality experience, net of reinsurance, of $\$ 16$ million, which was more unfavorable relative to expected levels in the current period, compared to the first nine months of 2011. The decrease in adjusted operating income also reflects an $\$ 11$ million charge in the first quarter of 2012 related to the correction of a delay in the execution of certain client mutual fund transactions. These unfavorable items were partially offset by a $\$ 20$ million benefit resulting from changes in our estimates of total gross profits arising from separate account fund performance that impacted the amortization of DAC and other costs. This largely reflects the impact of equity markets on separate account fund performance in the respective periods. Higher than expected market returns in the first nine months of 2012 resulted in a net benefit of $\$ 6$ million compared to lower than expected market returns in the first nine months of 2011 which resulted in a $\$ 14$ million net expense.

## Revenues

2012 to 2011 Three Month Comparison. Revenues, as shown in the table above under Operating Results, increased $\$ 305$ million, from $\$ 643$ million in the third quarter of 2011 to $\$ 948$ million in the third quarter of 2012. Policy charges and fees and asset management fees and other income increased $\$ 290$ million including a $\$ 246$ million increase in amortization of URR reflecting the impact of our annual reviews and update of economic and actuarial assumptions. Absent this item, policy charges and fees and asset management fees and other income increased $\$ 44$ million, primarily driven by $\$ 24$ million of income on an affiliated note received as part of a financing transaction for certain regulatory capital requirements, which is offset by higher interest expense as described below. Also included in policy charges and fees and asset management fees and other income was an increase driven by growth in our universal life insurance business and higher income from alternative investments, partially offset by the ongoing impact of run-off of variable life insurance in force. Partially offsetting these favorable items was a $\$ 26$ million decrease in amortization of URR due to changes in our estimates of total gross profits primarily reflecting the impact of favorable market conditions on separate account fund performance in the third quarter of 2012 compared to unfavorable market conditions in the prior year period. Net investment income increased $\$ 13$ million reflecting business growth, partially offset by the impact of lower portfolio reinvestment rates.

2012 to 2011 Nine Month Comparison. Revenues increased $\$ 396$ million, from $\$ 2,131$ million in the first nine months of 2011 to $\$ 2,527$ million in the first nine months of 2012. Policy charges and fees and asset management fees and other income increased $\$ 349$ million including a $\$ 246$ million increase in amortization of URR reflecting the impact of our annual reviews and update of economic and actuarial assumptions. Absent this item, policy charges and fees and asset management fees and other income increased $\$ 103$ million, primarily driven by $\$ 72$ million of income on an affiliated note received as part of a financing transaction for certain regulatory capital requirements, which is offset by higher interest expense as described below. The increase in policy charges and fees and asset management fees and other income also reflects growth in our universal life insurance business and higher income from alternative investments, partially offset by the ongoing impact of run-off of variable life insurance in force. These favorable items were partially offset by the impact of a $\$ 31$ million decrease in amortization of URR due to changes in our estimates of total gross profits primarily reflecting the impact of favorable market conditions on separate account fund performance in the current year period compared to unfavorable market conditions in the prior year period. Net investment income increased $\$ 42$ million reflecting business growth, partially offset by the impact of lower portfolio reinvestment rates.

## Benefits and Expenses

2012 to 2011 Three Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, increased $\$ 304$ million, from $\$ 532$ million in the third quarter of 2011 to $\$ 836$ million in the third quarter of 2012. Absent the impact of annual reviews conducted in the third quarter of both periods,

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benefits and expenses increased $\$ 4$ million, from $\$ 684$ million in the third quarter of 2011 to $\$ 688$ million in the third quarter of 2012. The increase in benefits and expenses includes higher interest expense of $\$ 32$ million reflecting higher costs associated with the financing of regulatory capital requirements, of which, $\$ 24$ million related to a financing transaction associated with certain universal life insurance policies is offset in revenues. The increase in benefits and expenses was partially offset by a $\$ 20$ million decrease in DAC amortization driven by changes in estimated total gross profits primarily reflecting the impact of favorable market conditions on separate account fund performance in the current year period compared to unfavorable market conditions in the prior year period. In addition, insurance and annuity benefits, including interest credited to policyholders account balances, decreased $\$ 13$ million primarily driven by improved mortality experience, net of reinsurance, of $\$ 38$ million, relative to expected levels, partially offset by an increase in interest credited to policyholders from higher universal life account balances from policyholder deposits and an increase in policyholder reserves driven by growth in our term and universal life blocks of business.

2012 to 2011 Nine Month Comparison. Benefits and expenses increased $\$ 455$ million, from $\$ 1,787$ million in the first nine months of 2011 to $\$ 2,242$ million in the first nine months of 2012. Absent the impact of annual reviews conducted in the third quarter of both periods, benefits and expenses increased $\$ 155$ million, from $\$ 1,939$ million in the first nine months of 2011 to $\$ 2,094$ million in the first nine months of 2012 . The increase in benefits and expenses includes higher interest expense of $\$ 94$ million reflecting higher costs associated with the financing of regulatory capital requirements, of which, $\$ 72$ million related to a financing transaction associated with certain universal life insurance policies is offset in revenues. Insurance and annuity benefits, including interest credited to policyholders account balances, increased $\$ 79$ million primarily driven by $\$ 44$ million higher policyholder benefits including more unfavorable mortality experience, net of reinsurance, of $\$ 16$ million, relative to expected levels, an increase in interest credited to policyholders from higher universal life account balances from policyholder deposits and an increase in policyholder reserves driven by growth in our term and universal life blocks of business. These unfavorable items were partially offset by a $\$ 32$ million decrease in DAC amortization primarily reflecting the impact of favorable market conditions on separate account fund performance in the current year period compared to unfavorable market conditions in the prior year period.

## Sales Results

The following table sets forth individual life insurance annualized new business premiums for the periods indicated. In managing our individual life insurance business, we analyze annualized new business premiums, which do not correspond to revenues under U.S. GAAP, because annualized new business premiums measure 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, in addition to current sales. Annualized new business premiums include $10 \%$ of first year excess premiums and deposits.

(1) Annualized scheduled premiums plus $10 \%$ of excess (unscheduled) and single premiums from new sales. Excludes corporate-owned life insurance.

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2012 to 2011 Three Month Comparison. Sales of new life insurance, measured as described above, increased $\$ 28$ million, from $\$ 70$ million in the third quarter of 2011 to $\$ 98$ million in the third quarter of 2012, primarily driven by increased sales in the third party distribution channel. This reflected a $\$ 31$ million increase in sales of universal life insurance products driven by a change in the competitive position of our products, partially offset by a $\$ 4$ million decrease in variable life insurance product sales.

2012 to 2011 Nine Month Comparison. Sales of new life insurance, measured as described above, increased $\$ 65$ million, from $\$ 203$ million in the first nine months of 2011 to $\$ 268$ million in the first nine months of 2012 , primarily driven by increased sales in the third party distribution channel. This primarily resulted from a $\$ 73$ million increase in sales of universal life insurance products, driven by a change in the competitive position of our products.

## 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 expected profitability. Generally, our term life insurance products do not provide for cash surrender values.

|  | Three Months Ended September 30, |  |  | Nine Months Ended September 30, |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2012 |  | 11 | 2012 |  | 11 |
|  | (\$ in millions) |  |  |  |  |  |
| Cash value of surrenders | \$ 165 | \$ | 148 | \$ 489 | \$ | 623 |
| Cash value of surrenders as a percentage of mean future policy benefit |  |  |  |  |  |  |
| reserves, policyholders account balances, and separate account balances | 2.6\% |  | 2.5\% | 2.7\% |  | 3.6\% |

2012 to 2011 Three Month Comparison. The total cash value of surrenders increased $\$ 17$ million, from $\$ 148$ million in the third quarter of 2011 to $\$ 165$ million in the third quarter of 2012 . The level of surrenders as a percentage of mean future policy benefit reserves, policyholders account balances and separate account balances for the third quarter of 2012 was relatively unchanged from the third quarter of 2011.

2012 to 2011 Nine Month Comparison. The total cash value of surrenders decreased $\$ 134$ million, from $\$ 623$ million in the first nine months of 2011 to $\$ 489$ million in the first nine months of 2012, driven by the surrenders of three large variable corporate-owned life insurance policies during 2011. The level of surrenders as a percentage of mean future policy benefit reserves, policyholders account balances and separate account balances decreased from $3.6 \%$ in the first nine months of 2011 to $2.7 \%$ in the first nine months of 2012 as a result of these large surrenders.

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## Group Insurance

## Operating Results

The following table sets forth the Group Insurance segment s operating results for the periods indicated.

|  | Three Months Ended <br> September 30, <br> $\mathbf{2 0 1 1}$ <br> (in millions) | Nine Months Ended <br> September 30, <br> 2012 |
| :--- | :---: | :---: | :---: | :---: | :---: |
| 2011 |  |  |

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

## Adjusted Operating Income

2012 to 2011 Three Month Comparison. Adjusted operating income decreased $\$ 10$ million, from $\$ 45$ million in the third quarter of 2011 to $\$ 35$ million in the third quarter of 2012. Reserve refinements in both group life and disability businesses, including the impact of annual actuarial assumption updates, contributed a $\$ 7$ million benefit to adjusted operating income in the third quarter of 2012 compared to a benefit of $\$ 22$ million in the third quarter of 2011. Excluding the impact of these reserve refinements, adjusted operating income increased $\$ 5$ million reflecting improved investment income in the third quarter of 2012 primarily from alternative investments and mortgage loan prepayments. Underwriting results in the third quarter of 2012 for our group life business partially offset this increase reflecting less favorable claims experience in our non-retrospectively experience-rated contracts, primarily driven by increased severity, largely offset by lower claims incidence. Results for our group disability business were relatively unchanged from the third quarter of 2011.

2012 to 2011 Nine Month Comparison. Adjusted operating income decreased $\$ 93$ million, from $\$ 121$ million in the first nine months of 2011 to $\$ 28$ million in the first nine months of 2012. Reserve refinements in both group life and disability businesses, including the impact of annual actuarial assumption updates, contributed a $\$ 7$ million benefit to adjusted operating income in the first nine months of 2012 compared to a benefit of $\$ 22$ million in the first nine months of 2011. In addition, updates to premium tax estimates provided a $\$ 17$ million unfavorable impact to the results for the first nine months of 2012 as compared to the first nine months of 2011. Excluding the impact of these reserve refinements and premium tax updates, adjusted operating income decreased $\$ 61$ million reflecting less favorable underwriting results in our group disability business primarily related to an increase in the number and severity of long-term disability claims reflecting the continued distressed economic

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conditions. The decrease in adjusted operating income also reflects higher general and administrative expenses in the first nine months of 2012 driven by higher operating costs. Additionally, results for the first nine months of 2012 in our group life business reflects unfavorable claims experience on non-retrospectively experience-rated contracts resulting from an increase in severity in the first quarter of 2012, as compared to a benefit of $\$ 9$ million in the first nine months of 2011 from a cumulative premium adjustment relating to prior periods on a non-retrospectively experience-rated case. Partially offsetting these decreases was improved investment income in the first nine months of 2012.

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## Revenues

2012 to 2011 Three Month Comparison. Revenues, as shown in the table above under Operating Results, decreased $\$ 27$ million, from $\$ 1,447$ million in the third quarter of 2011 to $\$ 1,420$ million in the third quarter of 2012 . Group life premiums and policy charges and fee income decreased $\$ 54$ million, from $\$ 1,064$ million in the third quarter of 2011 to $\$ 1,010$ million in the third quarter of 2012 reflecting lower premiums from retrospectively experience-rated contracts resulting from the decrease in policyholder benefits on these contracts, as discussed below. In addition, persistency declined from $96.2 \%$ in the third quarter of 2011 to $94.5 \%$ in the third quarter of 2012 . Partially offsetting this decrease are higher premiums from non-retrospectively experience-rated contracts resulting from growth in the business.

Additionally, group disability premiums and policy charges and fee income increased $\$ 13$ million, from $\$ 218$ million in the third quarter of 2011 to $\$ 231$ million in the third quarter of 2012 reflecting growth of in force business and new sales. Investment income also increased in the third quarter of 2012 primarily from income on alternative investments, mortgage loan prepayments and higher invested assets, due to business growth, partially offset by a decline in reinvestment rates.

2012 to 2011 Nine Month Comparison. Revenues, as shown in the table above under Operating Results, decreased $\$ 19$ million, from $\$ 4,222$ million in the first nine months of 2011 to $\$ 4,203$ million in the first nine months of 2012 . Group life premiums and policy charges and fee income decreased $\$ 77$ million, from $\$ 3,066$ million in the first nine months of 2011 to $\$ 2,989$ million in the first nine months of 2012 primarily driven by lower premiums from retrospectively experience-rated contracts resulting from the decrease in policyholder benefits on these contracts, as discussed below. Partially offsetting this decrease are higher premiums from non-retrospectively experience-rated contracts resulting from growth in the business, partially offset by a $\$ 9$ million benefit from a cumulative premium adjustment related to prior periods on a large group life non-retrospectively experience-rated case, as discussed above.

Additionally, group disability premiums and policy charges and fee income increased $\$ 34$ million, from $\$ 659$ million in the first nine months of 2011 to $\$ 693$ million in the first nine months of 2012 reflecting growth of in force business and new sales. In addition, investment income increased in the first nine months of 2012 reflecting higher income from alternative investments, mortgage loan prepayments and higher invested assets, due to business growth, partially offset by a decline in reinvestment rates.

## Benefits and Expenses

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

|  | Three Months Ended September 30, |  | Nine Months Ended September 30, |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2012 | 2011 | 2012 | 2011 |
| Benefits ratio(1): |  |  |  |  |
| Group life | 90.7\% | 89.3\% | 91.5\% | 90.6\% |
| Group disability | 93.9\% | 94.0\% | 97.8\% | 91.5\% |
| Administrative operating expense ratio(2): |  |  |  |  |
| Group life | 9.2\% | 8.7\% | 9.4\% | 8.3\% |
| Group disability | 23.8\% | 25.2\% | 24.3\% | 24.6\% |

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

2012 to 2011 Three Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, decreased $\$ 17$ million, from $\$ 1,402$ million in the third quarter of 2011 to $\$ 1,385$ million in the third quarter of 2012 . This decrease reflects a $\$ 22$ million decline in policyholders benefits, including the

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change in policy reserves, from $\$ 1,156$ million in the third quarter of 2011 to $\$ 1,134$ million in the third quarter of 2012 . Our group life business reflects a decrease in benefit costs from retrospectively experience-rated contracts that resulted in decreased premiums, as discussed above. Partially offsetting this decrease are greater benefit costs on non-retrospectively experience-rated business due to less favorable claims experience, as well as the unfavorable variance from reserve refinements, reflecting the impact of annual actuarial assumption updates, as discussed above. Our group disability business reflects an increase in policyholders benefits primarily from an increase in the number and severity of long-term disability claims partially offset by an increase in claim terminations.

The group life benefits ratio deteriorated 1.4 percentage points from the third quarter of 2011 to the third quarter of 2012 primarily due to less favorable claims experience in the non-retrospectively experience-rated business and the unfavorable variance from reserve refinements, reflecting the impact of annual actuarial assumption updates, as discussed above. The group disability benefits ratio was relatively unchanged from the third quarter of 2011. The group life administrative operating expense ratio deteriorated 0.5 percentage points from the third quarter of 2011 to the third quarter of 2012 primarily due to an increase in operating costs. The group disability administrative operating expense ratios improved 1.4 percentage points from the third quarter of 2011 to the third quarter of 2012 primarily due to an increase in premiums from business growth.

2012 to 2011 Nine Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, increased $\$ 74$ million, from $\$ 4,101$ million in the first nine months of 2011 to $\$ 4,175$ million in the first nine months of 2012. This increase reflects a $\$ 32$ million increase in policyholders benefits, including the change in policy reserves, from $\$ 3,383$ million in the first nine months of 2011 to $\$ 3,415$ million in the first nine months of 2012. Our group disability business reflects an increase in policyholders benefits primarily from an increase in the number and severity of long-term disability claims and growth in the business. Also contributing to the increase in benefits and expenses are higher general and administrative expenses driven by higher costs, primarily related to premium tax estimates, as discussed above. Our group life business reflects a decrease in benefit costs primarily from retrospectively experience-rated contracts that resulted in decreased premiums, as discussed above. This was partially offset by unfavorable claims experience from an increase in severity in the first quarter of 2012 and an increase in benefits from growth in the non-retrospectively experience-rated business, as well as the unfavorable variance from reserve refinements, reflecting the impact of annual actuarial assumption updates, as discussed above.

The group life benefits ratio deteriorated 0.9 percentage points from the first nine months of 2011 to the first nine months of 2012, primarily due to unfavorable claims experience reflecting an increase in severity in the first quarter of 2012, partially offset by lower claim incidence on non-retrospectively experience-related contracts. The group disability benefits ratio deteriorated 6.3 percentage points from the first nine months of 2011 to the first nine months of 2012 primarily due to an increase in the number and severity of long-term disability claims. The group life administrative operating expense ratio deteriorated 1.1 percentage points from the first nine months of 2011 to the first nine months of 2012 primarily due to the unfavorable comparative impact of updates to premium tax estimates and an increase in operating costs. The group disability administrative operating expense ratio was relatively unchanged from the first nine months of 2011.

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Sales Results

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

|  | Three Months Ended <br> September 30, <br> $\mathbf{2 0 1 1}$ | Nine Months Ended <br> September 30, <br> (in millions) |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| 2012 |  |  |  |

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

2012 to 2011 Three Month Comparison. Total annualized new business premiums increased $\$ 6$ million, from $\$ 40$ million in the third quarter of 2011 to $\$ 46$ million in the third quarter of 2012 resulting from increased long-term disability sales to existing clients, partially offset by lower premiums in group life associated with the assumption of existing liabilities from third parties.

2012 to 2011 Nine Month Comparison. Total annualized new business premiums decreased $\$ 185$ million, from $\$ 566$ million in the first nine months of 2011 to $\$ 381$ million in the first nine months of 2012 primarily driven by group life sales reflecting the impact of a large market case sale to a new customer in the first nine months of 2011. Group disability sales were relatively unchanged.

## International Insurance Division

## Foreign Currency Exchange Rate Movements and Related Hedging Strategies

As a U.S.-based company with significant business operations outside the U.S., particularly in Japan, we are subject to foreign currency exchange rate movements that could impact our U.S. dollar-equivalent shareholder return on equity. We seek to mitigate this impact through various hedging strategies, including the use of derivative contracts and through holding U.S. dollar-denominated assets in certain of our foreign subsidiaries.

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The operations of our International Insurance Division are subject to currency fluctuations that can materially affect their U.S. dollar-equivalent earnings from period to period, even if earnings on a local currency basis are relatively constant. We enter into forward currency derivative contracts, and hold dual currency and synthetic dual currency investments, as part of our strategy to effectively fix the currency exchange rates for a portion of our prospective non-U.S. dollar-denominated earnings streams, thereby reducing earnings volatility from foreign currency exchange rate movements. The forward currency hedging program is primarily associated with our insurance operations in Japan and Korea. In addition, our Japanese insurance operations offer a variety of non-yen denominated products which are supported by investments in corresponding currencies. While these non-yen denominated assets and liabilities are economically hedged, the accounting for changes in the value of these assets and liabilities due to changes in foreign currency exchange rate movements differs, resulting in volatility in reported U.S. GAAP earnings. For further information on the various hedging strategies used to mitigate the risks of foreign currency exchange rate movements on earnings, see Impact of foreign currency exchange rate movements on earnings.

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In the second quarter of 2012, we refined our yen hedging strategy to calibrate the level of hedges to preserve the relative contribution of the yen-based business to the Company s overall return on equity. This refinement did not result in a material change to the aggregate level of income and equity hedges that existed under the previous hedging strategy. Our existing hedges include a variety of instruments, including U.S. dollar-denominated assets held locally by our Japanese insurance subsidiaries financed by the combination of U.S. GAAP equity and yen-denominated liabilities. We may also hedge using instruments held in our U.S. domiciled entities, such as U.S. dollar-denominated debt that has been swapped to yen.

The table below presents the aggregate amount of instruments that serve to hedge the impact of foreign currency exchange movements on our U.S. dollar-equivalent shareholder return on equity from our Japanese insurance subsidiaries for the periods indicated.
$\left.\begin{array}{l|cc|} & \begin{array}{c}\text { September 30, } \\ \mathbf{2 0 1 2} \\ \text { (in billions) }\end{array} \\ \mathbf{2 0 1 1}\end{array}\right)$
(1) Represents the notional amount of forward currency contracts outstanding.
(2) Represents the present value of future cash flows, on a U.S. dollar-denominated basis.
(3) Excludes $\$ 26.4$ billion and $\$ 23.7$ billion as of September 30, 2012 and December 31, 2011, respectively, of U.S. dollar assets supporting U.S. dollar liabilities related to U.S. dollar-denominated products issued by our Japanese insurance operations.
(4) The yen-denominated liabilities are reported in Corporate and Other operations.
(5) Excludes Accumulated other comprehensive income (loss) components of equity and certain other adjustments.

The U.S. dollar-denominated investments that hedge the U.S. dollar-equivalent shareholder return on equity from our Japanese insurance operations are recorded on the books of yen-based entities and, as a result, foreign currency exchange rate movements will impact their value. To the extent the value of the yen strengthens as compared to the U.S. dollar, the value of these U.S. dollar-denominated investments will decrease. We seek to mitigate the risk that future unfavorable foreign currency exchange rate movements will decrease the value of our U.S. dollar-denominated investments and negatively impact the equity of, and therefore, the local solvency margins of, our yen-based entities by employing internal hedging strategies between a subsidiary of Prudential Financial and certain of our yen-based entities. These have the economic effect of moving the hedges from our Japanese yen-based entities to our U.S. dollar-based entities. See Liquidity and Capital Resources Liquidity and Capital Resources of Subsidiaries International Insurance Subsidiaries for a discussion of our internal hedging strategies.

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These U.S. dollar-denominated investments also pay a coupon which is generally higher than what a similar yen-denominated investment would pay. The incremental impact of this higher yield on our U.S. dollar-denominated investments, as well as our dual currency and synthetic dual currency investments discussed below, will vary over time, and is dependent on the duration of the underlying investments, as well as interest rate environments in the U.S. and Japan at the time of the investments. See General Account Investments Investment Results for a discussion of the investment yields generated by our Japanese insurance operations.

## Impact of foreign currency exchange rate movements on earnings

Forward currency hedging program

The financial results of our International Insurance segment for all periods presented reflect the impact of an intercompany arrangement with Corporate and Other operations pursuant to which the segment s non-U.S. dollar-denominated earnings in certain countries are translated at fixed currency exchange rates. The fixed rates are determined in connection with a foreign currency income hedging program designed to mitigate the impact of exchange rate changes on the segment s U.S. dollar-equivalent earnings. Pursuant to this program, Corporate and Other operations execute forward currency contracts with third parties to sell the net exposure of projected earnings from the hedged currency in exchange for U.S. dollars at specified exchange rates. 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. In establishing the level of non-U.S. dollar-denominated earnings that will be hedged through this program, we exclude the anticipated level of U.S. dollar-denominated earnings that will be generated by dual currency and synthetic dual currency investments, as well as the anticipated level of U.S. dollar-denominated earnings that will be generated by U.S. dollar-denominated products and investments, both of which are discussed in greater detail below. As a result of this intercompany arrangement, our International Insurance segment results for 2011 reflect the impact of translating yen and Korean won-denominated earnings at fixed currency exchange rates of 92 yen per U.S. dollar and 1190 Korean won per U.S. dollar. Results for 2012 reflect the impact of translating yen and Korean won-denominated earnings at fixed currency exchange rates of 85 yen per U.S. dollar and 1180 Korean won per U.S. dollar.

Results of Corporate and Other operations include any differences between the translation adjustments recorded by the segment at the fixed currency exchange rate versus the actual average rate during the period, and the gains or losses recorded from the forward currency contracts that settled during the period, which include the impact of any over or under hedging of actual earnings that differ from projected earnings. The table below presents, for the periods indicated, the increase (decrease) to revenues and adjusted operating income for the International Insurance segment and for Corporate and Other operations, reflecting the impact of this intercompany arrangement.

|  | Three Months Ended <br> September 30, <br> $\mathbf{2 0 1 1}$ | Nine Months Ended <br> September 30, <br> 2011 <br> 2012 <br> (in millions) |
| :--- | :---: | :---: | :---: | :---: | :---: |
| (in millions) |  |  |

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(1) Represents the difference between non-U.S. dollar-denominated earnings translated on the basis of weighted average monthly currency exchange rates versus fixed currency exchange rates determined in connection with the forward currency hedging program.

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As of September 30, 2012 and December 31, 2011, the notional amounts of these forward currency contracts were $\$ 3.6$ billion and $\$ 3.0$ billion, respectively, of which $\$ 3.0$ billion and $\$ 2.5$ billion, respectively, were related to our Japanese insurance operations.

## Dual currency and synthetic dual currency investments hedging program

In addition, our Japanese insurance operations hold dual currency investments in the form of fixed maturities and loans. The principal of these dual currency investments is yen-denominated while the related interest income is U.S. dollar-denominated. These investments are the economic equivalent of exchanging what would otherwise be fixed streams of yen-denominated interest income for fixed streams of U.S.
dollar-denominated interest income. Our Japanese insurance operations also hold yen-denominated investments that have been coupled with cross-currency coupon swap agreements, creating synthetic dual currency investments. The yen/U.S. dollar exchange rate is effectively fixed, as we are obligated in future periods to exchange fixed amounts of yen interest payments generated by the yen-denominated investments for fixed amounts of U.S. dollar interest payments at the yen/U.S. dollar exchange rates specified by the cross-currency coupon swap agreements. As of September 30, 2012 and December 31, 2011, the notional amount of these investments was $¥ 237$ billion, or $\$ 2.2$ billion, and $¥ 280$ billion, or $\$ 2.5$ billion, respectively, based upon the foreign currency exchange rates applicable at the time these investments were acquired. The weighted average yields generated by these investments were $3.4 \%$ for both the three and nine months ended September 30, 2012, and $2.9 \%$ and $3.0 \%$ for the three and nine months ended September 30, 2011, respectively.

Below is the fair value of these instruments as reflected on our balance sheet for the periods indicated.
$\left.\begin{array}{lccc} & \begin{array}{c}\text { September 30, } \\ \text { 2012 }\end{array} & \begin{array}{c}\text { December 31, } \\ \text { 2011 }\end{array} \\ \text { (in millions) }\end{array}\right)$

## U.S. GAAP earnings impact of products denominated in non-local currencies

Our international insurance operations primarily offer products denominated in local currency. However, several of our international insurance operations, most notably our Japanese operations, also offer products denominated in non-local currencies, primarily comprised of U.S. and Australian dollar-denominated products. The non-yen denominated insurance liabilities related to these products are supported by investments denominated in corresponding currencies, including a significant portion designated as available-for-sale. While these non-yen denominated assets and liabilities are economically hedged, the accounting for changes in the value of these assets and liabilities due to changes in foreign currency exchange rate movements differs, resulting in volatility in U.S. GAAP earnings. For example, unrealized gains and losses on available-for-sale investments, including those arising from foreign currency exchange rate movements, are recorded in Accumulated other comprehensive income (loss), whereas the non-yen denominated liabilities are remeasured for foreign currency exchange rate movements, and the related changes in value are recorded in earnings within Asset management fees and other income. Investments designated as held-to-maturity under U.S. GAAP, are recorded at amortized cost on the balance sheet, but are remeasured for foreign currency exchange rate movements, with the related change in value recorded in earnings within Asset management fees and other income. Due to this non-economic volatility that is reflected in U.S. GAAP earnings, the gains and losses resulting from the remeasurement of these non-yen denominated liabilities, and certain related non-yen denominated assets, are excluded from adjusted operating income and included in Realized investment gains (losses), net, and related adjustments. For the three and nine months ended September 30, 2012, Realized investment gains (losses), net, and related adjustments includes net losses of $\$ 384$ million and $\$ 191$ million, respectively, reflecting the remeasurement of these non-yen denominated insurance liabilities, which are presented in the table below, and the remeasurement of certain related non-yen denominated assets.

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These net losses were primarily driven by the weakening of the yen against both the Australian and U.S. dollar.

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The table below presents the carrying value of insurance liabilities related to products offered in non-local currencies within our Japanese insurance operations as of the periods indicated.
$\left.\begin{array}{lrrr} & \begin{array}{c}\text { September 30, } \\ \text { 2012 }\end{array} & \begin{array}{c}\text { December 31, } \\ \text { 2011 }\end{array} \\ \text { (in billions) }\end{array}\right)$

As of September 30, 2012 and December 31, 2011, $\$ 5.4$ billion and $\$ 4.5$ billion, respectively, of insurance liabilities for U.S. dollar-denominated products presented in the table above are associated with Prudential of Japan and coinsured to our U.S. domiciled insurance entities. These U.S. dollar-denominated liabilities are supported by U.S. dollar-denominated assets and are not subject to the remeasurement mismatch described above.

## International Insurance

Operating Results

The results of our International Insurance operations are translated on the basis of weighted average monthly exchange rates, inclusive of the effects of the intercompany arrangement discussed above. To provide a better understanding of operating performance within the International Insurance segment, where indicated below, we have analyzed our results of operations excluding the effect of the year over year change in foreign currency exchange rates. Our results of operations excluding the effect of foreign currency fluctuations were derived by translating foreign currencies to U.S. dollars at uniform exchange rates for all periods presented, including for constant dollar information discussed below. The exchange rates used were Japanese yen at a rate of 85 yen per U.S. dollar and Korean won at a rate of 1180 won per U.S. dollar, both of which were determined in connection with the foreign currency income hedging program discussed above. In addition, for constant dollar information discussed below, activity denominated in U.S. dollars is generally reported based on the amounts as transacted in U.S. dollars. Annualized new business premiums presented on a constant exchange rate basis in the Sales Results section below reflect translation based on these same uniform exchange rates.

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

|  | Three Months Ended <br> September 30, <br> $\mathbf{2 0 1 1}$ <br> (in millions) | Nine Months Ended <br> September 30, <br> $\mathbf{2 0 1 2}$ |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: |
| Operating results: <br> Revenues: <br> Life Planner operations <br> Gibraltar Life and Other operations |  |  |  |  |

(1) Revenues exclude Realized investment gains (losses), net, and related adjustments. Realized investment gains (losses), net, and related adjustments includes gains and losses from changes in value of certain assets and liabilities relating to foreign currency exchange movements that have been economically hedged, as discussed above. See Realized Investment Gains and Losses.
(2) Revenues exclude charges resulting from payments related to market value adjustment features of certain of our annuity products and the impact of Realized investment gains (losses), net, on the amortization of unearned revenue reserves. Benefits and expenses exclude charges that represent the element of Dividends to policyholders that is based on a portion of certain realized investment gains required to be paid to policyholders and the impact of Realized investment gains (losses), net, on the amortization of deferred policy acquisition costs.
(3) Revenues exclude net investment gains and losses on trading account assets supporting insurance liabilities. See Experience-Rated Contractholder Liabilities, Trading Account Assets Supporting Insurance Liabilities and Other Related Investments.
(4) Benefits and expenses exclude changes in contractholder liabilities due to asset value changes in the pool of investments supporting these experience-rated contracts. See Experience-Rated Contractholder Liabilities, Trading Account Assets Supporting Insurance Liabilities and Other Related Investments.
(5) Equity in earnings of operating joint ventures are included in adjusted operating income but excluded from income from continuing operations before income taxes and equity in earnings of operating joint ventures as they are reflected on a U.S. GAAP basis on an after-tax basis as a separate line in our Unaudited Interim Consolidated Statements of Operations. Earnings attributable to noncontrolling interests are excluded from adjusted operating income but included in income from continuing operations before taxes and equity earnings of operating joint ventures as they are reflected on a U.S. GAAP basis as a separate line in our Unaudited Interim Consolidated Statements of Operations. Earnings attributable to noncontrolling interests represent the portion of earnings from consolidated entities that relates to the equity interests of minority investors.

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Integration of Star and Edison

We have made significant progress integrating the acquired former Star and Edison businesses with Gibraltar Life and, as a result, have reduced our expected pre-tax integration costs by $\$ 50$ million and now anticipate incurring approximately $\$ 450$ million of total integration costs. In aggregate, we have incurred $\$ 303$ million of pre-tax integration costs, of which $\$ 174$ million was in 2011 and $\$ 129$ million was in the first nine months of 2012. After integration is complete, we continue to expect annual cost savings of approximately $\$ 250$ million, and to achieve two-thirds of the annual savings by the end of 2012. Actual integration costs may exceed, and actual cost savings may fall short of, such expectations.

## Adjusted Operating Income

2012 to 2011 Three Month Comparison. Adjusted operating income from our Life Planner operations increased $\$ 62$ million, from $\$ 331$ million in the third quarter of 2011 to $\$ 393$ million in the third quarter of 2012, including a net favorable impact of $\$ 14$ million from currency fluctuations. The current quarter includes a $\$ 20$ million benefit from a reduction in the amortization of deferred policy acquisition costs and lower reserves, reflecting the impact of our annual review and update of assumptions used in estimating the profitability of our business. Excluding the impact from these items, adjusted operating income of our Life Planner operations increased $\$ 28$ million driven by the continued growth of business in force, strong persistency in our Japanese Life Planner operations and, to a lesser extent, higher net spread earnings reflecting the impact of portfolio growth and crediting rate declines, offset by the impact of lower reinvestment rates.

Adjusted operating income from our Gibraltar Life and Other operations increased $\$ 61$ million, from $\$ 329$ million in the third quarter of 2011 to $\$ 390$ million in the third quarter of 2012, including a favorable impact of $\$ 13$ million from currency fluctuations. Integration costs relating to the acquisition of the Star and Edison Businesses were $\$ 34$ million in the current year quarter, reflecting a decrease of $\$ 9$ million from the prior year quarter. Adjusted operating income for both periods reflect the impact of partial sales of our investment, through a consortium, in China Pacific Group, which contributed a $\$ 60$ million benefit to the current quarter compared to an $\$ 84$ million benefit in the prior year quarter. As of September 30, 2012, the value of our indirect investment in China Pacific Group was $\$ 62$ million, including an unrealized gain of $\$ 48$ million. There are no restrictions on the consortium of investors from selling its remaining interest in China Pacific Group.

Excluding the effect of the items discussed above, adjusted operating income from our Gibraltar Life and Other operations increased \$63 million, primarily reflecting business growth across all distribution channels, as well as a $\$ 41$ million benefit from cost savings resulting from Star and Edison integration synergies in the current quarter compared to $\$ 6$ million in the year ago quarter. Additionally, adjusted operating income for the current quarter reflects greater contributions from investment results driven by favorable impacts from our equity method investments and portfolio growth, largely offset by lower yields on our investment portfolio compared to the prior year.

2012 to 2011 Nine Month Comparison. Adjusted operating income from Life Planner operations increased $\$ 203$ million, from $\$ 946$ million in the first nine months of 2011 to $\$ 1,149$ million in the first nine months of 2012, including a net favorable impact of $\$ 41$ million from currency fluctuations. The current quarter benefitted $\$ 20$ million from a reduction in the amortization of deferred policy acquisition costs and lower reserves, reflecting the impact of our annual review and update of assumptions used in estimating the profitability of our business. In addition, the increase in adjusted operating income includes a $\$ 19$ million benefit reflecting the comparative impact of a $\$ 13$ million charge in the 2011 period associated with estimated claims and expenses arising from the earthquake in Japan, and a $\$ 6$ million benefit in the current year period resulting from a cash distribution received from the Japan Financial Stability Fund. Excluding the impact of these items, adjusted operating income for our Life Planner operations increased $\$ 123$ million, primarily reflecting the growth of business in force driven by sales results and continued strong persistency in our Japanese Life Planner operations.

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Adjusted operating income from our Gibraltar Life and Other operations increased $\$ 79$ million, from $\$ 842$ million in the first nine months of 2011 to $\$ 921$ million in the first nine months of 2012, including a favorable impact of $\$ 35$ million from currency fluctuations. The increase in adjusted operating income reflects the absence of a $\$ 56$ million charge recognized in the prior year period associated with estimated claims and expenses arising from the 2011 earthquake in Japan, as well as a $\$ 33$ million benefit in the current year resulting from a cash distribution received from the Japan Financial Stability Fund. Partly offsetting these favorable variances is a $\$ 34$ million charge in the current year associated with an agreement entered into with DLF Ltd., or DLF, relating to our life insurance joint venture with DLF in India, for certain obligations to DLF in connection with the continuation of that venture with a potential new partner. Additionally, results for the first nine months of 2012 include $\$ 129$ million of integration costs relating to the acquisition of the Star and Edison Businesses, compared to $\$ 119$ million of integration and transaction costs in the prior year period. Both periods benefited from the impact of partial sales of our investment, through a consortium, in China Pacific Group, which contributed $\$ 60$ million in the current year period compared to $\$ 237$ million in the prior year period.

Excluding the effect of the items discussed above, adjusted operating income from our Gibraltar Life and Other operations increased \$176 million, primarily reflecting business growth across all distribution channels, including greater contributions from our cancer whole life products due to increased sales, and cost savings of $\$ 112$ million resulting from Star and Edison integration synergies, compared to $\$ 13$ million of cost savings in the year ago period. In addition, the current year benefit resulting from the impact of including two additional months of earnings from the former Star and Edison Businesses was largely offset by lower yields on our investment portfolio and higher policy benefits and expenses.

## Revenues

2012 to 2011 Three Month Comparison. Revenues, as shown in the table above under Operating Results, increased $\$ 3,049$ million, from $\$ 5,130$ million in the third quarter of 2011 to $\$ 8,179$ million in the third quarter of 2012, including a net favorable impact of $\$ 171$ million relating to currency fluctuations. Excluding the impact of currency fluctuations, revenues increased $\$ 2,878$ million, from $\$ 4,920$ million in the third quarter of 2011 to $\$ 7,798$ million in the third quarter of 2012.

Revenues from our Life Planner operations increased $\$ 161$ million, from $\$ 2,076$ million in the third quarter of 2011 to $\$ 2,237$ million in the third quarter of 2012, including a net unfavorable impact of $\$ 15$ million from currency fluctuations. Excluding the impact of currency fluctuations, revenues increased $\$ 176$ million, from $\$ 1,997$ million in the third quarter of 2011 to $\$ 2,173$ million in the third quarter of 2012. This increase in revenues came primarily from increases in premiums and policy charges and fee income of $\$ 130$ million driven by growth of business in force and continued strong persistency. Net investment income increased $\$ 46$ million primarily due to investment portfolio growth, partially offset by lower yields in our investment portfolio compared to the prior year period.

Revenues from our Gibraltar Life and Other operations increased $\$ 2,888$ million, from $\$ 3,054$ million in the third quarter of 2011 to $\$ 5,942$ million in the third quarter of 2012, including a net favorable impact of $\$ 186$ million from currency fluctuations. Excluding the impact of currency fluctuations, revenues increased $\$ 2,702$ million, from $\$ 2,923$ million in the third quarter of 2011 to $\$ 5,625$ million in the third quarter of 2012. This increase reflects a $\$ 2,671$ million increase in premiums and policy charges and fee income primarily driven by growth in the bank distribution channel, including $\$ 2,710$ million of higher premiums from sales of yen-denominated single premium whole life policies. Also contributing to the increase in revenues is higher net investment income of $\$ 72$ million primarily reflecting investment portfolio growth and favorable results from our equity method investments, partly offset by lower yields in comparison to the prior year quarter. Partially offsetting these increases is lower asset management fees and other income driven by the impact of partial sales, in both comparative periods, of our indirect investment in China Pacific Group, as discussed above.

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2012 to 2011 Nine Month Comparison. Revenues increased $\$ 5,960$ million, from $\$ 14,499$ million in the first nine months of 2011 to $\$ 20,459$ million in the first nine months of 2012, including a net favorable impact of $\$ 475$ million relating to currency fluctuations. Excluding the impact of currency fluctuations, revenues increased $\$ 5,485$ million, from $\$ 14,140$ million in the first nine months of 2011 to $\$ 19,625$ million in the first nine months of 2012.

Revenues from our Life Planner operations increased $\$ 629$ million, from $\$ 6,117$ million in the first nine months of 2011 to $\$ 6,746$ million in the first nine months of 2012, including a net favorable impact of $\$ 22$ million from currency fluctuations. Excluding the impact of currency fluctuations, revenues increased $\$ 607$ million, from $\$ 5,964$ million in the first nine months of 2011 to $\$ 6,571$ million in the first nine months of 2012. This increase in revenues came primarily from increases in premiums and policy charges and fee income of $\$ 469$ million driven by growth of business in force and continued strong persistency. Net investment income increased $\$ 117$ million primarily due to investment portfolio growth, partially offset by lower yields in our investment portfolio compared to the prior year period.

Revenues from our Gibraltar Life and Other operations increased $\$ 5,331$ million, from $\$ 8,382$ million in the first nine months of 2011 to $\$ 13,713$ million in the first nine months of 2012 , including a net favorable impact of $\$ 453$ million from currency fluctuations. Excluding the impact of currency fluctuations, revenues increased $\$ 4,878$ million, from $\$ 8,176$ million in the first nine months of 2011 to $\$ 13,054$ million in the first nine months of 2012. This increase reflects a $\$ 4,734$ million increase in premiums and policy charges and fee income reflecting growth in the bank distribution channel, including $\$ 3,865$ million of higher premiums from sales of yen-denominated single premium whole life policies, as well as higher renewal premiums of $\$ 760$ million in the Life Consultant distribution channel. Also contributing to the increase in revenues is higher net investment income of $\$ 308$ million primarily reflecting investment portfolio growth, partially offset by lower investment portfolio yields. Asset management fees and other income declined compared to the prior year period primarily driven by the impact of partial sales of our indirect investment in China Pacific Group, resulting in a $\$ 60$ million gain in the current year period compared to a $\$ 237$ million gain in the prior year period. This impact is partially offset by the $\$ 33$ million benefit related to the distribution received in the current year period from the Japan Financial Stability Fund.

## Benefits and Expenses

2012 to 2011 Three Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, increased $\$ 2,926$ million, from $\$ 4,470$ million in the third quarter of 2011 to $\$ 7,396$ million in the third quarter of 2012, including a net unfavorable impact of $\$ 144$ million related to currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased $\$ 2,782$ million, from $\$ 4,198$ million in the third quarter of 2011 to $\$ 6,980$ million in the third quarter of 2012.

Benefits and expenses of our Life Planner operations increased $\$ 99$ million, from $\$ 1,745$ million in the third quarter of 2011 to $\$ 1,844$ million in the third quarter of 2012, including a net favorable impact of $\$ 29$ million from currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased $\$ 128$ million, from $\$ 1,639$ million in the third quarter of 2011 to $\$ 1,767$ million in the third quarter of 2012. Benefits and expenses of our Japanese Life Planner operations increased $\$ 89$ million, primarily reflecting an increase in policyholder benefits due to changes in reserves driven by the growth in business in force. The current quarter also benefitted from a $\$ 20$ million reduction in the amortization of deferred policy acquisition costs and lower reserves, reflecting the impact of our annual review and update of assumptions used in estimating the profitability of our business.

Benefits and expenses of our Gibraltar Life and Other operations increased $\$ 2,827$ million, from $\$ 2,725$ million in the third quarter of 2011 to $\$ 5,552$ million in the third quarter of 2012 , including an unfavorable impact of $\$ 173$ million from currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased $\$ 2,654$ million, from $\$ 2,559$ million in the third quarter of 2011 to

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$\$ 5,213$ million in the third quarter of 2012. Policyholder benefits, including changes in reserves, increased $\$ 2,660$ million primarily driven by higher sales of yen-denominated single premium whole life policies in the current quarter. This is partly offset by lower general and administrative expenses, net of capitalization, driven by cost savings in the current year quarter resulting from Star and Edison integration synergies.

2012 to 2011 Nine Month Comparison. Benefits and expenses increased $\$ 5,678$ million, from $\$ 12,711$ million in the first nine months of 2011 to $\$ 18,389$ million in the first nine months of 2012, including a net unfavorable impact of $\$ 399$ million related to currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased $\$ 5,279$ million, from $\$ 12,197$ million in the first nine months of 2011 to $\$ 17,476$ million in the first nine months of 2012.

Benefits and expenses of our Life Planner operations increased $\$ 426$ million, from $\$ 5,171$ million in the first nine months of 2011 to $\$ 5,597$ million in the first nine months of 2012, including a net favorable impact of $\$ 19$ million from currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased $\$ 445$ million, from $\$ 4,948$ million in the first nine months of 2011 to $\$ 5,393$ million in the first nine months of 2012. Benefits and expenses of our Japanese Life Planner operations increased $\$ 363$ million, primarily reflecting an increase in policyholder benefits due to changes in reserves driven by the growth in business in force, partially offset by the absence of charges recognized in the prior year period associated with estimated claims from the 2011 earthquake in Japan. Additionally, the current period includes a $\$ 20$ million benefit from a reduction in the amortization of deferred policy acquisition costs and lower reserves, reflecting the impact of our annual review and update of assumptions used in estimating the profitability of our business.

Benefits and expenses of our Gibraltar Life and Other operations increased $\$ 5,252$ million, from $\$ 7,540$ million in the first nine months of 2011 to $\$ 12,792$ million in the first nine months of 2012 , including an unfavorable impact of $\$ 418$ million from currency fluctuations. Excluding the impact of currency fluctuations, benefits and expenses increased $\$ 4,834$ million, from $\$ 7,249$ million in the first nine months of 2011 to $\$ 12,083$ million in the first nine months of 2012. Policyholder benefits, including changes in reserves, increased $\$ 4,408$ million primarily driven by higher sales of yen-denominated single premium whole life products in the first nine months of 2012, partially offset by the absence of charges recognized in the prior year period associated with estimated claims from the 2011 earthquake in Japan. Higher general and administrative expenses, net of capitalization, are driven primarily by increased costs supporting business growth and the $\$ 34$ million charge associated with an agreement entered into with DLF, as discussed above, partially offset by cost savings in the current year period resulting from Star and Edison integration synergies.

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Sales Results

In managing our international insurance business, we analyze revenues, as well as annualized new business premiums, which do not correspond to revenues under U.S. GAAP. Annualized new business premiums measure the current sales performance of the segment, while revenues primarily reflect the renewal persistency of policies written in prior years and net investment income, in addition to current sales. Annualized new business premiums include $10 \%$ of first year premiums or deposits from single pay products. No other adjustments are made for limited pay contracts. The following table sets forth annualized new business premiums on an actual and constant exchange rate basis for the periods indicated.

|  | Three Months Ended <br> September 30, <br> 2011 <br> (in millions) | Nine Months Ended <br> September 30, <br> 2012 |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| 2012 |  |  |

With a diversified product mix supporting the growing demand for retirement and savings products, our international insurance operations offer various traditional whole life, term, endowment (which provide for payment on the earlier of death or maturity) and retirement income life insurance products that combine an insurance protection element similar to that of term life policies with a retirement income feature. In most of our operations, we also offer certain health products with fixed benefits, some of which include a high savings element, as well as annuity products, which are primarily represented by U.S. and Australian dollar-denominated fixed annuities in our Gibraltar Life operations.

Our Life Planners primary objective is to sell protection-oriented life insurance products on a needs basis to mass affluent and affluent customers, as well as to small businesses, whereas Gibraltar s Life Consultants, previously identified as Life Advisors, primarily sell individual protection products to the broad middle income market in Japan, particularly through relationships with affinity groups. Supplementing our core Life Planner and Gibraltar Life Consultant distribution channels, bank distribution channel sales primarily consist of products intended to provide premature death protection and retirement income, such as our yen-denominated single premium whole life product, as well as fixed annuity products primarily denominated in U.S. and Australian dollars. Our independent agency channel sells protection products and high cash value products for retirement benefits through the business market and sells a variety of other products including protection, medical and fixed annuity products through the individual market.

Historically, growth in annualized new business premiums was closely correlated to growth of our Life Planner and Gibraltar Life Consultant distribution force. Recently, growth in annualized new business premiums is being driven by increased average premium per new policy resulting in part from the growing demand for retirement-oriented products, as well as expanded distribution through third party channels, especially banks. As noted in the table below, bank channel sales contain a disproportionate number of single pay or limited pay contracts which tend to be larger policies and therefore have higher average premiums per policy. Our expectation is that this trend will continue.

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The amount of annualized new business premiums for any given period can be significantly impacted by several factors, including but not limited to, changes in credited interest rates for certain products and other product modifications, changes in tax laws, changes in life insurance regulations or changes in the competitive environment. Sales volume may increase or decrease prior to such changes becoming effective, and then fluctuate in the other direction following such changes.

The tables below present annualized new business premiums on a constant exchange rate basis, by product and distribution channel, for the periods indicated.

|  | Three Months Ended September 30, 2012 Accident |  |  |  |  |  |  |  | Three Months Ended September 30, 2011 Accident |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Life Planners | \$ 116 | \$ | 21 | \$ | 102 | \$ | 25 | \$ 264 | \$ 103 | \$ | 47 | \$ | 109 | \$ | 14 | \$ 273 |
| Gibraltar Life: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Life Consultants | 105 |  | 28 |  | 29 |  | 31 | 193 | 110 |  | 53 |  | 39 |  | 51 | 253 |
| Banks(3) | 378 |  | 0 |  | 2 |  | 26 | 406 | 104 |  | 8 |  | 7 |  | 46 | 165 |
| Independent Agency | 16 |  | 7 |  | 10 |  | 4 | 37 | 56 |  | 35 |  | 4 |  | 24 | 119 |
| Subtotal | 499 |  | 35 |  | 41 |  | 61 | 636 | 270 |  | 96 |  | 50 |  | 121 | 537 |
| Total | \$ 615 | \$ | 56 | \$ | 143 | \$ | 86 | \$ 900 | \$ 373 | \$ | 143 | \$ | 159 | \$ | 135 | \$ 810 |

(1) Includes medical insurance, cancer insurance and accident \& sickness riders. The three months ended September 30, 2012 and 2011 include $\$ 8$ million and $\$ 50$ million, respectively, of annualized new business premiums from cancer whole life insurance products.
(2) Includes retirement income, endowment and savings variable universal life.
(3) Single pay life annualized new business premiums, which include $10 \%$ of first year premiums, and 3-year limited pay annualized new business premiums, which include $100 \%$ of new business premiums, represented $84 \%$ and $13 \%$, respectively, of total bank distribution channel annualized new business premiums, excluding annuity products, for the three months ended September 30, 2012, and $23 \%$ and $59 \%$, respectively, of total bank distribution channel annualized new business premiums, excluding annuity products, for the three months ended September 30, 2011.

2012 to 2011 Three Month Comparison. On a constant exchange rate basis, annualized new business premiums increased $\$ 90$ million, from $\$ 810$ million in the third quarter of 2011 to $\$ 900$ million in the third quarter of 2012.

Annualized new business premiums, on a constant exchange rate basis, from our Life Planner operations decreased $\$ 9$ million, from $\$ 273$ million in the third quarter of 2011 to $\$ 264$ million in the third quarter of 2012, including a $\$ 27$ million decline in Japan. The current period decline in Japan sales was driven by accelerated sales of cancer whole life and U.S. dollar-denominated retirement income products in the preceding quarters of 2012. The increased sales of cancer products were in advance of an April 2012 tax law change which impacted the corporate tax deductibility of premiums paid for these products, and the increased sales of U.S. dollar-denominated retirement income products were in advance of a crediting rate change effective June 2012. These unfavorable items were partly offset by higher sales of yen-denominated retirement income products in the corporate market as well as growth in Korea, Brazil, and Italy, including the introduction of new products into these markets.

Annualized new business premiums, on a constant exchange rate basis, from our Gibraltar Life operations increased \$99 million, from $\$ 537$ million in the third quarter of 2011 to $\$ 636$ million in the third quarter of 2012 . The increase in annualized new business premiums was driven by higher sales of $\$ 241$ million in the bank channel driven by higher demand for our yen-denominated single premium whole life products
primarily reflecting a benefit from actions taken by certain of our competitors to limit sales and lower crediting rates on these products. This benefit was partly offset by lower sales of U.S. dollar-denominated whole life and retirement

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income products as well as cancer whole life products due to an acceleration of sales to the preceding quarters of 2012. The accelerated sales of U.S. dollar-denominated whole life and retirement income products was in advance of crediting rate changes effective April 2012, and the increased sales of cancer products were in advance of the April 2012 tax law change discussed above.

(1) Includes medical insurance, cancer insurance and accident \& sickness riders. The nine months ended September 30, 2012 and 2011 include $\$ 297$ million and $\$ 164$ million, respectively, of annualized new business premiums from cancer whole life insurance products.
(2) Includes retirement income, endowment and savings variable universal life.
(3) Single pay life annualized new business premiums, which include $10 \%$ of first year premiums, and 3-year limited pay annualized new business premiums, which include $100 \%$ of new business premiums, represented $66 \%$ and $24 \%$, respectively, of total bank distribution channel annualized new business premiums, excluding annuity products, for the nine months ended September 30, 2012, and $27 \%$ and $52 \%$, respectively, of total bank distribution channel annualized new business premiums, excluding annuity products, for the nine months ended September 30, 2011.

2012 to 2011 Nine Month Comparison. On a constant exchange rate basis, annualized new business premiums increased $\$ 605$ million, from $\$ 2,241$ million in the first nine months of 2011 to $\$ 2,846$ million in the first nine months of 2012.

Annualized new business premiums, on a constant exchange rate basis, from our Life Planner operations increased $\$ 219$ million, from $\$ 817$ million in the first nine months of 2011 to $\$ 1,036$ million in the first nine months of 2012. This increase was driven by higher sales in Japan of $\$ 185$ million reflecting increased demand for U.S. dollar-denominated retirement income products in anticipation of a change in crediting rate that became effective in June 2012, higher demand for yen-denominated retirement income products in the corporate market, and increased demand for cancer products in anticipation of the tax law change enacted in April 2012. Additionally, sales increased due to growth in our operations in Brazil, Taiwan, Korea, and Italy, including the introduction of new products into these markets.

Annualized new business premiums, on a constant exchange rate basis, from our Gibraltar Life operations increased $\$ 386$ million, from $\$ 1,424$ million in the first nine months of 2011 to $\$ 1,810$ million in the first nine months of 2012. The increase in annualized new business premiums was driven by increased sales of $\$ 403$ million in the bank channel driven by increased sales of yen-denominated single premium whole life products reflecting a benefit from actions taken by certain of our competitors to limit sales and lower crediting rates on these products. Sales also benefitted from increased demand for U.S. dollar denominated whole life and retirement income products in anticipation of pricing changes in April 2012, as well as increased demand for cancer whole life products in anticipation of tax law changes for these products, as discussed above. In addition, the benefit from including two additional months of sales from the former Star and Edison businesses when compared to the previous year period was partially offset by a temporary decline in sales in January 2012 attributable to an expected disruption in productivity resulting from the merger of these businesses on January 1, 2012. Sales in 2012 were also negatively impacted by the discontinuation of certain products previously offered by Star and Edison.

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The number of Life Planners increased by 230 from 6,699 as of September 30, 2011 to 6,929 as of September 30, 2012, driven by increases of 77 and 65 in Poland and Korea, respectively, reflecting stronger recruitment and retention and 76 in Brazil due to agency growth. Also contributing to the increase in Life Planners over the past twelve months were increases of 25 in Japan, 21 in Italy, and 7 in Argentina, partly offset by a decline of 39 in Taiwan.

The number of Gibraltar Life Consultants decreased by 1,253 from 12,936 as of September 30, 2011 to 11,683 as of September 30, 2012 primarily driven by anticipated resignations and terminations of former Star and Edison Life Consultants, due in part to their failure to meet minimum sales production standards.

## Corporate and Other

Corporate and Other includes corporate operations, after allocations to our business segments, and divested businesses except for those that qualify for discontinued operations accounting treatment under U.S. GAAP.

Corporate operations consist primarily of: (1) investment returns on capital that is not deployed in any business segments; (2) returns from investments not allocated to business segments, including debt-financed investment portfolios, and certain strategic joint venture investments, as well as tax credit investments and other tax enhanced investments financed by business segments; (3) capital debt that is used or will be used to meet the capital requirements of the Company and the related interest expense; (4) income and expense from qualified pension and other employee benefit plans, after allocations to business segments; (5) corporate-level income and expense, after allocations to business segments, including corporate governance, corporate advertising, philanthropic activities, deferred compensation, and costs related to certain contingencies; (6) certain retained obligations relating to pre-demutualization policyholders whom we had previously agreed to provide insurance for reduced or no premium in accordance with contractual settlements related to prior individual life insurance sales practices remediation; (7) results related to our Capital Protection Framework, as described below; and (8) the impact of transactions with and between other segments.

|  | Three Months Ended September 30, |  | Nine Months Ended September 30, |  |
| :---: | :---: | :---: | :---: | :---: |
| Operating results: |  |  |  |  |
| Capital debt interest expense | \$ (176) | \$ (155) | \$ (519) | \$ (459) |
| Net investment income, net of interest expense, excluding capital debt interest expense | (12) | (20) | (38) | (15) |
| Pension income and employee benefits | 22 | 56 | 54 | 139 |
| Other corporate activities(1) | (286) | (230) | (576) | (523) |
| Adjusted operating income | (452) | (349) | $(1,079)$ | (858) |
| Realized investment gains (losses), net, and related adjustments(2) | 90 | $(1,312)$ | (9) | $(1,304)$ |
| Related charges(3) | (18) | 56 | (15) | 64 |
| Divested businesses(4) | (685) | 43 | (657) | 49 |
| Equity in earnings of operating joint ventures and earnings attributable to noncontrolling interests(5) | 1 | 3 | (2) | 2 |
| Income (loss) from continuing operations before income taxes and equity in earnings of operating joint ventures | \$ $(1,064)$ | \$ $(1,559)$ | \$ $(1,762)$ | \$ $(2,047)$ |

(1) Includes consolidating adjustments.
(2) Revenues exclude Realized investment gains (losses), net, and related adjustments. See Realized Investment Gains and Losses.
(3) Benefits and expenses exclude charges which represent consolidating adjustments.
(4) See Divested Businesses.

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(5) Equity in earnings of operating joint ventures are included in adjusted operating income but excluded from income from continuing operations before income taxes and equity in earnings of operating joint ventures as they are reflected on a U.S. GAAP basis on an after-tax basis as a separate line in our Unaudited Interim Consolidated Statements of Operations. Earnings attributable to noncontrolling interests are excluded from adjusted operating income but included in income from continuing operations before income taxes and equity in earnings of operating joint ventures as they are reflected on a U.S. GAAP basis as a separate line in our Unaudited Interim Consolidated Statements of Operations. Earnings attributable to noncontrolling interests represent the portion of earnings from consolidated entities that relate to the equity interests of minority investors.

2012 to 2011 Three Month Comparison. The loss from Corporate and Other operations, on an adjusted operating income basis, increased $\$ 103$ million, from $\$ 349$ million in the third quarter of 2011 to $\$ 452$ million in the third quarter of 2012 . Capital debt interest expense increased $\$ 21$ million primarily due to higher levels of capital debt. Increases in net investment income, net of interest expense, excluding capital debt interest expense, of $\$ 8$ million partially offset these deficits reflecting less unfavorable results from reduced levels of debt proceeds held as cash. Net charges from other corporate activities increased $\$ 56$ million. The third quarter of 2012 includes a $\$ 78$ million charge in the third quarter of 2012 from the impact of an annual review and update of assumptions on the reserves for certain retained obligations relating to pre-demutualization policyholders to whom we had previously agreed to provide insurance for reduced or no premium in accordance with contractual settlements related to prior individual life insurance sales practices remediation. In addition, corporate retained expenses in the third quarter of 2012 includes an increase of $\$ 73$ million to our compensation liabilities, primarily due to the impact of equity markets on deferred compensation plans, $\$ 16$ million of charges related to the prepayment of outstanding debt and $\$ 10$ million in less favorable results from our corporate foreign exchange hedging activities. These charges are offset by the absence of a $\$ 99$ million increase in reserves for estimated payments arising from use of the new Social Security Master Death file criteria to identify deceased policy and contract holders and a $\$ 20$ million expense related to a voluntary contribution to be made to the insurance industry insolvency fund, related to Executive Life Insurance, both reflected in the third quarter of 2011.

Results from corporate operations pension income and employee benefits decreased $\$ 34$ million primarily due to a decrease in income from our qualified pension plan and an increase in retained employee benefits costs. Income from our qualified pension plan decreased $\$ 15$ million, from $\$ 73$ million in the third quarter of 2011 to $\$ 58$ million in the third quarter of 2012 driven by changes in the discount rate and expected rate of return on plan assets as discussed in our Annual Report on Form 10-K for the year ended December 31, 2011, under Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations for Financial Services Businesses by Segment Corporate and Other.

2012 to 2011 Nine Month Comparison. The loss from Corporate and Other operations, on an adjusted operating income basis, increased $\$ 221$ million, from $\$ 858$ million in the first nine months of 2011 to $\$ 1,079$ million in the first nine months of 2012. Capital debt interest expense increased $\$ 60$ million primarily due to higher levels of capital debt. Net investment income, net of interest expense, excluding capital debt interest expense, decreased $\$ 23$ million reflecting less favorable results from equity method investments and higher levels of operating debt. Net charges from other corporate activities for the first nine months of 2012 include a $\$ 78$ million charge from the impact of an annual review and update of assumptions on the reserves for certain retained obligations relating to pre-demutualization policyholders to whom we had previously agreed to provide insurance for reduced or no premium in accordance with contractual settlements related to prior individual life insurance sales practices remediation and a $\$ 31$ million increase in our estimate of payments arising from the use of new Social Security Death File matching criteria to identify deceased policy and contract holders. In addition, retained in corporate expenses increased the first nine months of 2012, primarily from corporate advertising, the results of our corporate foreign exchange hedging activities and the prepayment of outstanding debt. These increases are offset by the absence of a $\$ 99$ million increase in reserves for estimated payments arising from use of the new Social Security Master Death file criteria to identify deceased policy and contract holders and a $\$ 20$ million expense related to a voluntary contribution to be made to the insurance industry insolvency fund, related to Executive Life Insurance, both reflected in the first nine months of 2011.

Results from corporate operations pension income and employee benefits decreased $\$ 85$ million primarily due to a decrease in income from our qualified pension plan and an increase in retained employee benefits costs.

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Income from our qualified pension plan decreased $\$ 44$ million, from $\$ 218$ million in the first nine months of 2011 to $\$ 174$ million in the first nine months of 2012 driven by changes in the discount rate and expected rate of return on plan assets as discussed above.

## Capital Protection Framework

Corporate and Other operations includes the results of our Capital Protection Framework, which includes among other initiatives, the capital hedge program. The capital hedge program broadly addresses the equity market exposure of the statutory capital of the Company as a whole, under stress scenarios, as described under Liquidity and Capital Resources Liquidity and Capital Resources of Subsidiaries Domestic Insurance Subsidiaries. This hedge program resulted in charges for amortization of derivative costs of $\$ 11$ million and $\$ 6$ million for the three months ended September 30, 2012 and 2011, respectively, and $\$ 28$ million and $\$ 14$ million for the nine months ended September 30, 2012 and 2011, respectively. The market value changes of these derivatives included in Realized investment gains (losses), net and related adjustments were a loss of $\$ 14$ million and a gain of $\$ 17$ million for the three months ended September 30, 2012 and 2011, respectively. The market value changes of these derivatives were a loss of $\$ 17$ million and a gain of $\$ 18$ million for the nine months ended September 30, 2012 and 2011, respectively. We assess the composition of our hedging program on an ongoing basis, and we may change it from time to time based on our evaluation of our risk position or other factors.

In addition to hedging equity market exposure, we may choose to manage the interest rate risk associated with certain of our products by holding capital against a portion of the interest rate exposure rather than fully hedging the risk. Realized investment gains (losses), net and related adjustments includes net gains of $\$ 139$ million and net losses of $\$ 1,428$ million for the three months ended September 30, 2012 and 2011 respectively, and net losses of $\$ 155$ million and $\$ 1,459$ million for the nine month ended September 30, 2012 and 2011, respectively, resulting from our decision to utilize this strategy to manage a portion of our interest rate risk. The capital consequences associated with our decision to hold capital against a portion of our interest rate exposure have been factored into our Capital Protection Framework.

In addition, we manage certain of the risks associated with our variable annuity products through our living benefit hedging program, which is described under U.S. Retirement Solutions and Investment Management Division Individual Annuities. Through our Capital Protection Framework, we maintain access to on-balance sheet capital and contingent sources of capital that are available to meet capital needs that may arise related to this hedging program.

For more information on our Capital Protection Framework, see Liquidity and Capital Resources.

## Results of Operations of Closed Block Business

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

Each year, the Board of Directors of Prudential Insurance determines the dividends payable on participating policies for the following year based on the experience of the Closed Block, including investment income, net realized and unrealized investment gains, mortality experience and other factors. Although Closed Block experience for dividend action decisions is based upon statutory results, at the time the Closed Block was

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established, we developed, as required by U.S. GAAP, an actuarial calculation of the timing of the maximum future earnings from the policies included in the Closed Block. If actual cumulative earnings in any given period

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are greater than the cumulative earnings we expected, we record this excess as a policyholder dividend obligation. We will subsequently pay this excess to Closed Block policyholders as an additional dividend unless it is otherwise offset by future Closed Block performance that is less favorable than we originally expected. The policyholder dividends we charge to expense within the Closed Block Business will include any change in our policyholder dividend obligation that we recognize for the excess of actual cumulative earnings in any given period over the cumulative earnings we expected in addition to the actual policyholder dividends declared by the Board of Directors of Prudential Insurance.

As of September 30, 2012, the excess of actual cumulative earnings over the expected cumulative earnings was $\$ 781$ million, which was recorded as a policyholder dividend obligation. Actual cumulative earnings, as required by U.S. GAAP, reflect the recognition of realized investment gains and losses in the current period, as well as changes in assets and related liabilities that support the Closed Block policies. Additionally, the accumulation of net unrealized investment gains that have arisen subsequent to the establishment of the Closed Block have been reflected as a policyholder dividend obligation of $\$ 5,582$ million at September 30, 2012, to be paid to Closed Block policyholders unless offset by future experience, with an offsetting amount reported in Accumulated other comprehensive income (loss).

## Operating Results

Management does not consider adjusted operating income to assess the operating performance of the Closed Block Business. Consequently, results of the Closed Block Business for all periods are presented only in accordance with U.S. GAAP. The following table sets forth the Closed Block Business U.S. GAAP results for the periods indicated.

|  | Three Months Ended <br> September 30, <br> 2011 <br> (in millions) | Nine Months Ended <br> September 30, <br> 2012 |
| :--- | :--- | :--- | :--- | :--- | :--- |
| 2012 |  |  |

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

2012 to 2011 Three Month Comparison. Income from continuing operations before income taxes and equity in earnings of operating joint ventures increased $\$ 23$ million, from $\$ 46$ million of income in the third quarter of 2011 to $\$ 69$ million in the third quarter of 2012. Results for third quarter of 2012 include $\$ 166$ million of lower realized investment gains, primarily driven by market value declines on derivatives used to hedge foreign denominated investments. For a discussion of Closed Block Business realized investment gains (losses), net, see Realized Investment Gains and Losses. Partially offsetting this item was a $\$ 34$ million lower increase in reserves for estimated payments arising from the use of new Social Security Master Death File matching criteria to identify deceased policy and contract holders. As a result of the above and other variances, a $\$ 2$ million policyholder dividend obligation expense was recorded in the third quarter of 2012, compared to $\$ 160$ million in the third quarter of 2011. As noted above, as of September 30, 2012, the excess of actual cumulative earnings over the expected cumulative earnings was $\$ 781$ million. If actual cumulative earnings fall below expected cumulative earnings in future periods, earnings volatility in the Closed Block Business, which is primarily due to changes in investment results, may not be offset by changes in the cumulative policyholder dividend obligation.

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2012 to 2011 Nine Month Comparison. Income from continuing operations before income taxes and equity in earnings of operating joint ventures increased $\$ 6$ million, from $\$ 91$ million in the first nine months of 2011 to $\$ 97$ million in the first nine months of 2012. Results for the first nine months of 2012 include $\$ 267$ million of

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lower realized investment gains, primarily due to lower trading gains on equity and fixed maturity investments, as well as unfavorable changes in the value of derivatives used to manage portfolio duration resulting from changes in interest rates. For a discussion of Closed Block Business realized investment gains (losses), net, see Realized Investment Gains and Losses. Also contributing to the decline in results was a $\$ 48$ million decrease in net investment income primarily due to lower reinvestment rates and a $\$ 36$ million expense related to an increase in the change in reserves for estimated payments arising from the use of new Social Security Master Death File matching criteria to identify deceased policy and contract holders. As a result of the above and other variances, a $\$ 19$ million policyholder dividend obligation expense was recorded in the first nine months of 2012, compared to $\$ 396$ million in the first nine months of 2011.

## Revenues

2012 to 2011 Three Month Comparison. Revenues, as shown in the table above under Operating Results, decreased $\$ 191$ million, from $\$ 1,695$ million in the third quarter of 2011 to $\$ 1,504$ million in the third quarter of 2012, principally driven by the $\$ 166$ million decrease in net realized investment gains, as discussed above. In addition, net investment income decreased by $\$ 22$ million primarily reflecting the impact of lower reinvestment rates and lower average invested assets as the business runs off.

2012 to 2011 Nine Month Comparison. Revenues decreased $\$ 389$ million, from $\$ 5,046$ million in the first nine months of 2011 to $\$ 4,657$ million in the first nine months of 2012 , principally driven by the $\$ 267$ million decrease in net realized investment gains, as discussed above. Premiums declined by $\$ 70$ million, with a related decrease in changes in reserves, primarily due to the expected in force decline as policies terminate. Also contributing to the decline in revenues was a $\$ 48$ million decrease in net investment income, as discussed above.

## Benefits and Expenses

2012 to 2011 Three Month Comparison. Benefits and expenses, as shown in the table above under Operating Results, decreased $\$ 214$ million, from $\$ 1,649$ million in the third quarter of 2011 to $\$ 1,435$ million in the third quarter of 2012 . This decrease was driven by a $\$ 161$ million decline in dividends to policyholders including a $\$ 158$ million decrease in the policyholder dividend obligation expense reflecting a lower increase in cumulative earnings. In addition, policyholders benefits, including changes in reserves, decreased $\$ 52$ million primarily due to a lower increase in reserves for estimated payments arising from the use of new Social Security Master Death File matching criteria to identify deceased policy and contract holders.

2012 to 2011 Nine Month Comparison. Benefits and expenses decreased $\$ 395$ million, from $\$ 4,955$ million in the first nine months of 2011 to $\$ 4,560$ million in the first nine months of 2012. This decrease was driven by a $\$ 394$ million decline in dividends to policyholders including a decrease of $\$ 377$ million in the policyholder dividend obligation expense reflecting a lower increase in cumulative earnings, as well as a $\$ 17$ million decline in dividends paid and accrued to policyholders driven by a decline in policies in force. These favorable items were partially offset by an increase in policyholders benefits, including changes in reserves, of $\$ 8$ million primarily due to an increase in the change in reserves for estimated payments arising from the use of new Social Security Master Death File matching criteria to identify deceased policy and contract holders and unfavorable mortality experience, partly offset by lower expenses, in line with the decline in premiums, due to the expected in force decline as policies terminate.

## Income Taxes

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Our income tax provision amounted to an income tax benefit of $\$ 331$ million in the third quarter of 2012 compared to an expense of $\$ 860$ million in the third quarter of 2011. The decrease in income tax expense primarily reflects the decrease in pre-tax net income from continuing operations before income taxes and equity in earnings of operating joint ventures from the third quarter of 2011 to the third quarter of 2012.

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Our income tax provision amounted to an income tax expense of $\$ 572$ million in the first nine months of 2012 compared to an expense of $\$ 1,312$ million in the first nine months of 2011. The first nine months of 2012 and 2011 includes $\$ 343$ million and $\$ 240$ million, respectively, of an additional U.S. tax related to the realization of a portion of the local deferred tax assets existing on the opening day balance sheet for the Star and Edison Businesses. The increase in the additional U.S. tax is a result of the merger of Star and Edison Businesses into the Gibraltar Life Insurance Company, Ltd. It represents the recomputed U.S. tax liability on Gibraltar s prior earnings as a result of the repatriation assumption and the merger of the entities. The local utilization of the deferred tax asset coupled with the repatriation assumption to the applicable earnings of our Japanese entities creates the effect of a double tax for U.S. GAAP purposes, whereas only one incidence of tax will ever be paid. In addition, income tax expense for the first nine months of 2011 includes a $\$ 42$ million tax benefit from the release of a valuation allowance related to a foreign subsidiary. Excluding the impact of the double tax and the release of the valuation allowance, the income tax expense decreased primarily due to the decrease in pre-tax income from continuing operations before income taxes and equity in earnings of operating joint ventures from the first nine months of 2011 to the first nine months of 2012.

For additional information regarding income taxes, see Note 12 to the Unaudited Interim Consolidated Financial Statements.

## Discontinued Operations

Included within net income are the results of businesses which are reflected as discontinued operations under U.S. GAAP. Income (loss) from discontinued operations, net of taxes, was $\$(2)$ million and $\$(9)$ million for the three months ended September 30, 2012 and 2011, respectively, and $\$ 12$ million and $\$ 21$ million for the nine months ended September 30, 2012 and 2011, respectively.

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

## Divested Businesses

Our income from continuing operations includes results from several businesses that have been or will be sold or exited that do not qualify for discontinued operations accounting treatment under U.S. GAAP. The results of these divested businesses are reflected in our Corporate and Other operations, but excluded from adjusted operating income. A summary of the results of these divested businesses that have been excluded from adjusted operating income is as follows for the periods indicated:

|  | Three Months Ended September 30, |  |  | Nine Months Ended September 30, |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | 2012 |  |  | 2012 |  |  |
|  | (in millions) |  |  |  |  |  |
| Long-Term Care Business | \$ (680) | \$ | 19 | \$ (662) | \$ | 34 |
| Real Estate and Relocation Services Business | 7 |  | 22 | 21 |  | 25 |
| Individual Health Insurance | (1) |  | (1) | (7) |  | (11) |
| Property and Casualty | (13) |  | 1 | (10) |  | 2 |
| Financial Advisory | (2) |  | (2) | (5) |  | (6) |
| Other | 4 |  | 4 | 6 |  | 5 |
| Total divested businesses excluded from adjusted operating income | \$ (685) | \$ | 43 | \$ (657) | \$ | 49 |

In July 2012, we announced our decision to cease sales of group long-term care insurance reflecting the challenging economics of the long-term care market including the continued low interest rate environment as well as our desire to focus our resources on our core group life and disability businesses. We discontinued sales

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of group long-term care products effective August 1,2012, or a later date as may be required by specific state law. We notified our clients of our intent to continue to accept enrollments on existing group long-term care contracts through June 30, 2013 or later as required by contractual provisions. In March 2012, we also discontinued sales of our individual long-term care products. As a result of our decision to wind down this business, we have reflected the results of the long-term care insurance business, previously reported within the Group Insurance segment, as a divested business for all periods presented. Results for three and nine months ended September 30, 2012, as presented in the table above, include a $\$ 693$ million net charge, before taxes, from adjustments to deferred policy acquisition and other costs and the reserves for our long-term care products, reflecting updates to the estimated profitability of the business, driven by updates to our morbidity assumptions and reductions to our long-term interest rate assumptions, partially offset by expected future premium increases. We have factored into our assumptions our best estimate of the timing and amount of anticipated and yet-to-be-filed premium increases which will require state approval. Our actual experience obtaining pricing increases could be materially different than what we have assumed, resulting in further policy liability increases which could be material.

## Experience-Rated Contractholder Liabilities,

Trading Account Assets Supporting Insurance Liabilities and Other Related Investments

Certain products included in the Retirement and International Insurance segments are experience-rated in that investment results associated with these products are expected to ultimately accrue to contractholders. The majority of investments supporting these experience-rated products are classified as trading and are carried at fair value. These trading investments are reflected on the statements of financial position as Trading account assets supporting insurance liabilities, at fair value ( TAASIL ). Realized and unrealized gains and losses for these investments are reported in Asset management fees and other income. Interest and dividend income for these investments is reported in Net investment income. To a lesser extent, these experience-rated products are also supported by derivatives and commercial mortgage and other loans. The derivatives that support these experience-rated products are reflected on the statement of financial position as Other long-term investments and are carried at fair value, and the realized and unrealized gains and losses are reported in Realized investment gains (losses), net. The commercial mortgage and other loans that support these experience-rated products are carried at unpaid principal, net of unamortized discounts and an allowance for losses, and are reflected on the statements of financial position as Commercial mortgage and other loans. Gains and losses on sales and changes in the valuation allowance for commercial mortgage and other loans are reported in Realized investment gains (losses), net.

Our Retirement segment has two types of experience-rated products that are supported by TAASIL and other related investments. Fully participating products are those for which the entire return on underlying investments is passed back to the policyholders through a corresponding adjustment to the related liability. The adjustment to the liability is based on changes in the fair value of all of the related assets, including commercial mortgage and other loans, which are carried at amortized cost, less any valuation allowance. Partially participating products are those for which only a portion of the return on underlying investments is passed back to the policyholders over time through changes to the contractual crediting rates. The crediting rates are typically reset semiannually, often subject to a minimum crediting rate, and returns are required to be passed back within ten years.

In our International Insurance segment, the experience-rated products are fully participating. As a result, the entire return on the underlying investments is passed back to policyholders through a corresponding adjustment to the related liability.

Adjusted operating income excludes net investment gains and losses on TAASIL, related derivatives and commercial mortgage and other loans. This is consistent with the exclusion of realized investment gains and losses with respect to other investments supporting insurance liabilities managed on a consistent basis. In addition, to be consistent with the historical treatment of charges related to realized investment gains and losses

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on investments, adjusted operating income also excludes the change in contractholder liabilities due to asset value changes in the pool of investments (including changes in the fair value of commercial mortgage and other loans) supporting these experience-rated contracts, which are reflected in Interest credited to policyholders account balances. The result of this approach is that adjusted operating income for these products includes net fee revenue and interest spread we earn on these experience-rated contracts, and excludes changes in fair value of the pool of investments, both realized and unrealized, that we expect will ultimately accrue to the contractholders.

The following tables set forth the impact of these items on results that are excluded from adjusted operating income for the periods indicated:

|  | Three Months Ended <br> September 30, <br> 2011 <br> (in millions) | Nine Months Ended <br> September 30, <br> 2012 |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| 2011 |  |  |

(1) Decreases to contractholder liabilities due to asset value changes are limited by certain floors and therefore do not reflect cumulative declines in recorded asset values of $\$ 4$ million and $\$ 8$ million as of September 30, 2012 and 2011, respectively. We have recovered and expect to recover in future periods these declines in recorded asset values through subsequent increases in recorded asset values or reductions in crediting rates on contractholder liabilities.
(2) Included in the amounts above related to the change in the liability to contractholders as a result of commercial mortgage and other loans are increases of $\$ 19$ million and $\$ 17$ million for the three months ended September 30, 2012 and 2011, respectively, and increases of $\$ 19$ million and $\$ 31$ million for the nine months ended September 30, 2012 and 2011, respectively. As prescribed by U.S. GAAP, changes in the fair value of commercial mortgage and other loans held for investment in our general account, other than when associated with impairments, are not recognized in income in the current period, while the impact of these changes in fair value are reflected as a change in the liability to fully participating contractholders in the current period.

As shown in the table above, the net impacts for the Retirement segment of changes in experience-rated contractholder liabilities and investment gains and losses on trading account assets supporting insurance liabilities and other related investments were net losses of $\$ 17$ million and $\$ 18$
million for the three months

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ended September 30, 2012 and 2011, respectively, and net losses of $\$ 13$ million and $\$ 28$ million for the nine months ended September 30, 2012 and 2011, respectively. These impacts primarily reflect timing differences between the recognition of the mark-to-market adjustments and the recognition of the recovery of these adjustments in future periods through subsequent increases in asset values or reductions in crediting rates on contractholder liabilities for partially participating products. These impacts also reflect the difference between the fair value of the underlying commercial mortgage and other loans and the amortized cost, less any valuation allowance, of these loans, as described above.

As shown in the table above, the International Insurance segment includes offsetting impacts, in all periods, from changes in investment gains and losses on trading account assets supporting insurance liabilities and experience-rated contractholder liabilities.

## Valuation of Assets and Liabilities

## Fair Value of Assets and Liabilities

The authoritative guidance related to fair value measurement establishes a framework that includes a three-level hierarchy used to classify the inputs used in measuring fair value. The level in the hierarchy within which the fair value falls is determined based on the lowest level input that is significant to the measurement. The fair values of assets and liabilities classified as Level 3 include at least one or more significant unobservable input in the measurement. See Note 13 to the Unaudited Interim Consolidated Financial Statements for an additional description of the valuation hierarchy levels.

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The tables below present the balances of assets and liabilities measured at fair value on a recurring basis, as of the periods indicated, split between the Financial Services Businesses and Closed Block Business, and the portion of such assets and liabilities that are classified in Level 3 of the valuation hierarchy. See Note 13 to the Unaudited Interim Consolidated Financial Statements for the balances of assets and liabilities measured at fair value on a recurring basis by hierarchy level presented on a consolidated basis.

|  | As of September 30, 2012 |  |  |  |  |  | As of December 31, 2011 |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Financial Services Businesses |  |  | Closed Block Business |  |  | Financial Services Businesses |  |  | Closed Block Business |  |  |
|  | Total at Fair Value |  | Total vel 3(1) | Total at Fair Value |  | Total <br> vel 3(1) <br> (in m | ```Total at Fair Value lions)``` |  | Total vel 3(1) | Total at <br> Fair Value |  | Total <br> el 3(1) |
| Fixed maturities, available-for-sale | \$ 226,015 | \$ | 3,958 | \$ 47,366 | \$ | 1,180 | \$ 208,132 | \$ | 3,098 | \$ 46,516 | \$ | 1,132 |
| Trading account assets supporting insurance liabilities: |  |  |  |  |  |  |  |  |  |  |  |  |
| Fixed maturities | 18,489 |  | 535 | 0 |  | 0 | 17,619 |  | 498 | 0 |  | 0 |
| Equity securities | 1,003 |  | 19 | 0 |  | 0 | 911 |  | 20 | 0 |  | 0 |
| Short-term investments and cash equivalents | 640 |  | 0 | 0 |  | 0 | 951 |  | 0 | 0 |  | 0 |
| Subtotal | 20,132 |  | 554 | 0 |  | 0 | 19,481 |  | 518 | 0 |  | 0 |
| Other trading account assets: |  |  |  |  |  |  |  |  |  |  |  |  |
| Fixed maturities | 1,017 |  | 102 | 136 |  | 0 | 1,302 |  | 114 | 189 |  | 0 |
| Equity securities | 1,429 |  | 1,135 | 128 |  | 114 | 1,493 |  | 1,153 | 128 |  | 123 |
| All other(2) | 3,164 |  | 32 | 0 |  | 0 | 2,433 |  | 93 | 0 |  | 0 |
| Subtotal | 5,610 |  | 1,269 | 264 |  | 114 | 5,228 |  | 1,360 | 317 |  | 123 |
| Equity securities, available-for-sale | 4,821 |  | 334 | 3,171 |  | 12 | 4,413 |  | 333 | 3,122 |  | 27 |
| Commercial mortgage and other loans | 248 |  | 68 | 0 |  | 0 | 600 |  | 86 | 0 |  | 0 |
| Other long-term investments | 1,675 |  | 1,014 | (100) |  | 0 | 1,107 |  | 1,110 | 185 |  | 0 |
| Short-term investments | 7,774 |  | 0 | 1,470 |  | 0 | 8,232 |  | 0 | 528 |  | 0 |
| Cash equivalents | 8,575 |  | 0 | 792 |  | 0 | 8,392 |  | 0 | 1,037 |  | 0 |
| Other assets | 75 |  | 8 | 110 |  | 0 | (13) |  | 9 | 111 |  | 0 |
| Subtotal excluding separate account assets | 274,925 |  | 7,205 | 53,073 |  | 1,306 | 255,572 |  | 6,514 | 51,816 |  | 1,282 |
| Separate account assets | 247,510 |  | 20,339 | 0 |  | 0 | 218,380 |  | 19,358 | 0 |  | 0 |
| Total assets | \$ 522,435 | \$ | 27,544 | \$ 53,073 | \$ | 1,306 | \$ 473,952 | \$ | 25,872 | \$ 51,816 | \$ | 1,282 |
| Future policy benefits | \$ 3,638 | \$ | 3,638 | \$ 0 | \$ | 0 | \$ 2,886 | \$ | 2,886 | \$ 0 | \$ | 0 |
| Other liabilities(2) | 565 |  | 395 | 0 |  | 0 | 444 |  | 285 | 0 |  | 0 |
| Total liabilities | \$ 4,203 | \$ | 4,033 | \$ 0 | \$ | 0 | \$ 3,330 | \$ | 3,171 | \$ 0 | \$ | 0 |

(1) The amount of Level 3 assets taken as a percentage of total assets measured at fair value on a recurring basis totaled $5.3 \%$ and $5.5 \%$ as of September 30 , 2012 and December 31, 2011, respectively, for the Financial Services Businesses, and 2.5\% as of both September 30, 2012 and December 31, 2011, respectively, for the Closed Block Business. The amount of Level 3 liabilities was immaterial to our balance sheet.
(2) All other and Other liabilities primarily include derivatives. The amounts classified as Level 3 for the Financial Services Businesses exclude the impact of netting.

The determination of fair value, which for certain assets and liabilities is dependent on the application of estimates and assumptions, can have a significant impact on our results of operations and may require the application of a greater degree of judgment depending on market conditions, as the ability to value assets and

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liabilities can be significantly impacted by a decrease in market activity or a lack of transactions executed in an orderly manner. The following sections provide information regarding certain assets and liabilities of our Financial Services Businesses and our Closed Block Business which are valued using Level 3 inputs and could have a significant impact on our results of operations.

## Fixed Maturity and Equity Securities

Fixed maturity securities included in Level 3 in our fair value hierarchy are generally priced based on internally-developed valuations or indicative broker quotes. For certain private fixed maturity and equity securities, the discounted cash flow or other valuation model uses significant unobservable inputs and, accordingly, such securities are included in Level 3 in our fair value hierarchy. Level 3 fixed maturity securities included approximately $\$ 4.1$ billion as of September 30, 2012 and $\$ 3.2$ billion as of December 31, 2011 of public fixed maturities, with values primarily based on indicative broker quotes, and approximately $\$ 1.7$ billion as of September 30, 2012 and $\$ 1.6$ billion as of December 31, 2011 of private fixed maturities, with values primarily based on internally-developed models. Significant unobservable inputs used included: issue specific credit adjustments, material non-public financial information, management judgment, estimation of future earnings and cash flows, default rate assumptions, liquidity assumptions and indicative quotes from market makers. These inputs are usually considered unobservable, as not all market participants will have access to this data.

The impact our determination of fair value for fixed maturity and equity securities has on our results of operations is dependent on our classification of the security as either trading, available-for-sale, or held-to-maturity. For our investments classified as trading, the impact of changes in fair value is recorded within Asset management fees and other income. For our investments classified as available-for-sale, the impact of changes in fair value is recorded as an unrealized gain or loss in Accumulated other comprehensive income (loss), a separate component of equity. Our investments classified as held-to-maturity are carried at amortized cost.

## Other Long-Term Investments

Other long-term investments classified in Level 3 primarily include real estate held in consolidated investment funds and fund investments where the fair value option has been elected. The fair value of real estate held in consolidated investment funds is determined through an independent appraisal process. The appraisals generally utilize a discounted cash flow model. The appraisals also include replacement cost estimates and recent sales data as alternate methods of fair value. These appraisals and the related assumptions are updated at least annually. Since many of the assumptions utilized are unobservable and are considered to be significant inputs to the valuation, the real estate investments within other long-term investments are reflected within Level 3. Consolidated real estate investment funds classified as Level 3 totaled approximately $\$ 0.5$ billion and $\$ 0.4$ billion as of September 30, 2012 and December 31, 2011, respectively. The fair value of fund investments, where the fair value option has been elected, is primarily determined by the fund managers. Since the valuations may be based on unobservable market inputs and cannot be validated by the Company, these investments are included within Level 3. Investments in these funds included in Level 3 totaled approximately $\$ 0.5$ billion and $\$ 0.4$ billion as of September 30, 2012 and December 31, 2011, respectively.

## Derivative Instruments

Derivatives classified as Level 3, excluding embedded derivatives which are discussed in Variable Annuity Optional Living Benefit Features below, include first-to-default credit basket swaps, look-back equity options and other structured products. These derivatives are recorded at fair value either as assets, within Other trading account assets, or Other long-term investments, or as liabilities, within Other liabilities, and are valued based upon models with some significant unobservable market inputs or inputs from less actively traded markets. We validate these values through periodic comparison of our fair values to broker-dealer values. The fair values of OTC derivative assets and liabilities classified

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as Level 3 totaled approximately $\$ 26$ million and $\$ 1$ million, respectively, as of September 30, 2012 and $\$ 84$ million and $\$ 3$ million, respectively, as of December 31, 2011, without giving consideration to the impact of netting.

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All realized and unrealized changes in fair value of these derivatives, with the exception of the effective portion of qualifying cash flow hedges and hedges of net investments in foreign operations, are recorded in current earnings. Generally, the changes in fair value of these derivatives, excluding those that qualify for hedge accounting, are recorded in Realized investment gains (losses), net. For additional information regarding the impact of changes in fair value of derivative instruments on our results of operations see Realized Investment Gains and Losses below.

## Separate Account Assets

Separate account assets included in Level 3 primarily include real estate investments for which values are determined consistent with similar instruments described above under Other Long-Term Investments. Separate account liabilities are reported at contract value and not fair value.

## Variable Annuity Optional Living Benefit Features

Future policy benefits classified in Level 3 primarily include liabilities related to guarantees associated with the optional living benefit features of certain variable annuity contracts offered by our Individual Annuities segment, including guaranteed minimum accumulation benefits ( GMAB ), guaranteed minimum withdrawal benefits ( GMWB ) and guaranteed minimum income and withdrawal benefits ( GMIWB ). These benefits are accounted for as embedded derivatives and carried at fair value with changes in fair value included in Realized investment gains (losses), net. The fair values of the GMAB, GMWB and GMIWB liabilities are calculated as the present value of future expected benefit payments to customers less the present value of assessed rider fees attributable to the embedded derivative feature. This methodology could result in either a liability or contra-liability balance, given changing capital market conditions and various policyholder behavior assumptions. Since there is no observable active market for the transfer of these obligations, the valuations are calculated using internally-developed models with option pricing techniques. These models utilize significant assumptions that are primarily unobservable, including assumptions as to lapse rates, NPR, utilization rates, withdrawal rates, mortality rates and equity market volatility. As a result, the liability included in future policy benefits is reflected within Level 3 in our fair value hierarchy. Future policy benefits classified as Level 3 were net liabilities of $\$ 3,638$ million and $\$ 2,886$ million as of September 30, 2012 and December 31, 2011, respectively. The change was driven by changes in the fair values of our GMAB, GMWB and GMIWB liabilities, primarily reflecting declines in interest rates and tightening of our NPR credit spreads, partially offset by the impact of equity market appreciation. For additional information see Results of Operations for Financial Services Businesses by Segment U.S. Retirement Solutions and Investment Management Division Individual Annuities.

For additional information about the key estimates and assumptions used in our determination of fair value, see Note 13 to the Unaudited Interim Consolidated Financial Statements.

## Realized Investment Gains and Losses

Realized investment gains and losses are generated from numerous sources, including the sale of fixed maturity securities, equity securities, investments in joint ventures and limited partnerships and other types of investments, as well as adjustments to the cost basis of investments for other-than-temporary impairments. Realized investment gains and losses are also generated from prepayment premiums received on private fixed maturity securities, net changes in the allowance for losses, as well as gains and losses on sales, certain restructurings and foreclosures on commercial mortgage and other loans and fair value changes on commercial mortgage loans carried at fair value. In addition, realized investment gains and losses are generated by fair value changes on embedded derivatives and free-standing derivatives that do not qualify for hedge accounting treatment (except those derivatives used in our capacity as a broker or dealer), including those related to certain optional living benefit guarantees and related hedge positions in our Individual Annuities segment. See Results of Operations for Financial Services Businesses by Segment U.S. Retirement Solutions and Investment Management Division Individual Annuities.

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For a further discussion of our policies regarding other-than-temporary declines in investment value and the related methodology for recording fixed maturity other-than-temporary impairments, see General Account Investments Fixed Maturity Securities Other-Than-Temporary Impairments of Fixed Maturity Securities below. For a further discussion of our policies regarding other-than-temporary declines in investment value and the related methodology for recording equity impairments, see General Account Investments Equity Securities Other-than-Temporary Impairments of Equity Securities below. For a further discussion of our policy regarding commercial mortgage and other loans, see General Account Investments Commercial Mortgage and Other Loans Commercial Mortgage and Other Loan Quality below.

The level of other-than-temporary impairments generally reflects economic conditions and is expected to increase when economic conditions worsen and to decrease when economic conditions improve. Historically, the causes of other-than-temporary impairments have been specific to each individual issuer and have not directly resulted in impairments to other securities within the same industry or geographic region. As discussed in more detail below, certain of the other-than-temporary impairments recognized for the three months and nine months ended September 30, 2012 primarily relate to losses from foreign currency exchange rate movements on securities that are approaching maturity, as well as asset-backed securities collateralized by sub-prime mortgages, reflecting adverse financial conditions of the respective issuers. Other-than-temporary impairments recognized for the three months and nine months ended September 30, 2011 primarily relate to losses from foreign currency exchange rate movements on securities that are approaching maturity, as well as asset-backed securities collateralized by sub-prime mortgages and Japanese commercial mortgage-backed securities, reflecting adverse financial conditions of the respective issuers.

We may realize additional credit and interest rate related losses through sales of investments pursuant to our credit risk and portfolio management objectives. Other-than-temporary impairments, interest rate related losses and credit related losses on sales (other than those related to certain of our businesses which primarily originate investments for sale or syndication to unrelated investors) are excluded from adjusted operating income.

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

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

Adjusted operating income generally excludes Realized investment gains (losses), net, subject to certain exceptions (realized investment gains or losses within certain of our businesses for which such gains or losses are a principal source of earnings and those associated with terminating hedges of foreign currency earnings and current period yield adjustments), and related charges and adjustments.

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The following tables set forth Realized investment gains (losses), net, by investment type for the Financial Services Businesses and Closed Block Business, as well as related charges and adjustments associated with the Financial Services Businesses, for the periods indicated. For additional details regarding adjusted operating income, which is our measure of performance for the segments of our Financial Services Businesses, see Note 11 to the Unaudited Interim Consolidated Financial Statements.

|  | Three Months Ended September 30, |  |  | Nine Months Ended September 30, |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  | 2011 | 2012 |  | 2011 |
|  | (in millions) |  |  |  |  |  |
| Realized investment gains (losses), net: |  |  |  |  |  |  |
| Financial Services Businesses | \$ $(1,519)$ |  | 2,288 | \$ $(1,284)$ |  | 2,461 |
| Closed Block Business | 74 |  | 240 | 218 |  | 485 |
| Consolidated realized investment gains (losses), net | \$ $(1,445)$ |  | 2,528 | \$ $(1,066)$ |  | 2,946 |
| Financial Services Businesses: |  |  |  |  |  |  |
| Realized investment gains (losses), net: |  |  |  |  |  |  |
| Fixed maturity securities | \$ (85) |  | (50) | \$ (194) |  | (87) |
| Equity securities | 10 |  | (82) | (59) |  | (98) |
| Commercial mortgage and other loans | 23 |  | 39 | 45 |  | 65 |
| Derivative instruments | $(1,467)$ |  | 2,398 | $(1,012)$ |  | 2,533 |
| Other | 0 |  | (17) | (64) |  | 48 |
| Total | \$ $(1,519)$ |  | 2,288 | \$ $(1,284)$ |  | 2,461 |
| Related adjustments | (432) |  | 1,097 | (325) |  | 714 |
| Realized investment gains (losses), net, and related adjustments | $(1,951)$ |  | 3,385 | $(1,609)$ |  | 3,175 |
| Related charges | 648 |  | $(1,568)$ | 498 |  | $(1,732)$ |
| Realized investment gains (losses), net, and related charges and adjustments | \$ $(1,303)$ |  | 1,817 | \$ $(1,111)$ | \$ | 1,443 |
| Closed Block Business: |  |  |  |  |  |  |
| Realized investment gains (losses), net: |  |  |  |  |  |  |
| Fixed maturity securities | \$ 32 |  | 48 | \$ 46 | \$ | 89 |
| Equity securities | 30 |  | 28 | 62 |  | 224 |
| Commercial mortgage and other loans | 5 |  | 7 | 4 |  | 15 |
| Derivative instruments | 9 |  | 159 | 109 |  | 160 |
| Other | (2) |  | (2) | (3) |  | (3) |
| Total | \$ 74 |  | 240 | \$ 218 |  | 485 |

2012 to 2011 Three Month Comparison

Financial Services Businesses

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The Financial Services Businesses net realized investment losses in the third quarter of 2012 were $\$ 1,519$ million, compared to net realized investment gains of $\$ 2,288$ million in the third quarter of 2011.

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Net realized losses on fixed maturity securities were $\$ 85$ million in the third quarter of 2012, compared to net realized losses of $\$ 50$ million in the third quarter of 2011, as set forth in the following table:
$\left.\begin{array}{l|ccc} & \begin{array}{c}\text { Three Months Ended } \\ \text { September 30, } \\ \text { 2011 }\end{array} \\ \text { (in millions) }\end{array}\right]$
(1) Amounts exclude prepayment premiums, other-than-temporary impairments, and credit related losses through sales of investments pursuant to our credit risk objectives.
(2) Excludes the portion of other-than-temporary impairments recorded in Other comprehensive income (loss), representing any difference between the fair value of the impaired debt security and the net present value of its projected future cash flows at the time of impairment.

Net losses on sales and maturities of fixed maturity securities were $\$ 7$ million in the third quarter of 2012 and were primarily due to sales within our International Insurance segment. Net trading gains on sales and maturities of fixed maturity securities were $\$ 44$ million in the third quarter of 2011 and were primarily due to sales within our Retirement and Individual Annuities segments. Sales of fixed maturity securities in our Individual Annuities segment in 2011 were primarily due to transfers of investments out of our general account and into separate accounts relating to an automatic rebalancing element embedded in the living benefit features of some of our variable annuity products. See below for additional information regarding the other-than-temporary impairments of fixed maturity securities in the third quarter of 2012 and 2011.

Net realized gains on equity securities were $\$ 10$ million in the third quarter of 2012 which included net trading gains on sales of equity securities of $\$ 31$ million, primarily due to sales within our Corporate and Other operations, partially offset by other-than-temporary impairments of $\$ 21$ million. Net realized losses on equity securities were $\$ 82$ million in the third quarter of 2011, which included net trading losses on sales of equity securities of $\$ 42$ million, primarily due to sales within our International Insurance business and other-than-temporary impairments of $\$ 40$ million. See below for additional information regarding the other-than-temporary impairments of equity securities in the third quarter of 2012 and 2011.

Net realized gains on commercial mortgage and other loans in the third quarter of 2012 were $\$ 23$ million, primarily related to a net decrease in the loan loss reserve of $\$ 25$ million and higher servicing revenue within our commercial mortgage operations, which was partially offset by realized losses on restructurings and sales of loans held within our Retirement segment. Net realized gains on commercial mortgage and other
loans in the third quarter of 2011 were $\$ 39$ million, primarily related to a net decrease in the loan loss reserve of $\$ 42$ million and mark-to-market gains on our interim loan portfolio within our commercial mortgage operations, which was partially offset by realized losses from foreclosures and payoffs. For additional information regarding our commercial mortgage and other loan loss reserves see General Account Investments Commercial Mortgage and Other Loans Commercial Mortgage and Other Loan Quality.

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Net realized losses on derivatives were $\$ 1,467$ million in the third quarter of 2012, compared to net realized gains of $\$ 2,398$ million in the third quarter of 2011. The net derivative losses in the third quarter of 2012 primarily reflect net losses of $\$ 1,360$ million on product related embedded derivatives and related hedge positions primarily associated with certain variable annuity contracts. Also contributing to these losses were net losses of $\$ 82$ million on foreign currency forward contracts used to hedge the future income of non-U.S. businesses primarily in Japan due to the weakening of the U.S. dollar against the Japanese yen. The net derivative gains in the third quarter of 2011 primarily reflect net gains of $\$ 1,624$ million on embedded derivatives and related hedge positions primarily associated with certain variable annuity contracts. Also, contributing to the net derivative gains were net mark-to-market gains of $\$ 441$ million on interest rate derivatives used to manage duration as interest rates declined, net gains of $\$ 262$ million on foreign currency forward contracts used in our Star and Edison Businesses to hedge portfolio assets primarily due to the strengthening of the Japanese yen against the U.S. dollar and Australian dollar, and net derivative gains of $\$ 73$ million on foreign currency derivatives used primarily in our Retirement segment to hedge portfolio assets denominated mainly in Euros and Canadian dollars, as the U.S. dollar strengthened against those currencies. These gains were offset by net losses of $\$ 93$ million on foreign currency forward contracts used to hedge the future income of non-U.S. businesses primarily in Japan due to the weakening of the U.S. dollar against the Japanese yen. See Results of Operations for Financial Services Businesses by Segment U.S. Retirement Solutions and Investment Management Division Individual Annuities for additional information regarding the product related embedded derivatives and related hedge positions associated with certain variable annuity contracts.

Net realized losses on other investments were less than $\$ 1$ million in the third quarter of 2012. Net realized losses on other investments were $\$ 17$ million in the third quarter of 2011, which included other-than-temporary impairments of $\$ 6$ million on real estate and joint ventures and partnerships investments and net trading losses of $\$ 11$ million primarily from the sale of a joint venture and partnership investment within our International Insurance business.

Related adjustments include that portion of Realized investment gains (losses), net that are included in adjusted operating income and that portion of Asset management fees and other income and Net investment income that are excluded from adjusted operating income. The adjustments are made to arrive at Realized investment gains (losses), net, and related adjustments which are excluded from adjusted operating income. Related adjustments to realized investment gains (losses) were a net negative adjustment of $\$ 432$ million in the third quarter of 2012. Adjustments for that portion of Realized investment gains (losses), net that are included in adjusted operating income were a net negative adjustment of $\$ 103$ million, primarily driven by net gains from settlements on interest rate swaps, and gains that represent a principal source of earnings for certain of our businesses. Adjustments for that portion of Asset management fees and other income and Net investment income that are excluded from adjusted operating income were a net negative adjustment of $\$ 329$ million, primarily driven by the impact of changes in foreign currency exchange rates on certain assets and liabilities for which we economically hedge the foreign currency exposure.

Related adjustments to realized investment gains (losses) were a net positive adjustment of $\$ 1,097$ million in the third quarter of 2011. Adjustments for that portion of Realized investment gains (losses), net that are included in adjusted operating income were a net negative adjustment of $\$ 66$ million for the third quarter 2011, primarily driven by net gains from settlements on interest rate swaps, and gains that represent a principal source of earnings for certain of our businesses, partially offset by losses related to the settlements of swaps used to hedge foreign-denominated earnings. Adjustments for that portion of Asset management fees and other income and Net investment income that are excluded from adjusted operating income were a net positive adjustment of $\$ 1,163$ million, primarily driven by the impact of changes in foreign currency exchange rates on certain assets and liabilities for which we economically hedge the foreign currency exposure.

Charges that relate to Realized investment gains (losses), net are also excluded from adjusted operating income. Related charges were a net positive adjustment of $\$ 648$ million and a net negative adjustment of $\$ 1,568$ million for the third quarter of 2012 and 2011, respectively. These adjustments were primarily driven by that

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portion of amortization of deferred policy acquisition and other costs relating to net losses and net gains for the third quarter of 2012 and 2011, respectively, on embedded derivatives and related hedge positions associated with certain variable annuity contracts.

During the third quarter of 2012 , we recorded other-than-temporary impairments of $\$ 103$ million in earnings, compared to other-than-temporary impairments of $\$ 147$ million recorded in earnings in the third quarter of 2011. The following tables set forth, for the periods indicated, the composition of other-than-temporary impairments recorded in earnings attributable to the Financial Services Businesses by asset type, and for fixed maturity securities, by reason.
$\left.\begin{array}{l|cc|} & \begin{array}{c}\text { Three Months Ended } \\ \text { September 30, } \\ \text { 2011 }\end{array} \\ \text { Other-than-temporary impairments recorded in earnings } \\ \text { (in millions) }\end{array}\right]$
(1) Excludes the portion of other-than-temporary impairments recorded in Other comprehensive income (loss), representing any difference between the fair value of the impaired debt security and the net present value of its projected future cash flows at the time of impairment.
(2) Includes other-than-temporary impairments relating to investments in joint ventures and partnerships and real estate investments.

|  | Three Months Ended September 30, 2012 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Asset-Backed Securities Collateralized By Sub-Prime Mortgages | All Other Fixed <br> Maturity <br> Securities (in millions) |  | Total Fixed Maturity Securities |  |
| Other-than-temporary impairments on fixed maturity securities recorded in earnings Financial Services Businesses(1) |  |  |  |  |  |
| Due to credit events or adverse conditions of the respective issuer(2) | \$ 13 | \$ | 15 | \$ | 28 |
| Due to other accounting guidelines(3) | 0 |  | 54 |  | 54 |
| Total | \$ 13 | \$ | 69 | \$ | 82 |


|  | Three Months Ended September 30, 2011 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Asset-Backed Securities Collateralized By Sub-Prime Mortgages | All Other Fixed <br> Maturity <br> Securities (in millions) |  | Total Fixed Maturity Securities |  |
| Other-than-temporary impairments on fixed maturity securities recorded in earnings Financial Services Businesses(1) |  |  |  |  |  |
| Due to credit events or adverse conditions of the respective issuer(2) | \$ 22 | \$ | 8 | \$ | 30 |
| Due to other accounting guidelines(3) | 2 |  | 69 |  | 71 |

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

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(2) Represents circumstances where we believe credit events or other adverse conditions of the respective issuers have caused, or will lead to, a deficiency in the contractual cash flows related to the investment. The amount of the impairment recorded in earnings is the difference between the amortized cost of the debt security and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security prior to impairment.
(3) Primarily represents circumstances where securities with losses from foreign currency exchange rate movements approach maturity.

Fixed maturity other-than-temporary impairments in the third quarter of 2012 were concentrated in the finance, capital goods, consumer non-cyclical, and technology sectors of our corporate securities, and asset-backed securities collateralized by sub-prime mortgages. These other-than-temporary impairments were primarily related to securities with unrealized losses from foreign currency exchange rate movements that are approaching maturity or related to securities with liquidity concerns, downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers, which have caused, or we believe will lead to, a deficiency in the contractual cash flows related to the investment. During the third quarter of 2012, we recorded other-than-temporary impairments of $\$ 51$ million in earnings related to securities with unrealized losses from foreign currency exchange rate movements that are approaching maturity. Our Japanese insurance operations hold non-yen denominated investments which in some cases, due primarily to the strengthening of the yen against the U.S. dollar, are currently in an unrealized loss position. As the securities approach maturity and remain in an unrealized loss position, it becomes less likely that the exchange rates will recover and more likely that losses will be realized upon maturity. Accordingly, additional impairments are to be recorded in earnings as they approach maturity. As of September 30, 2012, gross unrealized losses related to those securities maturing between October 1, 2012 and December 31, 2014 are $\$ 357$ million. Absent a change in currency rates, impairments of approximately $\$ 23$ million would be recorded in earnings over the remaining three months of 2012 and approximately $\$ 123$ million in 2013 on these securities. Fixed maturity other-than-temporary impairments in the third quarter of 2011 were concentrated in the consumer non-cyclical, utility, and finance sectors of our corporate securities, and asset-backed securities collateralized by sub-prime mortgages. These other-than-temporary impairments were primarily related to securities with unrealized foreign currency translation losses that are approaching maturity or related to securities with liquidity concerns, downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers, which have caused, or we believe will lead to, a deficiency in the contractual cash flows related to the investment.

Equity security other-than-temporary impairments in the third quarter of both 2012 and 2011 were primarily driven by circumstances where the decline in value was maintained for one year or greater or where we intend to sell the security.

Other invested assets other-than-temporary impairments in the third quarter of both 2012 and 2011 were mainly driven by a decline in value on certain real estate and joint ventures and partnerships investments.

Closed Block Business

For the Closed Block Business, net realized investment gains in the third quarter of 2012 were $\$ 74$ million, compared to net realized investment gains of $\$ 240$ million in the third quarter of 2011.

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Net realized gains on fixed maturity securities were $\$ 32$ million in the third quarter of 2012, compared to net realized gains of $\$ 48$ million in the third quarter of 2011, as set forth in the following table:
$\left.\begin{array}{l|l|l} & \begin{array}{c}\text { Three Months Ended } \\ \text { September 30, } \\ \text { 2011 }\end{array} \\ \text { (in millions) }\end{array}\right]$
(1) Amounts exclude prepayment premiums, other-than-temporary impairments, and credit related losses through sales of investments pursuant to our credit risk objectives.
(2) Excludes the portion of other-than-temporary impairments recorded in Other comprehensive income (loss), representing any difference between the fair value of the impaired debt security and the net present value of its projected future cash flows at the time of impairment.

Net trading gains on sales and maturities of fixed maturity securities were $\$ 37$ and $\$ 57$ million in the third quarter of 2012 and 2011, respectively. See below for additional information regarding the other-than-temporary impairments of fixed maturity securities in the third quarter of 2012 and 2011.

Net realized gains on equity securities were $\$ 30$ million in the third quarter of 2012 which included net trading gains on sales of equity securities of $\$ 33$ million, partially offset by other-than-temporary impairments of $\$ 3$ million. Net realized gains on equity securities were $\$ 28$ million in the third quarter of 2011, which included net trading gains on sales of equity securities of $\$ 30$ million, partially offset by other-than-temporary impairments of $\$ 2$ million. See below for additional information regarding the other-than-temporary impairments of equity securities in the third quarter of 2012 and 2011.

Net realized gains on commercial mortgage and other loans in the third quarter of 2012 of $\$ 5$ million primarily related to a net decrease in the loan loss reserve. Net realized gains on commercial mortgage and other loans in the third quarter of 2011 of $\$ 7$ million primarily related to a net decrease in the loan loss reserve. For additional information regarding our loan loss reserves, see General Account Investments Commercial Mortgage and Other Loans Commercial Mortgage and Other Loan Quality.

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Net realized gains on derivatives were $\$ 9$ million in the third quarter of 2012, compared to net realized gains of $\$ 159$ million in the third quarter of 2011. Derivative gains in the third quarter of 2012 primarily reflect net mark-to-market gains of $\$ 23$ million on interest rate derivatives primarily used to manage duration as short term interest rates decreased and net gains of $\$ 15$ million on to be announced ( TBA ) forward contracts. Partially offsetting these gains were net losses of $\$ 25$ million related to currency derivatives used to hedge foreign denominated investments as the U.S. dollar weakened against the euro. The net derivative gains in the third quarter of 2011 primarily reflect net gains of $\$ 118$ million on currency derivatives used to hedge foreign denominated investments as the U.S. dollar strengthened against the euro. Also, contributing to these gains are net derivative gains of $\$ 29$ million on TBA forward contracts, and $\$ 17$ million on interest rate derivatives used to manage duration as interest rates declined.

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During the third quarter of 2012, we recorded other-than-temporary impairments of $\$ 18$ million in earnings, compared to other-than-temporary impairments of $\$ 19$ million recorded in earnings in the third quarter of 2011. The following tables set forth, for the periods indicated, the composition of other-than-temporary impairments recorded in earnings attributable to the Closed Block Business by asset type, and for fixed maturity securities, by reason.
$\left.\begin{array}{l|cc|} & \begin{array}{c}\text { Three Months Ended } \\ \text { September 30, } \\ \text { 2011 }\end{array} \\ \text { (in millions) }\end{array}\right]$
(1) Excludes the portion of other-than-temporary impairments recorded in Other comprehensive income (loss), representing any difference between the fair value of the impaired debt security and the net present value of its projected future cash flows at the time of impairment.
(2) Includes other-than-temporary impairments relating to investments in joint ventures and partnerships.

|  | Three Months Ended September 30, 2012 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Asset-Backed Securities Collateralized By Sub-Prime Mortgages | All Other Fixed Maturity Securities (in millions) |  | Total Fixed Maturity Securities |  |
| Other-than-temporary impairments on fixed maturity securities recorded in earnings Closed Block Business(1) |  |  |  |  |  |
| Due to credit events or adverse conditions of the respective issuer(2) | \$ 7 | \$ | 6 | \$ | 13 |
| Due to other accounting guidelines | 0 |  | 0 |  | 0 |
| Total | \$ 7 | \$ | 6 | \$ | 13 |


|  | Three Months Ended September 30, 2011 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Asset-Backed Securities Collateralized By Sub-Prime Mortgages | All Other Fixed Maturity Securities (in millions) |  | Total Fixed Maturity Securities |  |
| Other-than-temporary impairments on fixed maturity securities recorded in earnings Closed Block Business(1) |  |  |  |  |  |
| Due to credit events or adverse conditions of the respective issuer(2) | \$ 6 | \$ | 6 | \$ | 12 |
| Due to other accounting guidelines | 3 |  | 0 |  | 3 |
| Total | \$ 9 | \$ | 6 | \$ | 15 |

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(1) Excludes the portion of other-than-temporary impairment recorded in Other comprehensive income (loss), representing any difference between the fair value of the impaired debt security and the net present value of its projected future cash flows at the time of impairment.
(2) Represents circumstances where we believe credit events or other adverse conditions of the respective issuers have caused, or will lead to, a deficiency in the contractual cash flows related to the investment. The amount of the impairment recorded in earnings is the difference between the amortized cost of the debt security and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security prior to impairment.

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Fixed maturity other-than-temporary impairments in the third quarter of 2012 and 2011 were concentrated in asset-backed securities collateralized by sub-prime mortgages and were primarily driven by liquidity concerns, downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers, which have caused, or we believe will lead to, a deficiency in the contractual cash flows related to the investment.

Equity security other-than-temporary impairments in the third quarter of 2012 and 2011 were primarily due to circumstances where the decline in value was maintained for one year or greater.

## 2012 to 2011 Nine Month Comparison

## Financial Services Businesses

The Financial Services Businesses net realized investment losses in the first nine months of 2012 were $\$ 1,284$ million, compared to net realized investment gains of $\$ 2,461$ million in the first nine months of 2011.

Net realized losses on fixed maturity securities were $\$ 194$ million in the first nine months of 2012, compared to net realized losses of $\$ 87$ million in the first nine months of 2011, as set forth in the following table:

|  | $\begin{gathered} \text { Nine Months Ended } \\ \text { September 30, } \\ 2012 \end{gathered}$ |  |  |
| :---: | :---: | :---: | :---: |
| Realized investment gains (losses), net Fixed Maturity Securities Financial Services Businesses |  |  |  |
| Gross realized investment gains: |  |  |  |
| Gross gains on sales and maturities(1) | \$ 229 | \$ | 391 |
| Private bond prepayment premiums | 14 |  | 23 |
| Total gross realized investment gains | 243 |  | 414 |
| Gross realized investment losses: |  |  |  |
| Net other-than-temporary impairments recognized in earnings(2) | (238) |  | (309) |
| Gross losses on sales and maturities(1) | (176) |  | (189) |
| Credit related losses on sales | (23) |  | (3) |
| Total gross realized investment losses | (437) |  | (501) |
| Realized investment gains (losses), net Fixed Maturity Securities | \$ (194) | \$ | (87) |
| Net gains (losses) on sales and maturities Fixed Maturity Securities(1) | \$ 53 | \$ | 202 |

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Amounts exclude prepayment premiums, other-than-temporary impairments, and credit related losses through sales of investments pursuant to our credit risk objectives.
(2) Excludes the portion of other-than-temporary impairments recorded in Other comprehensive income (loss), representing any difference between the fair value of the impaired debt security and the net present value of its projected future cash flows at the time of impairment.

Net trading gains on sales and maturities of fixed maturity securities in the first nine months of 2012 were $\$ 53$ million primarily due to sales within our International Insurance, Retirement, and Individual Annuities segments. Included in the net gains on sales and maturities of fixed maturity securities were $\$ 3$ million of net gains related to the sale of asset-backed securities collateralized by sub-prime mortgages. Net trading gains on sales and maturities of fixed maturity securities in the first nine months of 2011 were $\$ 202$ million primarily due to sales within our Retirement and Individual Annuities segments. Net gains on sales and maturities in the first nine months of 2011 included $\$ 34$ million related to asset-backed securities collateralized by sub-prime mortgages. Sales of fixed maturity securities in our Individual Annuities segment in 2012 and 2011 were primarily due to transfers of investments out of our general account and into separate accounts relating to an automatic rebalancing element embedded in the living benefit features of some of our variable annuity products. See General Account Investments Fixed Maturity Securities Asset-Backed Securities for additional

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information regarding our exposure to asset-backed securities collateralized by sub-prime mortgages. See below for additional information regarding the other-than-temporary impairments of fixed maturity securities in the first nine months of 2012 and 2011.


#### Abstract

Net realized losses on equity securities were $\$ 59$ million in the first nine months of 2012. The first nine months of 2012 included other-than-temporary equity securities impairments of $\$ 93$ million and net trading gains on sales of equity securities of $\$ 34$ million, which were primarily due to sales within our Corporate and Other operations. Net realized losses on equity securities were $\$ 98$ million in the first nine months of 2011. The first nine months of 2011 included other-than-temporary equity securities impairments of $\$ 85$ million and net trading losses on sales of equity securities of $\$ 13$ million, which were primarily due to sales within our International Insurance business. See below for additional information regarding the other-than-temporary impairments of equity securities in the first nine months of 2012 and 2011.


Net realized gains on commercial mortgage and other loans in the first nine months of 2012 were $\$ 45$ million, primarily related to a net decrease in the loan loss reserve of $\$ 46$ million and higher servicing revenue within our commercial mortgage operations, which was partially offset by realized losses related to restructurings and sales of loans held within our Retirement segment. Net realized gains on commercial mortgage and other loans in the first nine months of 2011 were $\$ 65$ million, primarily related to a net decrease in the loan loss reserve of $\$ 146$ million, which was partially offset by realized losses on related restructurings and sales within our commercial mortgage operations and International Insurance business. For additional information regarding our commercial mortgage and other loan loss reserves, see General Account
Investments Commercial Mortgage and Other Loans Commercial Mortgage and Other Loan Quality.

Net realized losses on derivatives were $\$ 1,012$ million in the first nine months of 2012, compared to net realized gains of $\$ 2,533$ million in the first nine months of 2011. The net derivative gains in the first nine months of 2012 primarily reflect net losses of $\$ 1,294$ million on product related embedded derivatives and related hedge positions primarily associated with certain variable annuity contracts. Partially offsetting these losses were net mark-to-market gains of $\$ 138$ million on interest rate derivatives used to manage duration as interest rates decreased and gains of $\$ 91$ million on fee-based synthetic guaranteed investment contracts which are accounted for as derivatives. The net derivative gains in the first nine months of 2011 primarily reflect net gains of $\$ 1,850$ million on embedded derivatives and related hedge positions associated with certain variable annuity contracts. Also, contributing to the net derivative gains were net mark-to-market gains of $\$ 416$ million on interest rate derivatives used to manage duration as interest rates declined, and net gains of $\$ 238$ million on Star and Edison foreign currency forward contracts used to hedge portfolio assets primarily due to the strengthening of the Japanese yen against the U.S. dollar and Australian dollar. See

Results of Operations for Financial Services Businesses by Segment U.S. Retirement Solutions and Investment Management Division Individual Annuities for additional information regarding the product related embedded derivatives and related hedge positions associated with certain variable annuity contracts.

Net realized losses on other investments were $\$ 64$ million in the first nine months of 2012, which included other-than-temporary impairments of $\$ 74$ million on real estate and joint ventures and partnerships investments, of which $\$ 58$ million relates to prior periods, partially offset by net trading gains of $\$ 10$ million, primarily from our Corporate and Other segment. Net realized gains on other investments were $\$ 48$ million in the first nine months of 2011, which included a $\$ 61$ million gain on the partial sale of a real estate seed investment and $\$ 9$ million of net trading gains, partially offset by other other-than-temporary impairments of $\$ 22$ million on real estate and joint venture and partnership investments.

Related adjustments include that portion of Realized investment gains (losses), net that are included in adjusted operating income and that portion of Asset management fees and other income and Net investment income that are excluded from adjusted operating income. The adjustments are made to arrive at Realized investment gains (losses), net, and related adjustments which are excluded from adjusted operating income. Related adjustments to realized investment gains (losses) were a net negative adjustment of $\$ 325$ million in the

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first nine months of 2012. Adjustments for that portion of Realized investment gains (losses), net that are included in adjusted operating income were a net negative adjustment of $\$ 191$ million, primarily driven by net gains from settlements on interest rate swaps, partially offset by losses related to the settlements of swaps used to hedge foreign-denominated earnings. Adjustments for that portion of Asset management fees and other income and Net investment income that are excluded from adjusted operating income were a net negative adjustment of $\$ 134$ million, primarily driven by the impact of changes in foreign currency exchange rates on certain assets and liabilities for which we economically hedge the foreign currency exposure.

Related adjustments to realized investment gains (losses) were a net positive adjustment of $\$ 714$ million in the first nine months of 2011. Adjustments for that portion of Realized investment gains (losses), net that are included in adjusted operating income were a net negative adjustment of $\$ 229$ million for the first nine months of 2011, primarily driven by net gains from settlements on interest rate swaps and gains that represent a principal source of earnings for certain of our businesses, partially offset by losses related to the settlements of swaps used to hedge foreign-denominated earnings. Adjustments for that portion of Asset management fees and other income and Net investment income that are excluded from adjusted operating income were a net positive adjustment of $\$ 943$ million in the first nine months of 2011, primarily driven by the impact of changes in foreign currency exchange rates on certain assets and liabilities for which we economically hedge the foreign currency exposure. Also included in the $\$ 943$ million adjustment for the first nine months of 2011 was a $\$ 95$ million loss from an out of period adjustment recorded in the first quarter of 2011, and a $\$ 65$ million loss related to our counterparty exposure on derivative transactions we had previously held with Lehman Brothers and affiliates. See Note 11 to the Unaudited Interim Consolidated Financial Statements for further details.

Charges that relate to Realized investment gains (losses), net are also excluded from adjusted operating income. Related charges were a net positive adjustment of $\$ 498$ million and a net negative adjustment of $\$ 1,732$ million for the first nine months of 2012 and 2011, respectively. These adjustments were primarily driven by that portion of amortization of deferred policy acquisition and other costs relating to net losses and net gains for the first nine months of 2012 and 2011, respectively, on embedded derivatives and related hedge positions associated with certain variable annuity contracts.

During the first nine months of 2012, we recorded other-than-temporary impairments of $\$ 405$ million in earnings, compared to total other-than-temporary impairments of $\$ 416$ million recorded in earnings in the first nine months of 2011. The following tables set forth, for the periods indicated, the composition of other-than-temporary impairments recorded in earnings attributable to the Financial Services Businesses by asset type, and for fixed maturity securities, by reason.

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

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|  | Nine Months Ended September 30, 2012 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Asset-Backed Securities Collateralized By Sub-Prime Mortgages | All Other Fixed Maturity Securities (in millions) |  | Total Fixed Maturity Securities |  |
| Other-than-temporary impairments on fixed maturity securities recorded in earnings Financial Services Businesses(1) |  |  |  |  |  |
| Due to credit events or adverse conditions of the respective issuer(2) | \$ 45 | \$ | 45 | \$ | 90 |
| Due to other accounting guidelines(3) | 2 |  | 146 |  | 148 |
| Total | \$ 47 | \$ | 191 | \$ | 238 |

$\left.\begin{array}{lcccc} & \begin{array}{c}\text { Asset-Backed } \\ \text { Securities }\end{array} \\ \text { Collateralized By Sub-Prime } \\ \text { Mortgages }\end{array} \quad \begin{array}{c}\text { All Other Fixed } \\ \text { Maturity } \\ \text { Securities } \\ \text { (in millions) }\end{array} \quad \begin{array}{c}\text { Total Fixed } \\ \text { Maturity } \\ \text { Securities }\end{array}\right]$
(1) Excludes the portion of other-than-temporary impairment recorded in Other comprehensive income (loss), representing any difference between the fair value of the impaired debt security and the net present value of its projected future cash flows at the time of impairment.
(2) Represents circumstances where we believe credit events or other adverse conditions of the respective issuers have caused, or will lead to, a deficiency in the contractual cash flows related to the investment. The amount of the impairment recorded in earnings is the difference between the amortized cost of the debt security and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security prior to impairment.
(3) Primarily represents circumstances where securities with losses from foreign currency exchange rate movements approach maturity or where we intend to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis.

Fixed maturity other-than-temporary impairments in the first nine months of 2012 were concentrated in the consumer non-cyclical and technology sectors of our corporate securities, and asset-backed securities collateralized by sub-prime mortgages. These other-than-temporary impairments were primarily related to securities with unrealized losses from foreign currency exchange rate movements that are approaching maturity or related to securities with liquidity concerns, downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers, which have caused, or we believe will lead to, a deficiency in the contractual cash flows related to the investment. During the first nine months of 2012, we recorded other-than-temporary impairments of $\$ 137$ million related to securities with unrealized losses from foreign currency exchange rate movements that are approaching maturity. Our Japanese insurance operations hold non-yen denominated investments which in some cases, due primarily to the strengthening of the yen against the U.S. dollar, are currently in an unrealized loss position. As the securities approach maturity and remain in an unrealized loss position, it becomes less likely that the exchange rates will recover and more likely that losses will be realized upon maturity. Accordingly, additional impairments are to be recorded in earnings as they approach maturity. As of September 30, 2012, gross unrealized losses related to those securities maturing between October 1, 2012 and December 31, 2014 are $\$ 357$ million. Absent a change in currency rates, impairments of approximately $\$ 23$ million would be recorded in earnings over the remaining three months of 2012 and approximately $\$ 123$ million in 2013 on these securities. Fixed maturity other-than-temporary impairments in the first nine months of 2011 were concentrated in the utility, finance, and consumer non-cyclical sectors of our corporate securities, asset-

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backed securities collateralized by sub-prime mortgages, and Japanese commercial mortgage-backed securities. These other-than-temporary impairments were primarily related to securities with unrealized foreign currency translation losses that are approaching maturity or related to securities with liquidity concerns, downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers, which have caused, or we believe will lead to, a deficiency in the contractual cash flows related to the investment.

Equity security other-than-temporary impairments in the first nine months of 2012 and 2011 were primarily driven by circumstances where the decline in value was maintained for one year or greater or where we intend to sell the security.

Other invested assets other-than-temporary impairments in the first nine months of 2012 and 2011 were mainly driven by a decline in value on certain real estate and joint ventures and partnerships investments.

## Closed Block Business

For the Closed Block Business, net realized investment gains in the first nine months of 2012 were $\$ 218$ million, compared to net realized investment gains of $\$ 485$ million in the first nine months of 2011.

Net realized gains on fixed maturity securities were $\$ 46$ million in the first nine months of 2012, compared to net realized gains of $\$ 89$ million in the first nine months of 2011, as set forth in the following table:
$\left.\begin{array}{l|ccc} & \begin{array}{c}\text { Nine Months Ended } \\ \text { September 30, } \\ \text { 2011 }\end{array} \\ \text { (in millions) }\end{array}\right]$

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(1) Amounts exclude prepayment premiums, other-than-temporary impairments, and credit related losses through sales of investments pursuant to our credit risk objectives.
(2) Excludes the portion of other-than-temporary impairments recorded in Other comprehensive income (loss), representing any difference between the fair value of the impaired debt security and the net present value of its projected future cash flows at the time of impairment.

Net trading gains on sales and maturities of fixed maturity securities in the first nine months of 2012 and 2011 were $\$ 105$ and $\$ 144$ million, respectively. See below for additional information regarding the other-than-temporary impairments of fixed maturity securities in the first nine months of 2012 and 2011.

Net realized gains on equity securities were $\$ 62$ million in the first nine months of 2012, which included net trading gains on sales of equity securities of $\$ 83$ million, partially offset by other-than-temporary impairments of $\$ 21$ million. Net realized gains on equity securities were $\$ 224$ million in the first nine months of 2011, which

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include net trading gains on sales of equity securities of $\$ 240$ million, partially offset by other-than-temporary impairments of $\$ 16$ million. See below for additional information regarding the other-than-temporary impairments of equity securities in the first nine months of 2012 and 2011.

Net realized gains on commercial mortgage and other loans in the first nine months of 2012 were $\$ 4$ million, primarily related to a net increase in the loan loss reserve. Net realized gains on commercial mortgage and other loans of $\$ 15$ million in the first nine months of 2011 were primarily related to a net decrease in the loan loss reserve of $\$ 23$ million, partially offset by realized losses on foreclosures. For additional information regarding our loan loss reserves see General Account Investments Commercial Mortgage and Other Loans Commercial Mortgage and Other Loan Quality.

Net realized gains on derivatives were $\$ 109$ million in the first nine months of 2012, compared to net realized gains of $\$ 160$ million in the first nine months of 2011. Derivative gains in the first nine months of 2012 primarily reflect net gains of $\$ 95$ million on interest rate derivatives primarily used to manage duration and net gains of $\$ 26$ million on TBA forward contracts as interest rates declined, partially offset by net losses of $\$ 14$ million on credit default swaps as credit spreads tightened. The net derivative gains in the first nine months of 2011 primarily reflect net gains of $\$ 110$ million on interest rate derivatives used to manage duration and $\$ 45$ million on TBA forward contracts as interest rates declined.

Net realized losses on other investments were $\$ 3$ million in the first nine months of both 2012 and 2011, driven by other-than-temporary impairments on joint ventures and partnership investments in both periods.

During the first nine months of 2012, we recorded other-than-temporary impairments of $\$ 86$ million in earnings, compared to other-than-temporary impairments of $\$ 82$ million recorded in earnings in the first nine months of 2011. The following tables set forth, for the periods indicated, the composition of other-than-temporary impairments recorded in earnings attributable to the Closed Block Business by asset type, and for fixed maturity securities, by reason.

|  | Nine Months EndedSeptember 30,$\left.2012 \begin{array}{c}\text { 2011 } \\ \text { (in millions) }\end{array}\right)$ |  |  |
| :---: | :---: | :---: | :---: |
| Other-than-temporary impairments recorded in earnings Closed Block Business(1) |  |  |  |
| Public fixed maturity securities | \$ 48 | \$ | 58 |
| Private fixed maturity securities | 14 |  | 6 |
| Total fixed maturity securities | 62 |  | 64 |
| Equity securities | 21 |  | 16 |
| Other invested assets(2) | 3 |  | 2 |
| Total | \$ 86 | \$ | 82 |

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|  | Nine Months Ended September 30, 2012 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Asset-Backed Securities Collateralized By Sub-Prime Mortgages | All Other Fixed Maturity Securities (in millions) |  | Total Fixed Maturity Securities |  |
| Other-than-temporary impairments on fixed maturity securities recorded in earnings Closed Block Business(1) |  |  |  |  |  |
| Due to credit events or adverse conditions of the respective issuer(2) | \$ 32 | \$ | 29 | \$ | 61 |
| Due to other accounting guidelines | 1 |  | 0 |  | 1 |
| Total | \$ 33 | \$ | 29 | \$ | 62 |

(1) Excludes the portion of other-than-temporary impairment recorded in Other comprehensive income (loss), representing any difference between the fair value of the impaired debt security and the net present value of its projected future cash flows at the time of impairment.
(2) Represents circumstances where we believe credit events or other adverse conditions of the respective issuers have caused, or will lead to, a deficiency in the contractual cash flows related to the investment. The amount of the impairment recorded in earnings is the difference between the amortized cost of the debt security and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security prior to impairment.

Fixed maturity other-than-temporary impairments in the first nine months of 2012 were concentrated in asset-backed securities collateralized by sub-prime mortgages and were primarily driven by liquidity concerns, downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers, which have caused, or we believe will lead to, a deficiency in the contractual cash flows related to the investment. Other-than-temporary impairments in the first nine months of 2011 were concentrated in asset-backed securities collateralized by sub-prime mortgages and were primarily driven by liquidity concerns, downgrades in credit, bankruptcy or other adverse financial conditions of the respective issuers, which have caused, or we believe will lead to, a deficiency in the contractual cash flows related to the investment.

Equity security other-than-temporary impairments in the first nine months of 2012 and 2011 were primarily due to circumstances where the decline in value was maintained for one year or greater.

## General Account Investments

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Our investment portfolio consists of public and private fixed maturity securities, commercial mortgage and other loans, equity securities and other invested assets. The composition of our general account reflects, within the discipline provided by our risk management approach, our need for competitive results and the selection of diverse investment alternatives available primarily through our Asset Management segment. The size of our portfolio enables us to invest in asset classes that may be unavailable to the typical investor.

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The following tables set forth the composition of the investments of our general account apportioned between the Financial Services Businesses and the Closed Block Business as of the dates indicated.

|  | Financial <br> Services <br> Businesses | September 30, 2012 <br> Closed Block <br> Business <br> $(\$$ in millions) | Total | \% of Total |
| :--- | ---: | ---: | ---: | ---: | ---: |


|  | Financial <br> Services <br> Businesses | December 31, 2011 <br> Closed Block <br> Business <br> $(\$$ in millions) | Total | \% of Total |
| :--- | ---: | ---: | ---: | ---: | ---: |

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(1) Other long-term investments consist of real estate and non-real estate-related investments in joint ventures and partnerships, investment real estate held through direct ownership and other miscellaneous investments. For additional information regarding these investments, see Other Long-Term Investments below.
(2) Includes invested assets of our trading, banking, and asset management operations. Excludes assets of our asset management operations managed for third parties and those assets classified as Separate account assets on our balance sheet. For additional information regarding these investments, see Invested Assets of Other Entities and Operations below.

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As of September 30, 2012, the average duration of our general account investment portfolio attributable to the domestic Financial Services Businesses, including the impact of derivatives, is between 5 and 6 years. The increase in general account investments attributable to the Financial Services Businesses in the first nine months of 2012 was primarily due to portfolio growth as a result of reinvestment of net investment income and net operating inflows, as well as a net increase in fair value driven by a decrease in interest rates. The general account investments attributable to the Closed Block Business also increased in the first nine months of 2012, primarily due to portfolio growth as a result of reinvestment of net investment income and a net increase in fair value driven by a decrease in interest rates, partially offset by net operating outflows. For information regarding the methodology used in determining the fair value of our fixed maturities, see Note 13 to the Unaudited Interim Consolidated Financial Statements.

We have substantial insurance operations in Japan, with $51 \%$ and $50 \%$ of our Financial Services Businesses general account investments relating to our Japanese insurance operations as of September 30, 2012 and December 31, 2011, respectively.

The following table sets forth the composition of the investments of our Japanese insurance operations general account as of the dates indicated.
$\left.\begin{array}{lrr} & \begin{array}{c}\text { September 30, } \\ \mathbf{2 0 1 2}\end{array} & \begin{array}{c}\text { December 31, } \\ \text { 2011 }\end{array} \\ \text { (in millions) }\end{array}\right)$
(1) Other long-term investments consist of real estate and non-real estate-related investments in joint ventures and partnerships, investment real estate held through direct ownership, derivatives, and other miscellaneous investments.
(2) Excludes assets classified as Separate accounts assets on our balance sheet.

As of September 30, 2012, the average duration of our general account investment portfolio related to our Japanese insurance operations, including the impact of derivatives, was approximately 10 years. The increase in general account investments related to our Japanese insurance operations in the first nine months of 2012 was primarily attributable to the portfolio growth as a result of business inflows and the reinvestment of net investment income, as well as a net increase in fair value primarily driven by declining interest rates, partially offset by the weakening of the yen against the U.S. dollar.

The functional currency of our Japanese insurance subsidiaries is the yen and, although the majority of the Japanese general account is invested in yen-denominated investments, our Japanese insurance operations also hold significant investments denominated in U.S. and Australian dollars.

As of September 30, 2012, our Japanese insurance operations had $\$ 44.6$ billion, at fair value, of investments denominated in U.S. dollars, including $\$ 4.5$ billion that were hedged to yen through third party derivative contracts and $\$ 31.3$ billion that support liabilities denominated in U.S. dollars. As of December 31, 2011, our

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Japanese insurance operations had $\$ 38.9$ billion, at fair value, of investments denominated in U.S. dollars, including $\$ 4.4$ billion that were hedged to yen through third party derivative contracts and $\$ 25.9$ billion that support liabilities denominated in U.S. dollars. The $\$ 5.7$ billion increase of U.S. dollar investments at fair value from December 31, 2011, is primarily driven by portfolio growth as a result of business inflows and an increase in fair value driven by a decrease in interest rates.

For additional information regarding U.S. dollar investments held in our Japanese insurance operations, see Results of Operations for Financial Services Businesses by Segment International Insurance Division.

Our Japanese insurance operations had $\$ 8.6$ billion and $\$ 6.4$ billion, at fair value, of investments denominated in Australian dollars that support liabilities denominated in Australian dollars as of September 30, 2012 and December 31, 2011, respectively. The $\$ 2.2$ billion increase of Australian dollar investments at fair value from December 31, 2011, is primarily driven by portfolio growth as a result of business inflows and an increase in fair value driven by a decrease in interest rates.

## Eurozone Exposure

Our investment portfolio includes direct investment exposure to the Eurozone region. We define this region as consisting of those countries within the European Union that have adopted the euro as their sole legal currency. The Eurozone region currently consists of seventeen countries, including Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain. Included in this region are peripheral countries, which we currently define as consisting of Portugal, Italy, Ireland, Greece and Spain. Specific country exposure is determined based on the issuer s country of incorporation.

The following tables set forth the composition of our gross direct exposure to the Eurozone region, by country of incorporation, attributable to our general account, as of September 30, 2012.

## Eurozone Gross Direct Exposure Financial Services Businesses

| Country | September 30, 2012 |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Sovereigns(6) | Financial Institutions(7) |  | Total Amortized Cost | Sovereigns(6) lions) | Financial Institutions(7) |  | Total Fair Value |
| Non-peripheral countries: |  |  |  |  |  |  |  |  |
| France | \$ 361 | \$ 648 | \$ 2,158 | \$ 3,167 | \$ 366 | \$ 605 | \$ 2,347 | \$ 3,318 |
| Netherlands | 26 | 805 | 2,401 | 3,232 | 25 | 842 | 2,496 | 3,363 |
| Germany | 643 | 300 | 832 | 1,775 | 680 | 314 | 854 | 1,848 |
| Luxembourg | 0 | 297 | 871 | 1,168 | 0 | 323 | 901 | 1,224 |
| Other non-peripheral(1) | 138 | 124 | 543 | 805 | 141 | 122 | 558 | 821 |
| Total non-peripheral exposure | 1,168 | 2,174 | 6,805 | 10,147 | 1,212 | 2,206 | 7,156 | 10,574 |
| Peripheral countries: |  |  |  |  |  |  |  |  |
| Italy(2) | 598 | 30 | 242 | 870 | 594 | 31 | 236 | 861 |

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| Ireland | 0 |  | 121 |  | 467 |  | 588 | 0 |  | 127 |  | 480 | 607 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Spain | 48 |  | 27 |  | 119 |  | 194 | 45 |  | 24 |  | 103 | 172 |
| Other peripheral(3) | 0 |  | 0 |  | 0 |  | 0 | 0 |  | 0 |  | 0 | 0 |
| Total peripheral exposure | 646 |  | 178 |  | 828 |  | 1,652 | 639 |  | 182 |  | 819 | 1,640 |
| International agencies(4) | 0 |  | 118 |  | 1,559 |  | 1,677 | 0 |  | 120 |  | 1,657 | 1,777 |
| Total exposure(5) | \$ 1,814 | \$ | 2,470 | \$ | 9,192 | \$ | 13,476 | \$ 1,851 | \$ | 2,508 | \$ | 9,632 | \$ 13,991 |

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## Eurozone Gross Direct Exposure Closed Block Business

| Country |  |  |  |  |  |  | September 30, 2012 |  |  |  | Fair Value |  |  |  | Total Fair Value |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Amortized CoFovereigns(6) Finstitutions(7) |  |  |  | All Other <br> Exposure |  | Total Amortized Cost |  | Financial vereigns(6Institutions(7) ons) |  |  |  | All <br> Other <br> Exposure |  |  |
| Non-peripheral countries: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| France | \$ | 3 | \$ | 99 | , | 913 | \$ | 1,015 | \$ | 3 | $\$$ | 105 | \$ | 1,017 | \$ 1,125 |
| Netherlands |  | 1 |  | 139 |  | 758 |  | 898 |  | 1 |  | 142 |  | 865 | 1,008 |
| Germany |  | 6 |  | 25 |  | 663 |  | 694 |  | 6 |  | 28 |  | 715 | 749 |
| Luxembourg |  | 0 |  | 59 |  | 495 |  | 554 |  | 0 |  | 65 |  | 543 | 608 |
| Other non-peripheral(1) |  | 1 |  | 131 |  | 380 |  | 512 |  | 1 |  | 131 |  | 405 | 537 |
| Total non-peripheral exposure |  | 11 |  | 453 |  | 3,209 |  | 3,673 |  | 11 |  | 471 |  | 3,545 | 4,027 |
| Peripheral countries: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Italy |  | 5 |  | 25 |  | 58 |  | 88 |  | 7 |  | 24 |  | 61 | 92 |
| Ireland |  | 0 |  | 26 |  | 336 |  | 362 |  | 0 |  | 28 |  | 358 | 386 |
| Spain |  | 0 |  | 15 |  | 69 |  | 84 |  | 0 |  | 14 |  | 67 | 81 |
| Other peripheral(3) |  | 0 |  | 0 |  | 2 |  | 2 |  | 0 |  | 0 |  | 2 | 2 |
| Total peripheral exposure |  | 5 |  | 66 |  | 465 |  | 536 |  | 7 |  | 66 |  | 488 | 561 |
| International agencies(4) |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 | 0 |
| Total exposure(5) | \$ 1 | 16 | \$ | 519 | \$ | 3,674 | \$ | 4,209 | \$ 1 |  | \$ | 537 | \$ | 4,033 | \$4,588 |

(1) Other non-peripheral countries include Austria, Belgium, Cyprus, Estonia, Finland, Malta, Slovakia, and Slovenia.
(2) Principally represents Italian government securities owned by our Italian insurance operations.
(3) Other peripheral countries include Greece and Portugal.
(4) International agencies include agencies such as Eurofima, European Investment Bank, Council of Europe Development, and Nordic Investment Bank, where a single country of incorporation could not be determined.
(5) For the Financial Services Businesses, of the $\$ 13,476$ million of amortized cost represented above, $86 \%$ is related to fixed maturities, $9 \%$ is related to trading account assets supporting insurance liabilities, and the remaining 5\% is related to all other asset types. For the Closed Block Business, of the $\$ 4,209$ million of amortized cost represented above, $94 \%$ is related to fixed maturities, and the remaining $6 \%$ is related to all other asset types.
(6) Sovereigns include local governments.
(7) Financial institutions include banking, brokerage, non-captive consumer and diversified finance, health insurance, life insurance, property and casualty insurance, other finance and real estate investment trusts.

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## Investment Results

The following tables set forth the income yield and investment income for each major investment category of our general account for the periods indicated. The yields are based on net investment income as reported under U.S. GAAP and do not include adjustments, such as settlements of duration management swaps that are included in adjusted operating income.

Three Months Ended September 30, 2012

|  | Financial Services Businesses |  | Closed Block Business |  |  | Combined |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Yield(1) | Amount | Yield(1) (\$ in | A | nount <br> s) | Yield(1) | Amount |
| Fixed maturities | 3.69\% | \$ 1,897 | 5.37\% | \$ | 532 | 3.96\% | \$ 2,429 |
| Trading account assets supporting insurance liabilities | 4.00 | 198 | 0.00 |  | 0 | 4.00 | 198 |
| Equity securities | 6.49 | 68 | 2.89 |  | 18 | 5.16 | 86 |
| Commercial mortgage and other loans | 5.50 | 356 | 6.13 |  | 149 | 5.67 | 505 |
| Policy loans | 4.60 | 73 | 5.77 |  | 74 | 5.12 | 147 |
| Short-term investments and cash equivalents | 0.24 | 8 | 2.12 |  | 2 | 0.27 | 10 |
| Other investments | 5.20 | 82 | 5.79 |  | 33 | 5.36 | 115 |
| Gross investment income before investment expenses | 3.83 | 2,682 | 5.42 |  | 808 | 4.10 | 3,490 |
| Investment expenses | (0.11) | (61) | (0.25) |  | (40) | (0.13) | (101) |
| Investment income after investment expenses | 3.72\% | 2,621 | 5.17\% |  | 768 | 3.97\% | 3,389 |
| Investment results of other entities and operations(2) |  | 44 |  |  | 0 |  | 44 |
| Total investment income |  | \$ 2,665 |  | \$ | 768 |  | \$ 3,433 |

Three Months Ended September 30, 2011

|  | Financial Services Businesses |  | Closed Block Business |  |  | Combined |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Yield(1) | Amount | Yield(1) (\$ in | (\$ in millions) | $\begin{aligned} & \text { mount } \\ & \text { s) } \end{aligned}$ | Yield(1) | Amount |
| Fixed maturities | 3.81\% | \$ 1,825 | 5.60\% | \$ | 559 | 4.12\% | \$ 2,384 |
| Trading account assets supporting insurance liabilities | 4.19 | 199 | 0.00 |  | 0 | 4.19 | 199 |
| Equity securities | 5.78 | 49 | 2.60 |  | 13 | 4.54 | 62 |
| Commercial mortgage and other loans | 5.44 | 325 | 6.26 |  | 140 | 5.66 | 465 |
| Policy loans | 4.72 | 72 | 6.13 |  | 80 | 5.38 | 152 |
| Short-term investments and cash equivalents | 0.39 | 13 | 0.58 |  | 1 | 0.40 | 14 |
| Other investments | 3.86 | 80 | 5.54 |  | 33 | 4.25 | 113 |
| Gross investment income before investment expenses | 3.87 | 2,563 | 5.56 |  | 826 | 4.18 | 3,389 |
| Investment expenses | (0.11) | (59) | (0.24) |  | (36) | (0.13) | (95) |
| Investment income after investment expenses | 3.76\% | 2,504 | 5.32\% |  | 790 | 4.05\% | 3,294 |
| Investment results of other entities and operations(2) |  | 39 |  |  | 0 |  | 39 |
| Total investment income |  | \$ 2,543 |  | \$ | 790 |  | \$ 3,333 |

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

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cost. Yields for fixed maturities and short-term investments and cash equivalents are calculated net of liabilities and rebate expenses corresponding to securities lending activity. Yields exclude investment income on assets other than those included in invested assets. Prior period s yields are presented on a basis consistent with the current period presentation.
(2) Includes investment income of trading, banking, and asset management operations.

See below for a discussion of the change in the Financial Services Businesses yields. The decrease in net investment income yield attributable to the Closed Block Business for the three months ended September 30, 2012, compared to the three months ended September 30, 2011 was primarily due to lower interest rates on floating rate investments due to rate resets and lower fixed income reinvestment rates.

The following tables set forth the income yield and investment income for each major investment category of our general account, for the periods indicated. The yields are based on net investment income as reported under U.S. GAAP and do not include adjustments, such as settlements of duration management swaps that are included in adjusted operating income.

|  | Nine Months Ended September 30, 2012 |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Financial Services Businesses |  |  | Closed Block Business |  |  | Combined |  |  |
|  | Yield(1) | Amount |  | (\$ in millions) | Amount lions) |  | Yield(1) | Amount |  |
| Fixed maturities | 3.75\% | \$ | 5,610 | 5.50\% | \$ | 1,619 | 3.57\% | \$ | 7,229 |
| Trading account assets supporting insurance liabilities | 4.05 |  | 591 | 0.00 |  | 0 | 4.05 |  | 591 |
| Equity securities | 6.11 |  | 186 | 3.19 |  | 61 | 4.98 |  | 247 |
| Commercial mortgage and other loans | 5.42 |  | 1,020 | 6.17 |  | 430 | 5.62 |  | 1,450 |
| Policy loans | 4.62 |  | 215 | 5.95 |  | 227 | 5.22 |  | 442 |
| Short-term investments and cash equivalents | 0.25 |  | 24 | 1.28 |  | 6 | 0.24 |  | 30 |
| Other investments | 4.09 |  | 194 | 7.55 |  | 127 | 5.01 |  | 321 |
| Gross investment income before investment expenses | 3.83 |  | 7,840 | 5.59 |  | 2,470 | 4.14 |  | 10,310 |
| Investment expenses | (0.11) |  | (186) | (0.26) |  | (116) | (0.10) |  | (302) |
| Investment income after investment expenses | 3.72\% |  | 7,654 | 5.33\% |  | 2,354 | 4.04\% |  | 10,008 |
| Investment results of other entities and operations(2) |  |  | 103 |  |  | 0 |  |  | 103 |
| Total investment income |  | \$ | 7,757 |  | \$ | 2,354 |  | \$ | 10,111 |

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|  | Nine Months Ended September 30, 2011 |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Financial Services Businesses |  |  | Closed Block Business |  |  | Combined |  |  |
|  | Yield(1)(3) | Amount |  | (\$ in millions) |  |  | Yield(1)(3) | Amount |  |
| Fixed maturities | 3.92\% | \$ | 5,214 | 5.65\% | \$ | 1,682 | 4.24\% | \$ | 6,896 |
| Trading account assets supporting insurance |  |  |  |  |  |  |  |  |  |
| liabilities | 4.26 |  | 584 | 0.00 |  | 0 | 4.26 |  | 584 |
| Equity securities | 6.22 |  | 185 | 2.84 |  | 58 | 4.84 |  | 243 |
| Commercial mortgage and other loans | 5.63 |  | 962 | 6.42 |  | 413 | 5.83 |  | 1,375 |
| Policy loans | 4.72 |  | 205 | 6.17 |  | 241 | 5.41 |  | 446 |
| Short-term investments and cash equivalents | 0.42 |  | 40 | 0.65 |  | 3 | 0.43 |  | 43 |
| Other investments | 4.45 |  | 213 | 7.83 |  | 114 | 5.25 |  | 327 |
| Gross investment income before investment expenses | 3.99 |  | 7,403 | 5.71 |  | 2,511 | 4.29 |  | 9,914 |
| Investment expenses | (0.12) |  | (172) | (0.25) |  | (109) | (0.14) |  | (281) |
| Investment income after investment expenses | 3.87\% |  | 7,231 | 5.46\% |  | 2,402 | 4.15\% |  | 9,633 |
| Investment results of other entities and operations(2) |  |  | 145 |  |  | 0 |  |  | 145 |
| Total investment income |  | \$ | 7,376 |  | \$ | 2,402 |  | \$ | 9,778 |

(1) Yields are annualized, for interim periods, and are based on quarterly average carrying values except for fixed maturities, equity securities and securities lending activity. Yields for fixed maturities are based on amortized cost. Yields for equity securities are based on cost. Yields for fixed maturities and short-term investments and cash equivalents are calculated net of liabilities and rebate expenses corresponding to securities lending activity. Yields exclude investment income on assets other than those included in invested assets. Prior period s yields are presented on a basis consistent with the current period presentation.
(2) Includes investment income of trading, banking, and asset management operations.
(3) Yields for the nine months ended September 30, 2011 are weighted for seven months of income and assets related to the Star and Edison Businesses.

See below for a discussion of the change in the Financial Services Businesses yields. The decrease in net investment income yield attributable to the Closed Block Business portfolio for the nine months ended September 30, 2012, compared to the nine months ended September 30, 2011, was primarily due to the impact of lower interest rates on floating rate investments due to rate resets and lower fixed income reinvestment rates.

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The following table sets forth the income yield and investment income for each major investment category of the Financial Services Businesses general account, excluding the Japanese insurance operations portion of the general account which is presented separately below, for the periods indicated. The yields are based on net investment income as reported under U.S. GAAP and do not include adjustments, such as settlements of duration management swaps that are included in adjusted operating income.

|  | Three Months Ended September 30, 2012 |  |  | Three Months Ended September 30, 2011 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | (\$ in millions) |  |  |  |  | mount |
| Fixed maturities | 5.21\% | , | 1,053 | 5.31\% | \$ | 1,051 |
| Trading account assets supporting insurance liabilities | 4.13 |  | 186 | 4.36 |  | 188 |
| Equity securities | 8.19 |  | 46 | 8.13 |  | 37 |
| Commercial mortgage and other loans | 5.89 |  | 294 | 5.84 |  | 270 |
| Policy loans | 5.41 |  | 48 | 5.72 |  | 48 |
| Short-term investments and cash equivalents | 0.28 |  | 7 | 0.28 |  | 6 |
| Other investments | 3.91 |  | 23 | 2.83 |  | 17 |
| Gross investment income before investment expenses | 4.89 |  | 1,657 | 4.92 |  | 1,617 |
| Investment expenses | (0.11) |  | (21) | (0.11) |  | (22) |
| Investment income after investment expenses | 4.78\% |  | 1,636 | 4.81\% |  | 1,595 |
| Investment results of other entities and operations(2) |  |  | 44 |  |  | 39 |
| Total investment income |  | \$ | 1,680 |  | \$ | 1,634 |

(1) Yields are annualized, for interim periods, and are based on quarterly average carrying values except for fixed maturities, equity securities and securities lending activity. Yields for fixed maturities are based on amortized cost. Yields for equity securities are based on cost. Yields for fixed maturities and short-term investments and cash equivalents are calculated net of liabilities and rebate expenses corresponding to securities lending activity. Yields exclude investment income on assets other than those included in invested assets. Prior period s yields are presented on a basis consistent with the current period presentation.
(2) Includes investment income of trading, banking, and asset management operations.

The net investment income yield attributable to the Financial Services Businesses general account, excluding the Japanese operations portfolio, for the three months ended September 30, 2012, is lower than the net investment income yield for the three months ended September 30, 2011, primarily as a result of lower interest rates on floating rate investments due to rate resets and lower fixed income reinvestment rates.

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The following table sets forth the income yield and investment income for each major investment category of the Financial Services Businesses general account, excluding the Japanese insurance operations portion of the general account which is presented separately below, for the periods indicated. The yields are based on net investment income as reported under U.S. GAAP and do not include adjustments, such as settlements of duration management swaps that are included in adjusted operating income.

|  | Nine Months Ended September 30, 2012 |  |  | Nine Months Ended September 30, 2011 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | (\$ in millions) |  |  |  |  | mount |
| Fixed maturities | 5.30\% | \$ | 3,154 | 5.43\% | \$ | 3,167 |
| Trading account assets supporting insurance liabilities | 4.23 |  | 561 | 4.47 |  | 556 |
| Equity securities | 8.65 |  | 136 | 8.97 |  | 129 |
| Commercial mortgage and other loans | 5.81 |  | 846 | 6.04 |  | 807 |
| Policy loans | 5.53 |  | 142 | 5.75 |  | 139 |
| Short-term investments and cash equivalents | 0.28 |  | 20 | 0.30 |  | 20 |
| Other investments | 3.49 |  | 61 | 4.46 |  | 69 |
| Gross investment income before investment expenses | 4.92 |  | 4,920 | 5.07 |  | 4,887 |
| Investment expenses | (0.11) |  | (62) | (0.11) |  | (67) |
| Investment income after investment expenses | 4.81\% |  | 4,858 | 4.96\% |  | 4,820 |
| Investment results of other entities and operations(2) |  |  | 103 |  |  | 145 |
| Total investment income |  | \$ | 4,961 |  | \$ | 4,965 |

(1) Yields are annualized, for interim periods, and are based on quarterly average carrying values except for fixed maturities, equity securities and securities lending activity. Yields for fixed maturities are based on amortized cost. Yields for equity securities are based on cost. Yields for fixed maturities and short-term investments and cash equivalents are calculated net of liabilities and rebate expenses corresponding to securities lending activity. Yields exclude investment income on assets other than those included in invested assets. Prior period s yields are presented on a basis consistent with the current period presentation.
(2) Includes investment income of trading, banking, and asset management operations.

The decrease in net investment income yield attributable to the Financial Services Businesses general account, excluding the Japanese operations portfolio, for the nine months ended September 30, 2012, compared to the nine months ended September 30, 2011, is primarily the result of lower interest rates on floating rate investments due to rate resets and lower fixed income reinvestment rates.

The following table sets forth the income yield and investment income for each major investment category of our Japanese operations general account for the periods indicated. The yields are based on net investment income as reported under U.S. GAAP and do not include adjustments, such as settlements of duration management swaps that are included in adjusted operating income.

|  | Three Months Ended September 30, 2012 |  |  | Three Months Ended September 30, 2011 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Yield(1) |  | ount | Yield(1) |  | ount |
|  | (\$ in millions) |  |  |  |  |  |
| Fixed maturities | 2.71\% | \$ | 844 | 2.75\% | \$ | 774 |
| Trading account assets supporting insurance liabilities | 2.63 |  | 12 | 2.54 |  | 11 |
| Equity securities | 4.58 |  | 22 | 3.70 |  | 12 |


| Commercial mortgage and other loans | 4.18 | 62 | 4.07 | 55 |
| :--- | :--- | ---: | ---: | ---: |
| Policy loans | 3.57 | 25 | 3.51 | 24 |
| Short-term investments and cash equivalents | 0.14 | 1 | 0.70 | 7 |
| Other investments | 6.00 | 59 | 4.25 | 63 |
|  |  |  |  |  |
| Gross investment income before investment expenses | 2.83 | 1,025 | 2.84 | 946 |
| Investment expenses | $(0.11)$ | $(40)$ | $(0.11)$ | $(37)$ |
| Total investment income | $2.72 \%$ | $\$$ | 985 | $2.73 \%$ |

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(1) Yields are annualized, for interim periods, and are based on quarterly average carrying values except for fixed maturities, equity securities and securities lending activity. Yields for fixed maturities are based on amortized cost. Yields for equity securities are based on cost. Yields for fixed maturities and short-term investments and cash equivalents are calculated net of liabilities and rebate expenses corresponding to securities lending activity. Yields exclude investment income on assets other than those included in invested assets. Prior period s yields are presented on a basis consistent with the current period presentation.

The decrease in net investment income yield on the Japanese insurance portfolio for the three months ended September 30, 2012, compared to the three months ended September 30, 2011, is primarily attributable to lower fixed maturity reinvestment rates in both the U.S. and Japan, partially offset by higher income from our joint ventures and limited partnerships driven by higher gains and appreciation on the underlying assets.

Both the U.S. dollar-denominated and Australian dollar-denominated fixed maturities that are not hedged to yen through third party derivative contracts provide a yield that is substantially higher than the yield on comparable yen-denominated fixed maturities. The average amortized cost of U.S. dollar-denominated fixed maturities that are not hedged to yen through third party derivative contracts for the three months ended September 30, 2012 and 2011, was approximately $\$ 30.6$ billion and $\$ 26.2$ billion, respectively. The majority of U.S. dollar-denominated fixed maturities support liabilities that are denominated in U.S. dollars. The average amortized cost of Australian dollar-denominated fixed maturities that are not hedged to yen through third party derivative contracts for the three months ended September 30, 2012 and 2011 was approximately $\$ 7.5$ billion and $\$ 5.4$ billion, respectively. These Australian dollar-denominated fixed maturities support liabilities that are denominated in Australian dollars.

For additional information regarding U.S. and Australian dollar investments held in our Japanese insurance operations see, Results of Operations for Financial Services Businesses by Segment International Insurance Division.

The following table sets forth the income yield and investment income for each major investment category of our Japanese operations general account for the periods indicated. The yields are based on net investment income as reported under U.S. GAAP and do not include adjustments, such as settlements of duration management swaps that are included in adjusted operating income.

|  | Nine Months Ended September 30, 2012 |  |  | Nine Months Ended September 30, 2011 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | (\$ in millions) |  |  |  |  |  |
| Fixed maturities | 2.73\% | \$ | 2,456 | 2.74\% | \$ | 2,047 |
| Trading account assets supporting insurance liabilities | 2.28 |  | 30 | 2.21 |  | 28 |
| Equity securities | 3.40 |  | 50 | 3.47 |  | 56 |
| Commercial mortgage and other loans | 4.09 |  | 174 | 4.15 |  | 155 |
| Policy loans | 3.50 |  | 73 | 3.44 |  | 66 |
| Short-term investments and cash equivalents | 0.16 |  | 4 | 0.77 |  | 20 |
| Other investments | 4.45 |  | 133 | 4.44 |  | 144 |
| Gross investment income before investment expenses | 2.79 |  | 2,920 | 2.82 |  | 2,516 |
| Investment expenses | (0.12) |  | (124) | (0.12) |  | (105) |
| Total investment income | 2.67\% | \$ | 2,796 | 2.70\% | \$ | 2,411 |

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(1) Yields are annualized, for interim periods, and are based on quarterly average carrying values except for fixed maturities, equity securities and securities lending activity. Yields for fixed maturities are based on amortized cost. Yields for equity securities are based on cost. Yields for fixed maturities and short-term investments and cash equivalents are calculated net of liabilities and rebate expenses corresponding to securities lending activity. Yields exclude investment income on assets other than those included in invested assets. Prior period s yields are presented on a basis consistent with the current period presentation
(2) Yields for the nine months ended September 30, 2011, are weighted for seven months of income and assets related to the Star and Edison Businesses.

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The decrease in net investment income yield on the Japanese insurance portfolio for the nine months ended September 30, 2012, compared to the nine months ended September 30, 2011, is primarily attributable to lower fixed maturity reinvestment rates and lower interest rates in both the U.S. and Japan, partially offset by asset growth supporting both U.S. and Australian dollar-denominated products.

Both the U.S. dollar-denominated and Australian dollar-denominated fixed maturities that are not hedged to yen through third party derivative contracts provide a yield that is substantially higher than the yield on comparable yen-denominated fixed maturities. The average amortized cost of U.S. dollar-denominated fixed maturities that are not hedged to yen through third party derivative contracts for the nine months ended September 30, 2012 and 2011 was approximately $\$ 29.3$ billion and $\$ 23.2$ billion, respectively. The majority of U.S. dollar-denominated fixed maturities support liabilities that are denominated in U.S. dollars. The average amortized cost of Australian dollar-denominated fixed maturities that are not hedged to yen through third party derivative contracts for the nine months ended September 30, 2012 and 2011 was approximately $\$ 6.9$ billion and $\$ 4.5$ billion, respectively. These Australian dollar-denominated fixed maturities support liabilities that are denominated in Australian dollars.

For additional information regarding U.S. and Australian dollar investments held in our Japanese insurance operations see, Results of Operations for Financial Services Businesses by Segment International Insurance Division.

## Fixed Maturity Securities

## Investment Mix

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

We manage our public portfolio to a risk profile directed or overseen by the Asset Liability Management and Risk Management groups and to a profile that also reflects the local market environments impacting both our domestic and international insurance portfolios. The investment objectives for fixed maturity securities are consistent with those described above. The total return that we earn on the portfolio will be reflected both as investment income and also as realized gains or losses on investments.

We use our private placement and asset-backed portfolios to enhance the diversification and yield of our overall fixed maturity portfolio. Within our domestic portfolios, we maintain a private fixed income portfolio that is larger than the industry average as a percentage of total fixed income holdings. Over the last several years, our investment staff has originated the majority of our annual private placement originations through direct borrower relationships. Our origination capability offers the opportunity to lead transactions and gives us the opportunity for better terms, including covenants and call protection, and to take advantage of innovative deal structures.

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Fixed Maturity Securities and Unrealized Gains and Losses by Industry Category

The following table sets forth the composition of the portion of our fixed maturity securities portfolio by industry category attributable to the Financial Services Businesses as of the dates indicated and the associated gross unrealized gains and losses.

## Fixed Maturity Securities Financial Services Businesses

| Industry(1) | Amortized Cost | Septembe Gross Unrealized Gains(2) |  | 30, 2012 <br> Gross <br> Unrealized <br> Losses(2) |  | Fair Value (in |  | Amortized Cost <br> lions) |  | December Gross Unrealized Gains(2) |  | 31, 2011(7) <br> Gross <br> Unrealized <br> Losses(2) |  | Fair <br> Value |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Corporate Securities: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Finance | \$ 17,871 | \$ | 1,127 | \$ | 381 | \$ | 18,617 | \$ | 18,336 | \$ | 653 | \$ | 775 | \$ | 18,214 |
| Consumer non-cyclical | 17,306 |  | 1,809 |  | 252 |  | 18,863 |  | 16,064 |  | 1,501 |  | 373 |  | 17,192 |
| Utility | 14,409 |  | 1,575 |  | 305 |  | 15,679 |  | 13,350 |  | 1,188 |  | 569 |  | 13,969 |
| Capital goods | 8,295 |  | 832 |  | 140 |  | 8,987 |  | 6,795 |  | 561 |  | 207 |  | 7,149 |
| Consumer cyclical | 7,934 |  | 684 |  | 158 |  | 8,460 |  | 7,173 |  | 507 |  | 228 |  | 7,452 |
| Foreign agencies | 5,834 |  | 464 |  | 32 |  | 6,266 |  | 5,371 |  | 191 |  | 141 |  | 5,421 |
| Energy | 5,751 |  | 693 |  | 58 |  | 6,386 |  | 5,582 |  | 548 |  | 98 |  | 6,032 |
| Communications | 5,425 |  | 562 |  | 128 |  | 5,859 |  | 5,350 |  | 401 |  | 224 |  | 5,527 |
| Basic industry | 4,997 |  | 353 |  | 80 |  | 5,270 |  | 4,429 |  | 299 |  | 112 |  | 4,616 |
| Transportation | 4,796 |  | 457 |  | 42 |  | 5,211 |  | 5,094 |  | 370 |  | 78 |  | 5,386 |
| Technology | 3,276 |  | 277 |  | 58 |  | 3,495 |  | 3,468 |  | 230 |  | 95 |  | 3,603 |
| Industrial other | 2,127 |  | 162 |  | 6 |  | 2,283 |  | 3,027 |  | 248 |  | 22 |  | 3,253 |
| Total corporate securities | 98,021 |  | 8,995 |  | 1,640 |  | 105,376 |  | 94,039 |  | 6,697 |  | 2,922 |  | 97,814 |
| Foreign government(3) | 80,708 |  | 7,076 |  | 89 |  | 87,695 |  | 73,418 |  | 4,749 |  | 165 |  | 78,002 |
| Residential mortgage-backed | 7,518 |  | 480 |  | 41 |  | 7,957 |  | 7,569 |  | 425 |  | 59 |  | 7,935 |
| Asset-backed securities(4) | 8,235 |  | 183 |  | 565 |  | 7,853 |  | 8,319 |  | 150 |  | 988 |  | 7,481 |
| Commercial mortgage-backed | 7,706 |  | 650 |  | 36 |  | 8,320 |  | 8,197 |  | 573 |  | 104 |  | 8,666 |
| U.S. Government | 8,527 |  | 2,439 |  | 12 |  | 10,954 |  | 7,592 |  | 1,920 |  | 17 |  | 9,495 |
| State \& Municipal(5) | 1,984 |  | 362 |  | 2 |  | 2,344 |  | 1,751 |  | 235 |  | 1 |  | 1,985 |
| Total(6) | \$ 212,699 | \$ | 20,185 | \$ | 2,385 |  | 230,499 |  | 200,885 | \$ | 14,749 | \$ | 4,256 |  | 11,378 |

(1) Investment data has been classified based on standard industry categorizations for domestic public holdings and similar classifications by industry for all other holdings.
(2) Includes $\$ 369$ million of gross unrealized gains and $\$ 70$ million of gross unrealized losses as of September 30, 2012, compared to $\$ 345$ million of gross unrealized gains and $\$ 98$ million of gross unrealized losses as of December 31, 2011 on securities classified as held-to-maturity.
(3) As of September 30, 2012 and December 31, 2011, based on amortized cost, $83 \%$ and $84 \%$, respectively, represent Japanese government bonds held by our Japanese insurance operations, with no other individual country representing more than $7 \%$ and $6 \%$, respectively, of the balance.
(4) Includes securities collateralized by sub-prime mortgages. See Asset-Backed Securities below.
(5) Includes securities related to the Build America Bonds program.
(6) Excluded from the table above are securities held outside the general account in other entities and operations. For additional information regarding investments held outside the general account, see Invested Assets of Other Entities and Operations below. Also excluded from the table above are fixed maturity securities classified as trading. See Trading Account Assets Supporting Insurance Liabilities and Other Trading Account Assets for additional information.
(7) Prior period s amounts are presented on a basis consistent with the current period presentation.

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The increase in net unrealized gains from December 31, 2011 to September 30, 2012, was primarily due to a net decrease in interest rates in both the U.S. and Japan.

The following table sets forth the composition of the portion of our fixed maturity securities portfolio by industry category attributable to the Closed Block Business as of the dates indicated and the associated gross unrealized gains and losses.

## Fixed Maturity Securities Closed Block Business


(1) Investment data has been classified based on standard industry categorizations for domestic public holdings and similar classifications by industry for all other holdings.
(2) Includes securities collateralized by sub-prime mortgages. See Asset-Backed Securities below.
(3) As of September 30, 2012 and December 31, 2011, based on amortized cost, no individual foreign country represented more than $12 \%$ and $8 \%$, respectively.
(4) The table above excludes fixed maturity securities classified as trading. See Other Trading Account Assets for additional information.
(5) Prior period $s$ amounts are presented on a basis consistent with the current period presentation.

The increase in net unrealized gains from December 31, 2011 to September 30, 2012, was primarily due to a net decrease in interest rates.

## Asset-Backed Securities

Included within asset-backed securities attributable to both the Financial Services Businesses and the Closed Block Business are securities collateralized by sub-prime mortgages. While there is no market standard definition, we define sub-prime mortgages as residential mortgages that are originated to weaker quality obligors

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as indicated by weaker credit scores, as well as mortgages with higher loan-to-value ratios, or limited documentation. The significant deterioration of the U.S. housing market, high interest rate resets, higher unemployment levels, and relaxed underwriting standards for some originators of sub-prime mortgages have led to higher delinquency rates, particularly for those mortgages issued in 2006 and 2007. Recently there has been significant attention given to potential deficiencies in lenders foreclosure documentation, causing delays in the foreclosure process. From the perspective of an investor in securities backed by sub-prime collateral, any significant delays in foreclosure proceedings could result in increased servicing costs which could negatively affect the value of the impacted securities. Separately, as an investor in sub-prime securities, we are pursuing legal and other actions with respect to potential remedies arising from any potential deficiencies related to the original lending and securitization practices.

The following tables set forth the amortized cost and fair value of our asset-backed securities attributable to the Financial Services Businesses as of the dates indicated, by credit quality, and for asset-backed securities collateralized by sub-prime mortgages, by year of issuance (vintage).

## Asset-Backed Securities at Amortized Cost Financial Services Businesses


(1) Included within the $\$ 2.3$ billion of asset-backed securities collateralized by sub-prime mortgages as of September 30, 2012, are $\$ 34$ million of securities collateralized by second-lien exposures.
(2) As of September 30, 2012, includes collateralized debt obligations with amortized cost of $\$ 161$ million, with none secured by sub-prime mortgages. Also includes asset-backed securities collateralized by education loans, equipment leases, aircraft, franchises, and timeshares.
(3) Excluded from the table above are asset-backed securities held outside the general account in other entities and operations. For additional information regarding asset-backed securities held outside the general account, see Invested Assets of Other Entities and Operations below. Also excluded from the table above are asset-backed securities classified as trading and carried at fair value. See Trading Account Assets Supporting Insurance Liabilities and Other Trading Account Assets for additional information regarding these securities.

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## Asset-Backed Securities at Fair Value Financial Services Businesses


(1) As of September 30, 2012, includes collateralized debt obligations with fair value of $\$ 158$ million, with none secured by sub-prime mortgages. Also includes asset-backed securities collateralized by education loans, equipment leases, aircraft, franchises, and timeshares.
(2) Excluded from the table above are asset-backed securities held outside the general account in other entities and operations. For additional information regarding asset-backed securities held outside the general account, see Invested Assets of Other Entities and Operations below. Also excluded from the table above are asset-backed securities classified as trading and carried at fair value. See Trading Account Assets Supporting Insurance Liabilities and Other Trading Account Assets for additional information regarding these securities.

The tables above provide ratings as assigned by nationally recognized rating agencies as of September 30, 2012, including Standard \& Poor s, Moody s, and Fitch. In making our investment decisions, rather than relying solely on the rating agencies evaluations, we assign internal ratings to our asset-backed securities based upon our dedicated asset-backed securities unit sindependent evaluation of the underlying collateral and securitization structure, including any guarantees from monoline bond insurers.

On an amortized cost basis, asset-backed securities collateralized by sub-prime mortgages attributable to the Financial Services Businesses decreased from $\$ 2.634$ billion as of December 31, 2011, to $\$ 2.332$ billion as of September 30, 2012, primarily reflecting sales, principal paydowns and other-than-temporary impairments recognized. Gross unrealized losses related to our asset-backed securities collateralized by sub-prime mortgages attributable to the Financial Services Businesses were $\$ 520$ million as of September 30, 2012, and $\$ 906$ million as of December 31, 2011. For additional information regarding other-than-temporary impairments of asset-backed securities collateralized by sub-prime mortgages see Realized Investment Gains and Losses above. For information regarding the methodology used in determining the fair value of our asset-backed securities collateralized by sub-prime mortgages, see Note 13 to the Unaudited Interim Consolidated Financial Statements.

The weighted average estimated subordination percentage of our asset-backed securities collateralized by sub-prime mortgages attributable to the Financial Services Businesses, excluding those supported by guarantees from monoline bond insurers, was $28 \%$ as of September 30, 2012.

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The subordination percentage represents the current weighted average estimated percentage of the capital structure subordinated to our investment holding

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that is available to absorb losses before the security incurs the first dollar loss of principal. As of September 30, 2012, based on amortized cost, approximately $58 \%$ of the asset-backed securities collateralized by sub-prime mortgages attributable to the Financial Services Businesses have estimated credit subordination percentages of $20 \%$ or more, and $39 \%$ have estimated credit subordination percentages of $30 \%$ or more.

In addition to subordination, certain securities, referred to as front pay or second pay securities, benefit from the prioritization of principal cash flows within the senior tranches of the structure. In most instances, these shorter duration senior securities have priority to principal cash flows over other securities in the structure, including longer duration senior securities. Included within the $\$ 2.332$ billion of asset-backed securities collateralized by sub-prime mortgages attributable to the Financial Services Businesses as of September 30, 2012, were $\$ 433$ million of securities, on an amortized cost basis, that represent front pay or second pay securities, depending on the overall structure of the securities.

The following tables set forth the amortized cost and fair value of our asset-backed securities attributable to the Closed Block Business as of the dates indicated, by credit quality, and for asset-backed securities collateralized by sub-prime mortgages, by year of issuance (vintage).

## Asset-Backed Securities at Amortized Cost Closed Block Business

|  | September 30, 2012 <br> Lowest Rating Agency Rating |  |  |  |  | Total Amortized Cost |  | Total December 31, 2011 |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Vintage | AAA | AA | A | $\begin{gathered} \text { BB and } \\ \text { BBB } \begin{array}{c} \text { below } \\ \text { (in millions) } \end{array} \end{gathered}$ |  |  |  |  |  |
| Collateralized by sub-prime mortgages: |  |  |  |  |  |  |  |  |  |
| 20122008 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ | 0 | \$ | 0 |
| 2007 | 6 | 0 | 20 | 1 | 338 |  | 365 |  | 431 |
| 2006 | 8 | 83 | 5 | 0 | 780 |  | 876 |  | 994 |
| 2005 | 9 | 36 | 70 | 21 | 126 |  | 262 |  | 296 |
| 2004 \& Prior | 0 | 5 | 25 | 26 | 468 |  | 524 |  | 569 |
| Total collateralized by sub-prime mortgages(1) | 23 | 124 | 120 | 48 | 1,712 |  | 2,027 |  | 2,290 |
| Other asset-backed securities: |  |  |  |  |  |  |  |  |  |
| Collateralized by credit cards | 234 | 5 | 65 | 146 | 2 |  | 452 |  | 659 |
| Collateralized by auto loans | 927 | 0 | 0 | 0 | 0 |  | 927 |  | 739 |
| Externally-managed investments in the European market | 0 | 0 | 0 | 204 | 0 |  | 204 |  | 199 |
| Collateralized by education loans | 19 | 438 | 0 | 0 | 0 |  | 457 |  | 485 |
| Other asset-backed securities(2) | 366 | 303 | 60 | 2 | 25 |  | 756 |  | 563 |
| Total asset-backed securities(3) | \$ 1,569 | \$ 870 | \$ 245 | \$ 400 | \$ 1,739 | \$ | 4,823 | \$ | 4,935 |

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## Asset-Backed Securities at Fair Value Closed Block Business

|  | September 30, 2012 <br> Lowest Rating Agency Rating |  |  |  |  |  | Total <br> Fair <br> Value | TotalDecember31,2011 |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Vintage | AAA | AA | A | $\begin{array}{cc}  & \text { BB } \\ \text { BBB } & \text { and below } \end{array}$(in millions) |  |  |  |  |  |
| Collateralized by sub-prime mortgages: |  |  |  |  |  |  |  |  |  |
| 20122008 | 0 |  | \$ 0 | \$ | \$ | 0 | \$ 0 | \$ | 0 |
| 2007 | 6 | 0 | 18 | 1 |  | 255 | 280 |  | 267 |
| 2006 | 8 | 77 | 5 | 0 |  | 557 | 647 |  | 597 |
| 2005 | 8 | 35 | 64 | 20 |  | 91 | 218 |  | 216 |
| 2004 \& Prior | 0 | 4 | 22 | 23 |  | 389 | 438 |  | 421 |
| Total collateralized by sub-prime mortgages | 22 | 116 | 109 | 44 |  | 1,292 | 1,583 |  | 1,501 |
| Other asset-backed securities: |  |  |  |  |  |  |  |  |  |
| Collateralized by credit cards | 238 | 5 | 65 | 146 |  | 2 | 456 |  | 669 |
| Collateralized by auto loans | 931 | 0 | 0 | 0 |  | 0 | 931 |  | 739 |
| Externally-managed investments in the European market | 0 | 0 | 0 | 241 |  | 0 | 241 |  | 233 |
| Collateralized by education loans | 19 | 438 | 0 | 0 |  | 0 | 457 |  | 474 |
| Other asset-backed securities(1) | 371 | 306 | 63 | 1 |  | 29 | 770 |  | 556 |
| Total asset-backed securities(2) | \$ 1,581 | \$ 865 | \$ 237 | \$ 432 | \$ | 1,323 | \$4,438 | \$ | 4,172 |

(1) As of September 30, 2012, includes collateralized debt obligations with fair value of $\$ 47$ million, with none secured by sub-prime mortgages. Also includes asset-backed securities collateralized by equipment leases, franchises, aircraft, manufacturing and time shares.
(2) Excluded from the table above are asset-backed securities classified as trading and carried at fair value. For additional information see Other Trading Account Assets.

On an amortized cost basis, asset-backed securities collateralized by sub-prime mortgages attributable to the Closed Block Business decreased from $\$ 2.290$ billion as of December 31,2011 , to $\$ 2.027$ billion as of September 30, 2012, primarily reflecting sales, principal paydowns and other-than-temporary impairments recognized. Gross unrealized losses related to our asset-backed securities collateralized by sub-prime mortgages attributable to the Closed Block Business were $\$ 453$ million as of September 30, 2012, and $\$ 789$ million as of December 31 , 2011. For additional information regarding other-than-temporary impairments of asset-backed securities collateralized by sub-prime mortgages see

Realized Investment Gains and Losses above. For information regarding the methodology used in determining the fair value of our asset-backed securities collateralized by sub-prime mortgages, see Note 13 to the Unaudited Interim Consolidated Financial Statements.

The weighted average estimated subordination percentage of asset-backed securities collateralized by sub-prime mortgages attributable to the Closed Block Business, excluding those supported by guarantees from monoline bond insurers, was $29 \%$ as of September 30 , 2012. The subordination percentage represents the current weighted average estimated percentage of the capital structure subordinated to our investment holding that is available to absorb losses before the security incurs the first dollar loss of principal. As of September 30, 2012, based on amortized cost, approximately $63 \%$ of the asset-backed securities collateralized by sub-prime mortgages attributable to the Closed Block Business have estimated credit subordination percentages of $20 \%$ or more, and $42 \%$ have estimated credit subordination percentages of $30 \%$ or more.

In addition to subordination, certain securities, referred to as front pay or second pay securities, benefit from the prioritization of principal cash flows within the senior tranches of the structure. In most instances, these shorter duration senior securities have priority to principal cash flows

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over other securities in the structure, including longer duration senior securities. Included within the $\$ 2.027$ billion of asset-backed securities

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collateralized by sub-prime mortgages attributable to the Closed Block Business as of September 30, 2012, were $\$ 411$ million of securities, on an amortized cost basis, that represent front pay or second pay securities, depending on the overall structure of the securities.

## Residential Mortgage-Backed Securities

The following tables set forth the amortized cost of our residential mortgage-backed securities attributable to the Financial Services Businesses and Closed Block Business as of the dates indicated.

## Residential Mortgage-Backed Securities at Amortized Cost

September 30, 2012

|  | Financial Services Businesses <br> Amortized <br> Cost | \% of Total <br> (\$ in millions) | Closed Block Business <br> Amortized <br> Cost | \% of Total |
| :--- | :---: | :---: | :---: | :---: | :---: |


|  | December 31, 2011 |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Financial S Amortized Cost | $\begin{aligned} & \text { Businesses } \\ & \% \\ & \text { of Total } \end{aligned}$ | $\qquad$ | Business <br> \% of Total |
| By security type: |  |  |  |  |
| Agency pass-through securities(1) | \$ 7,339 | 97.0\% | \$ 1,664 | 88.5\% |
| Collateralized mortgage obligations(2)(3) | 230 | 3.0 | 216 | 11.5 |
| Total residential mortgage-backed securities | \$ 7,569 | 100.0\% | \$ 1,880 | 100.0\% |
| Portion rated AA or higher(4) | \$ 7,489 | 99.0\% | \$ 1,664 | 88.5\% |

(1) As of September 30, 2012, of these securities, for the Financial Services Businesses, $\$ 5.392$ billion are supported by the U.S. government and $\$ 1.933$ billion are supported by foreign governments. As of December 31, 2011, of these securities, for the Financial Services Businesses, $\$ 5.408$ billion were supported by the U.S. government and $\$ 1.931$ billion were supported by foreign governments. For the Closed Block Business, all of the securities are supported by the U.S. government as of both September 30, 2012 and December 31, 2011.
(2) Includes alternative residential mortgage loans of $\$ 33$ million and $\$ 38$ million in the Financial Services Businesses, and $\$ 81$ million and $\$ 93$ million in the Closed Block Business, for September 30, 2012 and December 31, 2011, respectively.
(3) As of September 30, 2012, of these collateralized mortgage obligations, for the Financial Services Businesses, $68 \%$ have credit ratings of A or above, $5 \%$ have BBB credit ratings and the remaining $27 \%$ have below investment grade ratings, and as of December 31, 2011, $68 \%$ have credit ratings of A or above, $7 \%$ have BBB credit ratings and the remaining $25 \%$ have below investment grade ratings. As of September 30, 2012, for the Closed Block Business, $45 \%$ have BBB credit ratings, and 55\% have below investment grade ratings, and as of December 31, 2011, $16 \%$ have A credit ratings or above, $34 \%$ have BBB credit ratings, and $50 \%$ have below investment grade ratings.
(4) Based on lowest external rating agency rating.

Commercial Mortgage-Backed Securities

The commercial real estate market was severely impacted by the financial crisis and the subsequent recession; however, market fundamentals appear to have bottomed and have been showing signs of improvement since late 2010. Commercial real estate vacancy rates have declined from their peak, rent growth has turned positive for certain sectors, and prices of commercial real estate appear to be stabilizing and improving in some sectors. Additionally, the elevated delinquency rate on mortgages in the commercial mortgage-backed securities

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market is slowing and refinancing activity has increased, at least partially reflecting the improvement in these fundamentals. The loans included in new issues seem to reflect better underwriting and lower levels of leverage compared to 2007.

Although there are some positive signs in commercial real estate, there are still some significant challenges for this market, including numerous future loan workouts, a large wave of refinancings for over-leveraged properties and numerous legislative changes. To ensure our investment objectives and asset strategies are maintained, we consider these market factors in making our investment decisions on commercial mortgage-backed securities.

The following tables set forth the amortized cost and fair value of our commercial mortgage-backed securities attributable to the Financial Services Businesses as of the dates indicated, by credit quality and by year of issuance (vintage).

## Commercial Mortgage-Backed Securities at Amortized Cost Financial Services Businesses

|  | September 30, 2012 <br> Lowest Rating Agency Rating(1) |  |  |  |  |  |  | Total Amortized Cost |  | Total December$\begin{gathered} \text { 31, } \\ 2011 \end{gathered}$ |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | AAA | AA | A |  |  | BB and below ns) |  |  |  |  |  |
| Vintage |  |  |  |  |  |  |  |  |  |  |  |
| 2012 | \$ 3 | \$ 0 | \$ 0 | \$ | 0 | \$ | 0 | \$ | 3 | \$ | 0 |
| 2011 | 0 | 5 | 0 |  | 0 |  | 0 |  | 5 |  | 5 |
| 2010 | 0 | 99 | 0 |  | 0 |  | 0 |  | 99 |  | 99 |
| 2009 | 0 | 141 | 0 |  | 0 |  | 0 |  | 141 |  | 117 |
| 2008 | 154 | 0 | 0 |  | 4 |  | 22 |  | 180 |  | 197 |
| 2007 | 1,273 | 35 | 16 |  | 0 |  | 1 |  | ,325 |  | 1,887 |
| 2006 | 2,785 | 81 | 40 |  | 0 |  | 0 |  | ,906 |  | 2,955 |
| 2005 \& Prior | 2,799 | 154 | 76 |  | 11 |  | 7 |  | ,047 |  | 2,937 |
| Total commercial mortgage-backed securities(2)(3)(4) | \$7,014 | \$ 515 | \$ 132 | \$ |  | \$ | 30 | \$ | ,706 | \$ | 8,197 |

(1) The table above provides ratings as assigned by nationally recognized rating agencies as of September 30, 2012, including Standard \& Poor s, Moody s, Fitch and Realpoint.
(2) Excluded from the table above are commercial mortgage-backed securities held outside the general account in other entities and operations. For additional information regarding commercial mortgage-backed securities held outside the general account, see Invested Assets of Other Entities and Operations below. Also excluded from the table above are commercial mortgage-backed securities classified as trading and carried at fair value. See Trading Account Assets Supporting Insurance Liabilities for additional information regarding these securities.
(3) Included in the table above, as of September 30, 2012, are downgraded super senior securities with amortized cost of $\$ 93$ million in AA and $\$ 88$ million in A.
(4) Included in the table above, as of September 30, 2012, are agency commercial mortgage-backed securities with amortized cost of $\$ 280$ million, all rated AA.

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Commercial Mortgage-Backed Securities at Fair Value Financial Services Businesses

(1) The table above provides ratings as assigned by nationally recognized rating agencies as of September 30, 2012, including Standard \& Poor s, Moody s, Fitch and Realpoint.
(2) Excluded from the table above are commercial mortgage-backed securities held outside the general account in other entities and operations. For additional information regarding commercial mortgage-backed securities held outside the general account, see Invested Assets of Other Entities and Operations below. Also excluded from the table above are commercial mortgage-backed securities classified as trading and carried at fair value. See Trading Account Assets Supporting Insurance Liabilities for additional information regarding these securities.
(3) Included in the table above, as of September 30, 2012, are agency commercial mortgage-backed securities with fair value of $\$ 318$ million, all rated AA.

Included in the tables above are commercial mortgage-backed securities collateralized by non-U.S. properties, all related to Japanese commercial mortgage-backed securities held by our Japanese insurance operations, with an amortized cost of $\$ 13$ million in AAA, $\$ 3$ million in BBB and $\$ 23$ million in BB and below as of September 30, 2012, and $\$ 13$ million in AAA, $\$ 4$ million in A, $\$ 17$ million in BBB and $\$ 13$ million in BB and below as of December 31, 2011.

Included in the tables above are commercial mortgage-backed securities collateralized by U.S. properties, all related to commercial mortgage-backed securities held by our Japanese insurance operations, with an amortized cost of $\$ 771$ million in AAA, $\$ 122$ million in AA, $\$ 48$ million in A and $\$ 5$ million in BBB as of September 30, 2012, and $\$ 875$ million in AAA, $\$ 190$ million in AA, $\$ 125$ million in A, and $\$ 5$ million in BBB as of December 31, 2011.

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The following table sets forth the amortized cost of our AAA commercial mortgage-backed securities attributable to the Financial Services Businesses as of the dates indicated, by type and by year of issuance (vintage).

AAA Rated Commercial Mortgage-Backed Securities Amortized Cost by Type and Vintage Financial Services Businesses


The following tables set forth the amortized cost and fair value of our commercial mortgage-backed securities attributable to the Closed Block Business as of the dates indicated, by credit quality and by year of issuance (vintage).

## Commercial Mortgage-Backed Securities at Amortized Cost Closed Block Business

September 30, 2012
Lowest Rating Agency Rating(1)
Total

|  |  | Lowest Rating Agency Rating(1) |  |  |  |  |  |  |  | $\begin{array}{c}\text { Total } \\ \text { Total } \\ \text { December } \\ \text { 31, }\end{array}$ |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| 2011 |  |  |  |  |  |  |  |  |  |  |$]$

(1) The table above provides ratings as assigned by nationally recognized rating agencies as of September 30, 2012, including Standard \& Poor s, Moody s, Fitch and Realpoint.
(2) Included in the table above, as of September 30, 2012, are downgraded super senior securities with amortized cost of $\$ 139$ million in AA and $\$ 78$ million in A.
(3) Included in the table above, as of September 30, 2012, are agency commercial mortgage-backed securities with amortized cost of $\$ 434$ million, all rated AA.

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## Commercial Mortgage-Backed Securities at Fair Value Closed Block Business

September 30, 2012

|  | Lowest Rating Agency Rating(1) |  |  |  |  |  |  |  | Total December 31, 2011 |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | AAA | AA | A | BBBBB and <br> below(in millions) |  |  |  | Total <br> Fair <br> Value |  |  |
| Vintage |  |  |  |  |  |  |  |  |  |  |
| 2012 | \$ 132 | \$ 112 |  | \$ | 0 | \$ | 0 | \$ 244 | \$ | 0 |
| 2011 | 51 | 175 | 0 |  | 0 |  | 0 | 226 |  | 57 |
| 2010 | 0 | 51 | 0 |  | 0 |  | 0 | 51 |  | 5 |
| 2009 | 0 | 71 | 0 |  | 0 |  | 0 | 71 |  | 0 |
| 2008 | 6 | 0 | 0 |  | 0 |  | 0 | 6 |  | 4 |
| 2007 | 538 | 45 | 29 |  | 0 |  | 13 | 625 |  | 860 |
| 2006 | 1,249 | 146 | 26 |  | 0 |  | 0 | 1,421 |  | 986 |
| 2005 \& Prior | 1,399 | 29 | 28 |  | 5 |  | 3 | 1,464 |  | 1,803 |
| Total commercial mortgage-backed securities(2) | \$ 3,375 | \$ 629 | \$ 83 | \$ | 5 | \$ | 16 | \$4,108 | \$ | 3,715 |

(1) The table above provides ratings as assigned by nationally recognized rating agencies as of September 30, 2012, including Standard \& Poor s, Moody s, Fitch and Realpoint.
(2) Included in the table above, as of September 30, 2012, are agency commercial mortgage-backed securities with fair value of $\$ 454$ million, all rated AA.

The following table sets forth the amortized cost of our AAA commercial mortgage-backed securities attributable to the Closed Block Business as of the dates indicated, by type and by year of issuance (vintage).

## AAA Rated Commercial Mortgage-Backed Securities Amortized Cost by Type and Vintage Closed Block Business



The Securities Valuation Office, or SVO, of the NAIC, evaluates the investments of insurers for statutory reporting purposes and assigns fixed maturity securities to one of six categories called NAIC Designations. In general, NAIC Designations of 1 highest quality, or 2 high quality, include fixed maturities considered investment grade, which include securities rated Baa3 or higher by Moody s or BBB- or higher by Standard \& Poor s. NAIC Designations of 3 through 6 generally include fixed maturities referred to as below investment grade, which include securities rated Ba1 or lower by Moody s and BB+ or lower by Standard \& Poor s. The NAIC Designations for commercial mortgage-backed securities and non-agency residential

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mortgage-backed securities, including our asset-backed securities collateralized by sub-prime mortgages, are based on security level expected losses as modeled by an independent third party (engaged by the NAIC) and the statutory carrying value of the security, including any purchase discounts or impairment charges previously recognized.

As a result of time lags between the funding of investments, the finalization of legal documents, and the completion of the SVO filing process, the fixed maturity portfolio generally includes securities that have not yet been rated by the SVO as of each balance sheet date. Pending receipt of SVO ratings, the categorization of these securities by NAIC Designation is based on the expected ratings indicated by internal analysis.

Investments of our international insurance companies are not subject to NAIC guidelines. Investments of our Japanese insurance operations are regulated locally by the Financial Services Agency, an agency of the Japanese government. The Financial Services Agency has its own investment quality criteria and risk control standards. Our Japanese insurance companies comply with the Financial Services Agency s credit quality review and risk monitoring guidelines. The credit quality ratings of the investments of our Japanese insurance companies are based on ratings assigned by nationally recognized credit rating agencies, including Moody s, Standard \& Poor s, or rating equivalents based on ratings assigned by Japanese credit ratings agencies.

The amortized cost of our public and private fixed maturities attributable to the Financial Services Businesses considered other than high or highest quality, based on NAIC or equivalent rating, totaled $\$ 8.6$ billion, or $4 \%$, of the total fixed maturities as of September 30, 2012, and $\$ 9.3$ billion, or $5 \%$, of the total fixed maturities as of December 31, 2011. Fixed maturities considered other than high or highest quality, based on NAIC or equivalent rating, represented $27 \%$ and $30 \%$ of the gross unrealized losses attributable to the Financial Services Businesses as of September 30, 2012 and December 31, 2011, respectively. As of September 30, 2012, the amortized cost of our public and private below investment grade fixed maturities attributable to the Financial Services Businesses, based on the lowest of external rating agency ratings, totaled $\$ 10.3$ billion, or $5 \%$, of the total fixed maturities, and include securities considered high or highest quality by the NAIC based on the rules described above.

The amortized cost of our public and private fixed maturities attributable to the Closed Block Business considered other than high or highest quality, based on NAIC or equivalent rating, totaled $\$ 3.6$ billion, or $9 \%$, of the total fixed maturities as of September 30, 2012, and $\$ 4.4$ billion, or $10 \%$, of the total fixed maturities as of December 31, 2011. Fixed maturities considered other than high or highest quality, based on NAIC or equivalent rating, represented $49 \%$ and $51 \%$ of the gross unrealized losses attributable to the Closed Block Business as of September 30, 2012 and December 31, 2011, respectively. As of September 30, 2012, the amortized cost of our public and private below investment grade fixed maturities attributable to the Closed Block Business, based on the lowest of external rating agency ratings, totaled $\$ 4.8$ billion, or $11 \%$, of the total fixed maturities, and include securities considered high or highest quality by the NAIC based on the rules described above.

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## Public Fixed Maturities Credit Quality

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

Public Fixed Maturity Securities Financial Services Businesses

| (1)(2) | September 30, 2012 |  |  |  |  |  |  | December 31, 2011 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Amortized Cost | Gross <br> Unrealized Gains(3) |  | Gross <br> Unrealized Losses(3) |  | Fair $\quad$ AmortizedValue $\quad$ Cost(in millions) |  | Gross <br> Unrealized Gains(3) |  | Gross <br> Unrealized Losses(3) |  | Fair Value |
| 1 | \$ 162,378 | \$ | 15,565 | \$ | 918 | \$ 177,025 | \$ 151,700 | \$ | 11,143 | \$ | 1,756 | \$ 161,087 |
| 2 | 17,408 |  | 1,805 |  | 476 | 18,737 | 17,017 |  | 1,298 |  | 797 | 17,518 |
| Subtotal High or Highest Quality Securities | 179,786 |  | 17,370 |  | 1,394 | 195,762 | 168,717 |  | 12,441 |  | 2,553 | 178,605 |
| 3 | 3,152 |  | 77 |  | 281 | 2,948 | 3,446 |  | 66 |  | 574 | 2,938 |
| 4 | 1,254 |  | 76 |  | 150 | 1,180 | 1,328 |  | 34 |  | 296 | 1,066 |
| 5 | 376 |  | 8 |  | 108 | 276 | 443 |  | 6 |  | 174 | 275 |
| 6 | 123 |  | 13 |  | 28 | 108 | 219 |  | 15 |  | 105 | 129 |
| Subtotal Other Securities(4) | 4,905 |  | 174 |  | 567 | 4,512 | 5,436 |  | 121 |  | 1,149 | 4,408 |
| Total Public Fixed Maturities | \$ 184,691 | \$ | 17,544 | \$ | 1,961 | \$ 200,274 | \$ 174,153 | \$ | 12,562 | \$ | 3,702 | \$ 183,013 |

(1) Reflects equivalent ratings for investments of our international insurance operations.
(2) Includes, as of September 30, 2012 and December 31, 2011, 5 securities with amortized cost of $\$ 4$ million (fair value, $\$ 9$ million) and 10 securities with amortized cost of $\$ 2$ million (fair value, $\$ 12$ million), respectively, that have been categorized based on expected NAIC Designations pending receipt of SVO ratings.
(3) Includes $\$ 294$ million of gross unrealized gains and $\$ 70$ million gross unrealized losses as of September 30, 2012, compared to $\$ 282$ million of gross unrealized gains and $\$ 97$ million of gross unrealized losses as of December 31, 2011, on securities classified as held-to-maturity.
(4) On an amortized cost basis, as of September 30, 2012, includes $\$ 179$ million in emerging market securities and $\$ 48$ million in securitized bank loans.

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

## Public Fixed Maturity Securities Closed Block Business

| (1) | September 30, 2012 <br> Gross |  |  |  | Gross |  |  |  | December 31, 2011 <br> Gross |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| NAIC Designation |  |  |  |  |  |  |  |  |  |  |  |  |


| Subtotal High or Highest Quality Securities | 24,481 |  | 3,738 |  | 274 | 27,945 | 25,736 |  | 3,053 |  | 515 | 28,274 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| 3 | 933 |  | 60 |  | 77 | 916 | 1,103 |  | 59 |  | 82 | 1,080 |
| 4 | 615 |  | 17 |  | 127 | 505 | 808 |  | 14 |  | 245 | 577 |
| 5 | 189 |  | 10 |  | 46 | 153 | 369 |  | 5 |  | 156 | 218 |
| 6 | 21 |  | 12 |  | 3 | 30 | 66 |  | 10 |  | 14 | 62 |
| Subtotal Other Securities(2) | 1,758 |  | 99 |  | 253 | 1,604 | 2,346 |  | 88 |  | 497 | 1,937 |
| Total Public Fixed Maturities | \$ 26,239 | \$ | 3,837 | \$ | 527 | \$ 29,549 | \$ 28,082 | \$ | 3,141 | \$ | 1,012 | \$ 30,211 |

(1) Includes, as of September 30, 2012 and December 31, 2011, 5 securities with amortized cost of $\$ 7$ million (fair value, $\$ 11$ million) and 11 securities with amortized cost of $\$ 11$ million (fair value, $\$ 13$ million), respectively, that have been categorized based on expected NAIC Designations pending receipt of SVO ratings.
(2) On an amortized cost basis, as of September 30, 2012, includes $\$ 209$ million in securitized bank loans and $\$ 148$ million in emerging markets securities.

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Private Fixed Maturities Credit Quality

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

## Private Fixed Maturity Securities Financial Services Businesses

| (1)(2) | September 30, 2012 |  |  |  |  |  |  | December 31, 2011 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| NAIC Designation | Amortized Cost | Gross <br> Unrealized <br> Gains(3) |  | Gross Unrealized Losses(3) |  | FairValue(in millions)Amortized <br> Cost |  | Gross Unrealized Gains(3) |  | Gross Unrealized Losses(3) |  | Fair <br> Value |
| 1 | \$ 7,113 | \$ | 804 | \$ | 63 | \$ 7,854 | \$ 7,018 | \$ | 730 | \$ | 84 | \$ 7,664 |
| 2 | 17,180 |  | 1,574 |  | 293 | 18,461 | 15,847 |  | 1,273 |  | 362 | 16,758 |
| Subtotal High or Highest Quality Securities | 24,293 |  | 2,378 |  | 356 | 26,315 | 22,865 |  | 2,003 |  | 446 | 24,422 |
| 3 | 2,472 |  | 180 |  | 37 | 2,615 | 2,532 |  | 134 |  | 43 | 2,623 |
| 4 | 675 |  | 37 |  | 7 | 705 | 715 |  | 14 |  | 20 | 709 |
| 5 | 406 |  | 15 |  | 19 | 402 | 490 |  | 5 |  | 42 | 453 |
| 6 | 162 |  | 31 |  | 5 | 188 | 130 |  | 31 |  | 3 | 158 |
| Subtotal Other Securities(4) | 3,715 |  | 263 |  | 68 | 3,910 | 3,867 |  | 184 |  | 108 | 3,943 |
| Total Private Fixed Maturities | \$ 28,008 | \$ | 2,641 | \$ | 424 | \$ 30,225 | \$ 26,732 | \$ | 2,187 | \$ | 554 | \$ 28,365 |

(1) Reflects equivalent ratings for investments of our international insurance operations.
(2) Includes, as of September 30, 2012 and December 31, 2011, 133 securities with amortized cost of $\$ 1,314$ million (fair value, $\$ 1,378$ million) and 100 securities with amortized cost of $\$ 815$ million (fair value, $\$ 840$ million), respectively, that have been categorized based on expected NAIC Designations pending receipt of SVO ratings.
(3) Includes $\$ 75$ million of gross unrealized gains and no gross unrealized losses as of September 30, 2012, compared to $\$ 63$ million of gross unrealized gains and $\$ 1$ million of gross unrealized losses as of December 31, 2011, on securities classified as held-to-maturity.
(4) On an amortized cost basis, as of September 30, 2012, includes $\$ 358$ million in securitized bank loans and $\$ 273$ million in commercial asset finance securities.

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

## Private Fixed Maturity Securities Closed Block Business

| (1) | September 30, 2012 |  |  |  |  |  |  | December 31, 2011 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| NAIC Designation | Amortized Cost | Gross Unrealized Gains |  | Gross Unrealized Losses |  | FairValue(in millions)Cost |  | Gross Unrealized Gains |  | Gross Unrealized Losses |  | Fair <br> Value |
| 1 | \$ 3,939 | \$ | 754 | \$ | 0 | \$ 4,693 | \$ 3,651 | \$ | 660 | \$ | 0 | \$ 4,311 |
| 2 | 9,971 |  | 1,215 |  | 12 | 11,174 | 8,861 |  | 1,069 |  | 16 | 9,914 |
| Subtotal High or Highest Quality Securities | 13,910 |  | 1,969 |  | 12 | 15,867 | 12,512 |  | 1,729 |  | 16 | 14,225 |
| 3 | 1,021 |  | 87 |  | 4 | 1,104 | 1,061 |  | 66 |  | 10 | 1,117 |
| 4 | 519 |  | 13 |  | 5 | 527 | 618 |  | 11 |  | 16 | 613 |
| 5 | 216 |  | 3 |  | 9 | 210 | 215 |  | 1 |  | 18 | 198 |
| 6 | 97 |  | 14 |  | 2 | 109 | 152 |  | 3 |  | 3 | 152 |
| Subtotal Other Securities(2) | 1,853 |  | 117 |  | 20 | 1,950 | 2,046 |  | 81 |  | 47 | 2,080 |
| Total Private Fixed Maturities | \$ 15,763 | \$ | 2,086 | \$ | 32 | \$ 17,817 | \$ 14,558 | \$ | 1,810 | \$ | 63 | \$ 16,305 |

(1) Includes, as of September 30, 2012 and December 31, 2011, 64 securities with amortized cost of $\$ 1,150$ million (fair value, $\$ 1,202$ million) and 56 securities with amortized cost of $\$ 926$ million (fair value, $\$ 968$ million), respectively, that have been categorized based on expected NAIC Designations pending receipt of SVO ratings.
(2) On an amortized cost basis, as of September 30, 2012, includes $\$ 257$ million in commercial asset finance securities and $\$ 251$ million in securitized bank loans.

## Corporate Securities Credit Quality

The following table sets forth both our public and private corporate securities by NAIC Designation attributable to the Financial Services Businesses as of the dates indicated.

## Corporate Securities Financial Services Businesses



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|  |  |  |  |  |  |  |  |  |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Subtotal High or Highest Quality Securities | 90,601 | 8,647 | 1,285 | 97,963 | 86,282 | 6,442 | 2,238 | 90,486 |
| 3 | 5,288 | 242 | 260 | 5,270 | 5,529 | 185 | 512 | 5,202 |
| 4 | 1,483 | 56 | 62 | 1,477 | 1,467 | 26 | 109 | 1,384 |
| 5 | 457 | 13 | 27 | 443 | 585 | 9 | 51 | 543 |
| 6 | 192 | 37 | 6 | 223 | 176 | 35 | 12 | 199 |
| Subtotal Other Securities |  |  |  |  |  |  |  |  |
|  |  | 3,420 | 348 | 355 | 7,413 | 7,757 | 255 | 684 |
| Total Corporate Fixed Maturities | $\$ 98,021$ | $\$ 8,995$ | $\$ 1,640$ | $\$ 105,376$ | $\$ 94,039$ | $\$$ | 6,697 | $\$$ |

(1) Reflects equivalent ratings for investments of our international insurance operations.
(2) Prior period s amounts are presented on a basis consistent with the current period presentation.

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The following table sets forth our corporate securities by NAIC Designation attributable to the Closed Block Business as of the dates indicated.

## Corporate Securities Closed Block Business


(1) Prior period s amounts are presented on a basis consistent with the current period presentation.

Credit Derivative Exposure to Public Fixed Maturities

In addition to the credit exposure from public fixed maturities noted above, we sell credit derivatives to enhance the return on our investment portfolio by creating credit exposure similar to an investment in public fixed maturity cash instruments.

In a credit derivative, we sell credit protection on an identified name, and in return receive a quarterly premium. With single name credit default derivatives, this premium or credit spread generally corresponds to the difference between the yield on the referenced name s public fixed maturity cash instruments and swap rates at the time the agreement is executed.

The referenced names in the credit derivatives where we have sold credit protection, as well as all the counterparties to these agreements, are investment grade credit quality and our credit derivatives have a remaining term to maturity of four years or less. Credit derivative contracts are recorded at fair value with changes in fair value, including the premium received, recorded in Realized investment gains (losses), net. The premium received for the credit derivatives we sell attributable to the Financial Services Businesses was $\$ 0$ million and $\$ 2$ million for the three and nine months ended September 30, 2012, respectively, and $\$ 2$ million and $\$ 5$ million for the three and nine months ended September 30, 2011, respectively, and is included in adjusted operating income as an adjustment to Realized investment gains (losses), net.

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

## Credit Derivatives, Sold Protection Financial Services Businesses


(1) Excludes a credit derivative related to surplus notes issued by a subsidiary of Prudential Insurance and embedded derivatives contained in certain externally-managed investments in the European market. See Note 14 to the Unaudited Interim Consolidated Financial Statements for additional information regarding these derivatives.

As of September 30, 2012 and December 31, 2011, the Closed Block Business had $\$ 5$ million and $\$ 50$ million of outstanding notional amounts, respectively, reported at fair value as an asset of less than $\$ 1$ million of exposure where we have sold credit protection through credit derivatives.

In addition to selling credit protection, we have purchased credit protection using credit derivatives in order to hedge specific credit exposures in our investment portfolio, including exposures relating to certain guarantees from monoline bond insurers. As of September 30, 2012 and December 31, 2011, the Financial Services Businesses had $\$ 1.384$ billion and $\$ 1.598$ billion of outstanding notional amounts, reported at fair value as a liability of $\$ 25$ million and an asset of $\$ 2$ million, respectively. As of September 30, 2012 and December 31, 2011, the Closed Block Business had $\$ 344$ million and $\$ 381$ million of outstanding notional amounts, reported at fair value as a liability of $\$ 8$ million and an asset of less than $\$ 1$ million, respectively. The premium paid for the credit derivatives we purchase attributable to the Financial Services Businesses was $\$ 9$ million and $\$ 29$ million for the three and nine months ended September 30,2012 , and $\$ 11$ million and $\$ 33$ million for the three and nine months ended September 30, 2011, respectively, and is included in adjusted operating income as an adjustment to Realized investment gains (losses), net. See Note 14 to the Unaudited Interim Consolidated Financial Statements for additional information regarding credit derivatives and an overall description of our derivative activities.

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Unrealized Losses from Fixed Maturity Securities

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

## Unrealized Losses from Fixed Maturity Securities, Greater than $20 \%$ Financial Services Businesses

|  | September 30, 2012 |  |  |  | December 31, 2011 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  |  |  |  |  |
|  | Gross |  |  |  |  |  |  |
|  |  | nortized |  | $\begin{aligned} & \text { ealized } \\ & \operatorname{ses}(1) \end{aligned}$ | Amortized $\operatorname{Cost}(1)$ |  | $\begin{aligned} & \text { ealized } \\ & \operatorname{ses}(1) \end{aligned}$ |
|  | (in millions) |  |  |  |  |  |  |
| Less than three months |  | 252 | \$ | 52 | \$ 1,371 | \$ | 349 |
| Three months or greater but less than six months |  | 514 |  | 116 | 1,667 |  | 399 |
| Six months or greater but less than nine months |  | 239 |  | 60 | 864 |  | 309 |
| Nine months or greater but less than twelve months |  | 107 |  | 32 | 745 |  | 193 |
| Greater than twelve months |  | 3,574 |  | 1,074 | 3,809 |  | 1,392 |
| Total |  | 4,686 | \$ | 1,334 | \$ 8,456 | \$ | 2,642 |

(1) The aging of amortized cost and gross unrealized losses is determined based upon a count of the number of months the estimated fair value remained below amortized cost by $20 \%$ or more, using month-end valuations.

The gross unrealized losses were primarily attributable to foreign currency exchange rate movements, general credit spread widening in the structured credit marketplace and liquidity discounts as of September 30, 2012 and December 31, 2011. Gross unrealized losses attributable to the Financial Services Businesses, where the estimated fair value had declined and remained below amortized cost by $20 \%$ or more, of $\$ 1.334$ billion as of September 30, 2012 includes $\$ 404$ million relating to asset-backed securities collateralized by sub-prime mortgages. Also included in gross unrealized losses were $\$ 35$ million of gross unrealized losses on securities with amortized cost of $\$ 57$ million where the estimated fair value had declined and remained below amortized cost by $50 \%$ or more, of which $\$ 2$ million was included in the less than three months timeframe, $\$ 1$ million was included in the three months or greater but less than twelve months timeframe, and $\$ 32$ million was included in the greater than twelve months timeframe. We have not recognized the gross unrealized losses shown in the tables above as other-than-temporary impairments in earnings based on our detailed analysis of the underlying credit and cash flows on each of these securities. We believe the recoverable value of these investments based on the expected future cash flows is greater than or equal to our remaining amortized cost. At September 30, 2012, we do not intend to sell these securities and it is not more likely than not that we will be required to sell these securities before the anticipated recovery of its remaining amortized cost basis. See Other-Than-Temporary Impairments of Fixed Maturity Securities for a discussion of the factors we consider in making these determinations.

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

## Unrealized Losses from Fixed Maturity Securities, Greater than 20\% Closed Block Business

|  | September 30, 2012 |  |  |  | December 31, 2011 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  |  |  |  |  |  |  |  |
|  | Amortized $\operatorname{Cost}(1)$ |  | Gross <br> Unrealized <br> Losses(1) |  | Amortized <br> $\operatorname{Cost}(1)$ |  | Gross Unrealized Losses(1) |  |
|  | (in millions) |  |  |  |  |  |  |  |
| Less than three months | \$ | 4 | \$ | 1 | \$ | 122 | \$ | 33 |
| Three months or greater but less than six months |  | 16 |  | 3 |  | 353 |  | 90 |
| Six months or greater but less than nine months |  | 1 |  | 1 |  | 179 |  | 55 |
| Nine months or greater but less than twelve months |  | 23 |  | 5 |  | 122 |  | 34 |
| Greater than twelve months |  | ,083 |  | 368 |  | 1,263 |  | 605 |
| Total |  |  | \$ | 378 |  | 2,039 | \$ | 817 |

(1) The aging of amortized cost and gross unrealized losses is determined based upon a count of the number of months the estimated fair value remained below amortized cost by $20 \%$ or more, using month-end valuations.

The gross unrealized losses were primarily attributable to general credit spread widening in the structured credit marketplace, liquidity discounts and foreign currency exchange rate movements as of September 30, 2012 and December 31, 2011. Gross unrealized losses attributable to the Closed Block Business, where the estimated fair value had declined and remained below amortized cost by $20 \%$ or more, of $\$ 378$ million as of September 30, 2012 include $\$ 347$ million relating to asset-backed securities collateralized by sub-prime mortgages. Gross unrealized losses attributable to the Closed Block Business where the estimated fair value had declined and remained below amortized cost by $20 \%$ or more as of September 30, 2012 does not include any gross unrealized losses on securities where the estimated fair value had declined and remained below amortized cost by $50 \%$ or more. We have not recognized the gross unrealized losses shown in the tables above as other-than-temporary impairments in earnings based on our detailed analysis of the underlying credit and cash flows on each of these securities. We believe the recoverable value of these investments based on the expected future cash flows is greater than or equal to our remaining amortized cost. At September 30, 2012, we do not intend to sell these securities and it is not more likely than not that we will be required to sell these securities before the anticipated recovery of its remaining amortized cost basis. See Other-Than-Temporary Impairments of Fixed Maturity Securities for a discussion of the factors we consider in making these determinations.

## Other-Than-Temporary Impairments of Fixed Maturity Securities

We maintain separate monitoring processes for public and private fixed maturities and create watch lists to highlight securities that require special scrutiny and management. Our public fixed maturity asset managers formally review all public fixed maturity holdings on a quarterly basis and more frequently when necessary to identify potential credit deterioration whether due to ratings downgrades, unexpected price variances, and/or company or industry specific concerns.

For private placements, our credit and portfolio management processes help ensure prudent controls over valuation and management. We have separate pricing and authorization processes to establish checks and balances for new investments. We apply consistent standards of credit analysis and due diligence for all transactions, whether they originate through our own in-house origination staff or through agents. Our regional

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offices closely monitor the portfolios in their regions. We set all valuation standards centrally, and we assess the fair value of all investments quarterly. Our private fixed maturity asset managers formally review all private fixed maturity holdings on a quarterly basis and more frequently when necessary to identify potential credit deterioration whether due to ratings downgrades, unexpected price variances, and/or company or industry specific concerns.

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Fixed maturity securities classified as held-to-maturity are those securities where we have the intent and ability to hold the securities until maturity. These securities are reflected at amortized cost in our consolidated statements of financial position. Other fixed maturity securities are considered available-for-sale and, as a result, we record unrealized gains and losses to the extent that amortized cost is different from estimated fair value. All held-to-maturity securities and all available-for-sale securities with unrealized losses are subject to our review to identify other-than-temporary impairments in value.

In evaluating whether a decline in value is other-than-temporary, we consistently consider several factors including, but not limited to, the following:
the reasons for the decline in value (credit event, currency or interest rate related, including general credit spread widening);
the financial condition of and near-term prospects of the issuer; and
the extent and duration of the decline.

In determining whether a decline in value is other-than-temporary, we place greater emphasis on our analysis of the underlying credit versus the extent and duration of a decline in value. Our credit analysis of an investment includes determining whether the issuer is current on its contractual payments, evaluating whether it is probable that we will be able to collect all amounts due according to the contractual terms of the security, and analyzing our overall ability to recover the amortized cost of the investment. We continue to utilize valuation declines as a potential indicator of credit deterioration, and apply additional levels of scrutiny in our analysis as the severity and duration of the decline increases.

In addition, we recognize an other-than-temporary impairment in earnings for a debt security in an unrealized loss position when (a) we have the intent to sell the debt security, or (b) it is more likely than not we will be required to sell the debt security before its anticipated recovery, or (c) a foreign currency denominated security with a foreign currency translation loss approaches maturity. For all debt securities in unrealized loss positions that do not meet any of these criteria, we analyze our ability to recover the amortized cost by comparing the net present value of our best estimate of projected future cash flows with the amortized cost of the security. If the net present value is less than the amortized cost of the investment, an other-than-temporary impairment is recorded. The determination of the assumptions used in these projections requires the use of significant management judgment. See Note 2 to the Unaudited Interim Consolidated Financial Statements for additional information regarding these assumptions and our policies for recognizing other-than-temporary impairments for debt securities.

Other-than-temporary impairments of general account fixed maturity securities attributable to the Financial Services Businesses that were recognized in earnings were $\$ 82$ million and $\$ 101$ million for the three months ended September 30, 2012 and 2011, respectively, and $\$ 238$ million and $\$ 309$ million for the nine months ended September 30, 2012 and 2011, respectively. Included in the other-than-temporary impairments of general account fixed maturities attributable to the Financial Services Businesses for the three months ended September 30, 2012 and 2011, were $\$ 13$ million and $\$ 24$ million, respectively, of other-than-temporary impairments on asset-backed securities collateralized by sub-prime mortgages. Other-than-temporary impairments of general account fixed maturities attributable to the Financial Services Businesses for the nine months ended September 30, 2012 and 2011 include $\$ 47$ million and $\$ 83$ million, respectively, of other-than-temporary impairments on asset-backed securities collateralized by sub-prime mortgages.

Other-than-temporary impairments of fixed maturity securities attributable to the Closed Block Business that were recognized in earnings were $\$ 13$ million and $\$ 15$ million for the three months ended September 30, 2012, and 2011, respectively, and $\$ 62$ million and $\$ 64$ million for the nine months ended September 30, 2012 and 2011, respectively. Included in the other-than-temporary impairments of fixed maturities attributable to the Closed Block Business for the three months ended September 30, 2012, and 2011, were $\$ 7$ million and $\$ 9$ million, respectively, of
other-than-temporary impairments on asset-backed securities

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collateralized by sub-prime mortgages. Other-than-temporary impairments of general account fixed maturities attributable to the Closed Block Business for the nine months ended September 30, 2012 and 2011 include $\$ 33$ million and $\$ 47$ million, respectively, of other-than-temporary impairments on asset-backed securities collateralized by sub-prime mortgages. For a further discussion of other-than-temporary impairments, see Realized Investment Gains and Losses above.

## Trading account assets supporting insurance liabilities

Certain products included in the Retirement and International Insurance segments are experience-rated, meaning that we expect the investment results associated with these products will ultimately accrue to contractholders. The investments supporting these experience-rated products, excluding commercial mortgage and other loans, are primarily classified as trading and are reflected on the balance sheet as Trading account assets supporting insurance liabilities, at fair value. Realized and unrealized gains and losses for these investments are reported in Asset management fees and other income, and excluded from adjusted operating income. Investment income for these investments is reported in Net investment income, and is included in adjusted operating income.

The following table sets forth the composition of this portfolio as of the dates indicated.

|  | September 30, 2012 |  | December 31, 2011(1) |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Amortized Cost | Fair Value (in | Amortized Cost ions) | Fair Value |
| Short-term investments and cash equivalents | \$ 640 | \$ 640 | \$ 951 | \$ 951 |
| Fixed maturities: |  |  |  |  |
| Corporate securities | 11,122 | 12,153 | 10,369 | 11,113 |
| Commercial mortgage-backed securities | 1,951 | 2,095 | 2,157 | 2,247 |
| Residential mortgage-backed securities | 1,799 | 1,880 | 1,786 | 1,844 |
| Asset-backed securities | 1,227 | 1,150 | 1,504 | 1,367 |
| Foreign government bonds | 736 | 756 | 599 | 608 |
| U.S. government authorities and agencies and obligations of U.S. states | 408 | 455 | 413 | 440 |
| Total fixed maturities | 17,243 | 18,489 | 16,828 | 17,619 |
| Equity securities | 1,029 | 1,003 | 1,050 | 911 |
| Total trading account assets supporting insurance liabilities | \$ 18,912 | \$ 20,132 | \$ 18,829 | \$ 19,481 |

(1) Prior period s amounts are presented on a basis consistent with the current period presentation.

As a percentage of amortized cost, $74 \%$ and $75 \%$ of the portfolio was publicly-traded as of September 30, 2012 and December 31, 2011, respectively. As of September 30, 2012 and December 31, 2011, $93 \%$ and $92 \%$, respectively, of the fixed maturity portfolio was considered high or highest quality based on NAIC or equivalent rating. As of September 30, 2012, $\$ 1.696$ billion of the residential mortgage-backed securities were publicly-traded agency pass-through securities, which are supported by implicit or explicit government guarantees, of which $99 \%$ have credit ratings of A or higher. Collateralized mortgage obligations, including approximately $\$ 76$ million secured by ALT-A mortgages, represented the remaining $\$ 103$ million of residential mortgage-backed securities, of which $62 \%$ have credit ratings of A or better and $38 \%$ are BBB and below. For a discussion of changes in the fair value of our trading account assets supporting insurance liabilities see Experience-Rated Contractholder Liabilities, Trading Account Assets Supporting Insurance Liabilities and Other Related Investments, above.

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The following table sets forth the composition of the corporate securities included in our trading account assets supporting insurance liabilities portfolio, by industry category, as of the dates indicated.

## Corporate Securities by Industry Category Trading Account Assets Supporting Insurance Liabilities

|  | September 30, 2012 |  |  |  | December 31, 2011(2) |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Amortized Cost |  | Fair Value |  | Amortized |  | Fair Value |  |
| Industry(1) |  |  |  |  |  |  |  |  |
| Corporate Securities: |  |  |  |  |  |  |  |  |
| Finance | \$ | 2,380 | \$ | 2,538 | \$ | 2,021 |  | 2,057 |
| Consumer non-cyclical |  | 1,989 |  | 2,184 |  | 1,785 |  | 1,946 |
| Utility |  | 1,384 |  | 1,549 |  | 1,382 |  | 1,521 |
| Capital goods |  | 1,185 |  | 1,299 |  | 812 |  | 871 |
| Consumer cyclical |  | 812 |  | 885 |  | 595 |  | 641 |
| Energy |  | 741 |  | 819 |  | 650 |  | 721 |
| Basic industry |  | 682 |  | 741 |  | 653 |  | 706 |
| Communications |  | 593 |  | 681 |  | 662 |  | 721 |
| Transportation |  | 432 |  | 463 |  | 565 |  | 599 |
| Technology |  | 364 |  | 406 |  | 474 |  | 515 |
| Industrial other |  | 359 |  | 381 |  | 669 |  | 712 |
| Foreign agencies |  | 201 |  | 207 |  | 101 |  | 103 |
| Total Corporate Securities |  | 11,122 |  | 12,153 |  | 0,369 |  | 11,113 |

[^8]The following tables set forth our asset-backed securities included in our trading account assets supporting insurance liabilities portfolio as of the dates indicated, by credit quality, and for asset-backed securities collateralized by sub-prime mortgages, by year of issuance (vintage).

## Asset-Backed Securities at Amortized Cost Trading Account Assets Supporting Insurance Liabilities




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## Asset-Backed Securities at Fair Value Trading Account Assets Supporting Insurance Liabilities

|  | September 30, 2012 <br> Lowest Rating Agency Rating |  |  |  |  |  | Total <br> Fair <br> Value | TotalDecember31,2011 |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | AAA | AA | A | $\underset{\substack{\text { BBB } \\ \text { (in millions) }}}{$ BB and  <br>  below $}$ | BB and below ions) |  |  |  |  |
| Vintage |  |  |  |  |  |  |  |  |  |
| Collateralized by sub-prime mortgages: |  |  |  |  |  |  |  |  |  |
| 20122008 |  | \$ 0 |  |  | \$ | 0 | \$ 0 | \$ | 0 |
| 2007 | 0 | 0 | 0 | 0 |  | 63 | 63 |  | 42 |
| 2006 | 0 | 0 | 0 | 0 |  | 43 | 43 |  | 46 |
| 2005 | 0 | 0 | 0 | 0 |  | 24 | 24 |  | 25 |
| 2004 \& Prior | 0 | 6 | 5 | 0 |  | 35 | 46 |  | 44 |
| Total collateralized by sub-prime mortgages(1) | 0 | 6 | 5 | 0 |  | 165 | 176 |  | 157 |
| Other asset-backed securities: |  |  |  |  |  |  |  |  |  |
| Collateralized by auto loans | 249 | 0 | 0 | 0 |  | 0 | 249 |  | 293 |
| Collateralized by credit cards | 240 | 13 | 0 | 25 |  | 0 | 278 |  | 461 |
| Other asset-backed securities(2) | 232 | 183 | 28 | 1 |  | 3 | 447 |  | 456 |
| Total asset-backed securities | \$ 721 | \$ 202 | \$33 | \$ 26 |  | 168 | \$ 1,150 | \$ | ,367 |

(1) No securities collateralized by second-lien exposures were included within the $\$ 176$ million of asset-backed securities collateralized by sub-prime mortgages at fair value as of September 30, 2012.
(2) As of September 30, 2012, includes collateralized debt obligations with fair value of $\$ 13$ million, none of which is secured by sub-prime mortgages. Also includes asset-backed securities collateralized by education loans, franchises, timeshares, and equipment leases.

The following tables set forth our commercial mortgage-backed securities included in our trading account assets supporting insurance liabilities portfolio as of the dates indicated, by credit quality and by year of issuance (vintage).

## Commercial Mortgage-Backed Securities at Amortized Cost Trading Account Assets Supporting Insurance Liabilities


$\begin{array}{lllllllllllll}\text { Total commercial mortgage-backed securities(1) } & \$ 1,781 & \$ 133 & \$ 18 & \$ 8 & \$ & 11 & \$ & 1,951 & \$ & 2,157\end{array}$
(1) Included in the table above as of September 30, 2012, are downgraded super senior securities with amortized cost of $\$ 11$ million in AA.

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Commercial Mortgage-Backed Securities at Fair Value Trading Account Assets Supporting Insurance Liabilities


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

## Public Fixed Maturity Securities Trading Account Assets Supporting Insurance Liabilities


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

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

## Private Fixed Maturity Securities Trading Account Assets Supporting Insurance Liabilities

| (1)(2) | September 30, 2012 |  |  |  |  |  |  | December 31, 2011 |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| NAIC Designation | Amortized Cost | Gross Unrealized Gains(3) |  | Gross Unrealized Losses(3) |  | $\underset{\substack{\text { Vaire } \\ \text { (in millions) }}}{\text { Cost }}$Amortized |  | Gross Unrealized Gains(3) |  | Gross Unrealized Losses(3) |  | Fair <br> Value |
| 1 | \$ 791 | \$ | 76 | \$ | 0 | \$ 867 | \$ 828 | \$ | 74 | \$ | 10 | \$ 892 |
| 2 | 3,320 |  | 275 |  | 2 | 3,593 | 3,143 |  | 262 |  | 13 | 3,392 |
| Subtotal High or Highest Quality Securities | 4,111 |  | 351 |  | 2 | 4,460 | 3,971 |  | 336 |  | 23 | 4,284 |
| 3 | 588 |  | 39 |  | 3 | 624 | 588 |  | 33 |  | 2 | 619 |
| 4 | 159 |  | 4 |  | 2 | 161 | 123 |  | 3 |  | 5 | 121 |
| 5 | 56 |  | 1 |  | 1 | 56 | 76 |  | 0 |  | 4 | 72 |
| 6 | 9 |  | 0 |  | 8 | 1 | 13 |  | 0 |  | 2 | 11 |
| Subtotal Other Securities | 812 |  | 44 |  | 14 | 842 | 800 |  | 36 |  | 13 | 823 |
| Total Private Fixed Maturities | \$4,923 | \$ | 395 | \$ | 16 | \$ 5,302 | \$4,771 | \$ | 372 | \$ | 36 | \$ 5,107 |

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

## Other Trading Account Assets

Other trading account assets consist primarily of certain financial instruments that contain an embedded derivative where we elected to classify the entire instrument as a trading account asset rather than bifurcate. These instruments are carried at fair value, with realized and unrealized gains and losses reported in Asset management fees and other income, and excluded from adjusted operating income. Interest and dividend income from these investments is reported in Net investment income, and is included in adjusted operating income.

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The following table sets forth the composition of our other trading account assets as of the dates indicated.

|  | September 30, 2012 |  |  |  | December 31, 2011 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Financial Services Businesses |  | Closed Block Business |  | Financial Services Businesses |  | Closed Block Business |  |
|  | Amortized Cost | Fair Value | Amortized Cost | Fair Value (in m | Amortized Cost <br> illions) | Fair Value | Amortized Cost | $\begin{aligned} & \text { Fair } \\ & \text { Value } \end{aligned}$ |
| Short-term investments and cash equivalents | \$ 1 | \$ | \$ 0 | \$ 0 | \$ 4 | \$ 4 | \$ 0 | \$ 0 |
| Fixed maturities: |  |  |  |  |  |  |  |  |
| Corporate securities | 93 | 89 | 110 | 120 | 116 | 104 | 110 | 119 |
| Commercial mortgage-backed | 120 | 90 | 0 | 0 | 155 | 111 | 0 | 0 |
| Residential mortgage-backed | 0 | 0 | 0 | 0 | 186 | 96 | 0 | 0 |
| Asset-backed securities | 399 | 298 | 16 | 16 | 598 | 551 | 69 | 70 |
| Foreign government | 48 | 49 | 0 | 0 | 46 | 46 | 0 | 0 |
| U.S. government | 4 | 4 | 0 | 0 | 4 | 4 | 0 | 0 |
| Total fixed maturities | 664 | 530 | 126 | 136 | 1,105 | 912 | 179 | 189 |
| Equity securities(1) | 1,113 | 1,122 | 119 | 128 | 1,226 | 1,177 | 133 | 128 |
| Other | 0 | 0 | 0 | 0 | 11 | 11 | 0 | 0 |
| Total other trading account assets | \$ 1,778 | \$ 1,653 | \$ 245 | \$ 264 | \$ 2,346 | \$ 2,104 | \$ 312 | \$ 317 |

(1) Included in equity securities are perpetual preferred stock securities that have characteristics of both debt and equity securities.

As of September 30, 2012, on an amortized cost basis, $74 \%$ of asset-backed securities classified as Other trading account assets attributable to the Financial Services Businesses have credit ratings of A or above, $14 \%$ have BBB credit ratings, and the remaining $12 \%$ have BB or below credit ratings. As of September 30, 2012, on an amortized cost basis, $100 \%$ of asset-backed securities classified as Other trading account assets attributable to the Closed Block Business have credit ratings of A or above.

## Commercial Mortgage and Other Loans

## Investment Mix

As of both September 30, 2012 and December 31, 2011, we held approximately $10 \%$ of our general account investments in commercial mortgage and other loans. This percentage is net of a $\$ 282$ million and $\$ 310$ million allowance for losses as of September 30, 2012 and December 31, 2011, respectively.

The following table sets forth the composition of our commercial mortgage and other loans portfolio, before the allowance for losses, as of the dates indicated.

|  | September 30, 2012 <br> Financial <br> Services <br> Businesses | Closed <br> Block <br> Business <br> (in millions) | Dinancember 31, 2011 <br> Services <br> Cusineses | Closed <br> Block <br> Business |
| :--- | ---: | ---: | ---: | ---: |
| Commercial and agricultural mortgage loans | $\$ 23,679$ | $\$ 9,821$ | $\$ 21,988$ | $\$ 9,100$ |
| Uncollateralized loans | 1,938 | 2,236 | 0 |  |
| Residential property loans | 900 | 0 | 1,033 | 0 |
| Other collateralized loans | 53 | 0 | 66 | 0 |
| Total commercial mortgage and other loans $(1)$ | $\$ 26,570$ | $\$ 9,821$ | $\$ 25,323$ | $\$ 9,100$ |

(1) Excluded from the table above are commercial mortgage loans held outside the general account in other entities and operations. For additional information regarding commercial mortgage loans held outside the general account, see Invested Assets of Other Entities and Operations below.

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We originate commercial and agricultural mortgage loans using a dedicated investment staff and a network of independent companies through our various regional offices. All loans are underwritten consistently to our standards using a proprietary quality rating system that has been developed from our experience in real estate and mortgage lending.

Uncollateralized loans primarily represent reverse dual currency loans and corporate loans which do not meet the definition of a security under authoritative accounting guidance.

Residential property loans primarily include Japanese recourse loans. Upon default of these recourse loans we can make a claim against the personal assets of the property owner, in addition to the mortgaged property. These loans are also backed by third party guarantors.

Other collateralized loans attributable to the Financial Services Businesses include $\$ 51$ million and $\$ 63$ million of collateralized consumer loans as of September 30, 2012 and December 31, 2011, respectively.

Composition of Commercial and Agricultural Mortgage Loans

The commercial real estate market was severely impacted by the financial crisis and the subsequent recession, though the flow of capital to commercial real estate has been strong since 2010. Portfolio lenders are actively originating loans on the highest quality properties in primary markets, resulting in an increase in the liquidity and availability of capital in the commercial mortgage loan market. For certain property types, the market fundamentals are stabilizing to slightly improving, while other property types have farther to go in this recovery. In addition, the commercial banks are active and there has been new loan origination activity by securitization lenders. These conditions have led to greater competition for portfolio lenders such as our general account, though underwriting remains conservative. While there is still weakness in commercial real estate fundamentals that are dependent on employment recovery, delinquency rates on our commercial mortgage loans remain relatively stable. For additional information see Realized Investment Gains and Losses.

Our commercial and agricultural mortgage loan portfolio strategy emphasizes diversification by property type and geographic location. The following tables set forth the breakdown of the gross carrying values of our general account investments in commercial and agricultural mortgage loans by geographic region and property type as of the dates indicated.

|  | September 30, 2012 |  |  |  | December 31, 2011 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Financial Services Businesses |  | Closed Block Business |  | Financial Services Businesses |  | Closed Block Business |  |
|  | $\begin{aligned} & \text { Carrying } \\ & \text { Value } \end{aligned}$ | $\begin{aligned} & \% \text { of } \\ & \text { Total } \end{aligned}$ | Carrying <br> Value | \% of Total (\$ in m | Carrying Value ions) | $\%$ of Total | Carrying | \% of Total |
| Commercial and agricultural mortgage loans by region: |  |  |  |  |  |  |  |  |
| U.S. Regions: |  |  |  |  |  |  |  |  |
| Pacific | \$ 7,406 | 31.3\% | \$ 3,326 | 33.9\% | \$ 7,136 | 32.5\% | \$ 3,118 | 34.3\% |
| South Atlantic | 4,811 | 20.3 | 1,947 | 19.8 | 4,568 | 20.8 | 1,868 | 20.5 |
| Middle Atlantic | 3,567 | 15.1 | 2,139 | 21.8 | 3,221 | 14.6 | 2,109 | 23.2 |
| East North Central | 1,905 | 8.0 | 560 | 5.7 | 1,579 | 7.2 | 336 | 3.7 |
| West South Central | 2,149 | 9.1 | 735 | 7.5 | 1,858 | 8.4 | 688 | 7.6 |


|  | 1,171 | 4.9 | 372 | 3.8 | 1,181 | 5.4 | 356 | 3.9 |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Mountain | 689 | 2.9 | 322 | 3.3 | 637 | 2.9 | 257 | 2.8 |
| New England | 474 | 2.0 | 163 | 1.6 | 576 | 2.6 | 185 | 2.0 |
| West North Central | 359 | 1.5 | 152 | 1.5 | 307 | 1.4 | 152 | 1.7 |
| East South Central |  |  |  |  |  |  |  |  |
|  | 22,531 | 95.1 | 9,716 | 98.9 | 21,063 | 95.8 | 9,069 | 99.7 |
| Subtotal-U.S. | 700 | 3.0 | 0 | 0.0 | 519 | 2.4 | 0 | 0.0 |
| Asia | 448 | 1.9 | 105 | 1.1 | 406 | 1.8 | 31 | 0.3 |
| Other |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| Total commercial and agricultural mortgage | $\$ 23,679$ | $100.0 \%$ | $\$ 9,821$ | $100.0 \%$ | $\$ 21,988$ | $100.0 \%$ | $\$ 9,100$ | $100.0 \%$ |

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|  | September 30, 2012 |  |  |  | December 31, 2011 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Financial Services Businesses Gross |  | Closed Block Business |  | Financial Services Businesses Gross |  | Closed Block Business Gross |  |
|  | Gross Carrying Value | $\%$ of <br> Total | Gross Carrying Value | \% of Total (\$ in mi | Gross Carrying Value lions) | $\begin{aligned} & \% \text { of } \\ & \text { Total } \end{aligned}$ | $\begin{aligned} & \text { Gross } \\ & \text { Carrying } \\ & \text { Value } \end{aligned}$ | $\begin{aligned} & \% \text { of } \\ & \text { Total } \end{aligned}$ |
| Commercial and agricultural mortgage loans by property type: |  |  |  |  |  |  |  |  |
| Industrial | \$ 5,643 | 23.8\% | \$ 1,850 | 18.9\% | \$ 5,234 | 23.8\% | \$ 1,804 | 19.8\% |
| Retail | 5,420 | 22.9 | 2,662 | 27.1 | 4,988 | 22.7 | 2,207 | 24.2 |
| Office | 4,291 | 18.1 | 2,288 | 23.3 | 4,043 | 18.4 | 2,216 | 24.4 |
| Apartments/Multi-Family | 3,769 | 15.9 | 1,252 | 12.7 | 3,263 | 14.8 | 1,254 | 13.8 |
| Other | 2,114 | 8.9 | 577 | 5.9 | 2,079 | 9.5 | 517 | 5.7 |
| Agricultural properties | 1,458 | 6.2 | 702 | 7.1 | 1,363 | 6.2 | 674 | 7.4 |
| Hospitality | 984 | 4.2 | 490 | 5.0 | 1,018 | 4.6 | 428 | 4.7 |
| Total commercial and agricultural mortgage loans | \$ 23,679 | 100.0\% | \$9,821 | 100.0\% | \$ 21,988 | 100.0\% | \$ 9,100 | 100.0\% |

Loan-to-value and debt service coverage ratios are measures commonly used to assess the quality of commercial and agricultural mortgage loans. The loan-to-value ratio compares the amount of the loan to the fair value of the underlying property collateralizing the loan, and is commonly expressed as a percentage. Loan-to-value ratios greater than $100 \%$ percent indicate that the loan amount is greater than the collateral value. A smaller loan-to-value ratio indicates a greater excess of collateral value over the loan amount. The debt service coverage ratio compares a property s net operating income to its debt service payments. Debt service coverage ratios less than 1.0 times indicate that property operations do not generate enough income to cover the loan $s$ current debt payments. A larger debt service coverage ratio indicates a greater excess of net operating income over the debt service payments.

As of September 30, 2012, our general account investments in commercial and agricultural mortgage loans attributable to the Financial Services Businesses had a weighted average debt service coverage ratio of 2.02 times, and a weighted average loan-to-value ratio of $58 \%$. As of September 30, 2012, approximately $98 \%$ of commercial and agricultural mortgage loans attributable to the Financial Services Businesses were fixed rate loans. As of September 30, 2012, our general account investments in commercial and agricultural mortgage loans attributable to the Closed Block Business had a weighted average debt service coverage ratio of 2.0 times and a weighted average loan-to-value ratio of $54 \%$. As of September 30, 2012, approximately $99 \%$ of commercial and agricultural mortgage loans attributable to the Closed Block Business were fixed rate loans. For those general account commercial and agricultural mortgage loans attributable to the Financial Services Businesses that were originated in 2012, the weighted average debt service coverage ratio was 2.47 times and the weighted average loan-to-value ratio was $63 \%$.

The values utilized in calculating these loan-to-value ratios are developed as part of our periodic review of the commercial and agricultural mortgage loan portfolio, which includes an internal evaluation of the underlying collateral value. Our periodic review also includes a quality re-rating process, whereby we update the internal quality rating originally assigned at underwriting based on the proprietary quality rating system mentioned above. As discussed below, the internal quality rating is a key input in determining our allowance for loan losses.

For loans with collateral under construction, renovation or lease-up, a stabilized value and projected net operating income are used in the calculation of the loan-to-value and debt service coverage ratios. Our commercial and agricultural mortgage loan portfolio attributable to the Financial Services Businesses included approximately $\$ 0.5$ billion of such loans as of both September 30, 2012 and December 31, 2011, and our commercial and agricultural mortgage loan portfolio attributable to the Closed Block Business included

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approximately $\$ 0.1$ billion and $\$ 0.2$ billion of such loans as of September 30, 2012 and December 31, 2011, respectively. All else being equal, these loans are inherently more risky than those collateralized by properties that have already stabilized. As of September 30, 2012, there are no loan-specific reserves related to these loans attributable to the Financial Services Businesses or the Closed Block Business. In addition, these unstabilized loans are included in the calculation of our portfolio reserve as discussed below. For information regarding similar loans we hold as part of our commercial and agricultural mortgage operations, see Invested Assets of Other Entities and Operations.

The following tables set forth the gross carrying value of our general account investments in commercial and agricultural mortgage loans attributable to the Financial Services Businesses and the Closed Block Business as of the dates indicated by loan-to-value and debt service coverage ratios.

## Commercial and Agricultural Mortgage Loans by Loan-to-Value and Debt Service Coverage Ratios Financial Services Businesses



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

September 30, 2012
Debt Service Coverage Ratio


| $90 \%-100 \%$ | 0 | 0 | 0 | 0 | 0 | 45 | 45 |
| :--- | ---: | ---: | ---: | ---: | ---: | ---: | ---: |
| Greater than 100\% | 0 | 0 | 0 | 0 | 5 | 10 | 15 |
|  |  |  |  |  |  |  |  |
| Total commercial and agricultural mortgage loans | $\$ 3,719$ | $\$ 1,299$ | $\$ 1,985$ | $\$ 1,825$ | $\$ 693$ | $\$ 300$ | $\$$ |

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The following table sets forth the breakdown of our commercial and agricultural mortgage loans by year of origination as of September 30, 2012.

| Year of Origination | September 30, 2012 |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Financial Services Businesses Gross |  | Closed Block Business Gross |  |
|  | Carrying <br> Value | \% of Total (\$ in | Carrying Value s) | \% of <br> Total |
| 2012 | \$ 3,591 | 15.2\% | \$ 1,582 | 16.1\% |
| 2011 | 4,891 | 20.6 | 1,454 | 14.8 |
| 2010 | 3,165 | 13.4 | 1,075 | 10.9 |
| 2009 | 1,278 | 5.4 | 448 | 4.6 |
| 2008 | 2,622 | 11.1 | 1,091 | 11.1 |
| 2007 \& prior | 8,132 | 34.3 | 4,171 | 42.5 |
| Total commercial and agricultural mortgage loans | \$ 23,679 | 100.0\% | \$ 9,821 | 100.0\% |

## Commercial Mortgage and Other Loan Quality

Ongoing review of the portfolio is performed and loans are placed on watch list status based on a predefined set of criteria, where they are assigned to one of the following categories. We place loans on early warning status in cases where, based on our analysis of the loan scollateral, the financial situation of the borrower or tenants or other market factors, we believe a loss of principal or interest could occur. We classify loans as closely monitored when we determine there is a collateral deficiency or other credit events that may lead to a potential loss of principal or interest. Loans not in good standing are those loans where we have concluded that there is a high probability of loss of principal, such as when the loan is in the process of foreclosure or the borrower is in bankruptcy. In our domestic operations, our workout and special servicing professionals manage the loans on the watch list. As described below, in determining our allowance for losses we evaluate each loan on the watch list to determine if it is probable that amounts due according to the contractual terms of the loan agreement will not be collected. In our international portfolios, we monitor delinquency in consumer loans on a pool basis and evaluate any servicing relationship and guarantees the same way we do for commercial mortgage loans.

We establish an allowance for losses to provide for the risk of credit losses inherent in the lending process. The allowance includes loan specific reserves for loans that are determined to be impaired as a result of our loan review process, and a portfolio reserve for probable incurred but not specifically identified losses for loans which are not on the watch list. We define an impaired loan as a loan for which we estimate it is probable that amounts due according to the contractual terms of the loan agreement will not be collected. The loan specific portion of the loss allowance is based on our assessment as to ultimate collectability of loan principal and interest. Valuation allowances for an impaired loan are recorded based on the present value of expected future cash flows discounted at the loan seffective interest rate or based on the fair value of the collateral if the loan is collateral dependent. The portfolio reserve for incurred but not specifically identified losses considers the current credit composition of the portfolio based on the internal quality ratings mentioned above. The portfolio reserves are determined using past loan experience, including historical credit migration, loss probability, and loss severity factors by property type. These factors are reviewed and updated as appropriate. The valuation allowance for commercial mortgage and other loans can increase or decrease from period to period based on these factors.

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The following tables set forth the aging schedule of our general account investments in commercial mortgage and other loans, based upon the recorded investment gross of allowance for credit losses, attributable to the Financial Services Businesses and Closed Block Business as of the dates indicated.

## Commercial Mortgage and Other Loans Financial Services Businesses

|  | Current | September 30, 2012 |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | $\begin{aligned} & \text { 30-59 Days } \\ & \text { Past } \\ & \text { Due } \end{aligned}$ |  | 60-89 Days <br> Past <br> Due |  | Greater Than 90 DaysAccruing (in millions) |  | Greater Than 90 Days-Not Accruing |  | $\begin{aligned} & \text { Total Past } \\ & \text { Due } \end{aligned}$ |  | Total Commercial Mortgage and Other Loans |  |
| Commercial mortgage loans: |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Industrial | \$ 5,643 | \$ | 0 | \$ | 0 | \$ | 0 | \$ | 0 | \$ | 0 | \$ | 5,643 |
| Retail | 5,413 |  | 2 |  | 0 |  | 0 |  | 5 |  | 7 |  | 5,420 |
| Office | 4,286 |  | 5 |  | 0 |  | 0 |  | 0 |  | 5 |  | 4,291 |
| Apartments/Multi-Family | 3,768 |  | 1 |  | 0 |  | 0 |  | 0 |  | 1 |  | 3,769 |
| Hospitality | 984 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 984 |
| Other | 2,105 |  | 4 |  | 0 |  | 0 |  | 5 |  | 9 |  | 2,114 |
| Total commercial mortgage loans | 22,199 |  | 12 |  | 0 |  | 0 |  | 10 |  | 22 |  | 22,221 |
| Agricultural property loans | 1,422 |  | 0 |  | 0 |  | 0 |  | 36 |  | 36 |  | 1,458 |
| Residential property loans | 867 |  | 11 |  | 5 |  | 0 |  | 17 |  | 33 |  | 900 |
| Other collateralized loans | 53 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 53 |
| Uncollateralized loans | 1,938 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 1,938 |
| Total | \$ 26,479 | \$ | 23 | \$ | 5 | \$ | 0 | \$ | 63 | \$ | 91 | \$ | 26,570 |

## Commercial Mortgage and Other Loans Closed Block Business

|  | September 30, 2012 |  |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Current | $\begin{gathered} \text { 30-59 Days } \\ \text { Past } \\ \text { Due } \end{gathered}$ |  | 60-89 Days <br> Past <br> Due |  | Greater Than 90 DaysAccruing (in millions) |  | $\begin{aligned} & \text { Greater } \\ & \text { Than } \\ & 90 \\ & \text { Days-Not } \\ & \text { Accruing } \end{aligned}$ |  | Total Past Due |  | Total <br> Commercial Mortgage and Other Loans |  |
| Commercial mortgage loans: |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Industrial | \$ 1,850 | \$ | 0 | \$ | 0 | \$ | 0 | \$ | 0 | \$ | 0 | \$ | 1,850 |
| Retail | 2,662 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 2,662 |
| Office | 2,288 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 2,288 |
| Apartments/Multi-Family | 1,252 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 1,252 |
| Hospitality | 490 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 490 |
| Other | 577 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 577 |
| Total commercial mortgage loans | 9,119 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 9,119 |
| Agricultural property loans | 702 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 702 |

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| Residential property loans | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Other collateralized loans | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Uncollateralized loans | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Total | \$ 9,821 | \$ | 0 | \$ | 0 | \$ | 0 | \$ | 0 | \$ | 0 | \$ | 9,821 |

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## Commercial Mortgage and Other Loans Financial Services Businesses

|  | December 31, 2011 |  |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Current | $\begin{aligned} & \text { 30-59 Days } \\ & \text { Past } \\ & \text { Due } \end{aligned}$ |  | $\begin{aligned} & \text { 60-89 Days } \\ & \text { Past } \\ & \text { Due } \end{aligned}$ |  | Greater Than 90 DaysAccruing (in millions) |  | Greater Than 90 Days-Not Accruing |  | Total PastDue |  | Total Commercial Mortgage and Other Loans |  |
| Commercial mortgage loans: |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Industrial | \$ 5,234 | \$ | 0 | \$ | 0 | \$ | 0 | \$ | 0 | \$ | 0 | \$ | 5,234 |
| Retail | 4,983 |  | 0 |  | 0 |  | 0 |  | 5 |  | 5 |  | 4,988 |
| Office | 4,022 |  | 5 |  | 0 |  | 0 |  | 16 |  | 21 |  | 4,043 |
| Apartments/Multi-Family | 3,217 |  | 0 |  | 0 |  | 0 |  | 46 |  | 46 |  | 3,263 |
| Hospitality | 1,018 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 1,018 |
| Other | 2,029 |  | 13 |  | 10 |  | 0 |  | 27 |  | 50 |  | 2,079 |
| Total commercial mortgage loans | 20,503 |  | 18 |  | 10 |  | 0 |  | 94 |  | 122 |  | 20,625 |
| Agricultural property loans | 1,331 |  | 1 |  | 1 |  | 0 |  | 30 |  | 32 |  | 1,363 |
| Residential property loans | 987 |  | 22 |  | 6 |  | 0 |  | 18 |  | 46 |  | 1,033 |
| Other collateralized loans | 66 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 66 |
| Uncollateralized loans | 2,236 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 2,236 |
| Total | \$ 25,123 | \$ | 41 | \$ | 17 | \$ | 0 | \$ | 142 | \$ | 200 | \$ | 25,323 |

## Commercial Mortgage and Other Loans Closed Block Business

|  | December 31, 2011 |  |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Current | 30-59 Days Past Due |  | $\begin{aligned} & \text { 60-89 Days } \\ & \text { Past } \\ & \text { Due } \end{aligned}$ |  | Greater <br> Than 90 <br> Days- <br> Accruing <br> (in millions) |  | Greater Than 90 Days-Not Accruing |  | Total PastDue |  | Total Commercial Mortgage and Other Loans |  |
| Commercial mortgage loans: |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Industrial | \$ 1,802 | \$ | 0 | \$ | 2 | \$ | 0 | \$ | 0 | \$ | 2 | \$ | 1,804 |
| Retail | 2,207 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 2,207 |
| Office | 2,216 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 2,216 |
| Apartments/Multi-Family | 1,254 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 1,254 |
| Hospitality | 428 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 428 |
| Other | 517 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 517 |
| Total commercial mortgage loans | 8,424 |  | 0 |  | 2 |  | 0 |  | 0 |  | 2 |  | 8,426 |
| Agricultural property loans | 674 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 674 |
| Residential property loans | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Other collateralized loans | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Uncollateralized loans | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |  | 0 |
| Total | \$ 9,098 | \$ | 0 | \$ | 2 | \$ | 0 | \$ | 0 | \$ | 2 | \$ | 9,100 |

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The following table sets forth the change in valuation allowances for our commercial mortgage and other loan portfolio as of the dates indicated:
$\left.\begin{array}{l|rrrr} & \begin{array}{c}\text { September 30, 2012 } \\ \text { Cinancial } \\ \text { Services } \\ \text { Businesses }\end{array} & \begin{array}{c}\text { Block } \\ \text { Business } \\ \text { (in millions) }\end{array} & \begin{array}{c}\text { December 31, 2011 } \\ \text { Financial } \\ \text { Bervices } \\ \text { Closed } \\ \text { Block }\end{array} \\ \text { Business }\end{array}\right]$

As of September 30, 2012, the $\$ 226$ million valuation allowance for our commercial mortgage and other loan portfolio attributable to the Financial Services Businesses included $\$ 75$ million related to loan specific reserves and $\$ 151$ million related to the portfolio reserve for probable incurred but not specifically identified losses. As of December 31, 2011, the $\$ 250$ million valuation allowance for our commercial mortgage and other loan portfolio attributable to the Financial Services Businesses included $\$ 91$ million related to loan specific reserves and $\$ 159$ million related to the portfolio reserve for probable incurred but not specifically identified losses.

As of September 30, 2012, the $\$ 56$ million valuation allowance for our commercial mortgage and other loan portfolio attributable to the Closed Block Business included $\$ 4$ million related to loan specific reserves and $\$ 52$ million related to the portfolio reserve for probable incurred but not specifically identified losses. As of December 31, 2011, the $\$ 60$ million valuation allowance for our commercial mortgage and other loan portfolio attributable to the Closed Block Business included $\$ 2$ million related to loan specific reserves and $\$ 58$ million related to the portfolio reserve for probable incurred but not specifically identified losses. The decrease in the allowance for both the Financial Services Businesses and the Closed Block Business primarily reflects positive credit migration for certain mortgages.

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## Equity Securities

## Investment Mix

The equity securities attributable to the Financial Services Businesses consist principally of investments in common and preferred stock of publicly-traded companies, as well as mutual fund shares. The following table sets forth the composition of our equity securities portfolio attributable to the Financial Services Businesses and the associated gross unrealized gains and losses as of the dates indicated.

## Equity Securities Financial Services Businesses

|  | Cost | Septembe Gross Unrealized Gains |  | 30, 2012 <br> Gross Unrealized Losses |  | Fair <br> Value Cost (in millions) |  |  |  | Decembe <br> Gross Unrealized Gains |  | 31, 2011 <br> Gross Unrealized Losses |  | Fair Value |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Public Equity |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Non-redeemable preferred stocks | \$ 1 | \$ | 1 | \$ | 0 | \$ | 2 | \$ | 1 | \$ | 1 | \$ | 0 | \$ 2 |
| Mutual fund common stocks(1) | 1,841 |  | 488 |  | 0 |  | 2,329 |  | 1,708 |  | 428 |  | 2 | 2,134 |
| Other common stocks | 2,338 |  | 171 |  | 110 |  | 2,399 |  | 2,400 |  | 75 |  | 272 | 2,203 |
| Total public equity | 4,180 |  | 660 |  | 110 |  | 4,730 |  | 4,109 |  | 504 |  | 274 | 4,339 |
| Private Equity |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Non-redeemable preferred stocks | 16 |  | 1 |  | 0 |  | 17 |  | 18 |  | 0 |  | 1 | 17 |
| Common stock | 46 |  | 18 |  | 3 |  | 61 |  | 28 |  | 17 |  | 0 | 45 |
| Total private equity(2) | 62 |  | 19 |  | 3 |  | 78 |  | 46 |  | 17 |  | 1 | 62 |
| Total equity | \$4,242 | \$ | 679 | \$ | 113 |  | 4,808 |  | 4,155 | \$ | 521 | \$ | 275 | \$ 4,401 |

(1) Includes mutual fund shares representing our interest in the underlying assets of certain of our separate account investments supporting corporate-owned life insurance. These mutual funds invest primarily in high yield bonds.
(2) Hedge funds and other alternative investments are included in Other long-term investments.

The following table sets forth the composition of our equity securities portfolio attributable to the Closed Block Business and the associated gross unrealized gains and losses as of the dates indicated.

Equity Securities Closed Block Business

|  |  | Gross <br> Unrealized <br> Gains |  | Gross <br> Unrealized <br> Losses |  | Fair <br> Value <br> (in millions) |  | Gross <br> Unrealized <br> Gains |  | Gross <br> Unrealized <br> Losses |  | Fair <br> Value |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Public Equity |  |  |  |  |  |  |  |  |  |  |  |  |
| Non-redeemable preferred stocks | \$ 3 | \$ | 0 | \$ | 0 | \$ 3 | \$ 2 | \$ | 0 | \$ | 0 | \$ 2 |
| Common stock | 2,407 |  | 778 |  | 26 | 3,159 | 2,746 |  | 538 |  | 173 | 3,111 |
| Total public equity | 2,410 |  | 778 |  | 26 | 3,162 | 2,748 |  | 538 |  | 173 | 3,113 |
| Private Equity |  |  |  |  |  |  |  |  |  |  |  |  |
| Non-redeemable preferred stocks | 8 |  | 1 |  | 0 | 9 | 9 |  | 0 |  | 0 | 9 |
| Common stock | 0 |  | 0 |  | 0 | 0 | 0 |  | 0 |  | 0 | 0 |
| Total private equity | 8 |  | 1 |  | 0 | 9 | 9 |  | 0 |  | 0 | 9 |
| Total equity | \$ 2,418 | \$ | 779 | \$ | 26 | \$ 3,171 | \$ 2,757 | \$ | 538 | \$ | 173 | \$ 3,122 |

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Unrealized Losses from Equity Securities

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

Unrealized Losses from Equity Securities, Less than 20\% Financial Services Businesses

|  | September 30, 2012 |  |  | December 31, 2011 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Gross |  |  |  |  | Gross |  |
|  | Amortized $\operatorname{Cost}(1)$ | Unrealized <br> Losses(1) |  | Amortized <br> Cost(1) |  | Unrealized <br> Losses(1) |  |
| Less than three months | \$ 384 | \$ | 17 |  | 508 | \$ | 31 |
| Three months or greater but less than six months | 248 |  | 25 |  | 551 |  | 54 |
| Six months or greater but less than nine months | 109 |  | 7 |  | 191 |  | 24 |
| Nine months or greater but less than twelve months | 52 |  | 7 |  | 193 |  | 35 |
| Greater than twelve months | 2 |  | 0 |  | 0 |  | 0 |
| Total | \$ 795 | \$ | 56 |  | ,443 | \$ | 144 |

(1) The aging of amortized cost and gross unrealized losses is determined based upon a count of the number of months the estimated fair value remained below cost by less than $20 \%$, using month-end valuations.

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

## Unrealized Losses from Equity Securities, Greater than 20\% Financial Services Businesses

|  | September 30, 2012 |  |  | December 31, 2011 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Gross |  |  |  | Gross |  |
|  | Amortized $\operatorname{Cost}(1)$ |  |  | Amortized <br> Cost(1) <br> ions) |  | $\begin{aligned} & \text { alized } \\ & \text { es(1) } \end{aligned}$ |
| Less than three months | \$ 193 | \$ | 52 | \$ 243 | \$ | 63 |
| Three months or greater but less than six months | 6 |  | 2 | 172 |  | 60 |
| Six months or greater but less than nine months | 6 |  | 3 | 20 |  | 8 |
| Nine months or greater but less than twelve months | 0 |  | 0 | 0 |  | 0 |
| Greater than twelve months | 0 |  | 0 | 0 |  | 0 |
| Total | \$ 205 | \$ | 57 | \$ 435 | \$ | 131 |

(1) The aging of amortized cost and gross unrealized losses is determined based upon a count of the number of months the estimated fair value remained below cost by $20 \%$ or more, using month-end valuations.

The gross unrealized losses as of September 30, 2012, were primarily concentrated in the consumer cyclical, technology and finance sectors compared to December 31, 2011, where the gross unrealized losses were primarily concentrated in the finance, basic industry, and industrial other sectors. Gross unrealized losses attributable to the Financial Services Businesses where the estimated fair value had declined and remained below cost by $20 \%$ or more was $\$ 57$ million as of September 30, 2012 and does not include any gross unrealized losses on securities where the estimated fair value had declined and remained below cost by $50 \%$ or more. We have not recognized the gross unrealized losses shown in the table above as other-than-temporary impairments. See Other-Than-Temporary Impairments of Equity Securities for a discussion of the factors we consider in making these determinations.

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

## Unrealized Losses from Equity Securities, Less than 20\% Closed Block Business

|  | September 30, 2012 |  |  | December 31, 2011 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Gross |  |  |  | Gross |  |
|  | Amortized $\operatorname{Cost}(1)$ |  |  | Amortized Cost(1) |  |  |
|  | (in millions) |  |  |  |  |  |
| Less than three months | \$ 272 | \$ | 10 | \$ 377 | \$ | 23 |
| Three months or greater but less than six months | 83 |  | 5 | 287 |  | 28 |
| Six months or greater but less than nine months | 49 |  | 4 | 151 |  | 14 |
| Nine months or greater but less than twelve months | 6 |  | 1 | 18 |  | 3 |
| Greater than twelve months | 0 |  | 0 | 0 |  | 0 |
| Total | \$ 410 | \$ | 20 | \$ 833 | \$ | 68 |

(1) The aging of amortized cost and gross unrealized losses is determined based upon a count of the number of months the estimated fair value remained below cost by less than $20 \%$, using month-end valuations.

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

## Unrealized Losses from Equity Securities, Greater than $\mathbf{2 0 \%}$ Closed Block Business

|  | September 30, 2012 |  |  |  | December 31, 2011 |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Gross |  |  |  |  | Gross |  |
|  | Amor Cos | $\begin{aligned} & \text { rtized } \\ & t(1) \end{aligned}$ |  |  | Amortized <br> $\operatorname{Cost}(1)$ <br> ions) |  | alized |
| Less than three months | \$ | 8 | \$ | 2 | \$ 164 | \$ | 43 |
| Three months or greater but less than six months |  | 9 |  | 3 | 166 |  | 59 |
| Six months or greater but less than nine months |  | 3 |  | 1 | 8 |  | 3 |
| Nine months or greater but less than twelve months |  | 0 |  | 0 | 0 |  | 0 |
| Greater than twelve months |  | 0 |  | 0 | 0 |  | 0 |
| Total |  | 20 | \$ | 6 | \$ 338 | \$ | 105 |

(1) The aging of amortized cost and gross unrealized losses is determined based upon a count of the number of months the estimated fair value remained below cost by $20 \%$ or more, using month-end valuations.

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The gross unrealized losses as of September 30, 2012, were primarily concentrated in the basic industry sector compared to December 31, 2011, where the gross unrealized losses were primarily concentrated in the finance, basic industry, and consumer non-cyclical sectors. Gross unrealized losses attributable to the Closed Block Business where the estimated fair value had declined and remained below cost by $20 \%$ or more of $\$ 6$ million as of September 30, 2012 and does not include any gross unrealized losses on securities where the estimated fair value had declined and remained below cost by $50 \%$ or more. We have not recognized the gross unrealized losses shown in the table above as other-than-temporary impairments. See Other-Than-Temporary Impairments of Equity Securities for a discussion of the factors we consider in making these determinations.

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Other-Than-Temporary Impairments of Equity Securities

For those equity securities classified as available-for-sale, we record unrealized gains and losses to the extent cost is different from estimated fair value. All securities with unrealized losses are subject to our review to identify other-than-temporary impairments in value. In evaluating whether a decline in value is other-than-temporary, we consistently consider several factors including, but not limited to, the following:
the extent and the duration of the decline; including, but not limited to, the following general guidelines:
declines in value greater than $20 \%$, maintained for six months or greater;
declines in value maintained for one year or greater; and
declines in value greater than $50 \%$;
the reasons for the decline in value (issuer specific event, currency or market fluctuation);
our ability and intent to hold the investment for a period of time to allow for a recovery of value, including certain equity securities managed by independent third parties where we do not exercise management discretion concerning individual buy or sell decisions; and
the financial condition of and near-term prospects of the issuer.

We generally recognize other-than-temporary impairments for securities with declines in value greater than $50 \%$ maintained for six months or greater or with any decline in value maintained for one year or greater. In addition, in making our determinations we continue to analyze the financial condition and near-term prospects of the issuer, including an assessment of the issuer s capital position, and consider our ability and intent to hold the investment for a period of time to allow for a recovery of value.

For those securities that have declines in value that are deemed to be only temporary, we make an assertion as to our ability and intent to retain the security until recovery. Once identified, these securities are restricted from trading unless authorized based upon events that could not have been foreseen at the time we asserted our ability and intent to retain the security until recovery. Examples of such events include, but are not limited to, the deterioration of the issuer s creditworthiness, a major business combination or disposition, a change in regulatory requirements, certain other portfolio actions or other similar events. For those securities that have declines in value for which we cannot assert our ability and intent to retain until recovery, including certain equity securities managed by independent third parties where we do not exercise management discretion concerning individual buy or sell decisions, impairments are recognized as other-than-temporary regardless of the reason for, or the extent of, the decline. For perpetual preferred securities, which have characteristics of both debt and equity securities, we apply an impairment model similar to our fixed maturity securities, factoring in the position of the security in the capital structure and the lack of a formal maturity date. For additional discussion of our policies regarding other-than-temporary impairments of fixed maturity securities, see Fixed Maturity Securities Other-than-Temporary Impairments of Fixed Maturity Securities above.

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When we determine that there is an other-than-temporary impairment, we record a writedown to estimated fair value, which reduces the cost basis and is included in Realized investment gains (losses), net. See Note 2 to the Unaudited Interim Consolidated Financial Statements for additional information regarding our policies around other-than-temporary impairments for equity securities. See Note 13 to the Unaudited Interim Consolidated Financial Statements for information regarding the fair value methodology used for equity securities.

Impairments of equity securities attributable to the Financial Services Businesses were $\$ 21$ million and $\$ 40$ million for the three months ended September 30, 2012, and 2011, respectively, and $\$ 93$ million and $\$ 85$ million for the nine months ended September 30, 2012, and 2011, respectively. Impairments of equity securities attributable to the Closed Block Business were $\$ 3$ million and $\$ 2$ million for the three months ended September 30, 2012, and 2011, respectively, and $\$ 21$ million and $\$ 16$ million for the nine months ended September 30, 2012, and 2011, respectively. For a further discussion of impairments, see Realized Investment Gains and Losses above.

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## Other Long-Term Investments

Other long-term investments are comprised as follows:

|  | September 30, 2012 |  | December 31, 2011 |  |
| :---: | :---: | :---: | :---: | :---: |
|  | Financial <br> Services <br> Businesses | Closed <br> Block <br> Business <br> (in | Financial <br> Services <br> Businesses lions) | $\begin{gathered} \text { Closed } \\ \text { Block } \\ \text { Business } \end{gathered}$ |
| Joint ventures and limited partnerships: |  |  |  |  |
| Real estate-related | \$ 340 | \$ 480 | \$ 360 | \$ 413 |
| Non-real estate-related | 1,840 | 1,390 | 1,733 | 1,284 |
| Real estate held through direct ownership(1) | 1,717 | 8 | 1,956 | 10 |
| Other(2) | 913 | 144 | 432 | 283 |
| Total other long-term investments | \$4,810 | \$ 2,022 | \$ 4,481 | \$ 1,990 |

(1) Primarily includes investments in office buildings within our Japanese insurance operations.
(2) Primarily includes derivatives and member and activity stock held in the Federal Home Loan Banks of New York and Boston. For additional information regarding our holdings in the Federal Home Loan Banks of New York and Boston, see Note 9 to the Unaudited Interim Consolidated Financial Statements.

## Invested Assets of Other Entities and Operations

The following table sets forth the composition of the investments held outside the general account in other entities and operations as of the dates indicated.

|  | September 30, <br> 2012 | December 31, <br> (in millions) |
| :--- | ---: | ---: | ---: |
| 2011 |  |  |

[^9]The table above includes the invested assets of our trading, banking, and asset management operations. Assets of our asset management operations managed for third parties and those assets classified as Separate account assets on our balance sheet are not included.

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Fixed Maturity Securities

The following table sets forth the composition of the portion of our fixed maturity securities portfolio by industry category attributable to our other entities and operations as of the date indicated.

## Fixed Maturity Securities Invested Assets of Other Entities and Operations

|  | September 30, 2012 |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | AAA | AA | A | BBB <br> (in |  | and <br> ow <br> ) | Total Amortized Cost |  | Total <br> Fair <br> Value |
| Industry(1) | (in millions) |  |  |  |  |  |  |  |  |
| Residential mortgage-backed | \$ 0 | \$ 178 |  | \$ 0 | \$ | 5 | \$ | 183 | \$ 192 |
| Asset-backed securities | 8 | 20 | 1 | 18 |  | 21 |  | 68 | 76 |
| Commercial mortgage-backed | 41 | 19 | 0 | 15 |  | 5 |  | 80 | 82 |
| Corporate securities | 4 | 8 | 73 | 25 |  | 4 |  | 114 | 129 |
| U.S. government | 0 | 46 | 0 | 0 |  | 0 |  | 46 | 55 |
| State \& municipal | 0 | 0 | 1 | 0 |  | 0 |  | 1 | 1 |
| Foreign government | 1 | 0 | 0 | 0 |  | 0 |  | 1 | 0 |
| Total | \$ 54 | \$ 271 | \$ 75 | \$ 58 | \$ | 35 | \$ | 493 | \$ 535 |

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

The table above includes the invested assets of our trading, banking, and asset management operations. Assets of our asset management operations managed for third parties and those assets classified as Separate account assets on our balance sheet are not included.

Other Trading Account Assets

Other trading account assets primarily include trading positions held by our derivatives trading operations used in a non-dealer capacity. The positions maintained by our derivatives trading operations are used to manage interest rate, currency, credit and equity exposures in our insurance, investment and international businesses, and treasury operations.

Less than $\$ 1$ million of commercial mortgage-backed securities held outside the general account are classified as other trading account assets as of September 30, 2012, all of which have AAA credit ratings.

Our asset management operations include our commercial mortgage operations, which provide mortgage origination, asset management and servicing for our general account, institutional clients, and government sponsored entities such as Fannie Mae, the Federal Housing Administration, and Freddie Mac. We also originate shorter-term interim loans for spread lending that are collateralized by assets generally under renovation or lease-up. All else being equal, these interim loans are inherently more risky than those collateralized by properties that have already stabilized. Our interim loans are generally paid off through refinancing or the sale of the underlying collateral by the borrower.

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The following table sets forth information regarding the interim loan portfolio held outside the general account in other entities and operations as of the dates indicated.
$\left.\begin{array}{l|cc|} & \begin{array}{c}\text { September 30, } \\ \mathbf{2 0 1 2}\end{array} & \begin{array}{c}\text { December 31, } \\ \text { 2011 }\end{array} \\ \text { (\$ in millions) }\end{array}\right)$
(1) A stabilized value and projected net operating income are used in the calculation of the loan-to-value and debt service coverage ratios.

As of September 30, 2012, we hold no commercial real estate held-for-sale related to foreclosed interim loans. The mortgage loans of our commercial mortgage operations are included in Commercial mortgage and other loans, with related derivatives and other hedging instruments primarily included in Other trading account assets and Other long-term investments.

## Other Long-Term Investments

Other long-term investments primarily include strategic investments made as part of our asset management operations. We make these strategic investments in real estate, as well as fixed income, public equity and real estate securities, including controlling interests. Certain of these investments are made primarily for purposes of co-investment in our managed funds and structured products. Other strategic investments are made with the intention to sell or syndicate to investors, including our general account, or for placement in funds and structured products that we offer and manage (seed investments). As part of our asset management operations, we also make loans to our managed funds that are secured by equity commitments from investors or assets of the funds.

## Liquidity and Capital Resources

## Overview

Liquidity refers to the ability to generate sufficient cash resources to meet the payment obligations of the Company. Capital refers to the long term financial resources available to support the operation of our businesses, fund business growth, and provide a cushion to withstand adverse circumstances. Our ability to generate and maintain sufficient liquidity and capital depends on the profitability of our businesses, general economic conditions and our access to the capital markets and the alternate sources of liquidity and capital described herein.

## Liquidity and Capital Management

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Management monitors the liquidity of Prudential Financial and its subsidiaries on a daily basis and projects borrowing and capital needs over a multi-year time horizon through our quarterly planning process. We believe that cash flows from the sources of funds presently available to us are sufficient to satisfy the current liquidity requirements of Prudential Financial and its subsidiaries, including under reasonably foreseeable stress scenarios.

Our capital management framework is primarily based on statutory risk based capital measures. Due to our diverse mix of businesses and applicable regulatory requirements, we apply certain refinements to the framework that are designed to more appropriately reflect risks associated with our businesses on a consistent basis across the Company. In addition, we continue to use an economic capital framework for making certain capital decisions.

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## Capital Protection Framework

We employ a Capital Protection Framework to ensure the availability of capital resources to maintain adequate capitalization on a consolidated basis and competitive risk based capital ratios and solvency margins for our insurance subsidiaries, including under reasonably foreseeable stress scenarios. The Capital Protection Framework incorporates the potential impact from market related stresses, including equity markets, interest rates, credit losses, and foreign currency exchange rates. Potential sources of capital include on-balance sheet capital and proceeds from derivatives, reinsurance and contingent sources of capital. Although we continue to enhance our approach, we believe we currently have sufficient resources to maintain adequate capitalization and competitive risk based capital ratios and solvency margins under reasonably foreseeable stress scenarios.

## Regulation Under The Dodd-Frank Act

On October 19, 2012, Prudential Financial received notice that it is under consideration by the Financial Stability Oversight Council (the Council ) for a proposed determination that it should be subject to stricter prudential regulatory standards and supervision by the Board of Governors of the Federal Reserve System pursuant to the Dodd-Frank Act (a Covered Company ). The notice of consideration indicates that Prudential Financial is being reviewed in stage 3 of the three-stage process described in the Council s interpretative guidance for Covered Company determinations and does not constitute a notice of a proposed determination. The prudential standards under the Dodd-Frank Act include requirements regarding risk-based capital and leverage, liquidity, stress-testing and other matters. See Business Regulation and Risk Factors in our 2011 Annual Report on Form 10-K for more information regarding the potential impact of the Dodd-Frank Act on the Company, including as a result of these stricter prudential standards.

## Shareholder Dividend

On November 7, 2012, Prudential Financial declared an annual dividend for 2012 of $\$ 1.60$ per share of Common Stock, representing an increase of approximately $10 \%$ from the 2011 Common Stock dividend. The Company also announced that it will move to a quarterly Common Stock dividend schedule beginning in the first quarter of 2013.

## Liquidity and Capital Resources of Prudential Financial

The principal sources of funds available to Prudential Financial, the parent holding company, are dividends, returns of capital and interest income from its subsidiaries, and cash and short-term investments. These sources of funds may be supplemented by Prudential Financial saccess to the capital markets and the Alternative Sources of Liquidity described below.

The primary uses of funds at Prudential Financial include servicing our debt, operating expenses, capital contributions and other payments to subsidiaries, and the payment of declared shareholder dividends, as well as repurchases of outstanding shares of Common Stock if executed under Board authority.

As of September 30, 2012, Prudential Financial had cash and short-term investments of $\$ 4,003$ million, a decrease of $\$ 941$ million from December 31, 2011. Included in the cash and short-term investments of Prudential Financial is $\$ 185$ million held in an intercompany liquidity account that is designed to optimize the use of cash by facilitating the lending and borrowing of funds between Prudential Financial and its subsidiaries on a daily basis. Short-term investments of $\$ 1,233$ million primarily consist of government agency securities and money market funds.

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The following table sets forth Prudential Financial s principal sources and uses of cash and short-term investments for the period indicated.
$\left.\begin{array}{l|r} & \begin{array}{c}\text { Nine Months Ended } \\ \text { September 30, } \\ \text { 2012 }\end{array} \\ \text { (in millions) }\end{array}\right\}$
(1) Includes dividends and/or returns of capital of $\$ 600$ million from Prudential Insurance, $\$ 415$ million from international subsidiaries, $\$ 349$ million from asset management subsidiaries, $\$ 248$ million from Prudential Annuities Life Assurance Corporation and $\$ 65$ million from other subsidiaries.
(2) Represents net repayments under the transitional financing agreements provided in connection with the sale of the real estate brokerage franchise and relocation business in 2011. The financing agreements consisted of three credit facilities: two six-month facilities that were repaid and expired on June 6 , 2012 and a three-year facility that was repaid and terminated on October 26, 2012.
(3) Includes capital contributions of $\$ 713$ million to Pruco Reinsurance, Ltd., $\$ 294$ million to international insurance and investment subsidiaries, $\$ 7$ million to asset management subsidiaries and $\$ 1$ million to other subsidiaries.
(4) Includes a decrease of $\$ 1,225$ million in net borrowings in our intercompany liquidity account and a repayment of $\$ 20$ million to Prudential Holdings, LLC, partially offset by net borrowings of $\$ 569$ million by Pruco Reinsurance, Ltd., $\$ 290$ million by asset management subsidiaries, $\$ 50$ million by Pruco Life Insurance Company and $\$ 21$ million by other subsidiaries.

In June 2012, our Board of Directors authorized the Company to repurchase at management s discretion up to $\$ 1.0$ billion of its outstanding Common Stock during the period from July 1, 2012 through June 30, 2013. As of September 30, 2012, 2.7 million shares of our Common Stock were repurchased under this authorization for a total cost of $\$ 150$ million. The Company exhausted the Board s previous $\$ 1.5$ billion repurchase authority which covered the prior twelve-month period. During the first nine months of 2012, 11.5 million shares of our Common Stock were repurchased, for a total cost of $\$ 650$ million. The timing and amount of any future share repurchases will be determined by management based on market conditions and other considerations. Repurchases may be effected in the open market, through derivative, accelerated repurchase and other negotiated transactions and through plans designed to comply with Rule 10b5-1(c) under the Exchange Act. Numerous factors could affect the timing and amount of any future repurchases under the share repurchase program, including increased capital needs of our businesses due to opportunities for growth and acquisitions, as well as adverse market conditions.

We seek to capitalize all of our subsidiaries and businesses in accordance with their ratings targets, and we believe Prudential Financial s capitalization and use of financial leverage are consistent with those ratings targets. Our long-term senior debt rating targets for Prudential Financial are A for Standard \& Poor s Rating Services, or S\&P, Moody s Investors Service, Inc., or Moody s, and Fitch Ratings Ltd., or Fitch, and a for

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A.M. Best Company, or A.M. Best. Our financial strength rating targets for our domestic life insurance companies are AA/Aa/AA for S\&P, Moody s and Fitch, respectively, and A+ for A.M. Best. Currently, some of our ratings are below these targets. For a description of material rating actions that have occurred from the beginning of 2012 through the date of this filing and a discussion of the potential impacts of ratings downgrades, see Ratings.

## Restrictions on Dividends and Returns of Capital from Subsidiaries

Our insurance and various other companies are subject to regulatory limitations on the payment of dividends and other transfers of funds to affiliates. With respect to Prudential Insurance, New Jersey insurance law provides that, except in the case of extraordinary dividends (as described below), all dividends or other distributions paid by Prudential Insurance may be paid only from unassigned surplus, as determined pursuant to statutory accounting principles, less unrealized investment gains and losses and revaluation of assets as of the prior calendar year-end. As of December 31, 2011, Prudential Insurance s unassigned surplus was $\$ 5,070$ million, and it recorded applicable adjustments for cumulative unrealized investment gains of $\$ 2,184$ million. Prudential Insurance must give prior notification to the New Jersey Department of Banking and Insurance, or NJDOBI, or the Department, of its intent to pay any dividend or distribution. Also, if any dividend, together with other dividends or distributions made within the preceding twelve months, exceeds the greater of (i) $10 \%$ of the prior calendar year s statutory surplus or (ii) the prior calendar year s statutory net gain from operations, which excludes realized investment gains and losses, the dividend is considered to be an extraordinary dividend and the prior approval of the Department is required for payment of the dividend. Prudential Insurance s statutory surplus as of December 31, 2011, was $\$ 8,160$ million and its statutory net gain from operations, excluding realized investment gains and losses, for the year ended December 31, 2011, was $\$ 584$ million. The laws regulating dividends of the other states where our other domestic insurance companies are domiciled are similar, but not identical, to New Jersey s. The ability of our asset management subsidiaries to pay dividends is largely unrestricted from a regulatory standpoint. Nevertheless, the payment of dividends by any of our subsidiaries is subject to declaration by their Board of Directors and can be affected by market conditions and other factors. In addition to the regulatory limitations, the terms of the IHC debt contain restrictions potentially limiting dividends by Prudential Insurance applicable to the Financial Services Businesses in the event the Closed Block Business is in financial distress and under certain other circumstances.

On May 18, 2012, Prudential Insurance paid an ordinary dividend of $\$ 316$ million and an extraordinary dividend of $\$ 284$ million to its parent, Prudential Holdings, LLC, all of which was in turn distributed to Prudential Financial. On June 29, 2012, Prudential Annuities Life Assurance Corporation paid an extraordinary dividend of $\$ 248$ million to Prudential Financial. On September 6, 2012, Prudential Retirement Insurance and Annuity Company paid an ordinary dividend of $\$ 200$ million to its parent, Prudential Insurance.

With respect to The Prudential Life Insurance Company Ltd., or POJ, and Gibraltar Life, Japan insurance law provides that common stock dividends may be paid in an amount of up to $100 \%$ of prior fiscal year statutory earnings, after certain reserving thresholds are met including providing for policyholder dividends. POJ and Gibraltar must give prior notification to the Financial Services Agency, or the FSA, of their intent to pay any dividend or distribution. Also, dividends in excess of prior fiscal year earnings and other forms of capital distribution require the prior approval of the FSA. Although Gibraltar is able to pay common stock dividends to Prudential Financial, subject to these legal and regulatory restrictions, we do not anticipate receiving common stock dividends for several years as Gibraltar may return capital to Prudential Financial through other means, such as the repayment of subordinated debt or preferred stock obligations held by Prudential Financial or other affiliates. Based on fiscal year-end March 31, 2012 results, in the second quarter of 2012, POJ declared a dividend of $¥ 19$ billion, or approximately $\$ 237$ million, to its parent, Prudential Holdings of Japan. We expect this dividend to be paid in the fourth quarter of 2012. On July 27, 2012, Gibraltar Life repaid $¥ 31.5$ billion, or $\$ 401$ million, in subordinated debt to its parent, Prudential Holdings of Japan, of which $\$ 259$ million was ultimately sent to Prudential Financial.

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## Alternative Sources of Liquidity

Prudential Financial maintains an intercompany liquidity account that is designed to optimize the use of cash by facilitating the lending and borrowing of funds between Prudential Financial and its affiliates on a daily basis. Depending on the overall availability of cash, Prudential Financial invests excess cash on a short-term basis or borrows funds in the capital markets. Additional longer term liquidity is available through inter-affiliate borrowing arrangements. Prudential Financial and certain of its subsidiaries also have access to the alternative sources of liquidity described below.

## Commercial Paper Programs

Prudential Financial and Prudential Funding, LLC, or Prudential Funding, a wholly-owned subsidiary of Prudential Insurance, have commercial paper programs with an authorized issuance capacity of $\$ 3.0$ billion and $\$ 7.0$ billion, respectively. Prudential Financial commercial paper borrowings generally have been used to fund the working capital needs of our subsidiaries. Prudential Funding commercial paper borrowings have generally served as an additional source of financing to meet the working capital needs of Prudential Insurance and its subsidiaries. Prudential Funding also lends to other subsidiaries of Prudential Financial up to limits agreed with NJDOBI. Prudential Funding maintains a support agreement with Prudential Insurance whereby Prudential Insurance has agreed to maintain Prudential Funding s positive tangible net worth at all times. Prudential Financial has also issued a subordinated guarantee covering Prudential Funding s commercial paper program. As of September 30, 2012, Prudential Financial and Prudential Funding had outstanding borrowings of $\$ 264$ million and $\$ 700$ million, respectively, under these commercial paper programs. The daily average commercial paper outstanding during the nine months ended September 30, 2012 for the Prudential Financial and Prudential Funding programs was $\$ 268$ million and $\$ 935$ million, respectively. For additional information on our commercial paper programs, see Note 9 to the Unaudited Interim Consolidated Financial Statements.

## Asset-based Financing

We conduct asset-based or secured financing within our insurance and other subsidiaries, including transactions such as securities lending, repurchase agreements and mortgage dollar rolls to earn spread income, to borrow funds, or to facilitate trading activity. These programs are primarily driven by portfolio holdings of securities that are lendable based on counterparty demand for these securities in the marketplace. The collateral received in connection with these programs is primarily used to purchase securities in the short-term spread portfolios of our domestic insurance entities. Investments held in the short-term spread portfolios include cash and cash equivalents, short-term investments, mortgage loans and fixed maturities, including mortgage- and asset-backed securities, with a weighted average life at time of purchase by the short-term portfolios of four years or less. A portion of the asset-backed securities held in our short-term spread portfolios, including our enhanced short-term portfolio, are collateralized by sub-prime mortgages. Floating rate assets comprise the majority of our short-term spread portfolio. These short-term portfolios are subject to specific investment policy statements, which among other things, do not allow for significant asset/liability interest rate duration mismatch.

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The following table sets forth our liabilities under asset-based or secured financing programs attributable to the Financial Services Businesses and Closed Block Business as of the dates indicated.

(1) The daily weighted average outstanding for the three and nine months ended September 30, 2012 was $\$ 7,259$ million and $\$ 6,623$ million, respectively, for the Financial Services Businesses and $\$ 4,585$ million and $\$ 4,398$ million, respectively, for the Closed Block Business.
(2) Excludes securities that may be returned to the Company overnight.

The $\$ 2.2$ billion increase in these programs during the first nine months of 2012 has been driven by attractive financing and investment opportunities.

In addition, as of September 30, 2012, our Closed Block Business had outstanding mortgage dollar rolls, under which we are committed to repurchase $\$ 548$ million of mortgage-backed securities, or TBA forward contracts. These repurchase agreements do not qualify as secured borrowings and are accounted for as derivatives. These mortgage-backed securities are considered high or highest quality based on NAIC or equivalent rating.

As of September 30, 2012, our domestic insurance entities had assets eligible for the asset-based or secured financing programs of $\$ 82.4$ billion, of which $\$ 11.2$ billion were on loan. Taking into account market conditions and outstanding loan balances as of September 30, 2012, we believe approximately $\$ 29.2$ billion of the remaining eligible assets are readily lendable, of which approximately $\$ 20.6$ billion relates to the Financial Services Businesses; however, these amounts are subject to potential regulatory constraints and to changes in market conditions.

## Membership in the Federal Home Loan Banks

Prudential Insurance is a member of the Federal Home Loan Bank of New York, or FHLBNY. Membership allows Prudential Insurance access to the FHLBNY s financial services, including the ability to obtain loans and to issue funding agreements as an alternative source of liquidity that are collateralized by qualifying mortgage-related assets or U.S. Treasury securities. Under FHLBNY guidelines, if Prudential Insurance s financial strength ratings decline below A/A2/A Stable by S\&P/Moody s/Fitch, respectively, and the FHLBNY does not receive written assurances from NJDOBI regarding Prudential Insurance s solvency, new borrowings from the FHLBNY would be limited to a term of 90 days or less. Currently there are no restrictions on the term of borrowings from the FHLBNY. NJDOBI permits Prudential Insurance to pledge collateral to the FHLBNY in an amount of up to $5 \%$ of its statutory net admitted assets, excluding separate account assets. Based on this

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limitation and after taking into account required collateralization levels and purchases of activity-based stock, as of September 30, 2012, Prudential Insurance had an estimated maximum borrowing capacity of $\$ 6.3$ billion under the FHLBNY facility, of which $\$ 2.4$ billion was outstanding. Nevertheless, FHLBNY borrowings are subject to the FHLBNY s discretion and to the availability of qualifying assets at Prudential Insurance.

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Prudential Retirement Insurance and Annuity Company, or PRIAC, is a member of the Federal Home Loan Bank of Boston, or FHLBB, which provides PRIAC access to collateralized advances. As of September 30, 2012, based on guidance from the Connecticut Department of Insurance, PRIAC had an estimated maximum borrowing capacity of $\$ 1.6$ billion under the FHLBB facility; however, no advances were outstanding.

For additional information on our participation in the Federal Home Loan Bank programs, see Note 9 to the Unaudited Interim Consolidated Financial Statements.

## Credit Facilities

We have access to an aggregate of $\$ 3.75$ billion of syndicated, committed credit facilities, which includes a $\$ 2$ billion five-year facility expiring in December 2016 that has Prudential Financial as borrower and a $\$ 1.75$ billion three-year facility expiring in December 2014 that has both Prudential Financial and Prudential Funding as borrowers. There were no outstanding borrowings under these credit facilities as of September 30, 2012 or as of the date of this filing.

The facilities may be used for general corporate purposes, including as backup liquidity for our commercial paper programs. Prudential Financial expects that it may borrow under the five-year credit facility from time to time to fund its working capital needs and those of its subsidiaries. In addition, up to $\$ 300$ million of the five-year facility may be drawn in the form of standby letters of credit that can be used to meet the Company s operating needs. The credit facilities contain representations and warranties, covenants and events of default that are customary for facilities of this type; however, borrowings under the facilities are not contingent on our credit ratings nor subject to material adverse change clauses. Borrowings are conditioned on the continued satisfaction of customary conditions, including the maintenance at all times of consolidated net worth, relating to the Company s Financial Services Businesses only, of at least $\$ 18.985$ billion, which for this purpose is calculated as U.S. GAAP equity, excluding Accumulated other comprehensive income (loss) and excluding equity of noncontrolling interests. As of September 30, 2012 and December 31, 2011, the consolidated net worth of the Company s Financial Services Businesses exceeded the minimum amount required to borrow under the credit facilities.

## Liquidity and Capital Resources of Our Subsidiaries

## Domestic Insurance Subsidiaries

## General Liquidity

We manage the liquidity of our domestic insurance operations to ensure stable, reliable and cost-effective sources of cash flows to meet all of our obligations. Liquidity is provided by a variety of sources, as described more fully below, including portfolios of liquid assets. The investment portfolios of our domestic operations are integral to the overall liquidity of those operations. We segment our investment portfolios and employ an asset/liability management approach specific to the requirements of our product lines. This enhances the discipline applied in managing the liquidity, as well as the interest rate and credit risk profiles, of each portfolio in a manner consistent with the unique characteristics of the product liabilities. We use a projection process for cash flows from operations to ensure sufficient liquidity is available to meet projected cash outflows, including claims. The impact of Prudential Funding s financing capacity on liquidity, as discussed more fully under Alternative Sources of Liquidity, is considered in the internal liquidity measures of the domestic insurance operations.

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

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Cash Flow

The principal sources of liquidity for Prudential Insurance and our other domestic insurance subsidiaries are premiums and certain annuity considerations, investment and fee income, and investment maturities and sales associated with our insurance and annuity operations, as well as internal and external borrowings. The principal uses of that liquidity include benefits, claims, dividends paid to policyholders, and payments to policyholders and contractholders in connection with surrenders, withdrawals and net policy loan activity. Other uses of liquidity include commissions, general and administrative expenses, purchases of investments, hedging activity and payments in connection with financing activities.

We believe that the cash flows from our operations are adequate to satisfy the current liquidity requirements of these operations, including under reasonably foreseeable stress scenarios. The continued adequacy of this liquidity will depend upon factors such as future securities market conditions, changes in interest rate levels, policyholder perceptions of our financial strength, and the relative safety and attractiveness of competing products, each of which could lead to reduced cash inflows or increased cash outflows. In addition, market volatility can impact the level of capital required to support our businesses, particularly in our annuity business. Our domestic insurance operations cash flows from investment activities result from repayments of principal, proceeds from maturities and sales of invested assets and investment income, net of amounts reinvested. The primary liquidity risks with respect to these cash flows are the risk of default by debtors or bond insurers, our counterparties willingness to extend repurchase and/or securities lending arrangements, commitments to invest and market volatility. We closely manage these risks through our credit risk management process and regular monitoring of our liquidity position.

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

|  | September 30, 2012 |  | December 31, 2011 |  |
| :---: | :---: | :---: | :---: | :---: |
|  |  | \% of |  | \% of |
|  | (\$ in millions) |  |  |  |
| Not subject to discretionary withdrawal provisions | \$ 38,288 | 46\% | \$ 38,896 | 47\% |
| Subject to discretionary withdrawal, with adjustment: |  |  |  |  |
| With market value adjustment | 22,795 | 27 | 22,211 | 27 |
| At market value | 2,578 | 3 | 2,208 | 3 |
| At contract value, less surrender charge of 5\% or more | 1,810 | 2 | 2,036 | 2 |
| Subtotal | 65,471 | 78 | 65,351 | 79 |
| Subject to discretionary withdrawal at contract value with no surrender charge or surrender charge of less than 5\% | 17,777 | 22 | 17,760 | 21 |
| Total annuity reserves and deposit liabilities | \$ 83,248 | 100\% | \$ 83,111 | 100\% |

Individual life insurance policies are less susceptible to withdrawal than our annuity reserves and deposit liabilities because policyholders may incur surrender charges and be subject to a new underwriting process in order to obtain a new insurance policy. Our annuity reserves with guarantee features may be less susceptible to withdrawal than historical experience indicates, due to the perceived value of these guarantee features to policyholders as a result of market declines in recent years. Annuity benefits and guaranteed investment withdrawals under group annuity contracts are generally not subject to early withdrawal. Gross account withdrawals for our domestic insurance operations products were consistent with our assumptions in asset/liability management, and the associated cash outflows did not have a material adverse impact on our overall liquidity.

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Liquid Assets

Liquid assets include cash and cash equivalents, short-term investments, fixed maturities that are not designated as held-to-maturity and public equity securities. Our domestic insurance companies liquidity is managed through access to substantial investment portfolios as well as a variety of instruments available for funding and/or managing cash flow mismatches, including from time to time those arising from claim levels in excess of projections. As part of our management process, we consider attributes of the various categories of liquid assets (for example, type of asset and credit quality) in calculating internal liquidity measures to evaluate the adequacy of our domestic insurance operations liquidity under a variety of stress scenarios. We believe that the liquidity profile of our assets is sufficient to satisfy current liquidity requirements, including under reasonably foreseeable stress scenarios.

The following table sets forth the fair value of our domestic insurance operations portfolio of liquid assets, including cash and short-term investments, fixed maturity investments other than those designated as held-to-maturity, by NAIC or equivalent rating, and public equity securities, as of the dates indicated.

|  | September <br> 2012 |  | 31, |
| :---: | :---: | :---: | :---: |
|  | (in billions) |  |  |
| Cash and short-term investments | \$ 6.5 | \$ | 6.6 |
| Fixed maturity investments: |  |  |  |
| High or highest quality | 130.9 |  | 124.6 |
| Other than high or highest quality | 9.6 |  | 10.3 |
| Subtotal fixed maturity investments | 140.5 |  | 134.9 |
| Public equity securities | 3.2 |  | 3.3 |
| Total | \$ 150.2 | \$ | 144.8 |

Given the size and liquidity profile of our investment portfolios, we believe that claim experience varying from our projections does not constitute a significant liquidity risk. Our asset/liability management process takes into account the expected maturity of investments and expected claim payments as well as the specific nature and risk profile of the liabilities. To the extent we need to pay claims in excess of projections, we may borrow temporarily or sell investments sooner than anticipated to pay these claims, which may result in increased borrowing costs or realized investment gains or losses affecting results of operations. Additionally, we believe that borrowing temporarily or selling investments earlier than anticipated will not have a material impact on the liquidity of our domestic insurance companies. However, payment of claims and sale of investments earlier than anticipated would have an impact on the reported level of cash flow from operating, investing, and financing activities, respectively, in our financial statements. Instead of selling investments at depressed market prices externally, in order to preserve economic value (including tax attributes), we may also sell investments from one subsidiary to another at fair market value or transfer investments internally between businesses within the same subsidiary, subject to applicable regulatory constraints. Historically, there has been no significant variation between the expected maturities of our investments and the payment of claims.

## Capital

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

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$491 \%$ as of December 31, 2011. The RBC ratio is an annual calculation; however based upon September 30, 2012 amounts, we estimate that the RBC ratios for Prudential Insurance and our other domestic life insurance subsidiaries would exceed the minimum level required by applicable insurance regulations. The reporting of RBC measures is not intended for the purpose of ranking any insurance company or for use in connection with any marketing, advertising or promotional activities.

The level of statutory capital of our domestic life insurance subsidiaries can be materially impacted by interest rate and equity market fluctuations, changes in the values of derivatives, the level of impairments recorded, credit quality migration of the investment portfolio, and business growth, among other items. Further, the recapture of business subject to reinsurance arrangements due to defaults by, or credit quality migration affecting, the reinsurers could result in higher required statutory capital levels. The level of statutory capital of our domestic life insurance subsidiaries is also affected by statutory accounting rules, which are subject to change by insurance regulators.

As part of our Capital Protection Framework, we have developed a broad view of the impact of market distress on the statutory capital of the Company. The program focuses on tail risk to protect our capital in a cost-effective manner under stress scenarios. To support this tail risk, in addition to holding on-balance sheet and other contingent sources of capital, we purchase equity index-linked derivatives that are designed to mitigate the impact of a severe equity market stress event on statutory capital. We assess the composition of our hedging program on an ongoing basis, and we may change it from time to time based on our evaluation of our risk position or other factors. Additionally, we may choose to manage the interest rate risk associated with certain of our products by holding capital against a portion of the interest rate exposure. The capital consequences associated with our decision to utilize this risk management strategy have been factored into the Capital Protection Framework.

## Captive Reinsurance Companies

We utilize captive reinsurance companies to more effectively manage our capital on an economic basis. To support the risks they assume, our captives are capitalized to a level consistent with the financial strength rating targets of our domestic insurance entities. All of our captive reinsurance companies are wholly-owned subsidiaries and are typically organized in the state of domicile of the direct writing entity that cedes business to the captive.

Our domestic life insurance subsidiaries are subject to a regulation entitled Valuation of Life Insurance Policies, commonly known as Regulation XXX, and a supporting guideline entitled The Application of the Valuation of Life Insurance Policies, commonly known as Guideline AXXX. This regulation and supporting guideline require insurers to establish statutory reserves for term and universal life insurance policies with long-term premium guarantees that are consistent with the statutory reserves required for other individual life insurance policies with similar guarantees. Many market participants believe that this level of reserves is non-economic. We use captive reinsurance companies to implement reinsurance and capital management actions, including financing these non-economic reserves through internal and external solutions, to mitigate the impact of Regulation XXX and Guideline AXXX on our term and universal life insurance business. See Prudential Financial Financing Activities Consolidated Borrowings Financing of regulatory reserves associated with domestic life insurance products below for additional information on our financing activities related to Regulation XXX and Guideline AXXX.

We reinsure living benefit guarantees on certain variable annuity and retirement products from our domestic life insurance companies to a captive reinsurance company, Pruco Reinsurance, Ltd., or Pruco Re. This enables us to execute our living benefit hedging program primarily within one legal entity, Pruco Re. In this living benefits hedging program, we enter into a range of exchange-traded and over the counter equity and interest rate derivatives to hedge certain optional living benefit features accounted for as embedded derivatives against changes in certain capital market assumptions such as interest rate and equity market levels. For a full discussion

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our living benefits hedging program, see Results of Operations for Financial Services Businesses by Segment U.S. Retirement Solutions and Investment Management Division Individual Annuities. Through our Capital Protection Framework discussed above, we maintain access to on-balance sheet capital and contingent sources of capital that are available to meet capital needs that may arise related to this hedging program. These capital needs can vary due to, among other items, changes in equity markets, interest rates, mortality and policyholder behavior.

Effective as of July 1, 2011, Pruco Re re-domiciled from Bermuda to Arizona. As a result, beginning in the third quarter of 2011, our Arizona domiciled life insurance company, Pruco Life Insurance Company, is able to claim statutory reinsurance reserve credit for business ceded to Pruco Re without any need for Pruco Re to collateralize its obligations under the reinsurance arrangement. However, for business ceded to Pruco Re by Prudential Annuities Life Assurance Corporation, or PALAC, and Pruco Life Insurance Company of New Jersey, or PLNJ, we must continue to collateralize Pruco Re s obligations under the reinsurance arrangement in order for PALAC and PLNJ to claim reinsurance reserve credit for their business ceded. We satisfy this requirement by depositing assets into statutory reserve credit trusts for Pruco Re. Funding needs for the statutory reserve credit trusts are separate and distinct from the capital needs of Pruco Re. However, assets pledged to the statutory reserve credit trusts may include assets supporting the capital of Pruco Re, provided that they meet eligibility requirements prescribed by the Arizona Department of Insurance. Reinsurance reserves credit requirements can move materially in either direction due to changes in equity markets and interest rates, actuarial assumptions and other factors. Higher reinsurance reserves credit requirements would require us to deposit additional assets in the statutory reserve credit trusts, while lower reinsurance reserves credit requirements would allow assets to be removed from the statutory reserve credit trusts. Lower interest rates offset by the impact of higher equity markets during the first nine months of 2012 led to an increase in our need to fund the captive reinsurance trusts by an amount of $\$ 113$ million.

We formed a captive reinsurance company domiciled in New Jersey to reinsure $90 \%$ of the short-term risks under the policies in Prudential Insurance s Closed Block. These short-term risks represent the impact of variations in experience of the Closed Block that are expected to be recovered over time as a result of corresponding adjustments to policyholder dividends. The reinsurance arrangement is intended to alleviate the short-term surplus volatility within Prudential Insurance resulting from the Closed Block, including volatility caused by the impact of any unrealized mark-to-market losses or realized credit losses within the investment portfolio of the Closed Block. In connection with the Closed Block reinsurance arrangement, we entered into a $\$ 2$ billion letter of credit facility with certain financial institutions, pursuant to which the New Jersey captive can obtain a letter of credit during a 3-year availability period to support its funding obligations under the reinsurance arrangement. Prudential Financial guarantees all obligations of the New Jersey captive under the facility, including its obligation to reimburse any draws made under a letter of credit. Because experience of the Closed Block is ultimately passed along to policyholders over time through the annual policyholder dividend, we believe that any draw under a letter of credit is unlikely. Our ability to obtain a letter of credit under the facility is subject to the continued satisfaction of customary conditions, including the satisfaction of the same minimum net worth covenant for the Financial Services Businesses as in our syndicated credit facilities described under Credit Facilities above and maintenance of at least $\$ 5.5$ billion of total adjusted capital by Prudential Insurance based on statutory accounting principles prescribed under New Jersey law.

## International Insurance Subsidiaries

In our international insurance operations, liquidity is provided through operating cash flows from ongoing operations as well as portfolios of liquid assets. In managing the liquidity, and the interest rate and credit risk profiles of our international insurance portfolios, we employ a discipline similar to the discipline employed for our domestic insurance subsidiaries. We monitor liquidity through the use of internal liquidity measures, taking into account the liquidity of the asset portfolios. We also consider attributes of the various categories of liquid assets (for example, type of asset and credit quality) in calculating internal liquidity measures to evaluate the adequacy of our international insurance operations liquidity under stress scenarios. We believe that ongoing operations and the liquidity profile of our international insurance assets provide sufficient liquidity under reasonably foreseeable stress scenarios.

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The following table sets forth the fair value of our international insurance operations portfolio of liquid assets, including cash and short-term investments, fixed maturity investments other than those designated as held-to-maturity, by NAIC or equivalent rating, and public equity securities, as of the dates indicated.

|  | Prudential of Japan | September 30, 2012 |  |  |  |  |  | $\begin{gathered} \text { December 31, } \\ 2011 \end{gathered}$ |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | Gibraltar Life(1) |  | All Other(2) (in billions) |  | Total |  |  |  |
| Cash and short-term investments | \$ 1.6 | \$ | 4.7 | \$ | 0.2 | \$ |  | \$ | 5.4 |
| Fixed maturity investments: |  |  |  |  |  |  |  |  |  |
| High or highest quality(3) | 31.2 |  | 92.2 |  | 11.2 |  | 34.6 |  | 120.6 |
| Other than high or highest quality | 0.4 |  | 2.0 |  | 0.1 |  | 2.5 |  | 2.0 |
| Subtotal | 31.6 |  | 94.2 |  | 11.3 |  | 37.1 |  | 122.6 |
| Public equity securities | 1.2 |  | 2.1 |  | 0.4 |  | 3.7 |  | 3.4 |
| Total | \$ 34.4 | \$ | 101.0 | \$ | 11.9 |  | 47.3 | \$ | 131.4 |

(1) Includes Prudential Gibraltar Financial Life Insurance Company, Ltd., or Prudential Gibraltar, a wholly-owned subsidiary of Gibraltar Life.
(2) Represents our international insurance operations, excluding Japan.
(3) Of the $\$ 134.6$ billion of fixed maturity investments that are not designated as held to-maturity and considered high or highest quality as of September 30, 2012, $\$ 93$ billion, or $69 \%$, were invested in government or government agency bonds.

As with our domestic operations, in managing the liquidity of these operations, we consider the risk of policyholder and contractholder withdrawals of funds earlier than our assumptions in selecting assets to support these contractual obligations. The following table sets forth the total general account insurance-related liabilities (other than dividends payable to policyholders) of our international insurance subsidiaries, as of the dates indicated.

|  | September 30, <br> 2012 | December 31, <br> (in billions) |
| :--- | ---: | ---: | ---: |
| 2011 |  |  |

(1) As of September 30, 2012 and December 31, 2011, $\$ 5.4$ billion and $\$ 4.5$ billion, respectively, of the insurance-related liabilities for Prudential of Japan are associated with U.S. dollar-denominated products that are coinsured to our U.S. domiciled insurance operations and supported by U.S. dollar-denominated assets.
(2) Represents our international insurance operations, excluding Japan.

Our Japanese operations did not have a material amount of general account annuity reserves or deposit liabilities subject to discretionary withdrawal without a market value adjustment as of September 30, 2012 and December 31, 2011. Additionally, we believe that the longer term recurring pay individual life insurance policies sold by our Japanese operations do not have significant withdrawal risk because policyholders may incur surrender charges and must undergo a new underwriting process in order to obtain a new insurance policy. Individual life insurance

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policies sold by our Japanese operations with a higher savings component may be subject to increased levels of surrenders if interest rates increase.

Similar to the RBC ratios that are employed by U.S. insurance regulators, regulatory authorities in the international jurisdictions in which we operate generally establish some form of minimum solvency margin requirements for insurance companies. All of our international insurance subsidiaries have solvency margins in excess of the minimum levels required by the applicable regulatory authorities. These solvency margins are also

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a primary measure by which we evaluate the capital adequacy of our international insurance operations. We manage these solvency margins to a capitalization level consistent with our AA ratings target. Maintenance of our solvency ratios at certain levels is also important to our competitive positioning, as in certain jurisdictions, such as Japan, these solvency margins are required to be disclosed to the public and therefore impact the public perception of an insurer $s$ financial strength.

Solvency margin levels in our international insurance subsidiaries can be materially impacted by interest rate, equity market and real estate market fluctuations, the level of impairments recorded, credit quality migration of the investment portfolio, changes in regulation, and foreign exchange rate movements, among other items. We evaluate the solvency margin capital levels of our Japanese insurance operations under reasonably foreseeable stress scenarios and believe our solvency margin levels would be comfortably above regulatory requirements under these scenarios.

The Financial Services Agency, the insurance regulator in Japan, has implemented revisions to the solvency margin requirements to alter risk charges for certain assets and change the manner in which an insurance company s core capital is calculated. These changes became effective for the fiscal year ended March 31, 2012. Under this new method, the fiscal year-end solvency margin ratios for our Japanese insurance subsidiaries continue to exceed our targets. The March 31, 2012 solvency margin ratio for Gibraltar also reflects the merger of Star, Edison, and Gibraltar Life, which was effective January 1, 2012. The table below presents the solvency margins of our Japanese insurance subsidiaries under the new method as of March 31, 2012.

|  | March 31, 2012 |
| :--- | ---: |
| Prudential of Japan | $721 \%$ |
| Gibraltar Life Consolidated | $810 \%$ |
| Gibraltar Life | $862 \%$ |
| Prudential Gibraltar(1) | $756 \%$ |

(1) Represents Prudential Gibraltar Financial Life Insurance Company, Ltd., a wholly-owned subsidiary of Gibraltar Life.

We employ various hedging strategies to manage potential exposure to foreign currency exchange rate movements, including the strategies discussed in Results of Operations for Financial Services Businesses by Segment International Insurance Division. These hedging strategies include both internal and external hedging programs.

The internal hedges are between a subsidiary of Prudential Financial and certain of our yen-based entities and serve to hedge a portion of the value of U.S. dollar-denominated investments held on the books of these yen-based entities. These U.S. dollar-denominated investments are part of our hedging strategy to mitigate the impact of foreign currency exchange rate movements on our U.S. dollar-equivalent investment in our Japanese subsidiaries. Absent an internal hedge, the changes in market value of these U.S. dollar-denominated investments attributable to changes in the yen-dollar exchange rate would create volatility in the solvency margins of these subsidiaries. In order to minimize this volatility, we enter into inter-company hedges. Cash settlements from these hedging activities result in cash flows between Prudential Financial and these yen-based subsidiaries. The cash flows are dependent on changes in foreign currency exchange rates and the notional amount of the exposures hedged. During the first nine months of 2012, Prudential Financial funded $\$ 85$ million of cash settlements related to the internal hedge program, which were paid to the yen-based subsidiaries. As of September 30, 2012, the market value of the internal hedges was a liability of $\$ 837$ million owed to the yen-based subsidiaries of Prudential Financial. Absent any changes in forward exchange rates from those expected as of September 30, 2012, the $\$ 837$ million internal hedge liability represents the present value of the net cash flows from Prudential Financial to these entities over the life of the hedging instruments, up to 30 years, and would require additional liquidity and capital to fund contributions from Prudential Financial to our subsidiaries. A significant yen appreciation over an extended period of time, and in excess of the forward exchange rates, would result in higher capital and liquidity needs to fund the net cash outflows from Prudential Financial.

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Our external hedges primarily serve to hedge foreign-denominated future income of our foreign subsidiaries and equity investments in certain of these subsidiaries. The external hedges are between a subsidiary of Prudential Financial and external parties. Cash settlements on these activities result in cash flows between Prudential Financial and the external parties and are dependent on changes in foreign currency exchange rates and the notional amount of the exposures hedged. During the first nine months of 2012, Prudential Financial paid $\$ 89$ million of net cash flows for international insurance-related external hedge settlements. As of September 30, 2012, the net liability related to external foreign currency hedges was $\$ 415$ million. A significant appreciation in the yen and other foreign currencies could result in net cash outflows in excess of our liability.

## Asset Management Subsidiaries

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

The principal sources of liquidity for our fee-based asset management businesses include asset management fees and commercial mortgage servicing fees. The principal uses of liquidity include general and administrative expenses and distribution of dividends and returns of capital to Prudential Financial. The primary liquidity risks for our fee-based asset management businesses relate to their profitability, which is impacted by market conditions and our investment management performance. We believe the cash flows from our fee-based asset management businesses are adequate to satisfy the current liquidity requirements of these operations, as well as requirements that could arise under reasonably foreseeable stress scenarios, which are monitored through the use of internal measures.

The principal sources of liquidity for our strategic investments and interim loans held in our asset management businesses are cash flows from investments, the ability to liquidate investments, and available borrowing lines from internal sources, including Prudential Funding and Prudential Financial. The primary liquidity risks include the inability to sell assets in a timely manner, declines in the value of assets and credit defaults.

Our commercial mortgage origination and servicing business participates in a Fannie Mae alternative delivery program known as ASAP Plus ( As Soon as Pooled delivery). Our approval limit for outstanding balances on ASAP Plus is $\$ 150$ million. This program allows us to assign a qualified Fannie Mae loan trade commitment to Fannie Mae as early as the next business day after a loan closes, and receive 99\% of the loan purchase price from Fannie Mae. The program does not eliminate the need to provide temporary warehouse financing, but does significantly reduce the duration of funding requirements for eligible Fannie Mae originated loans from the normal delivery cycle of two to four weeks down to as little as one to two days. There was no balance outstanding on this program as of September 30, 2012.

Certain real estate funds under management are held for the benefit of clients in insurance company separate accounts sponsored by Prudential Insurance. In the normal course of business, Prudential Insurance, on behalf of these separate accounts, may contractually agree to various funding commitments which may include, among other things, commitments to purchase real estate, to invest in real estate partnerships (both existing and to-be-formed) to acquire or develop real estate, and/or to fund additional construction or other expenditures on previously-acquired real estate investments. Certain commitments to purchase real estate are contingent on the developer s development of the property according to plans and specifications outlined in a pre-sale agreement or the completed property achieving a certain level of leasing. These contractual commitments are typically entered into by Prudential Insurance on behalf of the particular separate account. Real estate investments that are

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acquired for a separate account are titled either in the name of Prudential Insurance or an LLC subsidiary specifically formed to hold title. In the majority of cases, the commitments specify that Prudential Insurance s recourse liability for the obligation is limited to the assets of the separate account.

At September 30, 2012 and December 31, 2011, total outstanding purchase commitments related to such separate account activity were $\$ 2.8$ billion and $\$ 3.4$ billion, respectively, which amounts include both off- and on-balance sheet commitments. The decrease in total outstanding purchase commitments during the last nine months was primarily driven by the satisfaction of outstanding debt commitments, which were funded from investor capital contributions and property sales. The following is a summary of the outstanding purchase commitments for these separate account portfolios as of September 30, 2012. Off-balance sheet commitments include capital commitments and commitments with respect to properties that have not yet substantially satisfied pre-conditions and are considered contingent liabilities. On-balance sheet commitments represent obligations which have substantially satisfied conditions to funding of the commitments.

|  | Contractual Maturity Date |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | $\begin{gathered} \text { Remaining } \\ 2012 \end{gathered}$ | $\begin{gathered} 2013 \\ \text { (in } \end{gathered}$ | After 2013 <br> ons) | Total |
| Off-Balance Sheet Commitments: |  |  |  |  |
| Recourse to Prudential Insurance | \$ 15 | \$ 110 | \$ 0 | \$ 125 |
| Recourse limited to assets of separate accounts | 109 | 318 | 371 | 798 |
| Total Off-Balance Sheet Commitments | 124 | 428 | 371 | 923 |
| On-Balance Sheet Commitments: |  |  |  |  |
| Recourse to Prudential Insurance | 341 | 64 | 17 | 422 |
| Recourse limited to assets of separate accounts | 203 | 905 | 318 | 1,426 |
| Total On-Balance Sheet Commitments | 544 | 969 | 335 | 1,848 |
| Total Commitments | \$ 668 | \$ 1,397 | \$ 706 | \$ 2,771 |

The contractual maturity dates of some of the outstanding purchase commitments may accelerate upon a failure to maintain required loan-to-value ratios, failure of Prudential Insurance to maintain required ratings or failure to satisfy other financial covenants.

Some separate accounts have also entered into syndicated credit facilities providing for borrowings in the aggregate amount of up to $\$ 0.8$ billion. As of September 30, 2012, there were no outstanding borrowings under these credit facilities. These facilities also include loan-to-value ratio requirements and other financial covenants. Recourse on obligations under these facilities is limited to the assets of the applicable separate account. As of September 30, 2012, these separate account portfolios had combined gross and net asset values of $\$ 28.4$ billion and $\$ 19.2$ billion, respectively.

At the time of maturity of a funding commitment, Prudential Insurance often endeavors to negotiate extensions, refinancings, or other solutions with counterparties. Management believes that the separate accounts have sufficient resources to ultimately meet their obligations. However, there is a risk that the separate accounts may not be able to timely fund all maturing obligations from regular sources such as asset sales, operating cash flow, deposits from clients, debt refinancings or from the above-mentioned portfolio level credit facilities. In cases where the separate account is not able to fund maturing obligations, Prudential Insurance may be called upon or required to provide interim funding solutions. To date, Prudential Insurance has not been required to provide any such funding.

As of September 30, 2012 and December 31, 2011, our asset management subsidiaries had cash and cash equivalents and short-term investments of $\$ 1.2$ billion and $\$ 1.3$ billion, respectively.

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## Financing Activities

Prudential Financial maintains a shelf registration statement with the SEC that permits the issuance of public debt, equity and hybrid securities. As a Well-Known Seasoned Issuer under SEC rules, Prudential Financial s shelf registration statement provides for automatic effectiveness upon filing, pay-as-you-go fees and the ability to add securities by filing automatically effective amendments. Also, in accordance with these rules, the shelf registration statement has no stated issuance capacity.

As of September 30, 2012 and December 31, 2011, total short- and long-term debt of the Company on a consolidated basis was $\$ 26.9$ billion and $\$ 27.0$ billion, respectively, which includes $\$ 17.6$ billion and $\$ 18.6$ billion, respectively, related to the parent company, Prudential Financial.

## Issuance of Hybrid Securities

In August 2012, Prudential Financial sold $\$ 1$ billion aggregate principal amount of $5.875 \%$ fixed-to-floating rate junior subordinated notes in a public offering. The notes are considered hybrid securities that receive enhanced equity treatment from the rating agencies. The notes mature on September 15, 2042, and interest is payable semi-annually at a fixed rate of $5.875 \%$ until September 15,2022 , after which interest is payable quarterly at a floating rate of 3-month LIBOR plus $4.175 \%$. We have the right to defer interest payments on the notes for a period of up to five years, during which time interest will be compounded. We may redeem notes at par on or after September 15, 2022. We may also redeem the notes, in whole but not in part, prior to September 15, 2022 (i) at par in the event of a future change in the regulatory capital treatment of the notes with respect to the Company or (ii) at the greater of par or a make-whole price in the event of a future change in the tax treatment of the notes or a change relating to the equity credit assigned to the notes by a rating agency. The net proceeds received from the sale of the notes were used for general corporate purposes and to redeem some of our outstanding retail medium-term notes.

## Sale of Asset-Backed Notes

On March 30, 2012, Prudential Insurance sold, in a Rule 144A private placement, $\$ 1$ billion aggregate principal amount of $2.997 \%$ notes with a final maturity of September 30, 2015. The notes are secured by the assets of a trust, consisting of approximately $\$ 2.8$ billion aggregate principal balance of residential mortgage-backed securities deposited into the trust by Prudential Insurance. Payments of interest and principal on the notes will be made only to the extent of funds available to the trust in accordance with a priority of payments set forth in the indenture governing the notes. Prudential Financial guaranteed to the holders of the notes the timely payment of all principal and interest due on the notes and any make-whole payments that may become due as a result of the payment of principal on the notes prior to its scheduled payment date. The deposit of the residential mortgage-backed securities into the trust by Prudential Insurance did not result in recognition of a gain or loss on the securities, or de-recognition of the securities from the balance sheet, under statutory accounting principles or U.S. GAAP but is consistent with Prudential Insurance s overall tax planning strategies to monetize statutory deferred tax assets.

## Existing Hybrid Securities and the Related Replacement Capital Covenants

Prudential Financial has outstanding $\$ 600$ million of $8.875 \%$ fixed-to-floating rate junior subordinated notes issued to institutional investors and $\$ 920$ million of $9.0 \%$ fixed-rate junior subordinated notes issued to retail investors. Both issuances are considered hybrid securities that receive enhanced equity treatment from the rating agencies. The $9.0 \%$ fixed-rate junior subordinated notes are redeemable by the Company at par on or after June 15, 2013. See Note 14 to our Consolidated Financial Statements included in our 2011 Annual Report on Form 10-K for more
information on the junior subordinated notes.

In April 2012, we terminated the replacement capital covenants that were entered into in 2008 in connection with our issuance of these junior subordinated notes. We received the consent of holders of a majority in principal amount of our $6.625 \%$ medium-term notes due 2037, as was required for the termination of the

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replacement capital covenants. We also entered into a new replacement capital covenant with respect to the $8.875 \%$ junior subordinated notes only. The new replacement capital covenant was entered into for the benefit of the holders of our $5.90 \%$ medium-term notes due March 2036 and requires that the Company not repay, redeem or purchase the $8.875 \%$ junior subordinated notes prior to June 15,2038 unless we have received proceeds from the sale or issuance of common stock or other qualifying securities that have certain characteristics that are at least as equity-like as the $8.875 \%$ junior subordinated notes. However, the terms of the new replacement capital covenant will not apply in certain instances, including (i) if Standard \& Poor s upgrades our corporate credit rating by at least one notch above A+ or (ii) if we repurchase or redeem up to $10 \%$ of the outstanding principal amount of the $8.875 \%$ junior subordinated notes in any one-year period, provided that no more than $25 \%$ of the outstanding principal amount of the $8.875 \%$ junior subordinated notes are repurchased or redeemed in any ten-year period.

## Prudential Financial Borrowings

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


Prudential Financial maintains a Medium-Term Notes, Series D program under its shelf registration statement with an authorized issuance capacity of $\$ 20$ billion, of which as of September 30, 2012 approximately $\$ 9.1$ billion remained available. The weighted average interest rates on Prudential Financial s medium-term and senior notes, including the effect of interest rate hedging activity, were $5.26 \%$ for both the nine months ended September 30, 2012 and 2011, excluding the effect of debt issued to consolidated subsidiaries. During the first nine months of 2012, $\$ 850$ million of these notes matured.

Prudential Financial also maintains a retail medium-term notes program, including the InterNotes ${ }^{\circledR}$ program, under its shelf registration statement with an authorized issuance capacity of $\$ 5.0$ billion, of which as of September 30, 2012 approximately $\$ 3.8$ billion remained available. The retail medium-term notes program traditionally has served as a funding source for a product of our Retirement segment for which we earn investment spread; however, proceeds from the program are also used for general corporate purposes. The weighted average interest rates on Prudential Financial s retail medium-term notes were $5.94 \%$ and $5.85 \%$ for the nine months ended September 30, 2012 and 2011,
respectively, excluding the effect of debt issued to

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consolidated subsidiaries. As of September 30, 2012, $\$ 1.1$ billion of the outstanding retail notes were redeemable by the Company at par. During the first nine months of 2012, the Company redeemed $\$ 959$ million of its outstanding retail notes. We may continue to redeem some or all of the remaining retail notes as part of our overall liquidity and capital management.

## Consolidated Borrowings

Current capital markets activities for the Company on a consolidated basis principally consist of unsecured short-term and long-term borrowings by Prudential Funding and Prudential Financial, unsecured third party bank borrowings, and asset-based or secured financing. As of September 30, 2012, we were in compliance with all debt covenants related to the borrowings in the table below.

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

|  | September 30 2012 |  | nber 31, $011$ |
| :---: | :---: | :---: | :---: |
|  | (in millions) |  |  |
| Borrowings: |  |  |  |
| General obligation short-term debt(1) | \$ 3,013 | \$ | 2,336 |
| General obligation long-term debt: |  |  |  |
| Senior debt | 14,711 |  | 16,488 |
| Junior subordinated debt (hybrid securities) | 2,519 |  | 1,519 |
| Surplus notes(2)(3) | 4,140 |  | 4,140 |
| Other(4) | 725 |  | 725 |
| Total general obligation long-term debt | 22,095 |  | 22,872 |
| Total general obligations | 25,108 |  | 25,208 |
| Limited and non-recourse borrowing: |  |  |  |
| Limited and non-recourse long-term $\operatorname{debt}(5)$ | 1,750 |  | 1,750 |
| Total limited and non-recourse borrowing | 1,750 |  | 1,750 |
| Total borrowings(6) | 26,858 |  | 26,958 |
| Total asset-based financing | 11,441 |  | 9,196 |
| Total borrowings and asset-based financings | \$ 38,299 | \$ | 36,154 |

(1) As of both September 30, 2012 and December 31, 2011, includes $\$ 199$ million of short-term debt representing collateralized advances with the Federal Home Loan Bank of New York.
(2) As of both September 30, 2012 and December 31, 2011, includes $\$ 3.2$ billion of floating rate surplus notes issued by subsidiaries of Prudential Insurance to fund regulatory reserves, as well as $\$ 940$ million of fixed rate surplus notes issued by Prudential Insurance.
(3) As of September 30, 2012 and December 31, 2011, the $\$ 4.1$ billion of surplus notes outstanding is net of $\$ 750$ million and $\$ 500$ million, respectively, of assets under set-off arrangements, respectively, representing a reduction in the amount of surplus notes included in long-term debt, relating to an arrangement where valid rights of offset exist and it is the intent of both parties to settle on a net basis under legally enforceable arrangements.
(4) Reflects collateralized advances with Federal Home Loan Bank of New York.

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(5) As of both September 30, 2012 and December 31, 2011, the limited and non-recourse long-term debt outstanding was attributable to the Closed Block Business.
(6) Does not include $\$ 2.3$ billion and $\$ 3.2$ billion of medium-term notes of consolidated trust entities secured by funding agreements purchased with the proceeds of such notes as of September 30, 2012 and December 31, 2011, respectively, or $\$ 1.5$ billion of collateralized funding agreements issued to the Federal Home Loan Bank of New York as of both September 30, 2012 and December 31, 2011. These notes and funding agreements are included in Policyholders account balances. For additional information on the trust notes, see Funding Agreement Notes Issuance Program.

Total general debt obligations decreased by $\$ 100$ million from December 31, 2011 to September 30, 2012, primarily reflecting the redemption of retail notes, the maturity of medium-term notes, and a reduction in commercial paper outstanding offset by the issuance of junior subordinated debt and the sale of asset-backed notes as described above.

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Our total borrowings consist of capital debt, investment-related debt, securities business-related debt and debt related to specified other businesses. Capital debt consists of borrowings that are used or will be used to meet the capital requirements of Prudential Financial, as well as borrowings invested in equity or debt securities of direct or indirect subsidiaries of Prudential Financial and subsidiary borrowings utilized for capital requirements. Investment-related borrowings consist of debt issued to finance specific investment assets or portfolios of investment assets, including institutional spread lending investment portfolios, real estate and real estate-related investments held in consolidated joint ventures, assets supporting reserve requirements under Regulation XXX and Guideline AXXX as described below, as well as institutional and insurance company portfolio cash flow timing differences. Securities business-related debt consists of debt issued to finance the liquidity of our capital markets and other securities business-related operations. Debt related to specified other businesses primarily consists of borrowings associated with our individual annuities business. Those borrowings where the holder is entitled to collect only against the assets pledged to the debt as collateral, or where the borrower has only very limited rights to collect against other assets, have been classified as limited and non-recourse debt.

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

|  | $\begin{gathered} \text { September 30, } \\ 2012 \end{gathered}$ | D | $\begin{aligned} & \text { nber 31, } \\ & 011 \end{aligned}$ |
| :---: | :---: | :---: | :---: |
| General obligations: |  |  |  |
| Capital debt(1) | \$ 11,886 | \$ | 11,224 |
| Investment-related | 8,535 |  | 8,897 |
| Securities business-related | 1,071 |  | 1,518 |
| Specified other businesses(2) | 3,616 |  | 3,569 |
| Total general obligations | 25,108 |  | 25,208 |
| Limited and non-recourse debt(3) | 1,750 |  | 1,750 |
| Total borrowings | \$ 26,858 | \$ | 26,958 |

(1) Includes $\$ 2,519$ and $\$ 1,519$ million of total outstanding junior subordinated debt at September 30, 2012 and December 31, 2011, respectively.
(2) Primarily consists of borrowings associated with our individual annuities business supporting new business acquisition costs in certain life insurance companies, as well as hedging costs, reinsurance reserves credit requirements and other operating needs within Pruco Re.
(3) As of both September 30, 2012 and December 31, 2011, the limited and non-recourse debt outstanding was attributable to the Closed Block Business.

The following table presents, as of September 30, 2012, the contractual maturities of the Company s total borrowings.

|  | Financial <br> Services <br> Businesses | Closed <br> Block <br> Business <br> (in millions) | Consolidated |  |
| :--- | ---: | ---: | ---: | ---: |
| Calendar Year: | $\$ 3,019$ | $\$$ | 75 | $\$$ |
| 2013 and prior | 2,053 | 3,094 |  |  |
| 2014 | 3,801 | 100 | 2,128 |  |
| 2015 | 1,355 | 125 | 1,901 |  |
| 2016 | 14,880 | 1,375 | 16,250 |  |
| 2017 and thereafter | $\$ 25,108$ | $\$ 1,750$ | $\$$ | 26,858 |

We may, from time to time, seek to redeem or repurchase our outstanding debt securities through open market purchases, individually negotiated transactions or otherwise. Any such repurchases will depend on prevailing market conditions, our liquidity position, contractual restrictions and other factors. The amounts involved may be material.

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Financing of regulatory reserves associated with domestic life insurance products


#### Abstract

As discussed above under Liquidity and Capital Resources of our Subsidiaries Domestic Insurance Subsidiaries Captive Reinsurance Companies, we use reinsurance arrangements and financing transactions involving captive reinsurance companies in order to mitigate the impact of Regulation XXX and Guideline AXXX on our term and universal life insurance products. These activities are described below.


During 2011, a captive reinsurance subsidiary entered into agreements providing for the issuance and sale of up to $\$ 1$ billion of ten-year fixed-rate surplus notes in order to finance reserves required under Regulation XXX. In June 2012, this subsidiary entered into another agreement for the issuance of up to an additional $\$ 500$ million of ten-year fixed rate surplus notes for the same purpose. At September 30, 2012, an aggregate of $\$ 750$ million of surplus notes were outstanding under this facility. Under the agreements, the subsidiary received debt securities, with a principal amount equal to the surplus notes issued, which are redeemable under certain circumstances, including upon the occurrence of specified stress events affecting the subsidiary. Because valid rights of set-off exist, interest and principal payments on the surplus notes and on the debt securities are settled on a net basis, and the surplus notes are reflected in the Company s total consolidated borrowings on a net basis. Prudential Financial has agreed to make capital contributions to the subsidiary in order to reimburse it for investment losses in excess of specified amounts. In addition, during 2011, another captive reinsurance subsidiary issued a $\$ 1.5$ billion surplus note to an affiliate to finance reserves required under Guideline AXXX.

Other captive reinsurance subsidiaries have outstanding an additional $\$ 3.2$ billion of surplus notes that were issued in 2006 through 2008 with unaffiliated institutions to finance reserves required under Regulation XXX and Guideline AXXX. Prudential Financial has agreed to maintain the capital of these subsidiaries at or above a prescribed minimum level and has entered into arrangements (which are accounted for as derivative instruments) that require it to make certain payments in the event of deterioration in the value of these surplus notes. As of September 30, 2012 and December 31, 2011, there were no collateral postings made under these derivative instruments.

The surplus notes described above are subordinated to policyholder obligations, and the payment of principal on the surplus notes may only be made with prior insurance regulatory approval. The payment of interest on the surplus notes has been approved by the regulator, subject to the ability of the regulator to withdraw that approval.

As we continue to underwrite term and universal life business, and as we assume the business being ceded to us in the acquisition of The Hartford s individual life business, we expect to have additional borrowing needs to finance statutory reserves required under Regulation XXX and Guideline AXXX. However, we believe we have sufficient financing resources available, including those internal and external resources described above, to meet our financing needs under Regulation XXX into 2014 and under Guideline AXXX beyond 2014, assuming that the volume of new business remains consistent with current sales projections.

## Funding Agreement Notes Issuance Program

Prudential Insurance maintains a Funding Agreement Notes Issuance Program pursuant to which a Delaware statutory trust issues medium-term notes (which are included in our statements of financial position in Policyholders account balances and not included in the foregoing table) secured by funding agreements issued to the trust by Prudential Insurance and included in our Retirement segment. The funding agreements provide cash flow sufficient for the debt service on the related medium-term notes. The medium-term notes are sold in transactions not requiring registration under the Securities Act of 1933. The notes have fixed or floating interest rates and original maturities ranging from five to ten years. As of September 30, 2012 and December 31, 2011, the outstanding aggregate principal amount of such notes totaled $\$ 2.3$ billion and $\$ 3.2$ billion respectively, out of a total authorized amount of up to $\$ 15$ billion. Our ability to issue under this program depends on market conditions.

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The aggregate maturities of these notes over the next 12 months are approximately $\$ 1.2$ billion. We intend to repay the maturing notes through a combination of cash flows from asset maturities and available cash.

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## Ratings

Financial strength ratings (which are sometimes referred to as claims-paying ratings) and credit ratings are important factors affecting public confidence in an insurer and its competitive position in marketing products. Nationally Recognized Statistical Ratings Organizations continually review the financial performance and financial condition of the entities they rate, including Prudential Financial and its rated subsidiaries. Our credit ratings are also important for our ability to raise capital through the issuance of debt and for the cost of such financing.

A downgrade in the credit or financial strength ratings of Prudential Financial or its rated subsidiaries could potentially, among other things, limit our ability to market products, reduce our competitiveness, increase the number or value of policy surrenders and withdrawals, increase our borrowing costs and potentially make it more difficult to borrow funds, adversely affect the availability of financial guarantees, such as letters of credit, cause additional collateral requirements or other required payments under certain agreements, allow counterparties to terminate derivative agreements and/or hurt our relationships with creditors, distributors or trading counterparties, thereby potentially negatively affecting our profitability, liquidity and/or capital. In addition, we consider our own risk of non-performance in determining the fair value of our liabilities. Therefore, changes in our credit or financial strength ratings may affect the fair value of our liabilities.

Financial strength ratings represent the opinions of rating agencies regarding the financial ability of an insurance company to meet its obligations under an insurance policy. Credit ratings represent the opinions of rating agencies regarding an entity s ability to repay its indebtedness. The following table summarizes the ratings for Prudential Financial and certain of its subsidiaries as of the date of this filing.

|  | A.M. <br> Best(1) | $\mathbf{S \& P ( 2 )}$ | Moody s(3) | Fitch(4) |
| :---: | :---: | :---: | :---: | :---: |
| Financial Strength Ratings: |  |  |  |  |
| The Prudential Insurance Company of America | A+ | AA- | A2 | A+ |
| Pruco Life Insurance Company | A+ | AA- | A2 | A+ |
| Pruco Life Insurance Company of New Jersey | A+ | AA- | NR* | A+ |
| Prudential Annuities Life Assurance Corporation | A+ | AA- | NR | A+ |
| Prudential Retirement Insurance and Annuity Company | A+ | AA- | A2 | A+ |
| The Prudential Life Insurance Company Ltd. (Prudential of Japan) | NR | AA- | NR | NR |
| Gibraltar Life Insurance Company, Ltd. | NR | AA- | NR | NR |
| Credit Ratings: |  |  |  |  |
| Prudential Financial, Inc.: |  |  |  |  |
| Short-term borrowings | AMB-1 | A-1 | P-2 | F2 |
| Long-term senior debt(5) | a- | A | Baa2 | BBB+ |
| Junior subordinated long-term debt | bbb | BBB+ | Baa3 | BBB- |
| The Prudential Insurance Company of America: |  |  |  |  |
| Capital and surplus notes | a | A | Baal | A- |
| Prudential Funding, LLC: |  |  |  |  |
| Short-term debt | AMB-1 | A-1+ | P-2 | F1 |
| Long-term senior debt | a+ | AA- | A3 | A |
| PRICOA Global Funding I: |  |  |  |  |
| Long-term senior debt | aa- | AA- | A2 | A+ |

[^10]ability to repay short-term debt obligations, to AMB-4, which correlates with a speculative ( bb ) long-term rating.

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(2) Standard \& Poor s Rating Services, which we refer to as S\&P, financial strength ratings currently range from AAA (extremely strong) to R (regulatory supervision). These ratings reflect $S \& P \mathrm{~s}$ opinion of an operating insurance company s financial capacity to meet the obligations of its insurance policies in accordance with their terms. $\mathrm{A}+$ or - indicates relative strength within a category. An S\&P credit rating is a current opinion of the creditworthiness of an obligor with respect to a specific financial obligation, a specific class of financial obligations or a specific financial program. S\&P s long-term issue credit ratings range from AAA (extremely strong) to D (default). S\&P short-term ratings range from A-1 (highest category) to D (default).
(3) Moody s Investors Service, Inc., which we refer to as Moody s, insurance financial strength ratings currently range from Aaa (exceptional) to C (lowest). Moody s insurance ratings reflect the ability of insurance companies to repay punctually senior policyholder claims and obligations. Numeric modifiers are used to refer to the ranking within the group with 1 being the highest and 3 being the lowest. These modifiers are used to indicate relative strength within a category. Moody s credit ratings currently range from Aaa (highest) to C (default). Moody s credit ratings grade debt according to its investment quality. Moody s considers A1, A2 and A3 rated debt to be upper medium grade obligations, subject to low credit risk. Moody s short-term ratings are opinions of the ability of issuers to honor senior financial obligations and contracts. Prime ratings range from Prime-1 ( $\mathrm{P}-1$ ), which represents a superior ability for repayment of senior short-term debt obligations, to Prime-3 (P-3), which represents an acceptable ability for repayment of such obligations. Issuers rated Not Prime do not fall within any of the Prime rating categories.
(4) Fitch Ratings Ltd., which we refer to as Fitch, financial strength ratings currently range from AAA (exceptionally strong) to D (distressed). Fitch s ratings reflect its assessment of the likelihood of timely payment of policyholder and contractholder obligations. Fitch long-term credit ratings currently range from AAA (highest credit quality), which denotes exceptionally strong capacity for timely payment of financial commitments, to D (default). Investment grade ratings range between AAA and BBB . Short-term ratings range from F 1 (highest credit quality) to C (high default risk). Within long-term and short-term ratings, $\mathrm{a}+$ or a may be appended to a rating to denote relative status within major rating categories.
(5) Includes the retail medium-term notes program.

The ratings set forth above reflect current opinions of each rating agency. Each rating should be evaluated independently of any other rating. These ratings are not directed toward shareholders and do not in any way reflect evaluations of the safety and security of the Common Stock. These ratings are reviewed periodically and may be changed at any time by the rating agencies. As a result, we cannot assure you that we will maintain our current ratings in the future.

Requirements to post collateral or make other payments as a result of ratings downgrades under certain agreements, including derivative agreements, can be satisfied in cash or by posting permissible securities held by the subsidiaries subject to the agreements. A ratings downgrade of three ratings levels from the ratings levels as of September 30, 2012 (relating to financial strength ratings in certain cases and credit ratings in other cases) would result in estimated additional collateral posting requirements or payments under such agreements of approximately $\$ 84$ million as of September 30, 2012. The amount of collateral required to be posted for derivative agreements is also dependent on the fair value of the derivative positions as of the balance sheet date. For additional information regarding the potential impacts of a ratings downgrade on our derivative agreements see Note 14 to the Unaudited Interim Consolidated Financial Statements. In addition, a ratings downgrade by A.M. Best to A- for our domestic life insurance companies would require Prudential Insurance to post a letter of credit in the amount of approximately $\$ 1.7$ billion, based on the level of statutory reserves related to the variable annuity business acquired from Allstate, that we estimate would result in annual cash outflows of approximately $\$ 15$ million, or collateral posting in the form of cash or securities to be held in a trust. We believe that the posting of such collateral would not be a material liquidity event for Prudential Insurance.

Rating agencies use an outlook statement for both industry sectors and individual companies. For an industry sector, a stable outlook generally implies that over the next 12-18 months the rating agency expects ratings to remain unchanged among companies in the sector. Currently, A.M. Best, S\&P and Fitch all have the U.S. life insurance industry on stable outlook. Moody $s$ has the U.S. life insurance industry on negative outlook. For a particular company, an outlook generally indicates a medium- or long-term trend (generally six months to two years) in credit fundamentals, which if continued, may lead to a rating change. These indicators are not necessarily a precursor of a rating change nor do they preclude a rating agency from changing a rating at any time without notice. Currently, Moody s has all of the Company s ratings on positive outlook; A.M. Best and Fitch have all of the Company s ratings on stable outlook; and S\&P has the ratings of our U.S.-domiciled entities on stable outlook and the ratings of The Prudential Life Insurance Company Ltd. and Gibraltar Life Insurance Company Ltd. on negative outlook as part of S\&P s decision to put the sovereign debt ratings of Japan on negative outlook.

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In view of the difficulties experienced recently by many financial institutions, the rating agencies have heightened the level of scrutiny that they apply to such institutions, increased the frequency and scope of their credit reviews, requested additional information from the companies that they rate, and may adjust upward the capital and other requirements employed in the rating agency models for maintenance of certain ratings levels, such as the financial strength ratings currently held by our life insurance subsidiaries. In addition, actions we might take to access third party financing or to realign our capital structure may in turn cause rating agencies to reevaluate our ratings.

The following is a summary of the significant changes or actions in our ratings and rating outlooks that have occurred from the beginning of 2012 through the date of this filing.

On January 4, 2012, Moody s affirmed the financial strength rating of Gibraltar Life Insurance Company, Ltd at A2. At the same time, Moody s withdrew the A2 financial strength rating of AIG Edison Life Insurance Company due to its merger with Gibraltar Life Insurance Company, Ltd.

On January 5, 2012, S\&P withdrew the financial strength and long-term counterparty ratings of AIG Edison Life Insurance Company due to its merger with Gibraltar Life Insurance Company, Ltd.

On February 16, 2012, at the request of the Company, Moody s withdrew the A2 financial strength rating of Gibraltar Life Insurance Company, Ltd.

On April 19, 2012, Fitch affirmed the long-term senior debt rating of Prudential Financial at BBB+ and the financial strength ratings of our life insurance subsidiaries at $\mathrm{A}+$.

On June 12, 2012, A.M. Best affirmed the long-term senior debt rating of Prudential Financial at a- and the financial strength ratings of our life insurance subsidiaries at A+.

On July 24, 2012, Moody s affirmed the long-term senior debt rating of Prudential Financial at Baa2 and the financial strength ratings of our life insurance subsidiaries at A2.

On July 26, 2012, S\&P affirmed the long-term senior debt rating of Prudential Financial at A and the financial strength ratings of our life insurance subsidiaries at AA-.

## Off-Balance Sheet Arrangements

## Guarantees and Other Contingencies

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In the course of our business, we provide certain guarantees and indemnities to third parties pursuant to whom we may be contingently required to make payments now or in the future. See Commitments and Guarantees within Note 15 to the Unaudited Interim Consolidated Financial Statements for additional information.

## Other Contingent Commitments

We also have other commitments, some of which are contingent upon events or circumstances not under our control, including those at the discretion of our counterparties. See Commitments and Guarantees within Note 15 to the Unaudited Interim Consolidated Financial Statements for additional information regarding these commitments. For further discussion of certain of these commitments that relate to our separate accounts, also see Liquidity and Capital Resources of Subsidiaries Asset Management Subsidiaries.

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Other Off-Balance Sheet Arrangements

We do not have retained assets or contingent interests in assets transferred to unconsolidated entities, or variable interests in unconsolidated entities or other similar transactions, arrangements or relationships that serve as credit, liquidity or market risk support, that we believe are reasonably likely to have a material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or our access to or requirements for capital resources. In addition, we do not have relationships with any unconsolidated entities that are contractually limited to narrow activities that facilitate our transfer of or access to associated assets.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the risk of change in the value of financial instruments as a result of absolute or relative changes in interest rates, foreign currency exchange rates, equity prices or commodity prices. To varying degrees, the investment and trading activities supporting all of our products and services generate exposure to market risk. The market risk incurred and our strategies for managing this risk vary by product. There have been no material changes in our market risk exposures from December 31, 2011, a description of which may be found in our Annual Report on Form 10-K, for the year ended December 31, 2011, Item 7A, Quantitative and Qualitative Disclosures about Market Risk , filed with the Securities and Exchange Commission. See Item 1A, Risk Factors included in the Annual Report on Form 10-K for the year ended December 31, 2011 for a discussion of how the difficult conditions in the financial markets and the economy generally may materially adversely affect our business and results of our operations.

## ITEM 4. CONTROLS AND PROCEDURES

In order to ensure that the information we must disclose in our filings with the SEC is recorded, processed, summarized, and reported on a timely basis, the Company s management, including our Chief Executive Officer and Chief Financial Officer, have reviewed and evaluated the effectiveness of our disclosure controls and procedures, as defined in Exchange Act Rule 13a-15(e), as of September 30, 2012. Based on such evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, as of September 30, 2012, our disclosure controls and procedures were effective. No change in our internal control over financial reporting, as defined in Exchange Act Rule 13a-15(f), occurred during the quarter ended September 30, 2012, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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## PART II OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

We are subject to legal and regulatory actions in the ordinary course of our businesses, including class action lawsuits. Our pending legal and regulatory actions include proceedings specific to us and proceedings generally applicable to business practices in the industries in which we operate, including in both cases, businesses that have either been divested or placed in wind-down status. We are also subject to litigation arising out of our general business activities, such as our investments, contracts, leases and labor and employment relationships, including claims of discrimination and harassment. In some of our pending legal and regulatory actions, parties are seeking large and/or indeterminate amounts, including punitive or exemplary damages.

For additional information regarding our litigation and regulatory matters accrual methodology and our estimated range of reasonably possible losses in excess of accruals established, as well as additional discussion on our litigation and regulatory matters referred to below, see Note 15 to the Unaudited Interim Consolidated Financial Statements included herein.

Following is a discussion of recent material developments concerning our legal and regulatory proceedings:

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

In October 2012, the Board of Directors received a shareholder demand letter (the Demand ), containing allegations of wrongdoing similar to those alleged in the Silverman complaint. The Demand alleges that the Company s Senior Management: (i) breached their fiduciary duties of loyalty and good faith in connection with the management, operation and oversight of the Company s business; (ii) breached their fiduciary duty of good faith to establish and maintain adequate internal controls; and (iii) breached their fiduciary duties by disseminating false, misleading and/or incomplete information, all in connection with the Company s alleged failure to use the SSDMF and to pay beneficiaries and escheat funds to states. The Demand requests that the Board of Directors: (a) undertake an independent internal investigation into Senior Management s violations of New Jersey and/or federal law; and (b) commence a civil action against each member of Senior Management to recover for the benefit of the Company the amount of damages sustained by the Company as a result of the alleged breaches described above.

In September 2012, the State of West Virginia, through its State Treasurer, filed a lawsuit, State of West Virginia ex. Rel. John D. Perdue v. Prudential Insurance Company of America, in the Circuit Court of Putnam County, West Virginia. The complaint alleges violations of the West Virginia Uniform Unclaimed Property Fund Act by failing to properly identify and report all unclaimed insurance policy proceeds which should either be paid to beneficiaries or escheated to West Virginia. The complaint seeks to examine the records of Prudential Insurance to determine compliance with the West Virginia Uniform Unclaimed Property Fund Act, and to assess penalties and costs in an undetermined amount.

In September 2012, the complaint filed in Total Asset Recovery Services v. Met Life Inc, et al., Prudential Financial, Inc., The Prudential Insurance Company of America, and Prudential Holdings, LLC, filed in the Circuit Court of Cook County, Illinois, was withdrawn without prejudice.

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In August 2012, in the matter of In re Prudential Insurance Company of America SGLI/VGLI Contract Litigation the court denied plaintiffs class certification motion without prejudice pending, the filing of summary judgment motions on the issue of whether plaintiffs sustained an actual injury. In October 2012, the parties filed their summary judgment motions.

In August 2012, a purported class action lawsuit, City of Sterling Heights General Employees Retirement System v. Prudential Financial, Inc., et al., was filed in the United States District Court for the District of New Jersey, alleging violations of federal securities law. The complaint names as defendants the Company s Chief Executive Officer, the Chief Financial Officer, the Principal Accounting Officer and certain Company Board of Directors. The complaint alleges that knowingly false and misleading statements were made regarding the Company s current and future financial condition based on, among other things, the alleged failure to disclose: (i) potential liability for benefits that should either have been paid to policyholders or their beneficiaries, or escheated to applicable states; and (ii) the extent of the Company s exposure for alleged state and federal law violations concerning the settlement of claims and the escheatment of unclaimed property. The complaint seeks an undetermined amount of damages, interest, attorneys fees and costs.

In August 2012, the Company filed four additional actions in New Jersey state court captioned The Prudential Insurance Company of America, et al. v. Nomura Securities International, Inc., et al., The Prudential Insurance Company of America, et al. v. Barclays Bank PLC, et al,, The Prudential Insurance Company of America, et al. v. Goldman Sachs \& Company, et al. and The Prudential Insurance Company of America, et al. v. RBS Financial Products, Inc., et al. to recover damages attributable to Company and affiliate entities and funds investments in residential mortgage-backed securities.

In June 2012, in the matter of Lederman v. Prudential Financial, Inc., et al, the court granted summary judgment against an additional plaintiff reducing to 39 the number of plaintiffs asserting claims against the Company.

Our litigation and regulatory matters are subject to many uncertainties, and given their complexity and scope, their outcome cannot be predicted. It is possible that our results of operations or cash flow in a particular quarterly or annual period could be materially affected by an ultimate unfavorable resolution of pending litigation or 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 our financial position. We believe, however, that, based on information currently known to us, 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 our financial position.

## ITEM 1A. RISK FACTORS

You should carefully consider the risks described under Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2011 ( 2011 Form 10-K ). These risks could materially affect our business, results of operations or financial condition, cause the trading price of our Common Stock to decline materially or cause our actual results to differ materially from those expected or those expressed in any forward looking statements made by or on behalf of the Company. These risks are not exclusive, and additional risks to which we are subject include, but are not limited to, the factors mentioned under Forward-Looking Statements above and the risks of our businesses described elsewhere in this Quarterly Report on Form 10-Q.

The risk factor contained in our 2011 Form 10-K titled The enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act will subject us to substantial additional federal regulation and we cannot predict the effect on our business, results of operations, cash flows or financial condition is hereby updated to note that on October 19, 2012, Prudential Financial received notice that it is under consideration by the

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Financial Stability Oversight Council for designation as a non-bank financial company to be subject to stricter prudential regulatory standards and supervision by the Board of Governors of the Federal Reserve System pursuant to the Dodd-Frank Act. For additional information on this notice of consideration by the Financial Stability Oversight Council, see Management s Discussion and Analysis of Financial Condition and Results of Operations Executive Summary.

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## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(c) The following table provides information about purchases by the Company during the quarter ended September 30, 2012, of its Common Stock:

| Period | Total Number of Shares Purchased(1)(2) | Average Price Paid per Share | Number of Shares urchased as Part <br> of <br> Publicly <br> Announced <br> Program(2) | Approximate Dollar Value of Shares that May Yet be Purchased under the Program |
| :---: | :---: | :---: | :---: | :---: |
| July 1, 2012 through July 31, 2012 | 5,681 | \$ 49.09 |  |  |
| August 1, 2012 through August 31, 2012 | 2,330 | \$ 53.95 |  |  |
| September 1, 2012 through <br> September 30, 2012 | 2,690,471 | \$ 55.77 | 2,689,857 |  |
| Total | 2,698,482 | \$ 55.75 | 2,689,857 | 850,000,000 |

(1) Includes shares of Common Stock withheld from participants for income tax withholding purposes whose shares of restricted stock units vested during the period. Restricted stock units were issued to participants pursuant to the Prudential Financial, Inc. Omnibus Incentive Plan that was adopted by the Company s Board of Directors in March 2003 (as subsequently amended and restated).
(2) In June 2012, Prudential Financial s Board of Directors authorized the Company to repurchase at management $s$ discretion up to $\$ 1.0$ billion of its outstanding Common Stock through June 2013.

## ITEM 6. EXHIBITS

10.1 First Amendment to The Prudential Insurance Company of America Deferred Compensation Plan, effective October 5, 2012.*
12.1 Statement of Ratio of Earnings to Fixed Charges.
31.1 Section 302 Certification of the Chief Executive Officer.
31.2 Section 302 Certification of the Chief Financial Officer.
32.1 Section 906 Certification of the Chief Executive Officer.
32.2 Section 906 Certification of the Chief Financial Officer.
101.INS - XBRL Instance Document.
101.SCH - XBRL Taxonomy Extension Schema Document.
101.CAL - XBRL Taxonomy Extension Calculation Linkbase Document.
101.LAB - XBRL Taxonomy Extension Label Linkbase Document.
101.PRE - XBRL Taxonomy Extension Presentation Linkbase Document.
101.DEF - XBRL Taxonomy Extension Definition Linkbase Document.

[^11]Prudential Financial, Inc. will furnish upon request a copy of any exhibit listed above upon the payment of a reasonable fee covering the expense of furnishing the copy. Requests should be directed to:

## Shareholder Services

Prudential Financial, Inc.

751 Broad Street, 21st Floor

Newark, New Jersey 07102

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## SIGNATURES

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

Prudential Financial, Inc.

By: /s/ Richard J. Carbone Richard J. Carbone
Executive Vice President and Chief Financial Officer
(Authorized signatory and principal financial officer)

Date: November 8, 2012

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## EXHIBIT INDEX

10.1 First Amendment to The Prudential Insurance Company of America Deferred Compensation Plan, effective October 5, 2012.*
12.1 $\quad$ Statement of Ratio of Earnings to Fixed Charges.

[^12]
[^0]:    (1) Class B Stock is not presented as the amounts are immaterial.

[^1]:    (1) Excludes notes with amortized cost of $\$ 1,000$ million (fair value, $\$ 1,052$ million) which have been offset with the associated payables under a netting agreement.

[^2]:    (1) Represents circumstances where the Company determined in the current period that it intends to sell the security or it is more likely than not that it will be required to sell the security before recovery of the security s amortized cost.

[^3]:    (1) Recorded investment reflects the balance sheet carrying value gross of related allowance.

[^4]:    (1) Represents valuations reflecting both internally-derived and market inputs, as well as third-party pricing information or quotes. See below for additional information related to internally-developed valuation for significant items in the above table.
    (2) Represents unadjusted prices from independent pricing services and independent indicative broker quotes where pricing inputs are not readily available.
    (3) Includes assets classified as fixed maturities available-for-sale, trading account assets supporting insurance liabilities and other trading account assets.

[^5]:    (1) Carrying values presented herein differ from those in the Company s Unaudited Interim Consolidated Statement of Financial Position because certain items within the respective financial statement captions are not considered financial instruments or out of scope under authoritative guidance relating to disclosures of the fair value of financial instruments. Financial statement captions excluded from the above table are not considered financial instruments.
    (2) Amount included in Other liabilities in the Company s Unaudited Interim Consolidated Statement of Financial Position.

[^6]:    (1) Excludes the portion of other-than-temporary impairments recorded in Other comprehensive income (loss), representing any difference between the fair value of the impaired debt security and the net present value of its projected future cash flows at the time of impairment.
    (2) Includes other-than-temporary impairments relating to investments in joint ventures and partnerships.

[^7]:    (1) Included within the $\$ 2.0$ billion of asset-backed securities collateralized by sub-prime mortgages as of September 30, 2012, are $\$ 2$ million of securities collateralized by second-lien exposures.
    (2) As of September 30, 2012, includes collateralized debt obligations with amortized cost of $\$ 42$ million, with none secured by sub-prime mortgages. Also includes asset-backed securities collateralized by equipment leases, franchises, aircraft, manufacturing and time shares.
    (3) Excluded from the table above are asset-backed securities classified as trading and carried at fair value. For additional information see Other Trading Account Assets.

[^8]:    (1) Investment data has been classified based on standard industry categorizations for domestic public holdings and similar classifications by industry for all other holdings.
    (2) Prior period $s$ amounts are presented on a basis consistent with the current period presentation.

[^9]:    (1) Book value is generally based on unpaid principal balance net of any allowance for losses, the lower of cost or fair value, or fair value, depending on the loan.

[^10]:    * NR indicates not rated.
    (1) A.M. Best Company, which we refer to as A.M. Best, financial strength ratings for insurance companies currently range from A++ (superior) to F (in liquidation). A.M. Best $s$ ratings reflect its opinion of an insurance company $s$ financial strength, operating performance and ability to meet its obligations to policyholders. An A.M. Best long-term credit rating is an opinion of the ability of an obligor to pay interest and principal in accordance with the terms of the obligation. A.M. Best long-term credit ratings range from aaa (exceptional) to $d$ (in default), with ratings from aaa to bbb considered as investment grade. An A.M. Best short-term credit rating reflects an opinion of the issuer s fundamental credit quality. Ratings range from AMB-1+, which represents an exceptional

[^11]:    * This exhibit is a management contract or compensatory plan or arrangement.

[^12]:    * This exhibit is a management contract or compensatory plan or arrangement

